

### Al Khalij Commercial Bank (KCBK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR1.17	Target Price	QR1.40
Implied Upside	19.4%	Old Target Price	QR1.50

#### In-Line 2Q2019 With YoY Earnings Driven by Lower Provisions

**KCBK posted 2Q2019 net income of QR175.8mn, in-line with our estimate of QR173.8mn. The bottom-line was up 6.0% YoY due to a significant decline in provisions (22%). Total revenue exhibited flattish performance YoY, mitigated by net interest income as FX and fees revenue displayed weak performance. However, NIM improvement was visible. Liquidity remained strong with LDR at 94%. Cost of Risk (annualized) improved to 46bps and we predict further improvement in 2019 and beyond. We retain our Market Perform rating but tweak our price target to QR1.40 from QR1.50 previously.**

#### Highlights

- KCBK's 2Q2019 net income increased by 6.0% YoY on the back of a 22% drop in provisions & impairments, while total revenue exhibited soft performance.** KCBK reported net income of QR175.8mn, in-line with our estimate of QR173.8mn (+1.1% variation). The bank's revenue inched up by 0.6%, aided by net interest income (+5.2 YoY) as weak FX revenue and fees prevented growth. Given the current operating environment, we are of the view that growth in 2019's bottom-line would be driven by an improvement in CoR.
- Opex containment persisted and an uptick in revenue led to a decline in C/I ratio.** Revenue inched up by 0.6%, while opex receded by 1.8%. As a result, KCBK generated positive JAWS in 2Q2019 (on a 1H2019 basis, JAWS remained negative). Moreover, C/I ratio moved down to 27.6% vs. 28.2% in 2Q2018 (26.8% in 1Q2019). We do note the current efficiency ratio is acceptable and still in-line with management's target of less than 30%.
- Margins further improved as the bank continued on shedding expensive deposits.** NIMs moved up by 28bps YoY and 17bps sequentially to 2.1%. It is worth mentioning that interest bearing liabilities declined by 2.0% QoQ (-4.0% YTD).
- Net loans declined as management continued to shed non-core low yielding assets, targeting more lucrative deals.** Net loans contracted by 5.6% QoQ to QR29.1bn (-8.0% YTD) while deposits dropped by 4.9% (-11.0% YTD) to QR25.7bn. The drop in deposits sequentially was mainly attributed to the corporate & public sector segments. Nevertheless, KCBK's liquidity position remained strong with LDR (based on stable sources of funds) amounting to 94%.
- Asset quality remains a non-issue for now; CoR dropped.** The bank's NPLs dropped by 9.5% QoQ (-7.9% YTD). As such, the NPL ratio dropped to 1.84% vs. 1.93% in 1Q2019 (1.88% in FY2018). On the other hand, the coverage ratio (coverage of stage 3 loans/NPLs) remained flattish at 80% vs. 83% in FY2018. We expect the coverage ratio to be adequately maintained as management exercises prudent risk control. 1H2019 CoR (annualized) also improved, receding to 46bps (in-line with our 2019 estimate) vs. 60bps both in 1H2018 & FY2018.
- Tier-1 remained robust as the bank continued on optimizing RWAs.** The bank's CET1 and Tier-1 ratios increased to 15.1% (13.0% in 2018) and 17.9% (15.6% in 2018), respectively. Moreover, KCBK ended 2Q2019 with a CAR of 19.1% (16.9% in 2018). We expect capitalization to remain robust in 2019 and the coming years.

#### Catalysts

- Visible progress in management's strategy:** 1) an expansion of attributable RoE beyond 12% (2019e and 2020e RoE: 10.7% and 11.1%, respectively), 2) improvement in the liquidity of the stock and 3) M&A activity.

#### Recommendation, Valuation and Risks

- Recommendation and valuation: We adjust our target price from QR1.50 to QR1.40 but maintain our Market Perform rating.** KCBK trades at P/TB and P/E of 0.7x and 6.9x on our 2019 estimates, respectively. We continue to think the name is in search of a catalyst to move the stock upward.
- Risks:** 1) Geopolitical factors/issues, 2) KCBK's market share gains do not materialize, 3) possible asset quality concerns and 4) concentration risk.

