

Banks

Cheerful, not cheap

With Qatar's strong economy and a fiscally expansionary budget, the backdrop could hardly be better, in our view. Consequently, even though valuations are looking high for the region, we believe these can just about be justified by the high-teens growth rate and high-teens rate of return.

Table 1 : Key forecasts

| | Close | Target | Rec | 2010 | PE | | | PB | | | ROTCE | Loan |
|------|-------|--------|------|-------|------|-------|-------|------|-------|-------|-------|----------|
| | (QR) | price | | Yield | 2010 | 2011F | 2012F | 2010 | 2011F | 2012F | 2011F | 2010-13F |
| QNB | 200.1 | 215.9 | Hold | 2.50% | 14.0 | 11.9 | 9.5 | 3.5 | 1.9 | 1.7 | 21.3% | 20% |
| CBQ | 90.0 | 109.4 | Buy | 7.80% | 12.8 | 11.2 | 10.0 | 1.9 | 1.7 | 1.6 | 16.0% | 16% |
| Doha | 62.6 | 63.2 | Hold | 8.00% | 12.0 | 10.6 | 9.2 | 2.3 | 2.1 | 2.0 | 20.9% | 13% |
| QIB | 84.0 | 87.9 | Hold | 6.00% | 14.3 | 12.3 | 10.7 | 2.3 | 1.9 | 1.8 | 16.7% | 19% |

Source: Rasmala

Strong macro supports further financial sector development

We see the banking sector in Qatar as underpinned by strong macroeconomic fundamentals (fiscal and current account surpluses of 11.3% and 15.6% 2010F). The IMF forecasts 2010 and 2011 real GDP growth of 16.0% and 18.6%, driven by the increased exploitation of natural gas. We also expect current and planned industrial and infrastructure projects amounting to US\$100bn-150bn to continue to drive budgetary expansion (2010F: 16% yoy).

Steady loan growth ahead

We forecast a public sector loan CAGR of 25% in 2011-13, after an estimated 53% in 2010, with a similar rate beyond that time horizon. We also expect the corporate and consumer segments to rebuild, leading to steady growth of 18-19% in 2011-13F, albeit significantly below the 40% CAGR we saw during 2005-09. We believe the Qatari banks have relatively unconstrained balance sheets, with loans to stable resources below 90%, average tier-1 ratios of 15.1%, and scope for further capital market financing.

Financial performance remains robust with high ROTCEs

The banks in our coverage universe have maintained solid profitability through the crisis (2010 ROTCE: 18.5%), and we expect this to continue, backed by high asset concentration resulting in high interest spreads (2011F: 3.70%) providing for a comfortable cost to income ratio (2011F: 28%). The government bailout (US\$5.8bn capital injection and US\$5.9bn buyback of real estate and financial assets) has underpinned the quality of the loan book (2010: 1.76% NPL ratio) with the provisioning margin never likely to reach double figures.

Only CBQ looks good value

Nevertheless, following strong appreciation during 2H10, the banks stand at a premium to regional valuations and we prefer the higher risk but less expensive UAE valuations. Our preferred choice is CBQ for its gearing to the private sector and, in our view, modest valuation. We see QNB as the best positioned bank in terms of growth and profitability, but too rich at 3.5x 2010 PB. QIB looks cheaper, but we believe it suffers from leverage issues related to its associates, and a lack of clarity as to its strategy. Doha Bank has a cleaner capital structure, in our view, delivering stronger returns, but we believe it is reliant on a weak retail sector for growth.

Important disclosures can be found in the Disclosures Appendix.

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Executive summary

We see many obvious reasons to like the Qatari banks, with the World Cup announcement topping off the strong economic backdrop. However, we feel that these are already reflected in valuations, and we prefer riskier, better value alternatives.

The Qatari perspective – seemingly perfect economic backdrop

Qatar probably has the world's best economic backdrop, with recent exploitation of natural gas resources leading to trade and current account surpluses, very strong economic growth and a government that is willing and able to quash risk and support diversification of the economy. Hosting the 2022 World Cup is the icing on the cake. With all this in mind, it is little surprise that Qatari banks have appreciated between 18% (QIB) and 49% (QNB) since the beginning of 2H10, against a 17% rise in the DJ MENA Index.

Table 2 : Bank sector valuation

| | Close (QR) | Target price | Rec | 2010 Yield | PE | | | | PB | | | | ROTCE 2011F | Loan CAGR 2010–13F |
|------|------------|--------------|------|------------|------|------|-------|-------|------|------|-------|-------|-------------|--------------------|
| | | | | | 2009 | 2010 | 2011F | 2012F | 2009 | 2010 | 2011F | 2012F | | |
| QNB | 200.10 | 215.89 | Hold | 2.5% | 19.1 | 14.0 | 11.9 | 9.5 | 4.24 | 3.52 | 1.98 | 1.70 | 21.32% | 20% |
| CBQ | 90.00 | 109.40 | Buy | 7.8% | 13.7 | 12.8 | 11.2 | 10.0 | 1.91 | 1.87 | 1.72 | 1.63 | 16.00% | 16% |
| Doha | 62.60 | 63.19 | Hold | 8.0% | 12.5 | 12.0 | 10.6 | 9.2 | 2.41 | 2.33 | 2.12 | 2.00 | 20.90% | 13% |
| QIB | 84.00 | 87.97 | Hold | 6.0% | 13.8 | 14.3 | 12.3 | 10.7 | 2.33 | 2.26 | 1.91 | 1.78 | 16.74% | 19% |

Priced at close of business 24 January 2011.
Source: Company reports, Zawya pricing data, Rasmala forecasts

Valuations still not looking immediately stretched

Despite recent rises and the compelling economic back drop, balance sheet multiples do not immediately seem stretched. Nevertheless, we believe that returns (ROA) are already not far below their peak and, over the long term, we may see increased competitive pressure, manifesting itself either in lower spreads or higher costs. Furthermore, although risk is significantly lower than, for example, banks in the UAE, we believe risk as a measure of the uncertainty of earnings and ultimately banking valuations can easily be understated in Qatar. For those banks with impressive yields, we also question whether these are sustainable, and compatible with the relatively solid growth rates we forecast, without having recourse to intermittent capital raising. We do think the Qatari banks justify their valuations, but see further upside potential as limited.

Reasonable value on a regional comparison

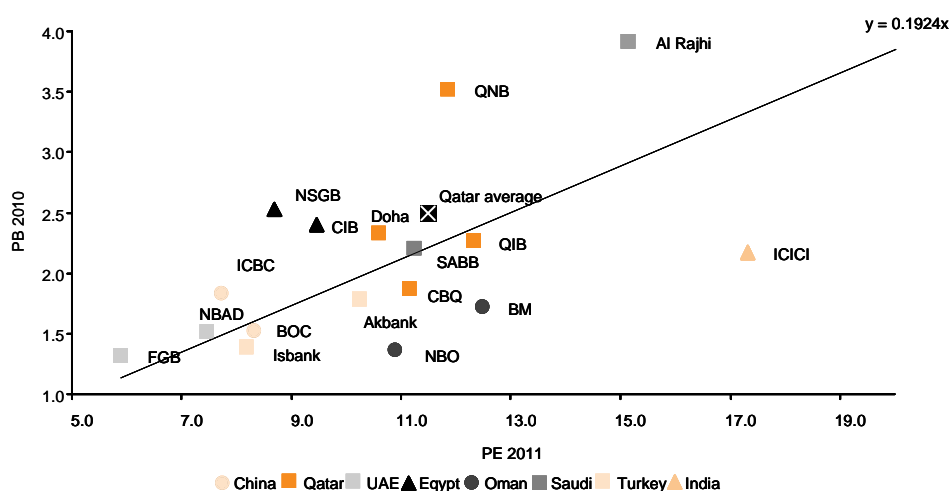
On our valuation chart below, the Indian banks and Al Rajhi look the most expensive, with their premium valuations reflecting a long-term penetration story, and in Al Rajhi's case a very strong level of returns. The Egyptian banks similarly trade at a premium generally, although short-term political risk has dented their valuations over the last two days. Compared to these, the Qatari banks we cover look good value. However, without the penetration story, we believe they are higher risk for long-term growth.

At the bottom end of the range are the banks in the energy states of the UAE and Oman. Compared to these, especially the UAE, Qatari Banks are more expensive, with the UAE banks seriously impacted by property sector risk, and the Omanis by lower returns. Looking outside the region, Qatar looks expensive compared with Turkey and China, our benchmark countries, but not nearly as expensive as the Indian banks, which only just fit on the chart.

We believe some of this general premium is justified by the high profitability, secure growth and low-risk banking environment. Nevertheless, we would prefer to recommend a higher-risk alternative in the UAE. Although the latter is still looking at a troubled year, a challenging property market and an uncertain economic environment, we believe the probability of returning to a highly profitable banking environment justifies the risk.

Cheaper than Egypt, and less risky than the region

Chart 1 : Regional valuations (2011F PE vs 2010F PB)



ICICI – March year end
 Price point 27 January 2011
 Source: Bloomberg; Rasmala Research (Qatar, UAE only)

Banks in Qatar have outperformed their regional peers with solid loan growth

Resilient loan growth

Commercial bank lending in Qatar rose 14% yoy in 2009 to QR252bn, bringing the four-year 2005-09 CAGR down to a still very respectable 40%. Able and willing to put public sector finances to work, Qatar has continued to drive public sector projects, which in turn have had a substantially positive impact on the private sector – both corporate and retail.

Table 3 : GCC loan growth (US\$bn)

| | 2008 | 2009 yoy Change | 1H09 | 1H10 yoy Change |
|--------------|------|-----------------|------|-----------------|
| Qatar | 61 | 69 14% | 79 | 97 23% |
| UAE | 271 | 277 2% | 259 | 280 8% |
| Saudi Arabia | 199 | 197 -1% | 198 | 203 2% |
| Kuwait | 94 | 101 7% | 99 | 100 1% |
| Oman | 24 | 25 5% | 25 | 26 5% |

Source: Respective central banks

We forecast double-digit lending growth (18-19% CAGR 2010-13F) continuing in the medium term, driven primarily by large-scale infrastructure projects. Although government borrowing should be firm for the next five years, in the longer term, growth should be increasingly dependent on the non-energy diversification efforts of the government.

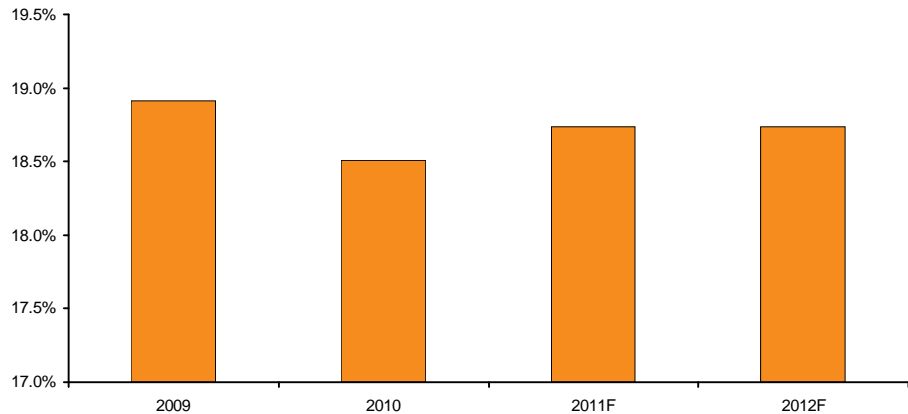
Returns have remained solid throughout the crisis

Notable declines in profit, but not dramatic

There has been very little volatility in average returns through the crisis. The net profit margin dropped from 72.5% in 2008 to 66.5% in 2009, and slipped further to 64.3% in 2010, largely due to an increase in provisioning. However, the decline in volatile sources of revenue also took its toll, and even fees and commissions were affected by lower growth rates. Overall, this resulted in a decline in ROAA from 3.55% to 2.79% in 2009 and 2.68% in 2010. This decline, however, we would regard as marginal, particularly in comparison with the UAE banks.

Indeed, just as big an effect was felt from the decline in the level of gearing, with the capital adequacy rules tightening up significantly and banks generally moving to a higher and more stable tier 1 ratio. This has created a structural change in the level of returns for the banking system, and to some extent presages Basel III.

Chart 2 : ROTCE (simple average for coverage universe)



Source: Company reports, Rasmala forecasts

The message for Qatari ROTCEs is one of resilience, however. So far we have not seen the banks dipping below high teens. Indeed, we expect the level of returns (ROATAs) to rise from here, although the increased level of capital will put a dent in ROTCEs, particularly for QNB.

Stock recommendations

Buy: CBQ and Hold: QIB, QNB and Doha Bank

Given that Qatari banks are in general expected to capitalise on the strong domestic growth story, we prefer stocks that provide the right mix of growth and value. Hence, we recommend CBQ, in spite of its recent 35% rally since 30 June 2010, against an increase of 17% for the DJ Mena Index. CBQ trades at 3% and 25% discounts to the unweighted sector average 2011F PE and 2010 PB ratios and provides a good dividend yield (2010: 7.8%), with improving growth prospects.

CBQ (price QR90.0, target price QR109.4, recommendation Buy)

Repositioning for stronger growth and better returns

As the leading large corporate bank in Qatar, CBQ is not a prime beneficiary of public sector loan growth or construction lending, but we believe it has the scope to reposition itself to take market share and therefore maintain adequate, growth rates of 15% through from 2010 - 2012. CBQ does have weaker ROTCEs, largely as a result of its associate investments, but there is further upside potential from increased public sector business allowing greater leverage and reduced costs, and from franchise improvements at UAB. We assign a target price of QR109.4, offering 22% upside potential, and a Buy recommendation.

QNB (price QR200.1, target price QR215.9, recommendation Hold)

In the fastest and most profitable part of the market, but in our view valuations reflect that

Although QNB, as the leading public sector bank, leads the sector when it comes to growth and shareholder returns, the question is how much of a premium we should pay for this. We forecast on the basis of superior loan growth (20% CAGR) for the next three years vs peers, although we bring the rate of return down from 26.6% in 2010 to 21.3% in 2011F and 19.3% in 2012F as a result of the very substantial rights issue announced for 2Q11. In the long term, we forecast a capital-efficient ROTCE of 23% (2014-23). Even with the lowest discount rate in the sector of 10.2% we believe that QNB's valuation is up with events.

The two most probable reasons for us to positively reassess are likely to be much stronger public sector growth than forecast, or a greater contribution from international operations, although there is risk that the latter may also dilute the level of returns. On the downside, our HOLD recommendation is contingent on QNB being able to maintain its cost income ratio in the 20% range, and we implicitly assume that Qatar does not embark on a process of gradual deleveraging after the immediate spending splurge.

QIB (price QR84.0, target price QR88.0, recommendation Hold)

Weak returns and uncertain strategy hamper our upside calculation

QIB looks well placed to continue gaining market share as the leading Islamic Bank in Qatar. However, we have concerns about the level of profitability (2010 ROTCE: 15.3%). Although this is partially the result of low levels of leverage, not all of which is necessarily structural, we don't expect a premium level of returns will be achievable within our 2013 time horizon. In addition, although from a multiples point of view (12.3x 2011F PE multiple is at a 7% premium to the sector average, while the 2.3x 2010 PB is at a 9% discount) QIB is not dramatically more expensive than CBQ, we believe its operations and strategy are more opaque, justifying a higher discount rate.

We believe the most likely source of additional upside would be an improvement in its capital structure, perhaps associated with improved visibility of value coming from its associates. In addition, if it can maintain its market share gains into 2011 and beyond, that could add upside. As an Islamic Bank, we would normally expect it to trade at a premium to an equivalent conventional bank, so do not see substantial downside risk, although slower growth would clearly impact profitability.

Doha Bank (Price QR62.6, target price 63.2, recommendation Hold)

Doha Bank looks poorly placed to take advantage of current growth opportunities, with little direct expectation of participation in public sector lending. Consequently, following on from its 4% growth rate in 2010, we also forecast the lowest CAGR growth rate in 2010-13F of 12.5%, and that contingent on a recovery in loan growth for the corporate and retail segments.

Hampered by weaker growth

As might be expected, Doha Bank trades at a discount earnings multiple of 10.6x 2011F PE. However, we expect it to have a premium level of returns (2011F: 12% ROTCE) based on a more efficient balance sheet (for which read no major associates), and this means it trades at a premium 2010A multiple to tangible book of 2.3x. We believe the structurally higher level of returns justifies this premium and recommend a Hold.

Principle positive risks include the potential for its international expansion to move ahead more strongly than expected (in India), as well as a pick-up in growth of the private sector. However, this is balanced by the possibility of tighter pricing in the private sector, adversely affecting returns.

Key risks and uncertainties

Growth – short term certainties, but narrowly focused longer term

Given the premium valuation of the stocks, long-term growth is a key consideration. Short-term growth is generally low risk, but we believe there are four significant areas of risk:

- LNG prices – could these be so volatile as to effect public sector spending commitments? Given World Cup commitments we don't expect that spending is closely linked to short term LNG pricing fluctuations. This is particularly so as the majority of LNG is sold on long term fixed price commitments. However, given the limited data, it is difficult to know where the tipping points are.
- Long-term growth – what happens after near term spending plans are concluded? We assume public sector growth continues to rise at double digit growth rates in 2015-20, and in single digit rates beyond that, but the slow down could be more severe and it could go into reverse.
- How much of the action will the local banks participate in? International banks and capital markets are arguably more suited to the current financing requirement. Nevertheless, the capital and liquidity injections seem to be a statement of purpose from the government.
- When will private sector loan demand pick up? We assume that a recovery begins in 2011 and that it will match sector growth from about 2013. However, there are no clear positive trends currently, and growth may remain narrowly focused.

