

Al Khilaj Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR17.11	Current Target Price	QR23.00
Implied Upside	34.4%		

KCBK Earnings Dip QoQ, Flat YoY; In-Line With Estimates

Al Khilaj is one of the smallest banks domestically with potential to grow. In terms of loans (~4% market share as of 2014), KCBK is one of the smallest of the five-listed conventional banks (6th among the eight-listed banks). Focused on Qatar, KCBK's management has set forth a 3 to 5 year strategy that would improve the bank's market share and boost its RoAE, catching up to that of its peers. KCBK has the lowest RoE (10.4%) among listed banks and it is below its cost of equity of 11.0%.

Highlights

- **KCBK reported net income of QR158.7mn in 4Q2015, broadly in-line with our estimate of QR168.8mn (-6.0% variation); 33.6% ahead of other broker.** Net income retreated by 3.4% QoQ, but was flat YoY.
- **Net provisions and investment impairments prevented sequential growth in the bottom-line.** The bank posted net operating income (pre-provision profit) of QR204.4mn, growing by 10.1% QoQ (+17.7% YoY). This was mainly driven by a significant drop in OPEX. KCBK reported net interest income of QR235.9mn, in-line with our estimate of QR228.9mn (+3.1% variation). Net interest income displayed flat performance sequentially (+16.8% YoY). NIMs were flat QoQ at ~1.80%. For FY2015, NIMs moved up by ~9bps to 1.86% vs. 1.77% in 2014. Net provisions proved to be detrimental to the bank's bottom-line. Net provisions and impairment grew by 139.6% QoQ and 233.3% YoY to QR37.1mn vs. QR15.5mn in 3Q2015 (QR11.1mn in 4Q2014).
- **Cost-to-income ratio improved significantly in FY2015.** KCBK's OPEX declined by 8.5% QoQ (down 20.9% YoY) to QR91.2mn. Cost-to-income dropped to 30.8% vs. 34.9% in 3Q2015 (39.9% in 4Q2014). On annual basis (FY2015), the efficiency ratio moved to 34.2% vs. 42.0% in 2014.
- **The bank announced cash DPS of QR1.00/share (unchanged from 2014); in-line with our estimate.** A cash DPS of QR1.00/share implies a dividend payout ratio of 59.0% and a yield of 5.8%.
- **Net Loans and deposits displayed robust growth.** Net loans grew by 5.6% QoQ (+24.4% YoY) to QR33.4bn. Deposits followed suit and increased by 5.4% QoQ (+12.7% YoY) to QR30.9bn. The main driver of loan growth in 2015 was the real estate segment and other corporates, which expanded by 36.8% and 37.2% YoY, respectively. The growth in FY2015's deposits is attributed to the corporate segment which expanded by 105.0% YoY. The bulk of KCBK's deposits (65.8%) is from the public sector deposits, which receded by 2.4% YoY. KCBK's FY2015 LDR was on the high side at 108% vs. 98% in 2014. KCBK needs to bring down its LDR ratio below 100% by the end of 2017. As such we expect funding pressure on the bank.
- **Asset quality remains healthy.** KCBK's NPL ratio as of FY2015 stood at 0.86% vs. 1.35%, while the coverage ratio improved to 89% vs. 49% in 2014.
- **CAR requires improvement.** KCBK generated a CAR of 13.8%. We are of the view that the bank needs to raise capital in order to grow. Management announced that the bank will be issuing Tier-1 notes.

Catalysts

- **Beyond a stabilization/recovery in oil prices, the following developments could be perceived positively by the market: Visible progress in management's strategy:** 1) a consistent rise in market share; 2) an expansion of attributable RoAE beyond 12% (2015e and 2016e RoAE: 10.0% and 10.9%, respectively); 3) less reliance on treasury operations and 4) announcements/newsflow on infrastructure projects.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Price Target of QR23.00.** We will revise our 2016, 2017 and 2018 estimates, shortly.
- **Risks:** 1) Depressed oil prices remains the biggest risk for KCBK and the banking sector; 2) KCBK's market share gains do not materialize; 3) Untested loan book and asset quality; 4) concentration risk and 5) LDR requirement from the QCB could create short-term issues.

Key Financial Data and Estimates

	FY2014	FY2015	FY2016e	FY2017e
Attributable EPS (QR)	1.52	1.69	1.88	2.26
P/E (x)	11.2	10.1	9.1	7.6
P/B (x)	1.1	1.0	1.0	0.9
DPS (QR)	1.00	1.00	1.00	1.00
Dividend Yield (%)	5.8	5.8	5.8	5.8

Source: Company data, QNBFS estimates; Note: All data based on current number of shares

Key Data

Current Market Price (QR)	17.11
Dividend Yield (%)	5.0
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Financial Services
52wk High/52wk Low (QR)	22.75/16.01
3-m Average Volume ('000)	37.0
Mkt. Cap. (\$ bn/QR bn)	1.7/6.2
Shares Outstanding (mn)	360.0
FO Limit* (%)	25.0
Current FO* (%)	11.3
1-Year Total Return (%)	(17.2)

Fiscal Year End December 31

Source: Bloomberg (as of January 20, 2016), *Qatar Exchange (as of January 20, 2016); Note: FO is foreign ownership

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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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