19 April 2011

Qatar Islamic Bank

Defying explanation

Hold

Target price
QR81.54 (from QR87.97)

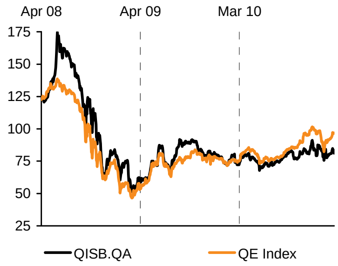
Price
QR81.20

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (QR)	78.50	91.10	80.30
Absolute (%)	3.4	-10.9	1.1
Rel market (%)	-2.2	-6.2	-11.1
Rel sector (%)	-0.9	-4.9	-13.9



Market capitalisation
QR19.19bn (€3.68bn)

Average (12M) daily turnover
QR18.61m (€5.12m)

Sector: QE Bank Index
RIC: QISB.QA, QIBK QD
Priced at close of business 14 Apr 2011.
Source: Bloomberg

QIB produced a set of seemingly poor 1Q results, below our expectations and consensus. In the absence of any confirmation from management, we limit the downgrade to our numbers, but the risk of further downgrades has sharply swung from the upside to the downside.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Reported PTP (QRm)	1,284	1,362	1,533	1,997	2,284
Reported net profit (QRm)	1,322	1,335	1,378 ▼	1,851	2,118
Reported EPS (QR)	6.10	5.85	5.96 ▼	7.36 ▼	8.42 ▼
Normalised EPS (QR)	6.10	5.85	5.96 ▼	7.36 ▼	8.42 ▼
Dividend per share (QR)	5.45	5.00	4.01 ▼	4.17 ▼	5.12 ▼
Normalised PE (x)	13.30	13.90	13.60	11.00	9.64
Price/book value (x)	2.25	2.19	1.85	1.72	1.61
Dividend yield (%)	6.72	6.16	4.94	5.14	6.31
Return on avg equity (%)	19.50	16.80	14.90 ▼	16.60	19.00

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
year to Dec, fully diluted
Accounting standard: IFRS
Source: Company data, Rasmala forecasts

Target price reduced from QR87.97 to QR81.54

Over 1Q11, the macro announcements were generally positive for QIB, particularly with the conventional banks no longer competing in the Islamic space. We therefore expected to raise our forecasts and target price after the 1Q11 results. However, weak lending volumes and related weak revenues, as well as the increasing opacity at QIB, have meant us actually reducing our short-term forecasts and target price.

Net lending volume decline of 16% requires explanation

The most surprising element of the 1Q results was a 16% decline in lending volumes. Although a fraction of this is related to deconsolidation of a subsidiary and the consolidation of QInvest, the bulk remains unexplained. QIB gave no indication of altering its 2011 guidance, and such a one-off decline is not without precedent (3Q10). Nevertheless, the sharp decline and a strong Qatar National Bank result (suggesting that the new regulation on Islamic Banking is not yet biting) makes a downgrade to our 18% 2011F loan growth number more likely than an upgrade.

Lending volume weakness may be related to other areas of weakness

In addition to deficient lending volumes, deposits also contracted 15% qoq. Nor was this lost business particularly low-margin, with calculated spreads recovering only modestly from weak 4Q10 levels, and net Islamic returns declining further from weak 4Q10 levels. In addition, fees and commissions were 29% below our forecast, although this may have been the result of falling loan volumes. Only strong income from investing activities salvaged an otherwise weak bottom line, resulting in a bottom line 7% below our forecast.

Increasingly opaque, but only modest downgrades so far

We assume a sharp bounce back from the quality deficiencies in these results. Nevertheless, we downgrade our below-consensus headline net income forecast from QR1,583 to QR1,378 for 2011, placing us 16% below Bloomberg consensus. We make more limited adjustments to our longer-term forecast (3% for 2012F), which, combined with going ex-dividend, result in a 7% decrease in our target price.