Competition – no evidence of short-term risk

The second key area of risk is of rising competition due to excess capital and liquidity in a lower growth environment (lower than 2005-08 that is). We believe there is little appetite for a price war amongst existing competitors, although this could in principle change. Newer entrants, such as Masraf al Rayan (NR) or Al Khaliji Commercial Bank (NR), currently merging with International Bank of Qatar (NR), might be the most likely candidates for breaking the current consensus on market behaviour, but so far there has been little propensity to do so. Recently-launched Islamic bank, Barwa Bank, could plausibly be a market spoiler (as is typical for a new market entrant), but this does not currently seem likely.

A greater issue is the possibility of banks aiming to grow market share outside their core area of competency, such as CBQ or QIB in the public sector, or QNB in the private sector. Masraf al Rayan has also seen its growth rate stall, and we may see it reposition itself for growth away from QIA related business.

Budgetary spending seems assured, but long-term public sector growth and near-term private sector growth are less certain

Breakdown of market discipline encouraged by new entrants and slower private sector growth

Other risks – geopolitical

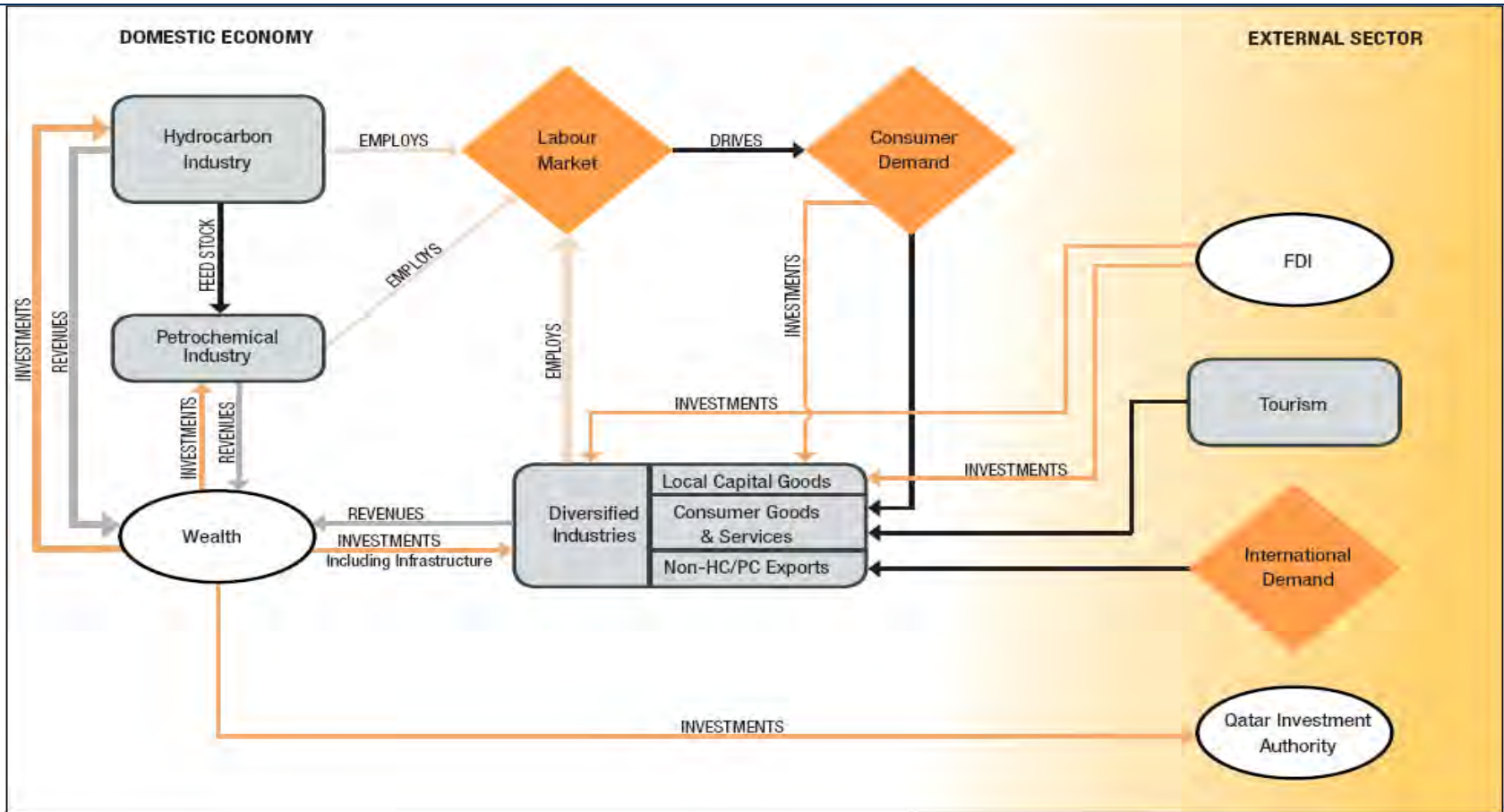
Finally, as for the rest of the region, nearby geopolitical uncertainties remains a feature. Although we make no pretence at quantifying this, we believe that investors will look for a slightly higher required return/discount rate to reflect that. The events in Tunisia, for example, may well affect investments there (such as QNB's Tunisian Qatari Bank).

We also highlight regulatory risk. The government has transferred significant value to the banks in the past, but going forward it is not clear that this is going to always be the case. Indeed the cancellation of the share buyback rights is a case in point, as may be the current rights issues.

Implications for the discount rate

We believe we have adequately captured these risks with current discount rates of 10.2-11.3%, despite short-term certainties.

Chart 3 : Schematic for the Qatar economy



Source: Rasmala

Low-risk banking and sustainable growth

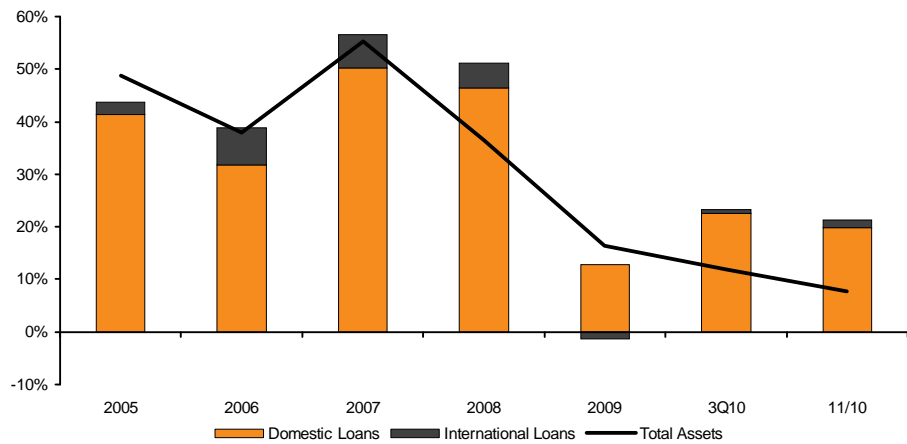
Qatari banks are emerging from the crisis looking good: loan growth levels stayed in double digits, and balance sheet risks were absorbed by strong government support. The result is that ROTCEs remained high, and with strong capital support.

Qatari banking through the crisis

Substantial spending on LNG capacity expansion and the opening up of the real estate sector provided an opportunity of uninterrupted growth to the banks

There is no doubt that the rate of growth has come down from what can only be described as a multi-year boom period. Nevertheless, in spite of the global crisis, loan growth in Qatar has been impressively resilient, never dropping below 11% yoy. In 2010, public sector lending, and particularly lending to government institutions recovered sharply, leading to 23% yoy loan growth as at 3Q09 – a trend maintained into 4Q10. Total asset growth was a little more modest, but only due to reductions in interbank balances.

Chart 4 : Contribution to system credit, % yoy

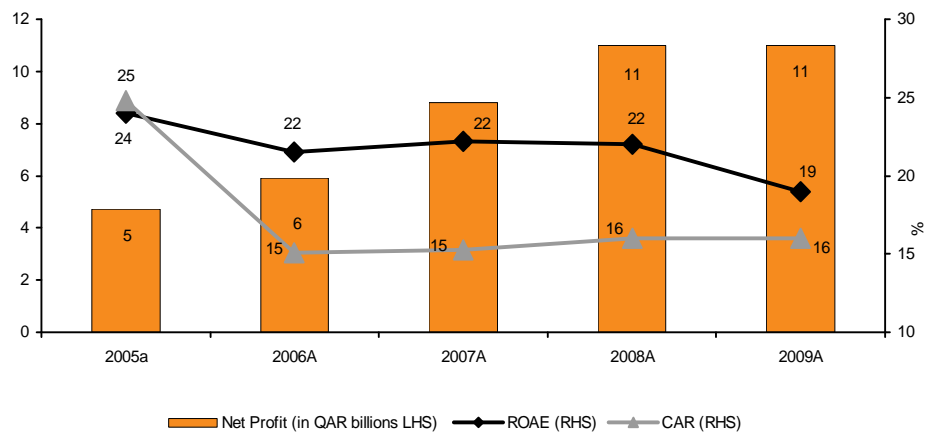


Source: Central Bank of Qatar

Risk absorbed by the Central Bank’s comprehensive bailout package

In addition, ROEs have been remarkably stable. The largest causes of losses for banks elsewhere in the region are mark-to-market balance sheet (or off-balance sheet) losses and loan loss provisioning. In Qatar, the government has sought to pre-emptively resolve not only these issues, but potential issues of liquidity and capital, drowning the banks in support.

Chart 5 : Qatar banking sector net profit, RoE and CAR



Source: Central Bank of Qatar

Key initiatives taken to support the financial system included:

- The government bought equity portfolios amounting to QR6.5bn (US\$1.8bn) from seven local banks (1.4% of 09 assets).
- The government bought real estate portfolios of QR15bn (US\$4.1bn) from nine local banks (3.2% of 09 assets).
- The QIA re-capitalised the banking sector – (QR21bn or 10% increase in paid up capital of various local banks – 5% in February 2009 and another 5% in December 2009).
- The government also guaranteed all deposits in the Qatari Banking system.

In addition the government also stepped up its level of fiscal support, running a budget deficit of 2% of GDP in 2009, equivalent to QR7.3bn. Indeed, support was so strong that the government issued US\$7bn of bonds, which soaked up a portion of the excess domestic liquidity.

Restrictive regulatory ratios and timing

In addition to financial support, the Qatari Central Bank has also maintained more conservative regulatory ratios than some of its neighbours. We believe this has limited excess monetary expansion, and limited leveraged investment. Instead the main projects have been developed by well-funded Qatari government sources. The main regulatory provisions have been:

- credit ratio (loans to stable resources, excluding equity) limited to 90%;
- real estate loans as a proportion of total deposits, limited to 15%; and
- the imposition of a 1.5% risk reserve ratio for loans.

We believe this has limited excessive monetary expansion and partially helped banks avoid the worst of asset bubble formation.

Consequently, profitability and asset quality have remained strong

The combined net profit for our universe was largely unchanged in 2009. Performance did to some extent suffer from higher impairment provisioning (2010: 0.60% of gross loans vs 0.13% in 2008) on rising loan defaults (2010 NPL ratio of 1.76% vs 1.33% in 2008), while it pressurised non-interest income on the back of slower loan growth, which dropped to 11% yoy in 2009 from 51% yoy in 2008, before recovering to an estimated 20% in 2010. However, this was partly offset by rising interest spreads (2010: 3.88%), reflecting strong asset re-pricing and falling liability yields. Consequently ROTCEs for 2009-10 remained strong at 18.9% and 18.5%.

Going forward, we believe the main impediment to ROTCE recovery will be the lower level of leverage, which is partially a structural issue, and partially related to a determination to build up capital and liquidity ahead of a growth spurt, we believe. Although this excess capital situation did partially normalise in 2010, in 2011 the rights issues (QNB) and private placements (CBQ, Doha Bank, QIB) are likely to limit the ROTCE rise.

**ROTCE: spread expansion
offsets higher cost of risk**

Prospects for loan growth underwritten

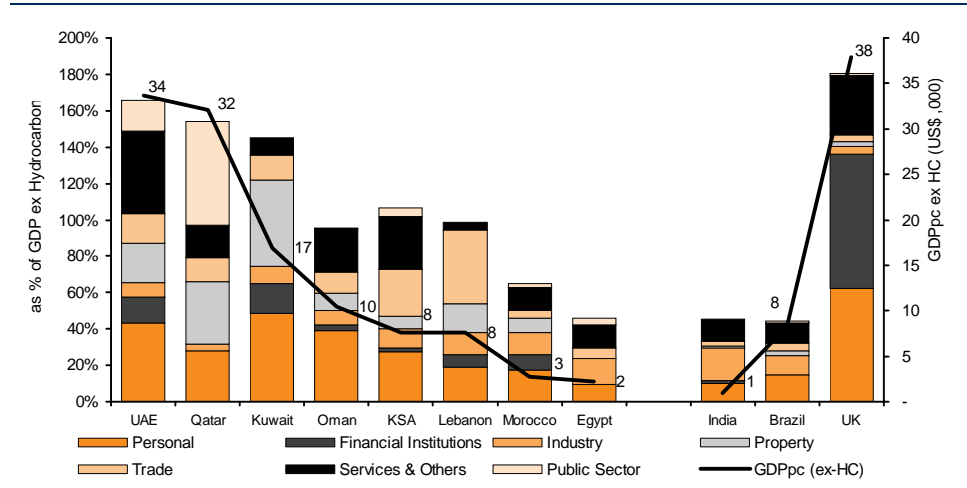
Growth prospects in Qatar may not match previous highs, but they are secure. We expect public sector loan growth to be the driver in the near term, but underpenetration of the private sector will offer further opportunities. We assume 18%+ CAGR in the medium term.

Lending penetration high but focused on public sector

Other than the UAE, Qatar has the highest loan penetration levels in the GCC, as measured by loans to GDP ex-hydrocarbon. Although this might be taken to suggest slower growth, the high level of penetration is asymmetric. Excluding the public sector, loan penetration is not that high.

Continued private sector under penetration, and a public sector able to handle the leverage

Chart 6 : Bank lending as a percentage of GDP ex Natural Resources



Source: Central Bank reports, GCC loan data generally Sept-10, otherwise 2009 data

Pinning down the exact areas of opportunity is tricky, however, with lending distribution affected by reporting consistency. At first glance, the two main areas of underpenetration appear to be “services & others”, and personal lending. In Qatar’s case, personal lending is only consumer loans, not personal lending for business purposes (UAE) or (we suspect) mortgages (Kuwait).

In spite of the difficulty with data consistency, the penetration data presents three conclusions: 1) Qatar’s overall penetration levels are no worse than in line with appropriate regional peers; 2) public sector penetration is the highest in the region; and 3) private sector lending is relatively underpenetrated, partially reflecting the development of the private sector.

Prospects remain solid: driven by strong macro performance

Average 14% 2010-13 nominal GDP growth IMF forecasts suggests further penetration

Looking ahead, we believe that loan growth will continue to benefit from the infrastructure and other development projects, as well as continuing economic reforms, FDI and the resultant growing population base, strengthening the domestic consumption market.

Strong nominal GDP growth suggests penetration numbers still not out of kilter

Led by the public sector, loan growth rebounds

Long term structural shift towards private sector lending

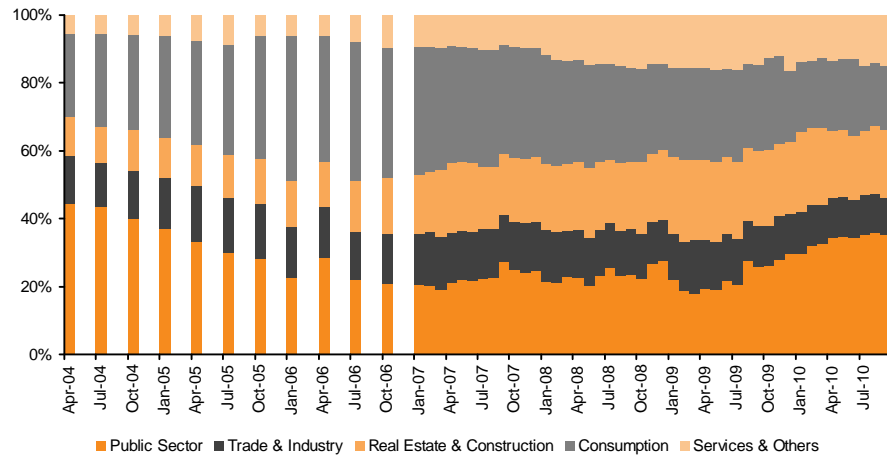
As of November 2010, total bank lending amounted to QR318bn (36% CAGR from October 2005), or 56% of total banking assets, with financial investments and interbank assets contributing 15% and 12% of assets, respectively.

From April 2004-07, despite the rapid development of public sector lending, the primary driver of growth was consumer loans. This expansion of consumer culture also had a knock on effect on the business sector, which expanded at a similar rate. However, the contribution of consumer lending shrank between January 2007 and June 2009, with real estate and construction loans expanding rapidly, and continuing to grow beyond the boom due to the time lag on lending, particularly to the property sector. The service sector was also a key driver as the economy had some success in diversification.

Public sector momentum likely to be here to stay

By 2Q09, however, most sources of growth other than public sector lending had dried up, resulting in the share of public sector lending rising from a 1Q09 low of 18% to a Nov-10 level of 37%. The only other significant area of growth was contractor loans, which we believe were benefitting from continued residential growth, continued industrial development and increased infrastructure spend.

