

Gulf Bank (GBK)

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	KWd 308	Target Price	KWd 345
Implied Upside	12.0%		

Lower Provisions Drive 1Q2019 Despite Weak Operating Income

Since we initiated coverage on GBK back on Dec. 17, 2018, the stock has rallied 15%. Consequently, we change our rating to Accumulate from Outperform. We maintain our PT of KWd 345. GBK trades at a 2019e PEG of 0.7x. Moreover, the market is pricing in a sustainable RoE of 12.4% vs. 13.3% based on our estimates. Thus, we believe there is room for further upside based on current valuation.

Highlights

- **GBK's 1Q2019 bottom-line increased by 9.0% YoY on the back of a sharp drop in provisions as net operating income was weak.** GBK reported a net profit of KWD 11.8mn vs. KWD 10.8mn in 1Q2018 (KWD 14.1mn in 4Q2018), growing by 9.0% YoY but dropping 16.2% QoQ.
- **Net operating income exhibited lackluster performance; however, lower provisions mitigated this drop resulting in growth in the bottom-line.** Net operating income declined by 21.4%, driven by a 21.1% drop in fees and a 38.3% growth in opex. However, net profit increased by 9.0% due to a significant drop (37.5%) in provisions and impairments.
- **Margins remained broadly stable YoY and sequentially.** Net interest income increased by 2.1% to KWD 37.6mn; GBK's net interest margin remained flattish at 2.99% vs 2.96% in 1Q2018. Stable NIM was due to yield on assets and CoFs moving in-line.
- **Operating efficiency to be under pressure in 2019.** GBK's C/I ratio jumped to 45.7% vs. 32.3% in 1Q2018 (38.7% in 4Q2018) driven by aggressive growth in opex (38.3% YoY), while revenue declined by 2.1%. Hence, the bank generated negative JAWS. On the conference call, management explained that increase in opex was due to establishing a central hub for customers and employees at Crystal Tower and a one-time KWD 2.8mn charge (which we classify under non-recurring items) due to system disruptions that occurred in the 1st quarter.
- **Asset quality deteriorated.** GBK's asset quality worsened with the bank's NPL ratio moving to 2.8% from 1.1% in FY2018 (1.8% in 2017) mainly due to a single corporate borrower. We note during the conference call, management disclosed they have already gained access to assets with significant value held by the borrower. However, these are not collateralized yet and cannot be included in the coverage ratio. However, GBK's coverage ratio remains very strong at 267%.
- **Net loans and deposits declined QoQ.** Net loans decreased by 1.5% sequentially to KWD 3.9bn while deposits (including OFIs) also contracted by 2.8% to KWD 4.6bn. Hence, the bank's LDR remained at a healthy 84% level vs. 83% in FY2018.
- **Capitalization remained strong.** GBK ended 1Q2019 with a Tier-1 ratio of 13.5% vs. 14.1% in FY2018, while total CAR rested at 16.9%.

Catalysts

- 1) Signs/hints of provision reversals and further write-backs

Recommendation, Valuation and Risks

- **Recommendation and valuation:** GBK is trading at a 2019e P/B and P/E of 1.3x and 11.8x, respectively. We change our rating to Accumulate from Outperform as the stock has another 12.0% upside.
- **Risks:** 1) Geo-political factors, 2) Unexpected asset quality deterioration, 3) CoR & RoE do not improve & 4) Retail loans in the banking system slow down significantly.

Key Financial Data and Estimates

	2018	2019e	2020e	2021e
EPS (KWd)	20.00	26.13	31.93	35.95
Growth	17.6	30.7	22.2	12.6
P/E(x)	15.7	11.8	9.6	8.6
BVPS (KWd)	216.9	233.1	253.0	274.9
P/B(x)	1.4	1.3	1.2	1.1
DPS (KWd)	10.00	12.00	14.00	16.00
Dividend Yield (%)	3.2	3.9	4.5	5.2

Source: Company data, QNB FS Research

Key Data

Current Market Price (KWd)	308
Dividend Yield (%)	3.2
Bloomberg Ticker	GBK KK
ADR/GDR Ticker	N/A
Reuters Ticker	GBKK.KW
ISIN	KW0EQ0100028
Sector	Banks
52wk High/52wk Low (KWd)	330/226
3-m Average Volume (mn)	14.8
Mkt. Cap. (\$ bn/KWD bn)	3.0/0.9
Shares Outstanding (mn)	2,898.1
Current FO* (%)	11.2
1-Year Total Return (%)	+22.3
Fiscal Year End	December 31

Source: Bloomberg (as of May 2, 2019), *Boursa Kuwait (as of May 1, 2019); Note: FO is foreign ownership

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Detailed Financial Statements

Income Statement (In KWD mn)	2016	2017	2018	2019e	2020e	2021e
Net Interest Income	117	132	153	171	188	204
Fees & Commissions	31	31	30	31	33	34
FX Income	9	9	9	9	9	10
Other Income	11	9	3	3	7	4
Non-Interest Income	52	49	42	44	49	48
Total Income	169	181	194	215	238	252
Operating Expenses	(63)	(64)	(67)	(70)	(73)	(77)
Operating Income	105	117	127	144	165	175
Net Provisions	(60)	(67)	(68)	(65)	(68)	(66)
Net Profit Before Tax	45	50	59	79	97	109
Tax	(2)	(2)	(3)	(4)	(4)	(5)
Net Profit Before Minority Interest	43	48	57	76	93	104
Minority Interest	0	0	0	0	0	0
Net Profit	43	48	57	76	93	104