#### Key Financial Data and Estimates

	2018	2019e	2020e	2021e
EPS (QR)	0.15	0.17	0.19	0.21
Growth (%)	11.7	11.0	8.8	12.6
P/E (x)	7.6	6.9	6.3	5.6
TBVPS (QR)	1.51	1.59	1.70	1.83
P/TB (x)	0.8	0.7	0.7	0.6
DPS (QR)	0.075	0.075	0.075	0.100
Dividend Yield (%)	6.4	6.4	6.4	8.5

Source: Company financials, QNB FS Research; Note: All data based on current number of shares

#### Key Data

Current Market Price (QR)	1.17
Dividend Yield (%)	6.4
Bloomberg Ticker	KCBK QD
ADR/GDR Ticker	N/A
Reuters Ticker	KCBK.QA
ISIN	QA000A0M6MD5
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	1.243/1.055
3-m Average Volume (mn)	0.85
Mkt. Cap. (\$ bn/QR bn)	1.2/4.2
Shares Outstanding (mn)	360.0
FO Limit* (%)	49.0
Current FO* (%)	10.5
1-Year Total Return (%)	14.9
Fiscal Year End	December 31

Source: Bloomberg (as of July 23, 2019), \*Qatar Exchange (as of July 23, 2019); Note: FO is foreign ownership

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## Detailed Financial Statements

Income Statement (In QR mn)	2016	2017	2018	2019e	2020e	2021e
<b>Net Interest Income</b>	<b>913</b>	<b>984</b>	<b>915</b>	<b>943</b>	<b>1,026</b>	<b>1,129</b>
Fees & Commissions	198	182	190	182	166	186
FX Income	31	39	38	40	42	40
Other Income	19	9	0	0	16	-2
<b>Non-Interest Income</b>	<b>248</b>	<b>231</b>	<b>228</b>	<b>222</b>	<b>224</b>	<b>223</b>
<b>Total Revenue</b>	<b>1,160</b>	<b>1,215</b>	<b>1,143</b>	<b>1,165</b>	<b>1,250</b>	<b>1,352</b>
Operating Expenses	-341	-335	-329	-330	-328	-340
<b>Net Operating Income</b>	<b>819</b>	<b>880</b>	<b>814</b>	<b>835</b>	<b>922</b>	<b>1,012</b>
Net Provisions & Investment Impairments	-403	-319	-190	-148	-179	-183
Net Profit Before Taxes & Non-Recurring Items	416	562	624	687	742	829
Non-Recurring Income/(Loss)	0	0	0	0	0	0
<b>Net Profit Before Taxes</b>	<b>416</b>	<b>562</b>	<b>624</b>	<b>687</b>	<b>742</b>	<b>829</b>
Tax	11	-11	-16	-17	-19	-21
<b>Net Profit (Headline/Reported)</b>	<b>427</b>	<b>551</b>	<b>608</b>	<b>669</b>	<b>724</b>	<b>808</b>
Interest Payment on Tier-1 Perpetual Note	-42	-55	-55	-55	-55	-55
Social & Sports Contribution Fund	-11	-14	-15	-17	-18	-20
<b>Net Profit (Attributable)</b>	<b>374</b>	<b>482</b>	<b>538</b>	<b>598</b>	<b>651</b>	<b>733</b>

Source: Company financials, QNB FS Research

Balance Sheet (In QR mn)	2016	2017	2018	2019e	2020e	2021e
Cash & Balances with Central Bank	2,359	2,587	2,881	3,724	3,351	3,871
Interbank Loans	6,489	6,617	6,100	6,517	4,357	5,530
Net Investments	15,608	12,506	10,788	11,661	10,479	9,971
Net Loans	35,180	35,094	31,636	32,688	35,476	39,238
Other Assets	620	689	219	229	248	275
Net PP&E	191	235	335	355	375	397
Goodwill & Intangible Assets	150	156	143	133	119	119
<b>Total Assets</b>	<b>60,597</b>	<b>57,885</b>	<b>52,102</b>	<b>55,306</b>	<b>54,407</b>	<b>59,401</b>
Liabilities						
Interbank Deposits	12,899	10,597	9,563	10,147	6,253	7,255
Customer Deposits	32,195	32,683	28,845	31,032	33,515	36,866
Term Loans	6,137	5,743	5,608	5,608	5,608	5,608
Other Liabilities	2,333	1,570	1,510	1,645	1,776	1,954
AT1 Perpetual Bond	1,000	1,000	1,000	1,000	1,000	1,000
<b>Total Liabilities</b>	<b>54,564</b>	<b>51,593</b>	<b>46,526</b>	<b>49,432</b>	<b>48,153</b>	<b>52,684</b>
<b>Total Shareholders' Equity</b>	<b>6,033</b>	<b>6,292</b>	<b>5,577</b>	<b>5,874</b>	<b>6,254</b>	<b>6,717</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>60,597</b>	<b>57,885</b>	<b>52,102</b>	<b>55,306</b>	<b>54,407</b>	<b>59,401</b>