Chart 7 : Shift in loan portfolio



Others includes non-resident loans
Source: Central Bank of Qatar

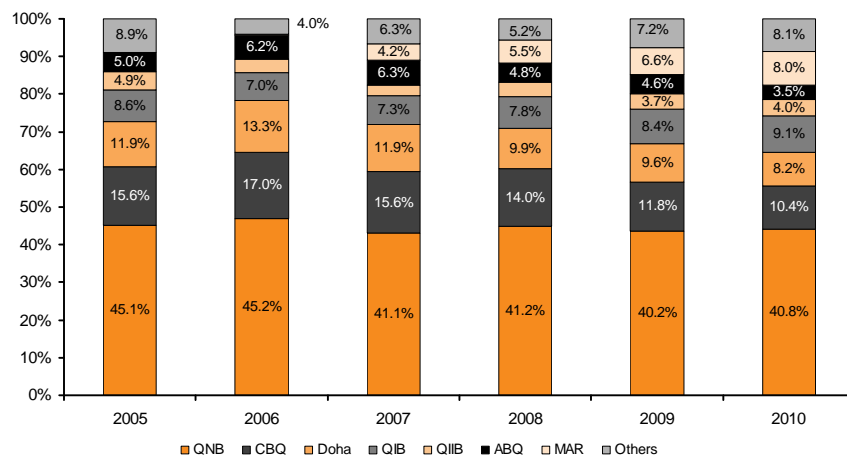
Low risk appetite keeps retail and corporate lending under check

We expect this trend to continue over the next couple of years. We do not expect significant appetite for extending further credit to the retail segment, while corporate lending is affected by business confidence. Nonetheless, we are of the view that during our second and terminal stages of forecast horizon (2014-23 and beyond 2024), demand for lending to the private sector will recover, and retail and corporate lending will regain market share.

QNB and QIB to lead loan growth

With the exception of QIB, the banks we cover have lost market share to new market entrants. QIB's growth has primarily been led by real estate and construction related lending in the past with increased corporate lending driving current growth. Unsurprisingly, despite a strong 36% CAGR over 2005-09, QNB has lost significant market share (300bp decline since 2005) as private sector lending dominated, before this reversed in 2010.

Chart 8 : Market share development to 2005-10

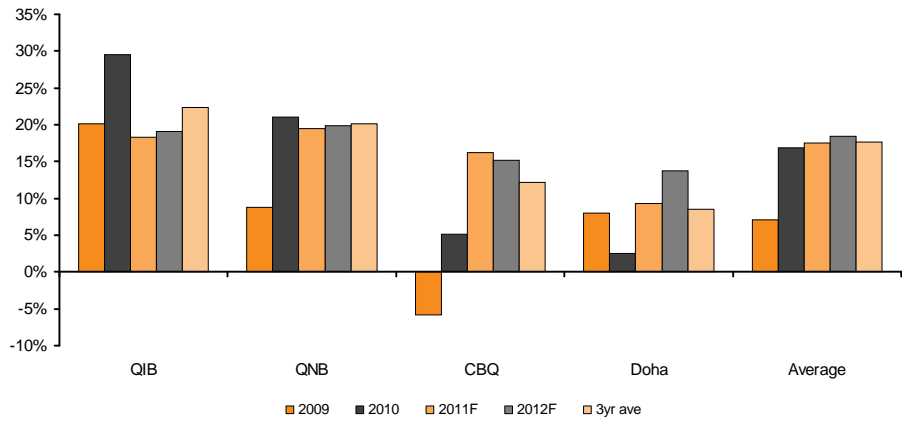


Source: Company reports, Central Bank statistics

Looking ahead, we forecast QIB's loan growth to be above the average for our coverage universe over 2010-13, with QNB taking the second spot. We expect the large private sector exposure to count against Doha Bank and CBQ over 2010-12, although we expect CBQ to offset this by taking a slice of the public sector business they have traditionally eschewed. We do expect some

reversion to more balanced growth in the medium term though, and therefore expect to see CBQ in particular closing the growth gap against its peers. Doha Bank is likely to suffer more in the short term, but should benefit from the underpenetration of the private sector in the longer term.

Chart 9 : Loan growth, yoy %



Source: Company reports, Rasmala forecasts

Public sector lending has risen over the past years as banks catalyse on the working capital requirement of the public sector, which is implementing various infrastructural diversification programmes

Government and public sector engine of growth

Lending to the public sector has been rising rapidly, with banks benefiting from the rising working capital and project financing requirements of the public sector which, backed by hydrocarbon revenues, is implementing various infrastructural diversification programs. As a result, by the end of November 2010, public sector lending amounted to 34% of total loans (from 28% at the beginning of the year), with a 49% CAGR from January 2006-November 2010.

Fiscal spending drives Government lending

Latest figures suggest that the growth rate picked up in 2010, to an annualised rate of 52%, which contrasts sharply with the 6% increase in private sector credit. With public sector lending accounting for 74% of all 2010 loan growth until November, it is little surprise to see the likes of CBQ and QIB have taken a more aggressive view with respect to targeting government sector business. Going forward we expect this trend to be maintained over the next couple of years, although the growth differential among the banks is more limited given their ability to reposition themselves.

QNB the top beneficiary, but CBQ and QIB looking to take share

Public sector lending is dominated by QNB (50% public sector ownership and 47% public sector loans), and this is the primary driver of its superior growth rate. Within public sector lending though, we expect the bank to yield market share to its peers over the next couple of years, with CBQ and QIB refocusing their public sector lending proposition. The other bank which has been extremely strong in public sector lending has been Masraf Al Rayan, with much of this growth likely due to Q-company (GRE) expansion.

We forecast a decline in the public sector contribution to the loan book

In the long run, however, we expect the contribution from public sector lending to reach a peak in two to three years, with the balance of public sector projects shifting from petrochemical to infrastructure, and with the government beginning to pay down loans on the earlier projects. We currently do not forecast a decline in public sector lending, but would assume no more than single digit increases from then.

Table 4 : Public sector lending, market share

| (QRbn) | 2005A | 2010A |
|--------------------------------|-------|--------|
| Market size | 16.1 | 114.0* |
| Market share comparison | | |
| QNB | 76.5% | 64.5% |
| CBQ | 9.3% | 4.6% |
| Doha Bank | 5.3% | 1.7% |
| QIB | 3.1% | 3.2% |

*estimated based on Nov-2010 data.
Source: Central Bank of Qatar, Company Reports,

Property lending: confused signals

Mixed sector

It has been an odd year for the property sector, which accounts for 35% of all private sector domestic lending. We believe that is because the sector is exposed to a number of largely unrelated industries. We believe the housing and office sector is generally troubled, although this is showing up in low loan growth rather than provisioning (see later). Meanwhile the industrial and infrastructure sectors are healthy, but in some cases were facing delays. With the World Cup 2022 announcement, the latter has essentially moved from flashing amber to green.

Although we do not have enough granularity or consistency of data to reflect this, we believe this two tier growth rate will continue, with office and residential investment and lending continuing to be small, while everything else will be accelerating. We believe that lending to this sector will be the early driver of growth in corporate banking, although gradually we expect growth prospects to broaden out.

Mortgage exposure remains small, CBQ remains market leader

The disclosure of banks mortgage exposures is weak, both at an individual bank level and at a system level, with central bank data lumping it under retail lending. Nevertheless, we believe that mortgages are only a minor contributor to loan books, with CBQ reporting the highest exposure at

QR1.4bn (4% of loans). With a 7% ytd rise in sector retail loans and retail loans accounting for around 70% of total NPLs, we do not expect the banks we cover to expand rapidly in this area in the near future.

Table 5 : Investment property and mortgage exposure

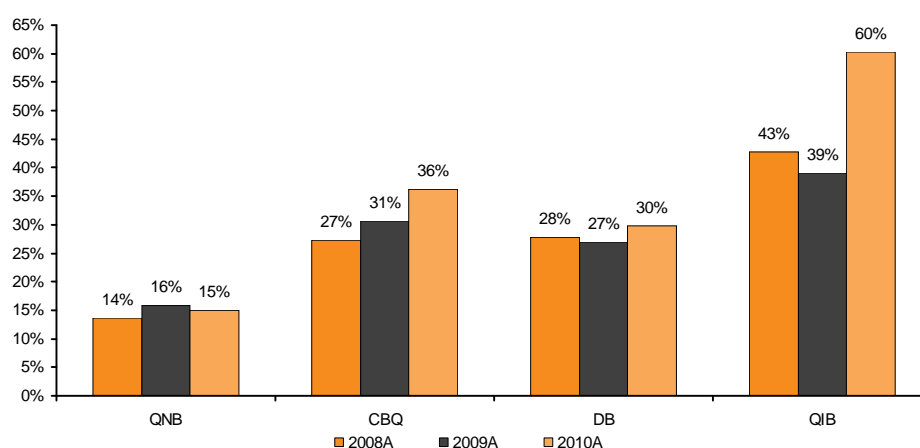
| (QRm) | 2008A | 2010A |
|-------------------------------------|-------|--------------|
| Investment property exposure | | |
| QIB | 2,262 | 1,115 |
| % of assets | 7% | 2% |
| Mortgage loans | | |
| | | 1H10A |
| QNB | | 600-800 |
| CBQ | | 1,400 |
| Doha Bank | | 50-100 |
| QIB | | 783* |

*Year end 2010 data.
Source: Company reports, Management guidance

Conservative policies of the Central Bank have prevented over-extension

The conservative approach of the Central Bank caps real estate loans by commercial banks to 15% of customer deposits (or 150% of the bank's capital and reserves, whichever is less) whilst maintaining a LTV of 65% for loans to developers and contractors. Further, conventional banks are not allowed to own investment properties for leasing or trading purpose. Islamic banks, on the other hand, are provided some leeway (allowed higher lending and investment property) as the Shariah law requires most lending to remain asset backed, resulting in higher than average real estate and construction lending.

Chart 10 : Real estate loans as a percentage of gross loans



Source: Company reports

Limited concerns over the quality of real estate lending

We have limited concerns about asset quality in real estate lending as stressed loans have been sold to the government and large projects are being executed by a few government related entities

After a 60% CAGR over the past five years, real estate loans are now under pressure with lending declining by 1% in the eleven months to November to QR40bn (13% of system loans). Nonetheless, we remain less concerned about the exposure of our universe to the real estate segment as stressed loans have been sold to the government (QIA) with regulators maintaining strict lending conditions and large projects being executed by a few government related entities (for example Qatari Diar, Barwa), providing for limited asset quality concern and better control over new supply in the market. Further, the lack of investment property (except QIB) also avoids the probability of a revaluation loss.

With the cap on real estate loans not applicable to Islamic banks, QIB maintains the highest real estate exposure within our universe

For QIB, we forecast QR47m of investment property sales during 4Q10

Policies promoting liberalisation and private sector participation have been catalysts behind the surge in commercial lending.

QIB bears highest real estate exposure

QIB maintains the proportionately highest real estate loan book, and investment property exposure in our coverage list, with exposures of QR7.9bn (2009) and QR1.2bn (1H10), or 31% of loans and 2.6% of assets, respectively. With the cap on real estate lending and investment property not applicable to QIB, the bank continues to fund a number of projects in both the freehold and non-freehold areas of Doha. Although this creates a certain amount of concentration risk, we believe credit risk is contained due to the disposal of its lowest quality loans and due to the quality of its remaining counterparties.

Direct property exposure: QIB's Bawabat Al Shamal

QIB also has a significant direct property exposure. The investment property portfolio is split into 60% land and 40% buildings (located in Doha city with a few being constructed in Pearl Qatar). Most land is slated for use for the upcoming QR6bn North Gate project, with the UAE-based Al Futtaim Group as the partner. For the current year, we do not expect the bank to account significant revaluation gains but expect investment property sales of QR47m for 4Q10 to be reported (yield of 4%).

Housing and office downturn slows corporate lending

Economic reforms remain key driver encouraging corporate sector growth

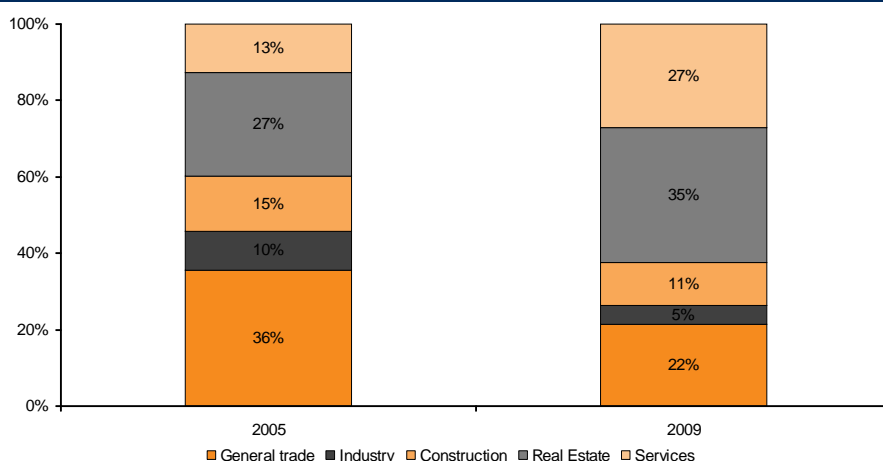
Corporate lending saw a 49% CAGR in 2005-09, with real estate and contracting dominating both growth and end balances (49% as of November 2010).

Catalysts behind the surge in corporate lending have been reforms by the Government to liberalise its economy and encourage private sector participation. The government has implemented several policies aimed at encouraging economic growth and attracting foreign capital into local markets – the setting up of free zones (ie, Qatar Financial Centre, Qatar Science & Technology Park), ownership and leasing of property, and reducing corporate tax rates to 10%.

However, the real powerhouse behind corporate lending has been real estate lending, which jumped from 24% of corporate loans in October 20-05 to 36% in November 2010. We believe the residential sector was the prime agent through much of this period, but increasingly the focus has shifted during the global crisis to other areas, such as corporate and hospitality as well as building the infrastructure in sectors such as education, aviation, transport and hospitals.

Looking ahead, we expect real estate and construction lending to continue to be an important component of corporate lending. However, we also expect to see a recovery in areas less directly linked to public sector spending, such as trade (new air and sea port), tourism and industry.

Chart 11 : Corporate sector credit breakdown



Source: Central Bank of Qatar

CBQ and QIB market share linked to domestic demand

QIB and CBQ maintain focus on corporate lending

Over 2009-10, our coverage universe lost market share in commercial lending. However, that was primarily the result of the continued expansion of Q-company business (Government-related entities) whose primary customer is the international market, while domestic demand has remained stagnant. Much of that business has gone to Masraf al Rayan. Both CBQ and QIB have determined to go after GRE business now though, and this shift in focus combined with a recovery in domestic demand should allow them to hold their own.

Within our universe, we expect QNB remains the largest corporate lender in absolute terms but also expect the general trend to be for a decline in market share to smaller players (2010 notwithstanding). On the other hand, CBQ and QIB are likely to be the most aggressive within the corporate lending segment; given the sector is their bread and butter. This general trend was reversed in 2010, due to QNB sharply increased its service sector loans.

Table 6 : Corporate loans (ex-property) market share comparison

| (QRbn) | 2005A | 2010A |
|----------------------------|-------|-------|
| Corporate loan market size | 10.2 | 68.0* |
| Market share | | |
| QNB | 48.7% | 45.1% |
| CBQ | 19.3% | 14.4% |
| Doha Bank | 19.2% | 12.4% |
| QIB | 13.6% | 15.2% |

* Estimated based on November 2010 data.
Source: Central Bank of Qatar, Company reports

With unemployment at low single digits, a growing population and continuing oil and non-energy projects, we expect consumer lending to rise

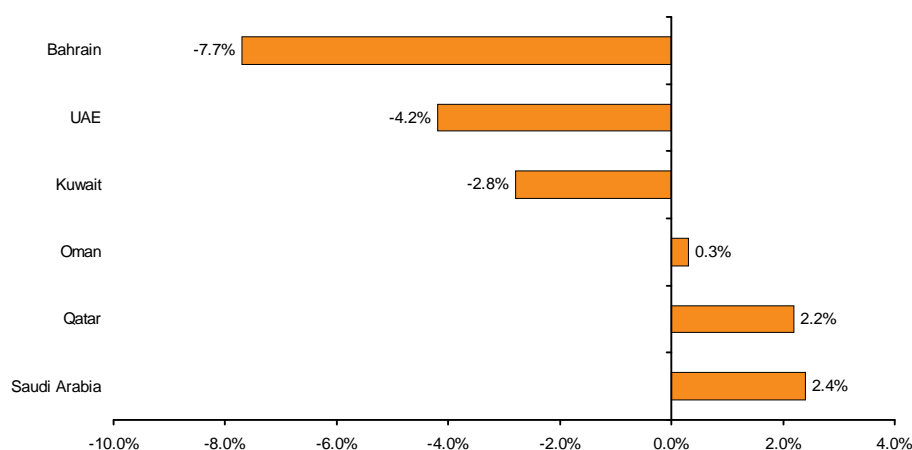
Consumer lending overstretched

Consumer lending went through a period of awakening from 2005-09, with generous public sector salary increases improving borrowers' ability to finance, while the expansion of consumer culture led to greater demand for lending products. This, combined with the sudden ubiquity of credit products, such as cards, auto and housing loans, and loans secured on salary, led to consumer lending growth amounting to 40% CAGR from January 2005 to December 2008, albeit weighted to the early part of that period. However, in the near two years since then (to November 2010), consumer loans have declined.

Regulatory changes and lack of salary increases have limited growth

In 2008, the central bank decided to limit personal loan repayment instalments to 50% of salary, and a maximum loan period to seven years. Although this may not seem to be much of a constraint, with loan instalments allegedly reaching up to 80% of salary in some cases, and instalment periods up to 25 years in others, it proved to be a break on lending, particularly to the Qatari population.

Chart 12 : Private sector expatriate employment (% change in headcount in 4Q09)



Source: GulfTalent

In addition to tighter control of personal lending ratios, the absence of public sector salary increases in 2009-10 has also limited the absolute amount of lending, although increases in public sector employment has allowed some flexibility of the aggregate.

Labour markets remain healthy – after KSA, Qatar leads regional recruitment

Not surprisingly, Chart 12 highlights that recruitment activity remains comparatively robust in Qatar. The results highlight that KSA and Qatar were the only two countries within the GCC which experienced a significant increase in private sector expatriate employees, reflected by an annual increase of 2.4% and 2.2%, respectively. The 12% and 33% increase in outward remittances from KSA and Qatar, respectively, in 2009 were a further indicator of the positive employment trend for expatriates in the country.