Analyst

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Income statement

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
Net interest income	1289	1339	1365	1666	1994
Non-interest income	513.7	552.1	887.3	1167	1258
Total income	**1802**	**1891**	**2253**	**2833**	**3252**
Operating costs	-487.4	-479.3	-615.7	-748.7	-875.7
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
Other costs	0.00	0.00	0.00	0.00	0.00
Pre-prov operating profit	1315	1412	1637	2084	2376
Provisions charges	-31.1	-50.0	-103.8	-87.4	-91.6
Post-prov op prof	1284	1362	1533	1997	2284
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	**1284**	**1362**	**1533**	**1997**	**2284**
Taxation	10.9	-66.4	-85.9	-111.8	-127.9
Minority interests	27.4	-27.4	-97.9	-145.2	-166.1
Preference dividends	0.00	0.00	0.00	0.00	0.00
Other post-tax items	0.00	66.4	28.4	111.8	127.9
Reported net profit	**1322**	**1335**	**1378**	**1851**	**2118**
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised PTP	1284	1362	1533	1997	2284
Normalised net profit	1322	1335	1378	1851	2118

Source: Company data, Rasmala forecasts — year to Dec

Balance sheet

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
Net loans to customers	22663	29352	34559	41129	48683
Other int earn assets	8903	12431	7603	9048	10710
Goodwill	0.00	0.00	216.1	216.1	216.1
Oth non-int earn assets	5165	7068	16917	17369	18533
Total assets	**39273**	**51840**	**62544**	**71510**	**82700**
Total customer deposits	20361	30258	34905	41540	49170
Oth int-bearing liabs	8691	11125	13185	14345	16481
Non int-bearing liab	2203	2207	2245	2529	3036
Total liabilities	**31255**	**43590**	**50334**	**58414**	**68687**
Share capital	7824	8041	10395	11149	11929
Reserves	0.00	0.00	0.00	0.00	0.00
Total equity (excl min)	**7824**	**8041**	**10395**	**11149**	**11929**
Minority interests	193.7	209.2	1815	1947	2083
Total liab & sh equity	**39273**	**51840**	**62544**	**71510**	**82700**
Risk weighted assets	38314	37523	44027	51986	61048
Est non-perf loans	n/a	n/a	n/a	n/a	n/a
Specific provisions	-248.2	-297.8	-401.1	-487.9	-578.6
General provisions	n/a	n/a	n/a	n/a	n/a

Source: Company data, Rasmala forecasts — year ended Dec

Capital

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
Risk weighted assets	38314	37523	44027	51986	61048
Reported net profit	1322	1335	1378	1851	2118
Opening risk assets	33591	38314	37523	44027	51986
Closing risk assets	38314	37523	44027	51986	61048
Change in risk assets	4723	-790.8	6504	7959	9061
Capital required	472.3	-79.1	650.4	795.9	906.1
Free capital flow	849.8	1414	727.6	1056	1212
Ordinary dividend paid	-1181	-1083	-948.1	-986.0	-1210
Share buy back/spec div	0.00	0.00	0.00	0.00	0.00
Equity / preference issue	1912	0.00	1912	0.00	0.00
Cash flow from financing	730.5	-1083	963.9	-986.0	-1210
Net capital flow	1580	330.6	1691	69.6	2.21
Tier 1 capital	6639	6518	9849	10763	11687
Tier 1 capital ratio (%)	17.3	17.4	22.4	20.7	19.1