Source: Company financials, QNB FS Research

<b>Ratios/Financial Indicators</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019e</b>	<b>2020e</b>	<b>2021e</b>
<b>Profitability (%)</b>						
RoE Attributable (Based on Beg. Book Value)	6.2	8.0	8.6	10.7	11.1	11.7
RoAA (Attributable)	0.6	0.8	1.0	1.1	1.2	1.3
RoRWA (Attributable)	0.7	0.9	1.1	1.2	1.3	1.4
NIM (% of IEAs)	1.7	1.8	1.8	1.9	2.0	2.2
NIM (% of RWAs)	2.3	2.4	2.4	2.5	2.6	2.6
NIM (% of AAs)	1.6	1.7	1.7	1.8	1.9	2.0
Spread	1.5	1.4	1.5	1.6	1.6	1.6
<b>Efficiency (%)</b>						
Cost-to-Income (Headline)	29.4	27.6	28.8	28.3	26.3	25.2
Cost-to-Income (Core)	29.9	27.8	28.8	28.3	26.6	25.1
<b>Liquidity (%)</b>						
LDR	109.3	107.4	109.7	105.3	105.9	106.4
Loans/Assets	58.1	60.6	60.7	59.1	65.2	66.1
Cash & Interbank Loans-to-Total Assets	14.6	15.9	17.2	18.5	14.2	15.8
Deposits to Assets	53.1	56.5	55.4	56.1	61.6	62.1
Wholesale Funding to Loans	51.7	46.3	46.1	46.4	31.8	31.3
IEAs to IBLs	123.1	117.6	120.8	114.7	118.9	117.8
<b>Asset Quality (%)</b>						
NPL Ratio	1.5	1.9	1.9	1.8	1.6	1.5
NPL to Shareholder's Equity	9.0	11.1	11.0	10.6	9.2	9.2
NPLs to Tier-1 Capital	8.4	10.5	10.4	9.7	8.4	8.5
Coverage Ratio	110	118	228	238	280	283
ALL/Average Loans	1.7	2.3	4.1	4.4	4.5	4.5
Cost of Risk	103	84	60	46	48	45
<b>Capitalization (%)</b>						
Tier-1 Ratio	15.8	16.7	15.6	16.5	16.8	15.8
CAR	15.8	16.7	16.9	16.5	16.8	15.8
Tier-1 Capital to Assets	10.7	11.5	11.3	11.7	12.6	12.2
Tier-1 Capital to Loans	18.5	19.0	18.6	19.8	19.4	18.4
Tier-1 Capital to Deposits	20.2	20.4	20.4	20.9	20.5	19.6
Leverage (x)	10.0	9.2	9.3	9.4	8.7	8.8
<b>Growth (%)</b>						
Net Interest Income	(1.2)	7.9	(7.0)	3.0	8.9	10.0
Non-Interest Income	12.7	(6.9)	(1.0)	(2.8)	0.8	(0.2)
OPEX	(12.8)	(1.9)	(1.6)	0.1	(0.5)	3.6
Net Operating Income	8.8	7.5	(7.5)	2.6	10.4	9.8
Net Income (Reported/Headline)	(31.8)	29.1	10.5	10.0	8.1	11.7
Loans	5.2	(0.2)	(9.9)	3.3	8.5	10.6
Deposits	4.1	1.5	(11.7)	7.6	8.0	10.0
Assets	7.0	(4.5)	(10.0)	6.1	(1.6)	9.2
RWAs	8.8	(3.1)	(5.5)	3.9	4.6	11.7

Source: Company financials, 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*

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

### Risk Ratings

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

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

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