Table 7 : Population and personal loans data

| | 2007A | 2008A | 2009A | May-2010A |
|-------------------------|-------|-------|-------|-----------|
| Qatar population (m) | 1.2 | 1.6 | 1.6 | 1.7 |
| % growth | 18% | 27% | 5% | 2% |
| Economically active (m) | - | 1.2 | 1.3 | - |
| EA % of population | - | 75% | 77% | - |
| GDP per capita ('000) | 211 | 260 | 219 | - |
| Personal loans (bn) | 47 | 57 | 53 | 57 |
| % growth | 34% | 20% | -6% | 8% |

Source: Central Bank of Qatar, QSA

We believe that segments of the population are going through a period of deleveraging, as spending is brought more closely into line with salaries, and salary expectations are matched to the more conservative increases over the last two years. We expect that once that deleveraging process nears completion, the underlying dynamic of strongly growing domestic population, increased economic participation, high immigration and wage increases will once again drive growth in consumer lending. Nevertheless, we expect only a limited recovery in 2011, and growth in line with labour force remuneration in the years beyond that.

QNB and Doha Bank market leaders in retail lending

Within our universe, QNB and Doha Bank account for the largest market shares in retail lending. Nevertheless in terms of its contribution to their respective loan books, it can only be described as marginal for QNB, but absolutely central for Doha Bank. With its disproportionately large branch network, Doha Bank has of course been successful in attracting the Qatari Nationals, but it has been particularly successful attracting the local and expatriate HNWIs (minimal investible assets of US\$1m).

For CBQ and QIB, we believe this remains an incidental part of their strategy, at least until growth prospects improve in the sector. Although retail lending has risen in absolute terms, the contribution to loan book has declined (CBQ 19% vs 34% in 2005, and QIB 16% vs 61% in 2005).

Table 8 : Retail loans market share comparison

| (QRbn) | 2005A | 2010A |
|---------------------------------------|-------|-------|
| Total retail loans market size | 30 | 53* |
| Market share | | |
| QNB | 21.8% | 27.4% |
| CBQ | 12.3% | 13.3% |
| Doha Bank | 14.8% | 16.8% |
| QIB | 5.9% | 10.5% |

*Estimate based on November 2010 data.
Source: Central Bank of Qatar, Company reports

In 2005 the Central Bank granted commercial banks the approval to provide Islamic banking services

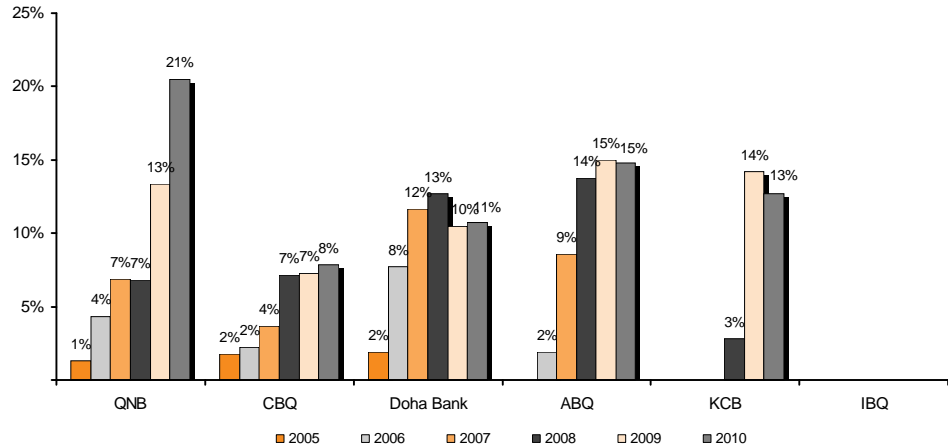
Islamic banking remains robust and gains asset market share

At the end of 2009, the aggregate assets of the top 500 Islamic banks in the world grew by 29% to US\$822bn (Source: S&P). Similarly, the global Sukuk market has staged a strong recovery and expanded remarkably as US\$23.3bn of notes were issued compared to US\$14.9bn in 2008.

Islamic lending has climbed to 32% market share

Until the central bank liberalised competition in Islamic Banking in 2005, there were two traditional Islamic banks in Qatar, QIB and QIIB, sharing 14.5% market share. There are now four Islamic banks in Qatar, including the recently launched Barwa bank, five conventional banks with Islamic banking subsidiaries or windows, and two foreign banks with Islamic branches. Over the past five years, Islamic loans have grown at a CAGR of 60%, with the banner years being 2007-08.

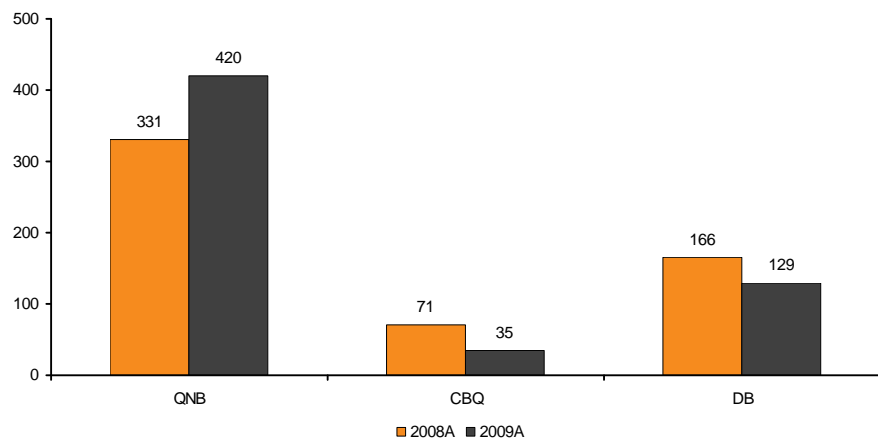
Chart 13 : Islamic finance as a percentage of gross loans



Source: Company reports

We believe that familiarity by the market (Government and private sector) and hence rising demand, increasingly easy substitution between Islamic and conventional offerings and Islamic branch expansion plans by conventional players are all reasons why the market share of Islamic assets will continue to rise. However, as the contribution of public sector lending begins to top out, and if Qatar is successful in attracting a professional expatriate population, any further increases in market share may be reversed.

Chart 14 : Net profit from Islamic banking (QRm)



Source: Company reports

QNB gains substantial Islamic loan market share

Masraf al Rayan has clearly dominated new Islamic lending, stealing 21.5% market share in its first full year of operation (2007), and stretching it further since then. In 2009, the last period for which we have a breakdown, substantially all the growth came from Murabaha lending to the real estate sector. Consequently, with 42% of its book going to government institutions and 49% going

QNB and Masraf al Rayan have taken substantial market share in Islamic banking since liberalisation

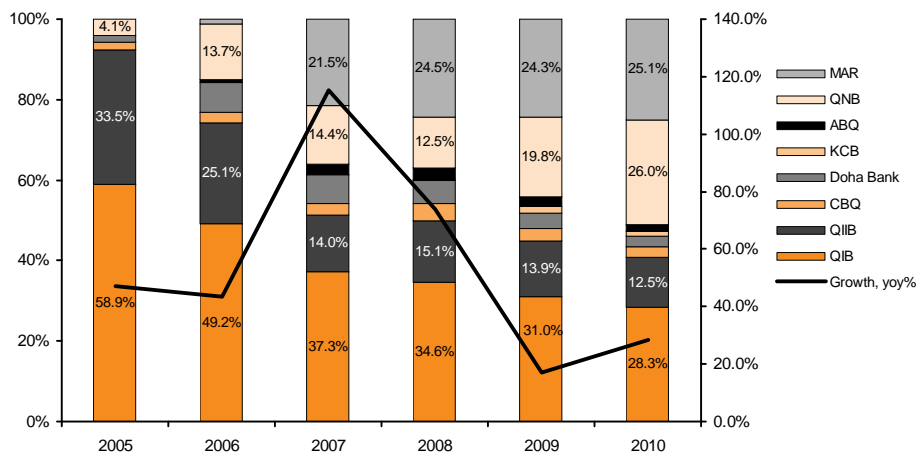
to real estate lending (which is dominated by government-owned companies), there may not be much going on in the way of real private sector commercial banking.

The other big gainer of recent times has been QNB, which also got off to a flying start, jumping to 13.7% market share in 2006. Since then, growth in Islamic loans has been a shade behind the market, until 3Q09, when, we believe, government borrowing pushed up Islamic loans by 163% over the following two quarters to 1Q10. As for Masraf al Rayan, qoq growth in 2Q10 was limited, perhaps related to the timing of budgetary expense.

With two big gainers of market share, it should come as little surprise that the incumbents have sharply lost market share, in QIIB's case, dramatically so, in spite of a CAGR of 31%. QIB has come closer to holding its own with expansion of the "trading" category making the greatest contribution, now that real estate/housing loans have slowed their rate of expansion.

Other market participants, including both Doha Bank and CBQ have largely registered false starts. CBQ's Islamic loans accumulated a total increase of just 9% over 3Q08-4Q10, while Doha Islamic registered a 6% decline over 2008-10. As a result, Al Safa Islamic is being relaunched as Commercialbank Islamic, while Doha Islamic is also rebranding.

Chart 15 : Market share of Islamic lending



Source: Company data, Rasmala forecasts

Going forward, we believe that government spend will be the primary driver for growth at QNB. QNB also intends to open a number of new branches before the December 2011 limit on domestic Islamic branch openings come into effect.

QIB, on the other hand, is likely to see some solid growth, come rain or shine, given its more diversified exposure. A weak property sector will still restrain growth, but overall we expect to see QIB take market share from the conventional segment.

Brand positioning a juggling act for conventional bank offshoots

The Islamic banking operations of CBQ and Doha banks have been caught between two stools. On the one hand they would like the operation to be held at a distance to the conventional operation so as to establish its authenticity as a Shariah compliant entity. On the other, the more it is positioned at arm's length from the conventional bank, the less clear the operational and branding synergies.

So far, the only conventional bank to have significant success in Islamic banking is QNB which focuses primarily on public sector business. None of the private sector operations have done as well. We understand that both Doha Bank and CBQ are now repositioning their Islamic Banking operations closer to the parent company, and that should enable them to perform a defensive function more effectively, and to leverage brand synergies, if not operational synergies.

New regulations aimed at protecting the dedicated Islamic banks

Limitations on conventional banks doing Islamic Banking business

In 3Q10 the central bank issued a circular aimed at limiting the ability of conventional banks to compete within the Islamic Banking space. The main provisions of this circular were as follows:

- The allocation of capital to the Islamic arm of the parent bank must not exceed 10% of the bank's total shareholder's equity.
- Regulatory limits on credit, mortgage finance, and investments are applied to the Islamic arm on a stand-alone basis.
- Lending limits: combined Mudaraba, Musharaka and similar loans (i.e. non-mortgage loans) should not exceed 5% of the total Islamic portfolio.
- The Islamic arm must maintain a maximum loan to deposit ratio of 90% at all times.
- The assets of the Islamic arm should not exceed 15% of the bank's total assets at all times.
- Banks should not plan any Islamic branch expansions; as the Central Bank will not accept any applications for new Islamic branches for the time being.
- The banks have until 31 December 2011 to comply with the regulations.

Most of the banks see limited impact from the regulations, given that they apply predominantly only to onshore transactions, and it should generally be possible to restructure loans to accommodate these limits. The most significant item is likely to be the constraint on branch openings, although with many branch openings having already obtained a licence, this is not likely to be an issue until 2012. In addition, we believe the banks are likely to be able to use onshore rep offices to service clients if necessary.

Finding funding: few constraints

Despite a credit ratio limited to 90%, we don't see funding as a constraint. As well as ample deposit funding, the banks are very well capitalised, by international standards and have yet to significantly tap capital market sources.

Deposit growth rebounds

At the end of 2009, customer deposits amounted to QR247bn (30% CAGR over 2005-09), or 60% of total liabilities, with rest of the funding primarily bridged by interbank borrowings and wholesale borrowings (combined 30% of liabilities). Although the break-up between interbank borrowings and foreign wholesale funding is not available, we believe, Qatar's banks liabilities are heavily weighted towards local deposits and inter-bank borrowings. It is only after the 2009 sovereign issue, that pricing has become reasonable and a trend has emerged towards increasing the proportion of foreign wholesale borrowing.

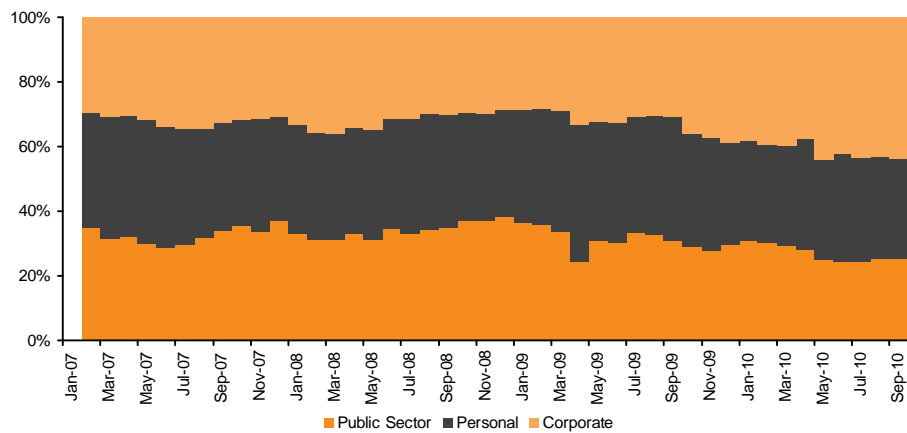
Concentration risk within deposits has declined

Over the past decade, the concentration risk within the deposit structure has also declined as various economic reforms helped the private sector to blossom and allowed investors to diversify into property and financial investments apart from the traditional bank fixed deposits. As a result, Chart 16 highlights that retail and Government segments have shed their dominance (2002 aggregate 85% of deposits) with corporate and non-residents increasing their respective participation. Nonetheless, we expect that the local banking system, in line with many of its GCC peers, will continue to enjoy strong public sector support (state deposits saw a 21% CAGR in 2005-09) as hydrocarbon inflows translate into a direct and indirect funding base for various commercial enterprises.

Qatar banks liabilities are heavily weighted towards local deposits and inter-bank borrowings with a lower reliance on wholesale funding

We expect that the local banking system, will continue to enjoy strong public sector support as hydrocarbon inflows translate into a direct and indirect funding base

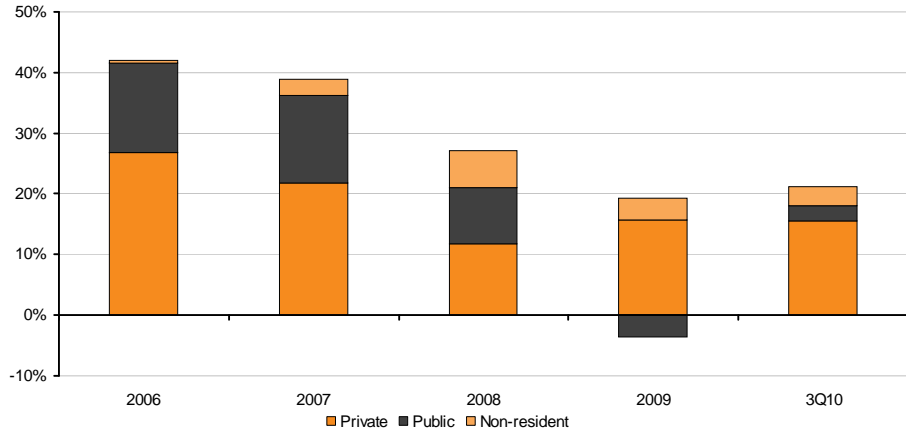
Chart 16 : Shift in deposit structure



Source: Central Bank of Qatar, Others includes non resident deposits

Looking ahead, we forecast that over 2010-12 the average deposit growth of our universe would remain in line with loan growth, with the Loan Deposit ratio inching higher by 100 bp to 102% in 2013. For the full year ending 2010, however, we forecast 21% deposit growth for our universe.

Chart 17 : Deposit growth



Source: Central Bank of Qatar, Rasmala forecasts

Too close a focus on deposit growth is a mistake

Overall though, we do not believe it makes sense to look at deposit growth as an exogenous variable. All being equal, stronger loan growth automatically means stronger deposit growth for a closed system. Although Qatar is not a closed system, we believe that the government can sterilise leakages into or out of the system by transferring overseas deposits with banks – a luxury available to Qatari government with its dominance of both the lending and borrowing market.

Indeed, we believe Qatar is effectively managing its monetary policy exactly through this mechanism, most recently by announcing the placement of QR50bn of bonds into the market, as a way of soaking up excess liquidity, while boosting banks' balance sheets. An individual bank can be short of funding of course, but with 2010 loan deposit ratios ranging from 80% (QNB) to 98% (CBQ), and with very substantial overcapitalisation, the banks have so far had limited need for capital market financing.

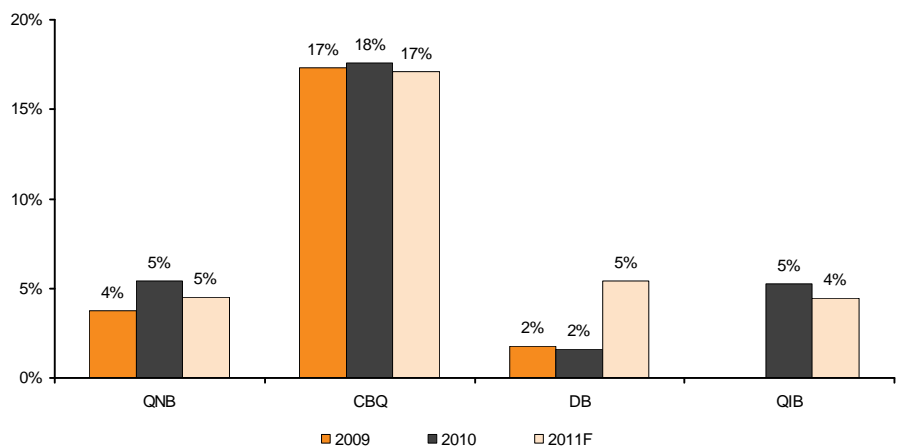
Capital market funding to liquidity

Returning to fund raising from 3Q10

Qatari commercial bank's reliance on external wholesale funding (primarily EMTNs and syndicate loans) has traditionally remained low (2009 7% of liabilities) as majority of the lending profile remained short to medium term with requirement fulfilled by the liquid interbank market and short term time deposits, keeping the credit ratio (which we calculate as net loans relative to customer deposits + repurchase agreements + wholesale funding) comfortably below the 90% regulatory limit.

