

Gulf Bank (GBK)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	KWd 279	Target Price	KWd 345
Implied Upside	+23.8%	Old Target Price	KWd 325

Margin Expansion & Credit Recoveries Drive Bottom-Line in 2018; Upping PT to KWd 345

We increase our estimates (based on expectations of lower provisions as GBK's general provisions have materially increased as of 2018) and our PT to KWd 345 vs. KWd 325 (previously). We maintain our Outperform rating. GBK trades at a 27% discount to its historical P/B and a 2019e PEG of 0.6x. Moreover, the market is pricing in a sustainable RoE of 11.7% vs. 13.3% based on our estimates (12.5% previously).

Highlights

- GBK's 2018 bottom-line increased by 18.2% on the back of margin expansion and credit recoveries.** GBK reported a net profit of KWd 56.7mn vs. KWd 48.0mn in 2017, in-line with our estimate of KWd 58.6mn (variation of -3.2%).
- Cash DPS grew by 11%, in-line with our estimate.** GBK recommended a cash DPS of KWd 10.00, in-line with our estimate (yielding 3.6% and payout of 51%).
- Spreads and margins expanded in 2018.** Net interest income increased by 15.4% to KWd 171.0mn; GBK's net interest margin expanded by 25bps. The widening in the NIM was due to yield on assets gaining by 49bps, while CoFs increased by only 29bps.
- Operating efficiency improved with positive JAWS.** GBK's C/I ratio improved to 34.5% vs. 35.5% in 2017 (37.5% in 2016) driven growth in revenue. Hence, the bank generated JAWS of 3.0% (5.8% in 2017). We estimate the C/I ratio to improve further in 2019 and 2020.
- RoE made progress to 9.4% in 2018 and gives us comfort in our estimate of 12.5% in 2019.**
- CoR surged but credit recoveries mitigated the negative effect from CoR.** GBK booked credit provisions of KWd 108.9mn vs. KWd 69.8mn in 2017, which translates into CoR of 262bps & 179bps (106bps in 2016), respectively. On the other hand, the bank booked credit recoveries of KWd 57.9mn, which partially offset the rise in credit provisions. As of 2018, general provisions to total provisions amounted to 84% vs. 79% in 2017.
- Provisions greater than IFRS 9 requirements.** GBK has so far built up credit reserves of KWd 312mn vs. ECLs of KWd 200mn under IFRS 9 resulting in excess provisions of KWd 112mn. We are still of the view that that bank should reverse a good chunk of excess provisions in order to unlock hidden value and expand RoE well above 12%.
- Asset quality continued its positive trajectory.** GBK's asset quality improved with the bank's NPLs dropping by 38.4% YoY to KWd 45.0mn. Moreover, the NPL ratio moved to 1.06% from 1.80% in 2017 (2.49% in 2016) partly driven by write-offs & reversals. Furthermore, GBK booked hefty credit recoveries of KWd 57.9mn. The coverage ratio surged to an unprecedented 655% vs. 344% in 2017.
- Net loans increased driven by the retail segment.** Net loans grew by 3.7% YoY to KWd 3.8bn while deposits (including OFIs) expanded by 6.3% to KWd 4.7bn. Hence, the bank's LDR remained at a healthy 83% level vs. 85% in 2017. The growth in loans was mainly attributed to the retail segment which expanded by 8.5% (which would also explain the expansion in NIM).
- Capitalization remains strong.** GBK ended 2018 with a CET1 ratio of 14.1% vs. 14.2% in 2017, while total CAR rested at 17.5%.

Catalysts

- 1) Signs/hints of provision reversals, 2) Stock will be included in the FTSE EM Index on March 18 & 3) Possible inclusion in the MSCI EM Index.

Recommendation, Valuation and Risks

- Recommendation and valuation:** GBK is trading at a 2019e P/B and P/E of 1.2x and 10.3x, respectively. We maintain our Outperform rating.
- Risks:** 1) Geo-political factors, 2) Unexpected asset quality deterioration, 3) CoR & RoE do not improve & 4) Retail loans in the banking system significantly slow down.

Key Financial Data and Estimates

	FY2018	FY2019e	FY2020e	FY2021e
EPS (KWd) Reported	20.00	27.09	31.94	35.96
EPS Growth (%)	17.6	35.5	17.9	12.6
P/E (x)	14.3	10.3	8.7	7.8
BVPS (KWd)	216.9	234.0	254.0	275.9
P/B (x)	1.3	1.2	1.1	1.0
DPS (KWd)	10.00	12.00	14.00	16.00
Dividend Yield (%)	3.6	4.3	5.0	5.7

Source: Company data, QNB FS Research

Key Data

Current Market Price (KWd)	279
Dividend Yield (%)	3.6
Bloomberg Ticker	GBK KK
ADR/GDR Ticker	N/A
Reuters Ticker	GBKK.KW
ISIN	KW0EQ0100028
Sector	Banks & Financial Svcs.
52wk High/52wk Low (KWd)	289/233
3-m Average Volume (mn)	12.5
Mkt. Cap. (\$ bn/KWd bn)	2.7/0.8
Shares Outstanding (mn)	2,898.1
1-Year Total Return (%)	+14.2
Fiscal Year End	December 31

Source: Bloomberg (as of February 24, 2019)

Shahan Keushgerian

+974 4476 6509

shahan.keushgerian@qnbfs.com.qa

Saugata Sarkar, CFA, CAIA

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Change in Estimates

(In QR mn)	2019e			2020e			2021e		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	169	171	1.2	183	188	2.9	199	204	2.5
Non Interest Income	46	46	0.7	48	49	2.8	48	48	(0.1)
Net Operating Income	143	147	3.0	156	165	5.5	166	175	5.7
Net Income (Reported/Headline)	71	79	10.6	83	93	11.5	90	104	16.3
Net Income (Attributable)	68	79	15.5	79	93	17.2	90	104	16.3

Source: QNB FS Research

Changes to our bottom-line estimates are mainly due to lowering provisions.