Source: Company data, QNB FS Research

Balance Sheet (In KWD mn)	2016	2017	2018	2019e	2020e	2021e
Cash & Balances with Central Bank	666	475	742	766	691	789
Interbank Loans	245	168	300	251	311	284
Net Investments	895	1,079	885	942	1,022	1,099
Net Loans	3,446	3,809	3,950	4,182	4,444	4,727
Other Assets	42	43	36	42	39	43
Net PP&E	29	30	32	33	34	36
OREO	145	79	71	71	71	71
Total Assets	5,467	5,683	6,016	6,287	6,612	7,047
Liabilities						
Interbank Deposits	480	412	414	270	179	124
Due From OFIs	825	969	1,006	1,066	1,133	1,224
Customer Deposits	3,395	3,490	3,735	4,034	4,316	4,640
Subordinated Tier-2 Notes	100	100	100	100	100	100
Other Liabilities	93	111	133	142	151	162
Total Liabilities	4,894	5,082	5,388	5,611	5,879	6,250
Total Shareholders' Equity	573	601	629	675	733	797
Total Liabilities & Shareholders' Equity	5,467	5,683	6,016	6,287	6,612	7,047

Source: Company data, QNB FS Research

Ratios & Financial Indicators	2016	2017	2018	2019e	2020e	2021e
Profitability (%)						
RoE	8.0	8.4	9.4	12.0	13.7	14.2
RoAA	0.8	0.9	1.0	1.2	1.4	1.5
RoRWA	1.1	1.2	1.3	1.7	1.9	2.0
NIM (% of IEAs)	2.61	2.77	3.02	3.28	3.40	3.45
NIM (% of RWAs)	3.06	3.26	3.51	3.73	3.88	3.96
NIM (% of AAs)	2.14	2.37	2.61	2.78	2.92	2.99
Spread	2.2	2.2	2.4	2.6	2.6	2.5
Efficiency (%)						
Cost-to-Income (Headline)	37.5	35.5	34.5	32.2	30.7	30.5
Cost-to-Income (Core)	39.6	36.3	34.8	32.6	31.1	30.7
Liquidity (%)						
LDR	81.7	85.4	83.3	82.0	81.6	80.6
Loans/Assets	63.0	67.0	65.7	66.5	67.2	67.1
Cash & Interbank Loans-to-Total Asset	16.6	11.3	17.3	16.2	15.1	15.2
Deposits to Assets	62.1	61.4	62.1	64.2	65.3	65.8
Wholesale Funding to Loans	40.8	38.9	38.5	34.3	31.8	30.6
IEAs to IBLs	1.3x	1.3x	1.3x	1.3x	1.3x	1.3x
Asset Quality (%)						
NPL Ratio	2.49	1.80	1.06	1.01	1.02	1.05
NPL to Shareholder's Equity	16.3	12.1	7.2	6.7	6.7	6.7
NPL to Tier 1 Capital	16.3	12.1	7.2	6.8	6.8	6.9
Coverage Ratio	331.5	344.0	654.8	698.6	710.2	719.0
ALL/Average Loans	2.4	1.4	1.1	1.1	1.3	1.6
Cost of Risk (%)	106	179	262	167	150	139
Capitalization (%)						
Tier 1 Ratio	14.7	14.2	14.1	14.2	14.3	14.7
CAR	18.5	17.8	17.5	17.6	17.7	18.1
Tier 1 Capital to Assets	10.5	10.6	10.4	10.6	10.8	11.0
Tier 1 Capital to Loans	16.6	15.8	15.9	15.9	16.1	16.4
Tier 1 Capital to Deposits	16.9	17.2	16.8	16.5	16.6	16.7
Leverage (x)	9.5	9.5	9.6	9.3	9.0	8.8
Growth (%)						
Net Interest Income	-1.7	13.2	15.4	12.0	10.2	8.3
Non-Interest Income	4.6	-5.2	-14.9	10.8	6.6	-2.9
Total Revenue	0.1	7.5	7.2	11.8	9.4	6.0
Opex	4.9	1.7	4.2	4.3	4.4	5.2
Net Operating Income	-2.5	11.0	8.8	15.7	11.8	6.3
Net Provisions & Impairments	-10.2	10.5	1.8	-4.2	4.1	-2.7
Net Income (Headline/Reported)	10.2	11.7	18.2	33.5	22.2	12.6
Loans	-5.2	10.5	3.7	5.9	6.3	6.3
Deposits	-11.5	2.8	7.0	8.0	7.0	7.5
Assets	0.5	4.0	5.9	4.5	5.2	6.6
RWAs	4.0	8.4	5.7	5.0	7.2	5.2

Source: Company data, QNB FS Research

Recommendations

Based on the range for the upside / downside offered by the 12 - month target price of a stock versus the current market price

OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings

Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals

R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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