We expect Doha Bank to shortly follow QIB in raising wholesale funding

Chart 18 : Capital market funding as % total assets



Source: Company reports

In line with management guidance, we expect Doha Bank to follow QIB in raising wholesale funding, in Doha Bank's case amounting to US\$500m. We believe risk appetite amongst investors for Qatar-domiciled debt remains robust. CBQ raised USD1.6bn in November 2009 and Qatari Diar Finance's USD3.5bn bond was oversubscribed 5.7 times in July 2010. QIBs 4Q10 capital raising was eight times oversubscribed.

Capital market likely to be a funding resource going forwards

We expect QNB to raise funds more cheaply with its peers having to pay a premium.

Capital market funding for these banks amounted to a relatively modest 7% of total assets at the end of 2010, with only CBQ actually significantly tapping the wholesale market. CBQ's 2009 debt capital raising of US\$1.6bn was used to primarily pay-down maturing debt (US\$380m) and maintain CAR (inclusion of subordinate debt of US\$600m in Tier 2 capital). It has also indicated that it intends to maintain its capital market funding at roughly these levels going forward (17-18% of the balance sheet). We expect QNB, backed by strong public sector ties, to raise funds more cheaply (existing facility at Libor + 19.5bp) with its peers having to pay a premium.

Regulatory capital in excess

Government support enhances capital adequacy

Capital adequacy has been strong over the last couple of years, and is set to become even stronger. At the onset of the crisis, the government through QIA funded a capital raising at a premium to the market for all the banks apart from QNB, amounting to 10% of capital, as well as a possible further 10% in the future. The result was a direct transfer of value from QIA to the relevant banks. In addition, this followed 2008 rights issues or other capital raisings at Doha Bank, QNB, CBQ and QIB. The result was that the banks were well enough capitalised through the crisis to maintain a 6-7% dividend yield without trouble, as can be seen by tier one ratios averaging (for the banks we cover) 14.8% as at year end 2009.

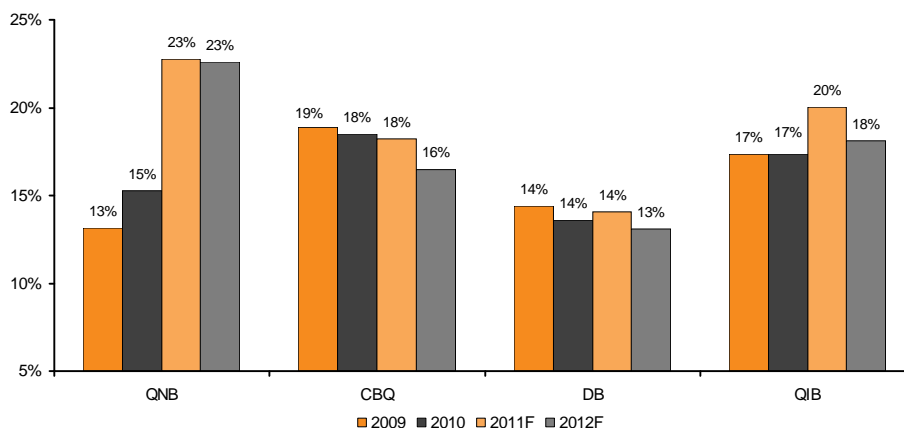
2010 regulatory changes have tightened up capital again

At the start of 2010, the central bank shifted its regulatory requirements perhaps partially in recognition of Basle III coming in the distant future, but also just to be more conservative. The result was that financial associates would be fully deducted from regulatory capital considerations. All four banks were affected, but particularly CBQ and QIB, and to a lesser extent QNB. In QIB's case, a rights issue or other capital raising looked to be inevitable if it aimed to maintain its dividend payout, as well as its growth rate.

New year, new capital

As things stand though, this no longer seems to be necessary. After expectations had drifted as to the intention for the second half of the QIA injection, the government confirmed that this would indeed take place in 2Q11. In addition, QNB's results suggest there has been a relaxation of the definition of regulatory capital, although this has yet to be confirmed. In addition, QNB announced a 25% rights issue, which given the stated premium would increase shareholders funds by 57%.

Chart 19 : Capital adequacy ratio



Source: Company reports, Rasmala forecasts

Overcapitalisation for the near future

We believe the government's intentions going forward are to ensure that the banks have sufficient capital to ensure they are not the weak link in the various development plans over the next few years. This could be taken to mean that the banks will be given a very much more important role than we have hitherto assumed in providing capital for development projects, but we currently believe that is too strong an assumption to make.

In terms of capital adequacy, the latest injection certainly makes any further capital raising by the banks unnecessary. Nevertheless, we believe capital ratios will tighten over the coming years, and sometime around 2014 the issue of capital adequacy may once again arise.

Risk-weighting an issue for leverage

The other point of interest is the fact that public sector lending has a much lower risk weighting than other types of lending. This has been a key differentiator for the banks, allowing QNB to get to a gearing ratio of 10.0x in 2010, in spite of major associates, while CBQ and QIB both languish with gearing ratios of 5-6x. As a result, QNB is putting its capital to work much harder, justifying its higher valuation multiples (see later).

Revenue margins strong and stable

Interest margins have been sustainably high in Qatar, and this has been supplemented by strong fee income and other non-interest income. We believe the primary issue is a stable banking market, avoiding cut-throat competition.

Excess returns and limits on competition

Qatari banks have a high level of returns (ROTCE), although at or about the 19% level (2010A), it is not immediately obvious how good those returns are. However, Qatari banks manage a 19% ROTCE on the back of a 15.1% Tier-1 ratio, with gearing of just 7.87. In other words, they manage to maintain a very high level of returns, in spite of being underleveraged. Qatari banks had a 2010 revenue margin (revenues to interest earning assets) of 4.6%, which compares with our UAE estimated equivalent of 4.4%. We believe the main reasons for this are behavioural, structural and temporary.

Fragmented market structure, concentrated control

The main behavioural reason for limited pricing competition is a degree of market discipline brought about by common control amongst a small population. The QIA investment is just the institutional embodiment of that.

Currently 18 banks serving 1.6m customers

With the launches of Masraf Al Rayan (MAR) and Al Khaliji in 2006 and 2007, respectively, the total number of banks in Qatar comes to 18, including six commercial, four Islamic, seven foreign and one specialised government-owned institution. The market share of the seven foreign banks has remained steady at roughly 10% of assets, with new branch openings being authorised on an ad hoc basis. We believe resident foreign banks focus primarily on a limited portion of the market, and thus have relatively little impact on the competitive landscape.

Ownership patterns reflect strategic and capital support

The government (through QIA) maintains a stake in all the banks in our coverage universe, amounting to 16.7% of each bank's shareholder base, following the upcoming capital raising. The main exception to that is QNB, in which QIA maintains a long-standing 50% stake, indicating a closer working relationship and allowing it to garner most government and related enterprises lending opportunities (public-sector-related loans account for 47% of QNB's loans). We believe this high level of government sponsorship helps credit ratings and lower wholesale funding costs.

Government stake-holding provides strategic (QNB) and capital support (CBQ, Doha Bank and QIB)

Table 9 : Credit rating

| 2010 | Loan book (QRbn) | Market share | QIA stake | Fitch rating |
|--------------------------|------------------|--------------|-----------|--------------|
| Qatar National Bank | 132 | 40.8% | 50.00% | A+ |
| Commercial Bank of Qatar | 34 | 10.4% | *16.70% | A |
| Doha Bank | 27 | 8.2% | *16.70% | A |
| Qatar Islamic Bank | 29 | 9.1% | *16.70% | A |
| Top 4 total | 221 | 68.5% | | |

* After 2Q11 capital raising.
Source: Central Bank of Qatar; Company Reports, Rasmala estimates, Press releases

Shifting market dynamics little threat, at this stage...

Exits and entrances

In spite of the fragmentation of the industry as a whole, the leading four banks maintain a dominant market share in lending of an estimated 69% (4Q10), and with Masraf Al Rayan accounting for a large portion of the remainder. There have been a number of new arrivals over the last few years, most notably Masraf Al Rayan, and most recently Barwa Bank. Nevertheless, the Central Bank has not prioritised increasing competition, but rather has focused on stabilising the market with regulatory prudence, government support and encouraging smaller players to merge, as in the case of Al Khaliji and International Bank of Qatar (announced May 2010, potentially forming a combination a little smaller than Doha Bank).

'Lane discipline'

However, we believe as significant a reason for limited competition is that the banks each have their own identities, and have voluntarily restricted expansion in one another's areas of specialisation. For example QNB is known to be first and foremost a public sector bank; QIB is the leading Islamic bank, particularly in the property and construction segments, but also in the retail

area. Masraf al Rayan takes a large portion of Q-company business, while CBQ is the leading specialist corporate bank. Finally Doha Bank can significantly be described as a retail bank.

... but some (if minor) evidence of changing behavioural patterns

Each bank could play many parts

This 'lane discipline' has been relatively well maintained while growth was strong. It was also strong during the initial stages of the crisis when banks reverted to balance sheet management rather than growth strategies. However, with asymmetric growth strongly favouring the public sector, we believe there are signs this is changing, particularly with QIB and CBQ emphasising public sector lending aspirations. Indeed QNB has also seen disproportionate growth in the corporate sector.

Structural dampeners on competition

Besides behavioural issues, there are also a number of institutional drivers of excess return, most of which relate to the relationship between clients and banks. If clients cannot shop around for the cheapest and best financial services, then the banks are in a good position to exercise a significant degree of supplier power. The main issues under this heading are mostly issues of account portability.

In addition, we believe there are a number of reasons why customers might be significantly less price sensitive. These include the lack of information on pricing, a transient population (at least for expats), and perhaps also a lack of clearly defined property rights, which would include issues such as standardised and regulated contracts.

Temporary factors

In the short term, repricing has also been a big factor. As the crisis struck, banks were able to re-price credit and liquidity risk sharply upwards. At the same time, the banks only saw a brief increase in deposit costs partially due to the central bank guarantee for deposits, and confidence in the overall banking system. With the government showing strong support for troubled industries, and absorbing any risk of systemic contagion this perceived risk did not result in any particularly high level of provisioning. The result was higher spreads with little related cost.

This situation was made all the more acute with the banking sector being awash with liquidity. The result is that interbank rates have stayed low, and deposit rates have stayed lower. The recent announcement of a QR50bn Qatari real bond to soak up this liquidity may raise liability yields, but only by adding to asset yields.

Finally, with rates declining over the last year, we believe that liabilities re-price downwards faster than longer duration assets. As such, we believe any such benefit will be relatively short-lived, and should dissipate over the coming year.

We believe spreads are at a peak

Variable rate lending provides strong interest spreads

Interest spreads remain stronger than many regional peers

Our universe has achieved significant net interest income growth over 2005-10 (34% CAGR) backed by strong lending volumes and resilient spreads. Looking ahead, we expect underlying spreads to decline during 2011, although the increase in cash balances may mean an increase in calculated spreads. The main reasons for this decline are: 1) the mix effect due to greater public sector lending; 2) stability of interbank rates; and 3) declining asset yields as risk premia decline.

Rising competition may have an impact

Beyond the immediate horizon, we may begin to see some pick up in competition, driving spreads back towards 2007 levels. However, with banks more mindful about risk based pricing and the importance of liquidity management, we expect that pricing will stabilise somewhere in the middle.

Doha Bank sports highest spreads but lacks lending volume

Retail driven Doha Bank maintains the strongest spreads

Reported spreads are very much in line with the structure of the respective loan and deposit books. On the asset side, Doha Bank has the highest consumer lending business and the lowest public sector business, and we would therefore expect the highest asset yields. On the deposit side, the high proportion of time deposits should imply higher liability yields, but the differential is too small to make a big difference. Consequently, it is the asset yields which dominate as we would expect.

The story for QNB is the converse. With high public sector lending and limited consumer loans, it has the lowest interest spread, in spite of a cheap funding base. CBQ and QIB lie somewhere in

between the two. However, we believe that QIB benefits from lower cost funding in high interest environments, with this difference narrowing as overall interest rates decline.

Table 10 : Interest spreads comparison, 2010

| | QNB | CBQ | Doha Bank | QIB |
|--|------|-------|-----------|------|
| 2010 Interest spread | 3.5% | 3.70% | 4.6% | 3.8% |
| Public sector loans (% of total loans) | 52% | 15% | 7% | 11% |
| Consumer loans (% of total loans) | 10% | 20% | 32% | 16% |
| Time deposits (% of total deposits) | 71% | 68% | 69% | 44% |
| Savings deposits (% of total deposits) | 1% | 9% | 5% | 13% |

Source: Company reports, data as of 2009

Fee income under pressure

It has been a disappointing year in 2010 for fee income, with the F&C margin (% of IEAs) slipping from 112bp to an average 84 bp. Slowing loan growth has been roundly blamed, but the evidence is mixed given the acceleration in loan growth in 2010. Instead, we believe the main issues were changes to regulations affecting the fees banks could charge, and a general increase in competition driving down arrangement fees on corporate loans. As might be expected this fell particularly heavily on CBQ and QIB, although the latter blamed it particularly on a decline in Istisna'a products (construction mortgages).

Going forward, we assume only a partial recovery from this. We expect banks to be able to restructure their fee schedules in part to offset this decline. In addition, we expect some of the fee pressure to be manifested as interest margin pressure instead. We also understand that many of the banks have been developing their fee business, particularly in areas such as brokerage, capital markets and asset management, and this should help fee penetration, albeit at higher costs. In particular, we should mention here QNB Capital and QNB Financial Services, as well as QIB Capital.

HNW banking – an opportunity left hanging

The opportunity

Most Qatari banks have high net worth product suites targeting investors with more than US\$1m of investible assets. In some cases this consists of little more than vanity products, and slightly preferential balance sheet products. However, in other cases the banks have sought to do more 'Swiss-style' private banking, developing fee driven products and structured balance sheet products, to provide options that currently clients have to move assets abroad to obtain. We believe the core opportunity is in the mid-tier, for those with financial assets in the US\$1-5m category, with assets predominantly in the GCC.

QNB – stable of products

QNB is one of the few GCC banks to offer a full service Swiss-style private banking operation. It targets the HNW segment with three different products. At the priority banking end, it offers QNB First, which offers portfolio management services to its higher end clients. However, for its top level clients the main product is QNB Private, a full service domestic private bank. Supporting this is QNB Banque Privée (Suisse), a Geneva-based operation launched in November 2010. QNB also owns the UK-based private bank Ansbacher, although this has undergone a multi-year restructuring process which has seen the disposal of most of its operations.

Limited differentiation amongst the other banks

By contrast, CBQ's Sadara premier banking operation focuses on offering investment products, as part of Wealth Management Solutions offered to the mass affluent. Although this has facilities to cater for HNW clients, the lower profile of this operation suggests it is of more limited scope. We believe this operation is primarily for defensive reasons, aiming to retain better value clients without building a substantial cost base to build a separate revenue base from liabilities.

Doha Bank main priority banking operation is Al Riyada, built on the foundations of Al Qemma, which was launched in 2007. Like CBQ it does not have a stand along cost base, and a readily defined independent strategy. Consequently, we believe this is again more of a defensive strategy, designed to retain existing clients, and subsequently to increase the level of investment activity of those customers.

QIB's private banking operations from a single branch jointly branded with corporate finance. We believe that this is an underserved segment for QIB and for Islamic Banking in Qatar generally. The main service providers are thought to be HSBC Amanah and bank Sarasin.

Primarily defensive focus

Overall, we believe that there is little incentive for the local banks to aggressively push full service private banking facilities to clients, at least until there begins to be an erosion of the local client base. For this reason, the banks have built primarily low cost defensive operations. However, in the current slower growth market that the banks find themselves in, there has been further interest in developing liability products.

The main exception has been QNB with its international presence. Its aims so far are defensive, looking to re-gather assets that have migrated internationally, and to defend business that is threatened by international competition. So far, we do not forecast that any of the banks will create substantial value from private banking, although it remains an upside possibility. The operations do, however, reduce the scope for international banks to cream off customers.

Government bonds lift financial investments quality

The sale of real estate and equity portfolios to the Government has significantly altered the balance sheet structure of our coverage universe, in turn reflecting positively on the overall quality of the income statement. Nevertheless, the impact on other non-interest income has not been positive.

In spite of substantial de-risking of the investment portfolios though, asset impairments have continued, and this has particularly affected Doha Bank (in 2009) and CBQ (2009-10). For those banks, we expect improved asset based revenues in 2011-12F, as well as growth in areas such as FX trading and derivative income.

Net profit margins strong by GCC standards

Limited price competition boosts revenues, while limited service competition limits costs. In addition, no taxation and an exceptionally supportive central bank when it comes to provisioning ensure that net profit margins are strong even by regional standards.