Source: Company data, Rasmala forecasts — year to Dec

Standard ratios

Performance	QIB FY09A	QIB FY10A	QIB FY11F	QIB FY12F	QIB FY13F	Comm Bank of Qatar FY11F	Comm Bank of Qatar FY12F	Comm Bank of Qatar FY13F	Qatar National Bank FY11F	Qatar National Bank FY12F	Qatar National Bank FY13F
Non-int inc/gr op inc (%)	28.5	29.2	39.4	41.2	38.7	30.6	30.4	31.2	21.0	20.6	21.1
Cost/income (%)	27.0	25.3	27.3	26.4	26.9	32.0	33.0	33.0	16.7	19.6	20.6
Costs/average assets (%)	1.34	1.05	1.08	1.04	1.22	1.34	1.35	1.53	0.62	0.73	0.90
Net income growth (%)	-24.1	0.06	11.7	30.2	14.4	19.6	16.1	12.0	26.5	31.1	15.1
Net cust loan growth (%)	20.1	29.5	17.7	19.0	18.4	16.2	15.2	15.8	20.6	19.8	20.1
Cust deposit growth (%)	22.7	48.6	15.4	19.0	18.4	15.2	15.4	16.1	17.1	20.8	18.1
Net interest margin (%)	4.50	3.62	3.23	3.26	3.94	3.67	3.50	3.89	3.38	3.29	3.85
Return on avg assets (%)	3.56	2.99	2.58	2.76	3.19	2.95	2.87	3.24	2.95	2.98	3.44
Return on avg equity (%)	19.5	16.8	14.9	16.6	19.0	16.4	16.6	18.7	23.2	20.3	23.5
RORWA (%)	3.68	3.52	3.38	3.54	4.07	3.64	3.38	3.82	5.84	5.77	6.89
					year to Dec			year to Dec			year to Dec

Valuation	QIB FY09A	QIB FY10A	QIB FY11F	QIB FY12F	QIB FY13F	Comm Bank of Qatar FY11F	Comm Bank of Qatar FY12F	Comm Bank of Qatar FY13F	Qatar National Bank FY11F	Qatar National Bank FY12F	Qatar National Bank FY13F
Normalised EPS growth (%)	-27.2	-4.08	1.80	23.5	14.4	14.4	11.2	12.0	26.5	31.1	15.1
Reported PE (x)	13.3	13.9	13.6	11.0	9.64	8.87	7.97	7.12	10.8	8.23	7.15
Normalised PE (x)	13.3	13.9	13.6	11.0	9.64	8.87	7.97	7.12	10.8	8.23	7.15
Price/book value (x)	2.25	2.19	1.85	1.72	1.61	1.36	1.30	1.23	1.91	1.65	1.42
Price/adjusted BVPS (x)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Dividend yield (%)	6.72	6.16	4.94	5.14	6.31	8.56	9.07	10.2	2.71	3.78	4.27
					year to Dec			year to Dec			year to Dec

Per share data	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	216.6	216.6	226.4	236.3	236.3
Pre-prov prof/share (QAR)	6.07	6.52	7.23	8.82	10.1
Reported EPS (QAR)	6.10	5.85	5.96	7.36	8.42
Normalised EPS (QAR)	6.10	5.85	5.96	7.36	8.42
Book value per sh (QAR)	36.1	37.1	44.0	47.2	50.5
Dividend per share (QAR)	5.45	5.00	4.01	4.17	5.12
Dividend cover (x)	1.12	1.23	1.45	1.88	1.75
					year to Dec

Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tier 1 capital ratio (%)	17.3	17.4	22.4	20.7	19.1
Total CAR (%)	17.3	17.4	22.4	20.7	19.1
Equity/assets (%)	19.9	15.5	16.6	15.6	14.4
Net cust loans/dep (%)	111.3	97.0	99.0	99.0	99.0
Rep NPL/gr cus adv (%)	0.00	0.00	0.00	0.00	0.00
Tot prov/rep NPLs (%)	0.00	0.00	0.00	0.00	0.00
Bad debts/advances (%)	0.14	0.17	0.30	0.21	0.19
					year to Dec

Priced as follows: QISB.QA - QR81.20; COMB.QA - QR71.50; QNBK.QA - QR149.80
Source: Company data, Rasmala forecasts