Detailed Financial Statements

Income Statement (In QR mn)	FY2018	FY2019e	FY2020e	FY2021e
Net Interest Income	153	171	188	204
Fees & Commissions	30	31	33	34
FX Income	9	9	9	10
Other Income	3	6	7	4
Non-Interest Income	42	46	49	48
Total Revenue	194	217	238	252
Operating Expenses	(67)	(70)	(73)	(77)
Net Operating Income	127	147	165	175
Net Provisions & Impairments	(68)	(65)	(68)	(66)
Net Profit Before Tax	59	82	97	109
Tax	(3)	(4)	(4)	(5)
Net Profit	57	79	93	104

Source: Company data, QNB FS Research

Balance Sheet (In KWD mn)	FY2018	FY2019e	FY2020e	FY2021e
Assets				
Cash & Balances with Central Bank	742	766	691	789
Interbank Loans	300	251	311	284
Net Investments	885	942	1,022	1,099
Net Loans	3,950	4,182	4,444	4,727
Other Assets	36	42	39	43
Net PP&E	32	33	34	36
OREO	71	71	71	71
Total Assets	6,016	6,287	6,612	7,047
Liabilities				
Interbank Deposits	414	267	176	121
Due From OFIs	1,006	1,066	1,133	1,224
Customer Deposits	3,735	4,034	4,316	4,640
Subordinated Tier-2 Notes	100	100	100	100
Other Liabilities	133	142	151	162
Total Liabilities	5,388	5,608	5,876	6,247
Shareholders' Equity	629	678	736	800
Total Liabilities & Shareholders' Equity	6,016	6,287	6,612	7,047

Source: Company data, QNB FS Research

Ratios	FY2018	FY2019e	FY2020e	FY2021e
Profitability (%)				
RoE	9.4	12.5	13.6	14.2
RoAA	1.0	1.3	1.4	1.5
RoRWA	1.3	1.7	1.9	2.0
NIM (% of IEAs)	3.02	3.28	3.40	3.45
NIM (% of RWAs)	3.51	3.74	3.88	3.96
NIM (% of AAs)	2.61	2.78	2.92	2.99
Spread	2.4	2.6	2.6	2.5
Efficiency (%)				
Cost-to-Income (Headline)	34.5	32.2	30.7	30.5
Cost-to-Income (Core)	34.8	32.6	31.1	30.7
Liquidity (%)				
LDR (incl. OFIs)	83.3	82.0	81.6	80.6
Loans/Assets	65.7	66.5	67.2	67.1
Cash & Interbank Loans-to-Total Assets	17.3	16.2	15.1	15.2
Deposits to Assets	62.1	64.2	65.3	65.8
Wholesale Funding to Loans	38.5	34.3	31.7	30.6
IEAs to IBLs	1.3x	1.3x	1.3x	1.3x
Asset Quality (%)				
NPL Ratio	1.06	1.01	1.02	1.05
NPLs to Shareholder's Equity	7.2	6.7	6.6	6.7
NPLs to Tier 1 Capital	7.2	6.8	6.8	6.9
Coverage Ratio	654.8	698.6	710.2	719.0
ALL/Average Loans	1.1	1.1	1.3	1.6
Cost of Risk	262	167	150	139
Capitalization (%)				
Tier 1 Ratio	14.1	14.2	14.3	14.7
CAR	17.5	17.7	17.8	18.2
Tier 1 Capital to Assets	10.4	10.6	10.9	11.0
Tier 1 Capital to Loans	15.9	16.0	16.2	16.4
Tier 1 Capital to Deposits	16.8	16.6	16.7	16.8
Leverage (x)	9.6	9.3	9.0	8.8
Growth (%)				
Net Interest Income	15.4	12.0	10.2	8.3
Non-Interest income	-14.9	10.8	6.6	-2.9
Total Revenue	7.2	11.8	9.4	6.0
Opex	4.2	4.3	4.4	5.2
Net Operating Income	8.8	15.7	11.8	6.3
Net Provisions & Impairments	1.8	-4.2	4.1	-2.7
Net Income	18.2	38.4	17.9	12.6
Loans	3.7	5.9	6.3	6.3
Deposits	7.0	8.0	7.0	7.5
Assets	5.9	4.5	5.2	6.6
RWAs	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

Contacts

Saugata Sarkar, CFA, CAIA

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Mehmet Aksoy, PhD

Senior Research Analyst

Tel: (+974) 4476 6589

mehmet.aksoy@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

QNB Financial Services Co. WLL

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Zaid Al Nafsoosi, CMT, CFTe

Senior Research Analyst

Tel: (+974) 4476 6535

zaid.alnafsoosi@qnbfs.com.qa

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