Average cost-income ratio sustainably below 30%

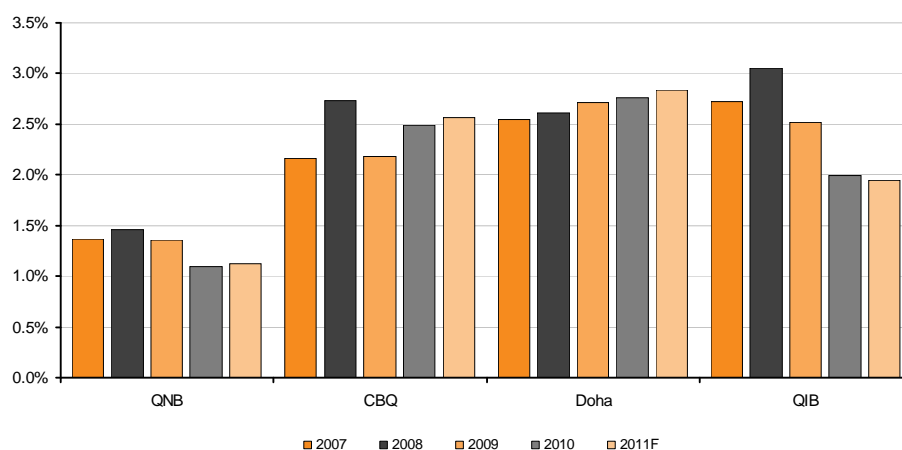
Structurally lower cost-income ratios

Given the high GDP per capita (even on an ex-energy basis), we believe ticket sizes are at or above developed world levels. Meanwhile, we believe salary costs, even for professionals, are lower than Western standards, albeit partly as a result of the lack of tax and other regulatory overheads. With this in mind, it is hardly surprising that cost income ratios are low.

In addition, however, we would highlight a low level of price sensitivity amongst both expatriates and Nationals, and consequently a low level of price competition between the banks, driven by a regional lack of consumer protection, common ownership structures, and the lack of account portability. In short, we believe banks are oligopolistic providers of services and oligopsonistic acquirers of labour, exercising buyer power on costs and seller power on revenues.

All the banks have low cost income ratios and these are generally driven by low cost to asset ratios and high revenue to asset ratios

Chart 20 : Cost to assets ratio



Source: Company reports, Rasmala forecasts

Lower growth and excess capital create a threat

With an (unweighted) average Tier-1 ratio of 14.8% in 2009, and using little in the way of Tier-2 capital, the banks have room to stretch their balance sheets, as soon as economic volatility gives them the confidence to do so. However, lower loan growth rates means there is more limited room to do so without affecting competition. Consequently, we believe the risk of price competition (affecting revenue) or service level competition (affecting costs) is rising.

Although the risk of competition has risen, we do not expect a sudden change in pricing and competitive behaviour by any of the banks. In principle, a new market entrant with a fundamentally different proposition would shake up the market, but we currently do not have strong concerns that this will take place. There have been some changes in the competitive landscape, such as the entrance of Masraf Al Rayan in 2006, and the more recent launch of Barwa Bank, as well as the presumed imminent merger of Al Khaliji Commercial Bank and International Bank of Qatar. However, there have not been signs (so far) that these will lead to an imminent change in competitive behaviour.

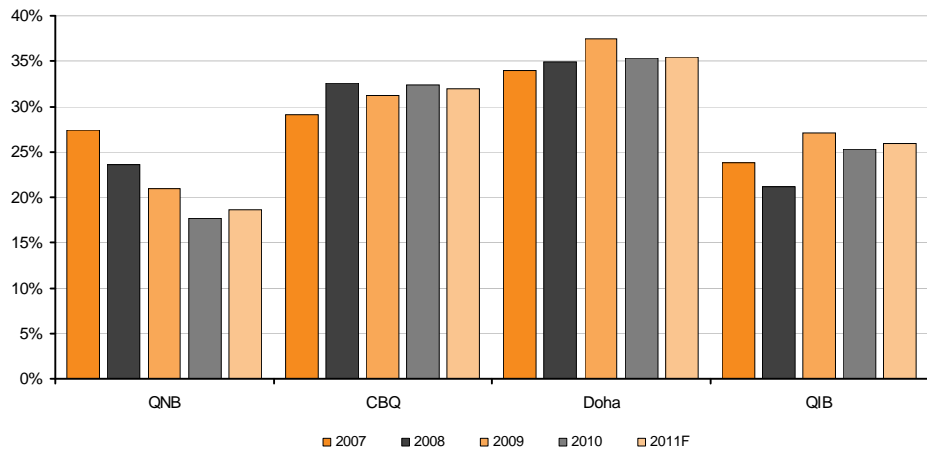
QNB and QIB report lower cost-income ratios

In spite of some increase in competition, we expect the average cost-income ratio for our investment universe to remain below the 30% level with QNB being particularly impressive. QNB is backed by a steady revenue stream (large scale government lending) with a lower concentration on retail branch expansion and we therefore expects its cost income ratio (2010F: 19%) to remain one of the lowest in the region.

Average cost income ratio broadly stable at under 30%

QIB also has an impressive cost income ratio, scarcely breaking above the mid-twenties level. Historically, this has been due to greater revenues to assets ratios. However, cost control has been impressive yoy for 2010, with costs declining 2% against growth in the loan book of 31%. Although cost reviews may have played their part, the likelihood is that the main driver was a shift in the business mix towards the public sector.

Chart 21 : Cost-income ratio



Source: Company reports

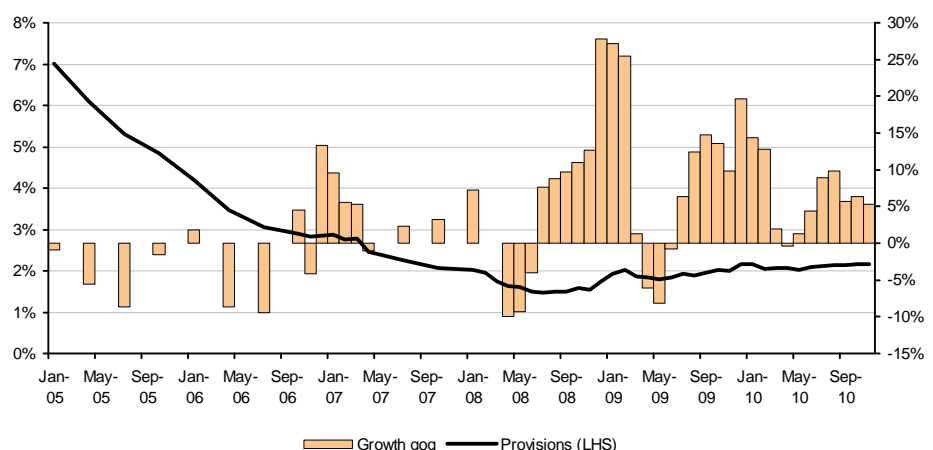
At CBQ, we have seen some shift in the business mix yoy, with a significant proportion of growth coming from the public sector. However, with overall customer asset growth scarcely reaching double figures, it has had a more limited impact. Meanwhile, Doha Bank has structurally higher costs related to its proportionately larger branch network and retail franchise.

Provisioning peaked in 2009, but rising provisions until 2011

We forecast a 347bp decline in provisioning margin in 2011.

Unsurprisingly the main trend in provisioning was for a sharp deterioration (increase) between September 2008 and February 2009. This was followed by a sudden drop after the central bank support package came in, among other things buying out property sector loans. However, from 3Q09, provisions were again on a rising trend and, apart from a moment of stability in 2Q10, have remained so ever since. Nevertheless, after the yoy growth rate peaked at 47% in September 2009, the yoy rate of growth has gradually diminished to a November 2010 level of 32%.

Chart 22 : Banking sector provisions, as % loans, qoq %



Source: Central Bank of Qatar

For our coverage universe, provisioning peaked in 2009-10

The peak in provisioning for our coverage universe came in 2009, but only because CBQ provisioned against a single large loan, and then wrote it back the next year. For the other banks, we think both the provisioning margin and net provisioning as a proportion of loans peaked in 2010, although balance sheet provisions and NPLs should still continue rising beyond 2010.

NPL ratio normalisation to be delayed

As a general trend we expect a peaking of retail NPLs as labour markets bottom, with a peaking of corporate NPLs as profitability and liquidity recovers. However, in Qatar, the bulk of retail lending is to the National population. We believe that retail NPLs among the National population are not primarily related to difficulties in the labour market, but rather to overleveraged borrowers. With little in the way of public sector salary increases over the last two years, this has been a growing problem. However, we do not expect retail lending to Qatari Nationals to result in substantial loans being written off.

We believe that corporate provisioning has focused mostly on services and trade. In general, industrial lending is to the hydrocarbon chain, which benefits from low feed-stock prices and high levels of government support. For real estate, the picture is more complex. Cash flow in the sector is clearly a significant problem, but with the market being dominated by deep-pocketed government-affiliated entities, we do not expect this to result in impairments. Furthermore, the buy-out of property loans in 1Q2009 will have ensured that any at-risk loans that they could foresee will already have been disposed of.

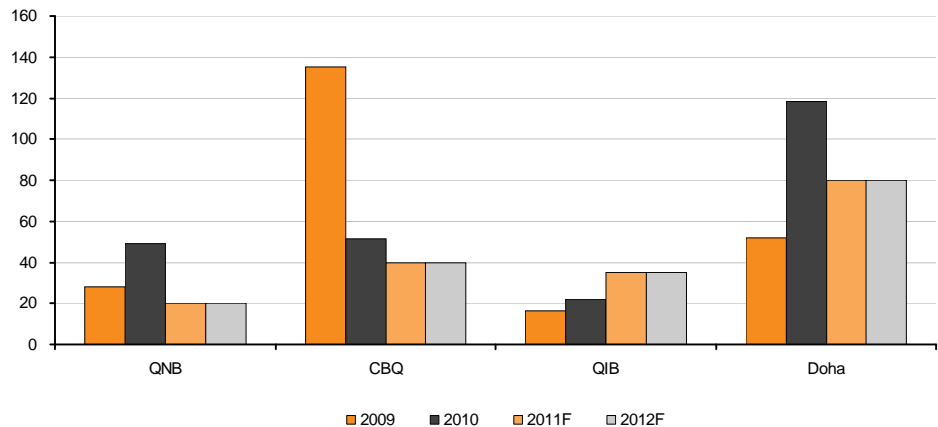
Although real estate lending itself we would not regard as a high risk loan category, nevertheless, the slow-down in real estate development will have affected contractors and building suppliers and service providers. However, without the build-up of trade creditors within the segment this will not be as strained as the equivalent sector is in Dubai. Furthermore, where contractors and suppliers are focused or can refocus on the industrial and infrastructure segments rather than residential or commercial, business is still strong.

Strong asset quality supports lower provisioning for QNB and QIB

Within our universe, QNB should see the lowest level of provisioning, given its public sector exposure. We expect net provisioning to have peaked at just 35 basis points in 2010, amounting to a provisioning margin of -5.5%. We expect provisioning for CBQ and QIB to be fairly similar going forward. They have a similar business mix, aside from QIB's substantial property exposure. Although we might expect the latter to be an issue, the government bailout of property loans is likely to ensure that the most vulnerable parts of this portfolio have been offloaded already. Only Doha Bank really stands out, with higher retail exposure leading to higher provisioning in 2009-12.

Backed by stronger asset quality and coverage ratios, QNB and QIB are expected to account for lower provisioning relative to operating profit

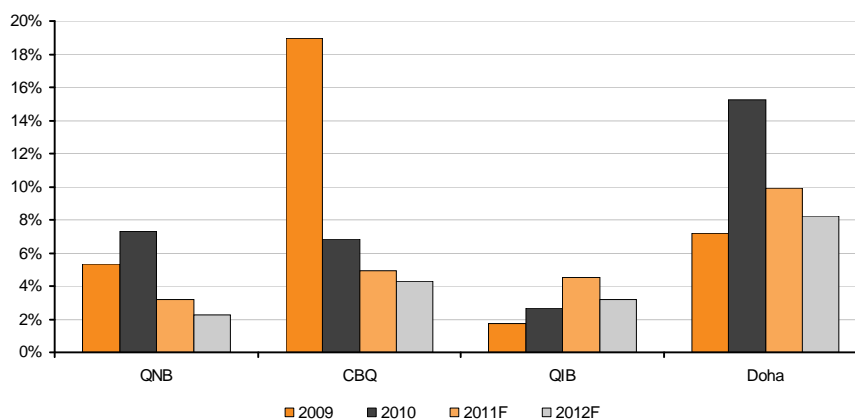
Chart 23 : Provisioning as % customer loans, basis points



Source: Company reports, Rasmala forecasts

Although it is possible to differentiate the banks fairly easily, the level of sensitivity to provisioning is fairly minor. We do not expect any Qatari bank to have a provisioning margin over 20% at any point in the near future, partly due to the very low level of provisioning and also the relatively high revenues as a proportion of assets (compared to the UAE for example).

Chart 24 : Provisioning margin (total provisioning as a percentage of revenue)



Source: Company data, Rasmala forecasts

High asset quality supports strong ROTCEs

Consumer financing NPLs form about 70% of total NPLs

Although non-performing loans (NPLs) rose in 2009, the impact of the downturn on the banks' NPL ratios has been largely contained, very much due to the pre-emptive Government buyout of real estate lending portfolios. Nevertheless, the decline in real estate and construction activity in late 2008 led to a significant contraction in the labour market (primarily that related to the construction industry), in turn triggering a rise in defaults on retail loans, primarily credit cards and auto loans. Adding to the number of NPLs though, has also been a number of Nationals facing cash flow problems and delaying payments on retail loans and sometimes sizeable mortgages.

We would, however, differentiate these two categories. Expatriates facing cash flow problems after losing their jobs are likely to have a very low recovery rate. Nationals, on the other hand, with arguably a lower sensitivity for delayed payment, but actually a very high sensitivity for actual default, are quite likely to become NPLs, but very unlikely to ultimately become losses, except in the case of disagreement.

Within the corporate book bad loans rose sharply early on in the downturn, primarily, we believe, due to the initial impact on SMEs without the reserves to withstand economic stress. Larger entities initially have a number of options when cash flow becomes tight. Overall though, NPLs within the corporate sector have remained well controlled, partially due to government spending driving cash flow in important sectors, and partially also due to the level of lending concentration. Consequently retail NPLs have accounted for about 70% of the total.

Universe NPL ratio expected to decline in 2011

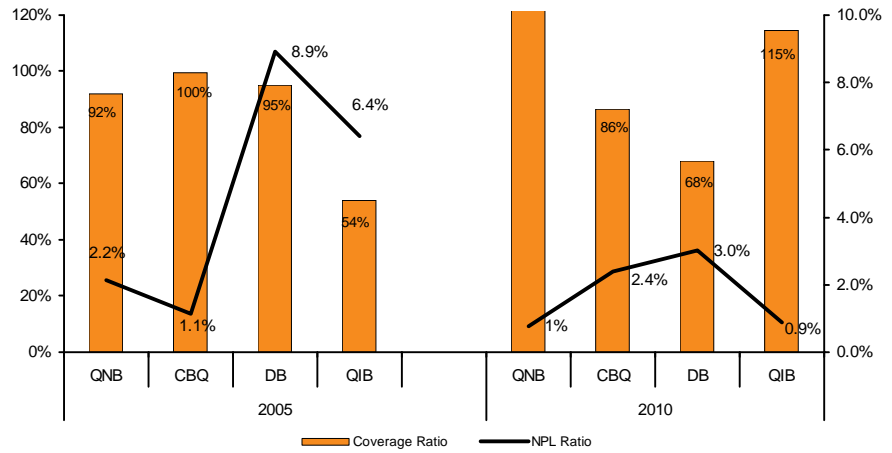
Looking ahead, we remain optimistic and expect the sector to report a decline in the overall NPL ratio in 2011 backed by a recovery in loan growth, higher emphasis on recovery/debt collection and a function of both the Central Bank and in-house individual bank risk procedures. Low Qatari unemployment (0.5% total and 2.3% among Qatari nationals, source: QSA) coupled with the accounting regulation lag (one-year lag for performing loans to move from the NPL to PL category) further strengthen our view of an improvement in asset quality in 2011.

With an average provisioning margin of 8.0% in 2010, there really isn't much room for a boost to earnings from falling provisioning. Nevertheless, we do expect a decline across the board going into 2011, with the exception of QIB, which benefited from a 4Q10 write-back. The earnings uplift for the remaining banks is likely to be of the order of 5%.

Continued infrastructure spending by the Government and lending only to a select group has kept the formation of commercial NPLs at bay, with the retail book causing much pain

We remain optimistic and expect the sector to report a decline in the overall NPL ratio in 2011

Chart 25 : Asset quality and coverage ratio



Source: Company Reports, Management guidance

QNB and QIB report better asset quality, CBQ NPL ratio expected to decline

Within our universe, we expect QNB to have the lowest NPL ratio (in the region) as a result of its high public-sector exposure (52% of the loan book). However, as retail and corporate lending rise in the years ahead, we may see this become increasingly cyclical. With CBQ increasingly focusing on public sector lending, we may see a long-term trend in the opposite direction.

Table 11: Total gross loans 2010

| | Real estate | Consumer | Total |
|-----------|-------------|----------|-------|
| QNB | 13% | 10% | 30% |
| CBQ | 28% | 20% | 50% |
| Doha Bank | 30% | 32% | 62% |
| QIB | 36% | 17% | 54% |

Source: Company reports

MENA expansion remains in focus

Despite the domestic market opportunities, the small absolute size of the domestic market has meant that banks have been increasingly tempted to deploy capital abroad. The MENA region has remained the core attraction as economic reforms have reduced entry barriers providing an opportunity for banks to form JVs or acquire minority stakes to serve an under penetrated and fairly liquid region.

Table 12 : Bank expansion

| | Local branches | International network |
|-----------|----------------|--|
| QNB | 38 | UK (1), France (1), Kuwait (1), Yemen (1), Oman (1), Sudan (1), Singapore (1) Rep offices in Libya and Iran 23.8% Commercial Bank International, UAE 2.78% Commercial Bank of Qatar 23% Mansour Bank, Iraq 50% Tunisian Qatari Bank, Tunisia 34% stake in Housing Bank for Trade and Finance, Jordan 49% stake in QNB Syria, Syria Plans to acquire a majority stake in Bank Kesawan, Indonesia Plans to announce another acquisition during 4Q10, MENA region |
| CBQ | 25 | 35% stake in National Bank of Oman, Oman 40% stake in United Arab Bank, UAE |
| Doha Bank | 36 | UAE (1), Kuwait (1) and USA (1) Rep offices in China, Turkey, Singapore, Romania, Japan, South Korea and UK |
| QIB | 26 | 32.51% stake in Arab Finance House, Lebanon; 21% stake in Asian Finance Bank, Malaysia; 60% stake in European Finance House, UK; presence in Bahrain, Yemen, Syria |

Source: Company reports

QNB and CBQ are the only banks with sizeable international investments. QNB's strategy has been to provide a broad network across the Arab World, as well as into key markets in Asia and Europe. By contrast CBQ's has been far more selective, taking only two strategic stakes in the relatively developed markets of the UAE (UAE) and Oman (NBO), taking effective control by implementing management contracts to develop cost and revenue synergies.