Valuation methodology – DCF calculation

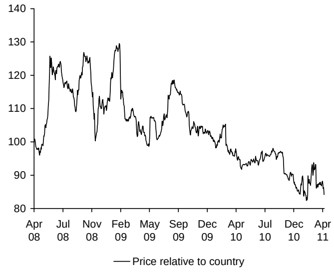
Stage 1 (2010-2013)				4q10	4q11	2012	2013
Explicit Dividends	Net CF to shareholders			1,083	948	986	1,210
	NPV Stage 1	**2,536**		3,619	2,817	2,075	1,210
Stage 2 (2014-23)				Model Numbers			
Modelled Dividends	Excess Capital	3,876		ROTCE1	Growth	Capital Req'd	RWA
	Modelled Dividends	982		20%	19%	7,838	61,048
	NPV Stage 2	**3,546**					
Stage 3 (2024+)				Model Numbers			
Terminal Value	2023	51,558		ROTCE2	Growth	Capital Req'd	
	NPV Stage 3	**13,184**		12%	5%	44,634	
Total NPV	Stage 1 (2010-2013)	2,536		**COE**			
	Stage 2 (2014-23)	3,546		US RFR			3.31%
	Stage 3 (2024+)	13,184		Country Risk Spread			3.00%
	NPV	19,266		Sector Risk Spread			2.50%
				Stock Spread			2.25%
	Shares	236		**Discount Rate**			11.06%
	Price Target	**81.54**					
	Price	**82.90**					
	Upside/(Downside)	**-2%**					

Source: Company data, Rasmala forecasts

Company description **Hold**

Qatar Islamic Bank (QIB), established in 1982, is the largest Islamic bank in Qatar, with 28% market share in Islamic lending and 9% in total lending. The bank provides a comprehensive range of Sharia-compliant retail, private banking, corporate and investment banking products. Since the re-branding and organisational restructuring in 2006, QIB has aggressively tapped the corporate and investment banking segments, apart from maintaining its strong retail foothold.

Price relative to country



Strategic analysis

Average SWOT company score: 3

Strengths 4

QIB has worked hard to modernise its product offering and has consequently held on to its market share in the face of competition. It has a well-entrenched position in the corporate (especially property-related) Islamic lending market, as well as a significant position in retail banking.

Weaknesses 2

Key weaknesses for QIB are losing market share in the Islamic banking segment, a real-estate-dominated loan book and investment property exposure.

Opportunities 3

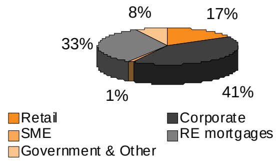
Corporate and private banking expansion, Islamic product innovation and international expansion are the primary opportunities for QIB. However, it also aims to have success in public sector lending and through QIB Capital.

Threats 3

The main threat is that the Islamic banking space has become increasingly crowded. Government regulations to limit competition will help.

Scoring range is 1-5 (high score is good)

Loan book split %



Source: QIB, 2010 Annual Report

Market data

Headquarters
Qatar Islamic Bank Building
Grand Hamad Street
P.O. Box 559
Al Doha
Qatar

Website
www.qib.com.qa

Shares in issue
236.3m

Freefloat
91%

Majority shareholders
Qatar Investment Authority (9%)

Country view: Qatar

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation or RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to M East & Africa

Competitive position

Average competitive score: 3+

Supplier power 5+

The lack of significant regulator control allows the banks to change contract arrangements (such as the base rate). This substantially increases the supplier power for all banks in Qatar.

Barriers to entry 3+

Strong government ownership in most banks, coupled with branch limits for foreign banks, keeps barriers to entry high for this sector. However, entry into its core public sector business is a threat.

Customer power 3+

Retail customer power is weak, but corporate and the public sector can be more demanding, if they were more price-sensitive.

Substitute products 2+

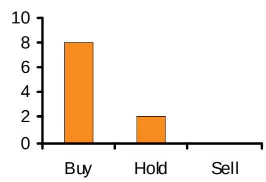
We believe the availability of substitute products (capital markets and wholesale lending) is rising, but it is currently unclear to what extent Qatar will favour its own banking system.

Rivalry 4+

Competition among local banks is low in Qatar. However, low growth rates have forced banks to look for growth where they can find it, and that may spark greater competition.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Qatar Islamic Bank (RIC: QISB.QA, Rec: Hold, CP: QR81.20, TP: QR81.54): We base our valuation on a three-stage DDM: a three-year stage of explicit forecasts, a 10-year stage of trend forecasts and a terminal stage based on a GGM. Downside risks to our target price are: increased competition in Islamic Banking, and overinvesting in less productive areas. We are also concerned about the quality of disclosures. Upside risks are: better-than-expected global economic recovery, higher oil prices and increased participation in local government infrastructure plans.

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