Meanwhile, QIB has looked to invest in key markets largely by taking minority positions in companies with established franchises, although European Finance House is a particular exception to that. Doha Bank's strategy has been downsized dramatically since the start of the crisis. Initially the focus was on building out to India and elsewhere with a full branch network. However, it is now more focused on its core competency of trade finance and related activities, and most of its international operations are in support of that.

In terms of geopolitical risk, it is clear that QNB is the most exposed. It has operations in a number of very frontier markets including Sudan and Iraq, with operations or aspirations across the Maghreb (North Africa) and Levant. For now, the Tunisian operations are clearly under a question mark, but the size of these operations is modest, with most value coming from CBI in the UAE, QNB Syria and HBTF (Jordan and Levant).

Other issues: the M&A story

Low operational gearing suggests cost synergies will be limited

In spite of the superfluity of banks in Qatar, we are not overall big believers in the economics of Qatari banking M&A. We believe that the primary driver of M&A should be cost or revenue synergies, although for banks additionally there could be capital synergies. The problem we have with in-market mergers is that revenue synergies are likely to be largely speculative, given the reach and product density of each of the banks, and cost synergies are unlikely to yield sufficient benefits to justify management distraction.

If there are mergers therefore, we believe that: 1) they are likely to be smaller or fringe players who are underperforming in one area or another; and/or 2) they are likely to be politically driven. Consequently, we believe this poses negative risk for buyers, although the likelihood is that any activity will be amongst and between the smaller banks for now. Ultimately, if competition begins to squeeze spreads, further consolidation is a possibility. The one exception to this would be a local bank buying in smaller teams in specialist areas.

Qatar generally less volatile

With sovereign risk remaining one of the lowest in the region, absolute returns are expected to remain high backed by sustainable growth and better dividend yields.

Market volatility expected to remain low, reflecting reliable cash flows

In 2008, the DSM General Index declined 28% but fared much better than its GCC peers (48% average decline). The limited slide in 2008, flat performance in 2009 and 9% ytd rise reflects the overall stability of the Qatari economy, with investor confidence remaining strong despite global volatility.

We believe cash flow visibility, higher profitability, sustainable growth and high dividend yields will continue to be the prime drivers for a growing market cap.

Table 13 : GCC equity indices comparison yoy percentage change

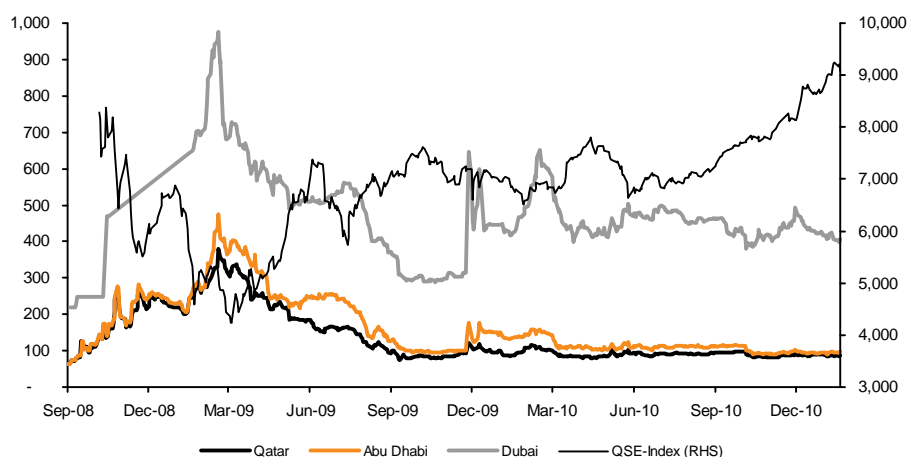
| | 2008 | 2009 | 2010 |
|---------------------|------|------|------|
| Bahrain (BAX) | -35% | -19% | -2% |
| Kuwait (KSE) | -38% | -10% | -1% |
| Oman (MSM) | -40% | 17% | 6% |
| Qatar (QE) | -28% | 1% | 25% |
| Saudi Arabia (TASI) | -57% | 28% | 8% |
| UAE (ADI) | -48% | 15% | -1% |
| UAE (DFM) | -72% | 10% | -10% |

Source: Reuters, QNB Capital, Zawya

Qatar's benchmark bond yields and 5 year CDS rates reiterate low risk

After peaking mid-way through the crisis at nearly 400 basis points, Qatar's five-year CDS spread dropped to below 100bp in 2H09. Although, the Dubai World vacillations put a hole in its steady progress, it has stayed somewhere in the region ever since. Latest data (19 January) suggests that the market is willing to differentiate regional economies, with Qatar's CDS spread (86bp, source: CMAN) comparing favourably with that of not only Dubai (406bp), but also Abu Dhabi (96bp).

Chart 26 : Qatar CDS spread (bp)



Source: Bloomberg, CMAN, IMF

In November 2009, the government issued US\$7bn bonds partially in order to set up a benchmark yield curve, with tranches maturing in 2015, 2020 and 2040. Issued yields ranged from 4% at the short end to 6.4% at the long end. Since issuance, asset yields have tightened significantly to 2.51%, 3.80% and 5.09%, respectively.

Good ROTCE stability in the recent past

While some of the smaller banks have performed less well, the larger banks have seen low levels of earnings volatility. We believe that earnings security is better amongst the Qatari banks than amongst any other banks in the region. Throughout the crisis, the banks have been able to maintain high levels of cash dividends, with an average yield of 6.0% in 2009, albeit with low levels of dividend cover.

Strong macro and operating margins provide for solid ROTCEs

We see banks in Qatar continuing to operate in a benign environment supported by a strong macro picture (2010F fiscal and current account surplus of 9% and 23%), a government able and willing to provide support (capital injections and buyback of assets) with continuing growth opportunities (rising nominal GDP and budget expenditure with US\$150bn of projects being executed).

Table 14 : ROTCE comparison

| | 2009 | 2010 | 2011F | 2012F |
|-----------|------|------|-------|-------|
| QNB | 24% | 25% | 21%* | 19%* |
| CBQ | 15% | 14% | 16% | 17% |
| Doha Bank | 20% | 16% | 21% | 22% |
| QIB | 18% | 15% | 17% | 17% |

*after the rights issue

Source: Company reports, Rasmala forecast

Consequently, we expect the financial performance of our universe to remain robust (18.5% 2010 ROTCE) backed by the high concentration of sector assets, and partially as a result limited price competition. Slower growth and high capital ratios does bring a threat of diminishing profitability, but we do not believe it is in the culture of any of the banks to aggressively grab market share at the cost of profitability, especially when there is still double digit growth forecast for the coming years.

With this in mind, spreads are wide and stable (2010 average: 3.88%), driving impressive revenue generation (2010: 4.6% as a proportion of IEAs). In addition with an average cost-income ratio below 30% (all years 2009-12F), and a bottom of the cycle provisioning margin of just 8.3% (in 2009), there are very substantial profit margins to absorb any profitability shock.

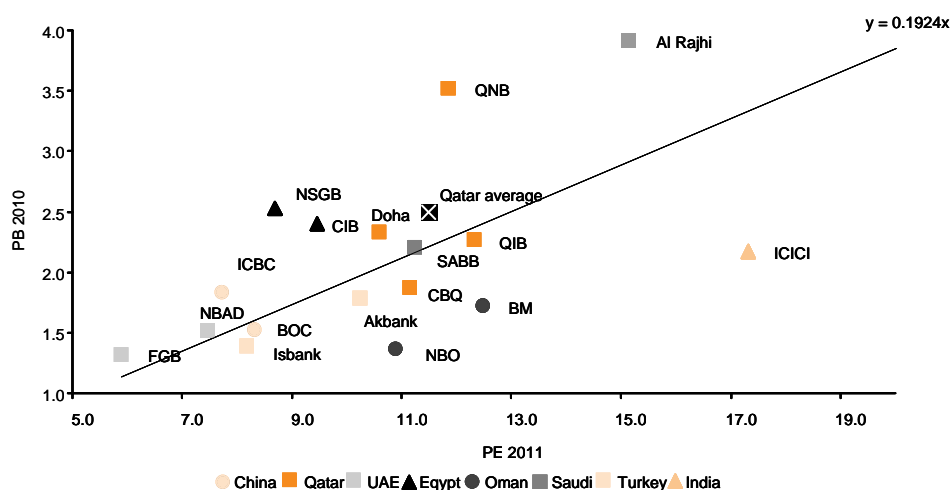
Furthermore, liquid balance sheets (below 90% credit ratio), high CAR (2010: 15.1%) and rising wholesale funding (9% of liabilities) are certainly sufficient to ensure growth is not constrained on either the funding or capital side. GDP growth driven by infrastructure spend the hydrocarbon industry, the petrochemical & energy intensive industries and industry diversification should provide loan growth opportunities into the medium term, albeit at a steadier pace than we have seen for some years.

Relative valuations

Valuation comparison within a regional context

Within a regional context, there are two categories of pricing. In KSA, and Egypt with large poor populations, there is a story to be made of increasing middle class penetration, and the consequent multi-decadal high growth rates. In UAE, Kuwait and Qatar, penetration is already high, particularly in retail (with the exception of the mortgage market). In these countries, the scope for very long-term growth is limited to the expansion of civil service salaries, and private sector development as a driver of immigration.

Chart 35 : Regional valuations (2011F PE vs 2010F PB)



Source: Bloomberg; Rasmala Research (Qatar, UAE only)

Valuation comparison within a global context

Qatar has a relatively unique position in the Middle East, with a massive amount of reserves and a very small population. In addition, the government has not been shy about providing strong support for the private sector. As a result, the perception has built up of a country with low risk economic and political risk, good returns, and high growth prospects driven by government spending. That understandably has led to a premium valuation.

However, the question is how big a valuation premium is justified. Certainly, compared to Bloomberg consensus forecasts for Al Rajhi (NR), valuations of the Qatari Banks look reasonable to us, before debating the value of lower risk against the value of potential longer-term growth. Against the Egyptian banks, the Qataris normally appear reasonably valued but acute political risk in Cairo has reversed that relationship for the time being.

However, against the UAE banks in particular the near-100% premiums seem hard to justify. National Bank of Abu Dhabi, which we view as the lowest risk bank in the UAE, trades at a discount of 35% and 39% on a 2011PE and PB basis respectively to the Qatari average, on our analysis. We do not believe that is justified, and would prefer the higher risk alternatives across the water from Doha.

As a global comparison, we use Bloomberg consensus forecasts for representative banks from India, China and Turkey, all of which have long-term penetration stories. The Indian banks we chose, HDFC and ICICI, were almost too expensive to fit on the above scatter graph, with 2011 PEs of 24.3x (ICICI) and 29.3x (HDFC). Against both the Turkish and the Chinese banks, the Qataris, with the possible exception of CBQ, look a little on the expensive side. Nevertheless, with strong, underwritten short term growth prospects, high returns and low risk, this is partially justified, in our view.

Valuation methodology

We use a three-stage Gordon growth model as our basic valuation tool. The first stage is explicitly forecast for the period 2010-13. Beyond 2013, we assume an efficient capital structure and then use structural ratios guided by 2013 exit variables. We use two exit variables and three modelling variables as key inputs to our model:

- the initial level of RWA, equal to the 2013 RWA;
- the initial common equity capital, equal to the exit common equity capital;
- RWA growth rate;
- a target equity to RWA ratio; and
- an efficient ROTCE, based on removing excess capital and assuming a return contribution on that excess capital of 5%.

Beyond 2024, we use a standard GGM, with an ROTCE of 12% and growth rate of 5%. We use a single discount rate of 11.1% throughout the period, for comparability purposes. The discount we use is based on a risk-free rate of 3.1% (US 10-year bond yield), a country-risk premium of 3% and a sector-risk premium of 5%.

Valuations: CBQ is our only Buy recommendation

Our preferred exposure and only positive recommendation in Qatar is CBQ. Once the highest rated stock in Qatar, it has suffered somewhat of a fall from grace, and is now the value stock, in our view. We believe that this is not a reflection of the underlying quality of the business, but rather a reflection of the sub-optimal positioning of the bank in an environment when strength in corporate banking gets few immediate returns.

Our positive view on CBQ is dependent on our assumptions:

- We believe it can derive a significant portion of its growth from the public sector over the next three years.
- We also expect that by 2013, the private sector will have caught up with the public sector in terms of growth, and the risk will shift to contraction in public sector lending.
- We think it can continue to maintain profitability in its Omani and UAE associates.
- We expect profitability not to be undermined in the medium term by aggressive private sector competition.

In addition, we see further upside potential if it can close the profitability gap against QNB, either by competing more successfully in its space or by improving its capital structure and leverage. We also do not assume much in the way of recovery in fees and commissions or particular success with the relaunch of its Islamic Bank. In spite of the recent 39% run we believe the stock continues to offer upside.

Table 15 : Valuation

| | Close | PT | Rec | 2010 Yield | PE | | | | PB | | | | ROTCE | Loan GR% 2010-13F |
|------|--------|--------|------|------------|------|------|------|------|------|------|------|------|--------|-------------------|
| | | | | | 2009 | 2010 | 2011 | 2012 | 2009 | 2010 | 2011 | 2012 | | |
| QNB | 200.10 | 215.89 | Hold | 2.5% | 19.1 | 14.0 | 11.9 | 9.5 | 4.24 | 3.52 | 1.98 | 1.70 | 21.32% | 20% |
| CBQ | 90.00 | 109.40 | Buy | 7.8% | 13.7 | 12.8 | 11.2 | 10.0 | 1.91 | 1.87 | 1.72 | 1.63 | 16.00% | 16% |
| Doha | 62.60 | 63.19 | Hold | 8.0% | 12.5 | 12.0 | 10.6 | 9.2 | 2.41 | 2.33 | 2.12 | 2.00 | 20.90% | 13% |
| QIB | 84.00 | 87.97 | Hold | 6.0% | 13.8 | 14.3 | 12.3 | 10.7 | 2.33 | 2.26 | 1.91 | 1.78 | 16.74% | 19% |

Source: Company reports, Zawya pricing data, Rasmala forecasts

For the remaining banks, we believe valuations are substantially up with events, and riskier investments outside Qatar offer more potential in our view. From a franchise point of view, we particularly like QNB, which is the leading public sector bank in Qatar, and stands to benefit from strong public sector growth. We also believe that the bank is likely to be the most successful both in terms of regional diversification and continued product diversification. The fact that it has the highest growth rate, the highest profitability and the lowest risk, on our analysis, certainly suggest that it deserves to trade at a premium, but we believe this is a well-appreciated story. There are

upside risks to our valuation, particularly from international operations and greater than forecast participation in the current lending bonanza, but we would prefer greater visibility.

In our eyes, QIB and Doha Bank each have one leg of the QNB story, with QIB likely to match the growth levels of the market leader, while Doha Bank may aspire to high levels of profitability. QIB is the leading Islamic Bank in Qatar, generating substantial growth from the property and housing market in the past. We believe it can leverage its public sector exposure though and maintain solid growth over the next couple of years, as well as being able to cater for the more conservative HNW client. Unfortunately, QIB's international investment plan through associates has hit its capital ratios, preventing high enough levels of leverage to pull returns out of the high teens region. Consequently we have concerns over how adequately it justifies its high earnings multiple. In addition, a possible capital raising exercise may well take the shine off the stock.

For Doha Bank, it looks well placed to benefit from the higher returns of a retail business, but there is currently little sign of growth in this market. Although Doha Bank is working hard to diversify its revenue streams, particularly by going after further trade finance volumes, we are concerned by the lack of retail growth and the potential for increased competition in its core business areas. This would not be an issue if the stock were not trading at a premium, but as our second most expensive stock on a multiple of book value basis we believe greater visibility is required for a further upgrade to our current target price. In addition, we are concerned that the high payout ratio may be difficult to maintain given the thin capital ratios.

Economic background: exploiting energy

The opportunity stemming from exploitation of the natural gas reserves is certainly no secret, but it is still worth reiterating just how important that opportunity is not only for GDP growth, but also for enabling fiscal profligacy.

Oil and natural gas production

Qatar produced 20% of global LNG

The Government in Qatar has invested significantly in the development, promotion and export of liquefied natural gas (LNG).

Qatar in 2006 became the world's largest exporter and trans-shipper of LNG

Table 16 : Qatar LNG infrastructure

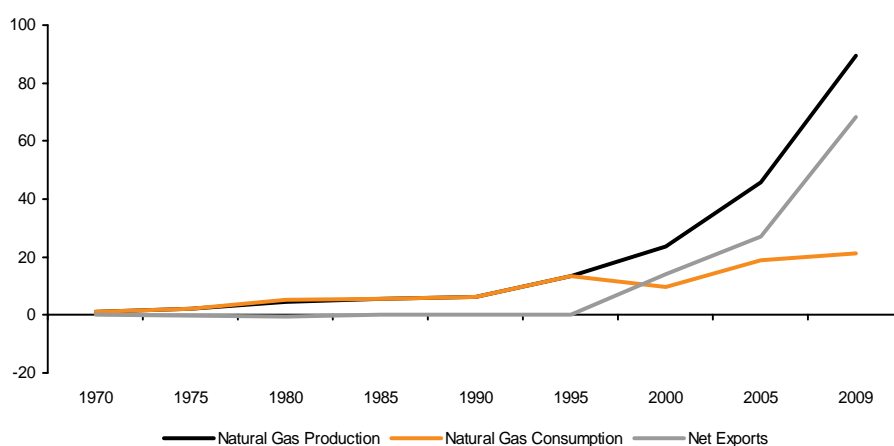
| Unit | Liquefaction capacity | Start-up | Primary markets |
|----------------------------|-----------------------|----------|--------------------|
| Rasgas facilities | | | |
| Trains 1 and 2 | 2 x 3.2Mtpa (320bcf) | Aug-99 | South Korea |
| Trains 3 | 4.7Mtpa (230bcf) | Feb-04 | India |
| Trains 4 | 4.7Mtpa (230bcf) | Aug-05 | Europe |
| Trains 5 | 4.7Mtpa (230bcf) | Mar-07 | Europe & Asia |
| Trains 6 | 7.8Mtpa (380bcf) | Oct-09 | China |
| Trains 7 | 7.8Mtpa (380bcf) | 2010 | China |
| Qatargas facilities | | | |
| Trains 1-3 | 3 x 3.2Mtpa (480bcf) | Dec-96 | Japan & Spain |
| Trains 4 | 7.8Mtpa (380bcf) | Apr-09 | UK |
| Trains 5 | 7.8Mtpa (380bcf) | Sep-09 | UK |
| Trains 6 | 7.8Mtpa (380bcf) | 2010 | US |
| Trains 7 | 7.8Mtpa (380bcf) | 2011 | China & N. America |

Source: Rasgas, Qatargas, EIA, Media reports

Qatar's LNG export capacity is expected to rise to 77Mtpa by 2011

2010 marks an important milestone for Qatar's gas industry, as the bulk of the LNG production trains have been delivered. This will bring the total number of LNG trains in the country to 14, six of which are the world's largest. Having expanded its production capacity together with a lower internal consumption rate, Qatar in 2006 became the world's largest exporter of LNG.

Chart 27 : Qatari natural gas production and consumption (bn cubic metres)



Source: British Petroleum

Downstream natural gas

Domestic consumption and utilisation are the most efficient solution

Once natural gas has been extracted and purified, there are a number of choices as to what to do with it. The chief issue is the very low energy (and so price) density – about 0.1% that of crude oil – and so relatively high transport costs. The easiest and therefore most cost efficient choice is to use it in situ, for local consumption. However, local consumer demand is finite. Consequently, industrial demand is the next best alternative, using gas either as a feedstock for the petrochemical industry or as an energy source for energy intensive industries such as metal ore processing, and particularly steel or aluminium extraction.

Regional utilisation of compressed natural gas

The simplest extension beyond that is for regional use, through compressed natural gas (CNG) pipelines, which increase the energy density to about 25% that of crude oil through pressurisation to 250 atmospheres. The Dolphin Energy pipeline is a good example of this. The economic rationale for selling gas to the oil-rich countries is to free up oil for export, as oil is both cheaper to transport and more flexible to export.

LNG & GTL for broader international exports

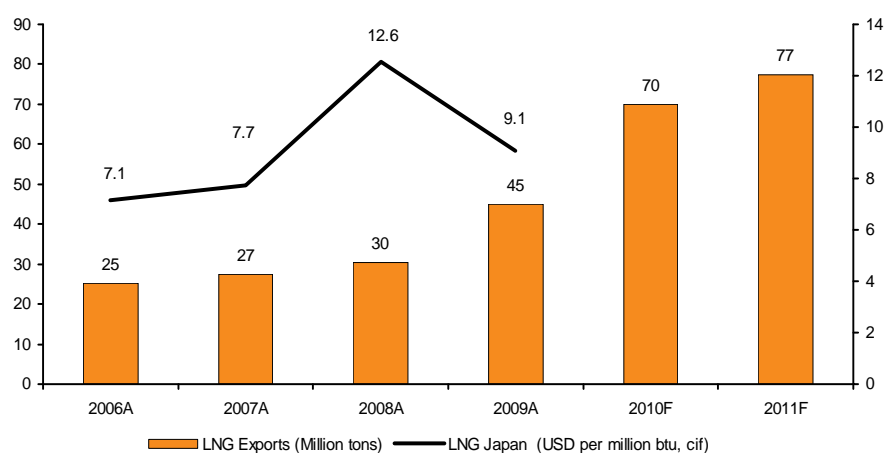
Finally, for those natural gas resources which cannot be consumed regionally, the main alternative is LNG – liquefied natural gas – which has an energy density approximately 60% that of crude oil. Although this should mean lower transportation costs, low temperature conversion and transportation brings its own costs, as well as requiring a specialised and so inflexible distribution network.

An alternative to cryogenic (low temperature) liquefaction is chemical liquefaction using so-called gas-to-liquid (GTL) technologies. Pearl GTL, which has been under construction since 2006 is the world's largest, with a project cost of US\$24bn, and production capacity of 120,000boe per day. GTL exports were scheduled to begin in 4Q10.

LNG export

Today, Qatar is the largest exporter of LNG in the world contributing 20% (49.4bn cu m) of global exports. By 2011, most government-owned oil and gas giants (primarily Qatargas and Rasgas) have plans to export 77m tonnes per annum (Mtpa), compared to 30Mtpa in 2008. This compares with total global export levels of 243Mtpa in 2009 (Source: BP).

Chart 28 : LNG exports and prices



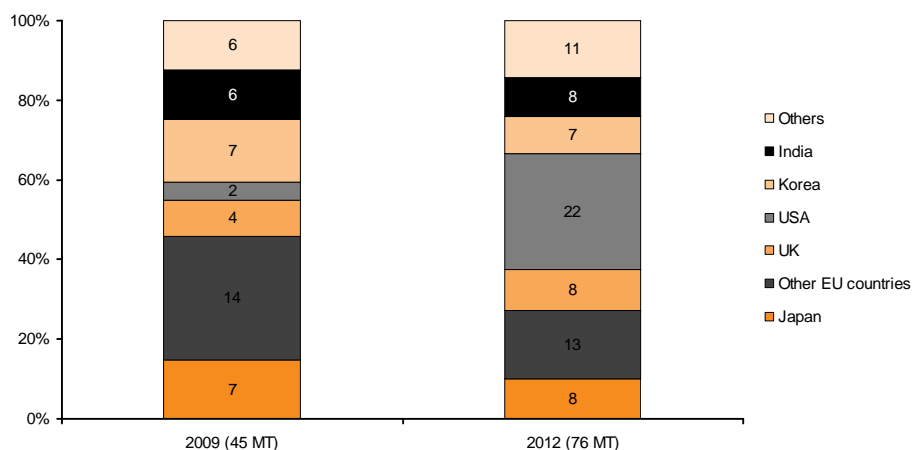
Source: BP, Qatargas, Rasgas, QNB

Geo-diversification and LT contracts minimise demand and pricing risks

Qatar currently has a concentrated client base, with the Asian region accounting for 80% of exports. Of the current exports, Japan, South Korea and Singapore together account for more than 65%. However, Qatar is making strong efforts to diversify this, with new sale and purchase agreements targeting the US and Europe. We expect the reduction in concentration risk, strong forecast growth rates for the Asian economies and the long-term nature of LNG contracts to all contribute to a sustainable revenue base for Qatar.

A reduction in concentration risk is expected as LNG exports would now serve a wider geographic client base

Chart 29 : LNG exports, sales and purchase agreements (Mtpa)



Source: Qatargas, Rasgas, QNB

Fiscal implications of the hydrocarbon industry

The exploitation of oil and gas resources has helped Qatar generate a significant amount of budgetary and sovereign wealth. The IMF forecast 2010F budgetary and current account surpluses of 9.7% and 17.3% of GDP, respectively. These substantial surpluses are despite an increase in budgetary expense of 16% to QR129bn in 2010. The Government of Qatar is expecting budgetary expense to remain at this level until at least 2016, with about 40% of the budget being allocated to infrastructure investment.

Excess reserves diverted to Qatar's SWF, the Qatar Investment Authority

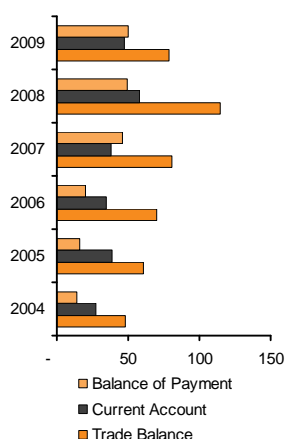
A significant amount of LNG revenue accruing to the government does not pass through the department of finance and hence is not included in the Qatari budget. Instead it gets diverted to Qatar's sovereign wealth fund, the Qatar Investment Authority (QIA), which the IIF estimates will increase in size to US\$120bn by 2011. QIA diversifies the government's wealth in natural resources by passively investing in various asset classes, around the world.

Table 17 : Hydrocarbon contribution to government revenue

| | 2008 | 2009E | 2010F |
|------------------------------|---------|---------|---------|
| Total revenues | 140,947 | 149,885 | 165,309 |
| Hydrocarbon revenues | 80,009 | 63,412 | 89,550 |
| Other revenues | 60,938 | 86,473 | 75,759 |
| Total expenditure | 98,855 | 111,486 | 128,557 |
| Surplus | 42,092 | 38,399 | 36,752 |
| Surplus % of GDP | 10.40% | 10.70% | 8.60% |
| Budget oil price assumption | US\$40 | US\$40 | US\$55 |
| Oil production (1,000bbl/dy) | 837 | 800 | 824 |
| LNG exports (Mts) | 30 | 45 | 70 |
| Trade balance | | | |
| Exports | 234,441 | 165,092 | 244,353 |
| Crude oil | 102,255 | 62,615 | 91,662 |
| LNG | 112,141 | 85,959 | 129,231 |
| Others | 20,045 | 16,518 | 23,460 |
| Imports | 91,491 | 86,374 | 115,432 |
| Trade balance | 142,950 | 78,719 | 128,922 |
| CA surplus % of GDP | 14% | 16% | 23% |

Source: IMF, Central Bank of Qatar, Ministry of Economy and Finance, Figures in QR m

Chart 30 : Balance of payments (QRbn)



Source: Central Bank of Qatar, QSA, IMF

Wholesale funding may benefit more than banks

We believe the key features of these projects tend to be that they are big ticket items, with long or very long duration and limited credit risk, albeit often as a result of strong sovereign support. As a result, banks, and especially relatively small local banks, are poorly equipped for providing financing. The limited credit risk means thin spreads, with banks unable to benefit from close customer relationships. Meanwhile, the big ticket and long maturity nature of the loans creates significant challenges for risk concentration and liquidity management. Even for QNB, less than 20% of its loan book has a maturity over one year.

Consequently, although the hydrocarbon surpluses are of unquestioned benefit for the economy as a whole, the direct impact on the bank lending is more limited. In many cases, these projects are cash financed. However, even when they are debt financed, they are as likely to be financed through the capital markets as through bank lending. Furthermore, those banks which can diversify exposure, namely the international banks, have a structural advantage when it comes to project finance. In spite of this, QNB and CBQ both have active syndication and project finance teams, as even taking a relatively small portion of the pie offers significant rewards.

How big is the capital market opportunity?

In terms of financing, the main opportunity for the banks is getting a slice of the debt capital market business. We believe this is why QNB and QIB have both been developing their capital market operations, although both are also keen to pick up any additional working capital requirements that the public sector entities may have. CBQ is positioned a little further away, aiming to pick up the financing of the private sector entities providing goods and services to the main infrastructure players. Doha Bank is positioned a step further away, looking to benefit from tertiary impacts.

In total, if we were to assume about US\$100bn of investment over the next decade (across all projects). For every US\$10bn financed, we estimate that every 100 basis points of loan arrangement fees would generate US\$100m of profit. We believe most of this will continue to go to the international banks, but US\$20m of fees per year to be split between the three main local players – QNB Capital, QIB Capital and QInvest – would certainly be a welcome revenue source, if not game altering.

Better rewards for diversification

Although the hydrocarbon and petrochemical sectors constitute the bulk of the economy, we see the rest of the economy offering the greatest opportunities for banks. Economic diversification based on a 'knowledge economy' remains a strategic objective for Qatar.

Aims of diversification

A key reason for the Qatari Government to seek diversification is the need to find domestic employment opportunities for Qatari nationals. Qatar has a young and growing population, and the government has made it clear that it regards providing life opportunities for them as a strategic aim. The petrochemical industry offers fairly limited possibilities in this area. As such, we do not believe that there is a hard minimum IRR consideration for assessing policies and developments.

A secondary objective of diversification is the exploitation of other competitive advantages of Qatar beyond the energy sector. The proximity to an ultra high net worth (UHNW) investor/consumer base is one example. Another is the willingness of the national population to accommodate huge immigration and demographic imbalance, which would simply be impossible in many other countries. This is further facilitated by the low population density. In addition the abundance of sunshine, cheap land costs (as a result of a very limited agricultural sector) are also potentially relevant factors of production, particularly for tourism.

Coordinated strategy based on QNV 2030

In 2008, Qatar published its strategy for diversification in a document known as the Qatar National Vision 2030 (QNV 2030). QNV 2030 aims to coordinate liberalisation and political support for diversification of the economy, sponsoring some sectors, such as tourism that can already stand on their own, seeding other industries for the long term, such as science and technology. In each case, Qatar is aiming to provide enabling infrastructure, and a facilitating legal structure, within an appropriate business environment.

Corporate reform

Increased foreign ownership flexibility

In a move that echoed the free zones of Dubai, a number of strategic sectors were opened to 100% foreign ownership in 2009. These included consultative and technical work services, the IT sector, distribution, and cultural, sports and leisure services. The last of these was targeted at leisure event tourism, an industry in which Qatar has already seemingly overtaken Dubai.

Reduced tax

In a further move, the ministry of finance recently cut the corporate tax rate for foreign firms from 35% to 10%.

Sector specific reforms

Financial sector reform: focussed on QFC

Since 2003, new foreign banks have been allowed to establish representational offices, while existing foreign banks have selectively been allowed to open branches. This was more generally implemented in 2005, with the opening of the Qatar Financial Center (QFC), a virtual free zone (allowing 100% ownership, free of capital controls, and a low 10% tax rate) for financial services companies, with the exception of retail banking. More than 100 companies are registered in and regulated by the QFC, in simple terms making it 15% of the size of DIFC.

Telecom sector reform: partially been open to competition since 2006

Since 2006, foreign companies have also been allowed to enter the local market as internet service, cable television and mobile phone network providers. The licensing of Vodafone has been a noteworthy development here.

Property sector reform

In the property sector the main reform was to allow freehold property ownership rights, although for commercial property this was limited to Qatari nationals in areas such as West Bay. Nevertheless, expats have also been allowed to invest in the residential waterfront development, Pearl Qatar, and potentially Lusail.

Pursuing the diversification agenda and following its regional peers, the government has made various regulatory changes

SME also a focus area

In 2007, when the UN Development Programme (UNDP) looked at the issue, it concluded that the sector was under developed, and was focussed on retail and distribution with limited value-add. In particular, the UNDP concluded three areas of improvement were required: promotion of an entrepreneurial culture in industry and government, accessibility of funding and improved availability of land. By 2010 this had evolved from the UNDP/General Secretariat of Development Planning to an independent body known as Enterprise Qatar, funded with seed capital of QR2bn.

With funding for the SME sector a key area for improvement, the government revamped and recapitalised Qatar Development Bank in 2007, aiming to expand its role into promoting SME funding, although its remit remains pretty broad. QNB is also active in the space, agreeing to work with QDB on an Al Dhameen assured loan programme. Taking a more commercial approach is Doha Bank, launching its Tatweer supply chain financing solution, notably including an invoice discounting facility.

Although the level of unmet need suggests a period of supernormal growth, we have yet to be persuaded that this is a major growth area on a sustainable basis. Doha Bank undoubtedly has the best communicated strategy, but perhaps this is due to the relative importance of the sector.

But what about the strategic objectives?

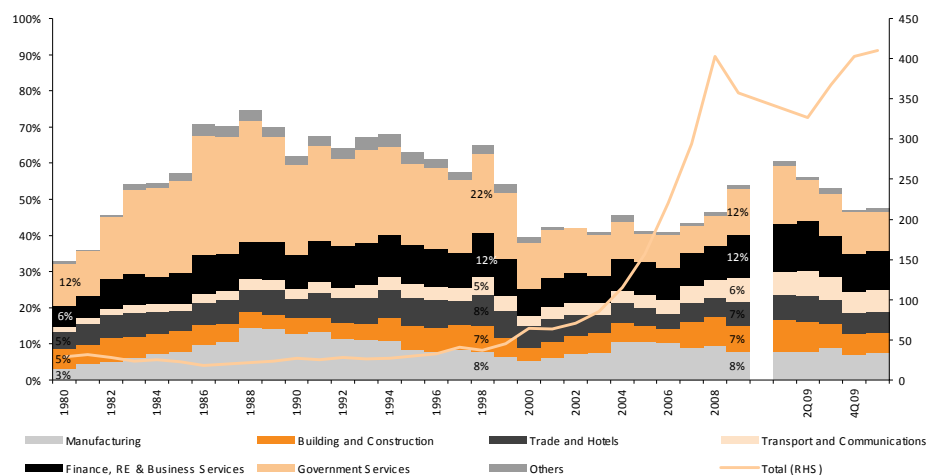
Although diversification is an end in itself, the most important strategic imperative – that of making the economy work for the domestic population – is going to be a challenge. National involvement only as consumers is not a sustainable model, and in recognition of this, there has also been change in the education sector. Notable achievements include opening up foreign investment in the educational sector, building the 14m sqm Education City, funding the Qatar Foundation, and founding the Qatar Science & Technology Park.

The journey, not the destination...

Over the long term, we believe this is an untested economic model, although it does echo education led development strategies elsewhere in the world. The chief uncertainty is whether the state will get an adequate social and financial return on its investment, and on this the jury is still out. Nevertheless, we do not think it is imperative to be able to see the end game, providing we have confidence that there will be no reversal of the strategy. As such, we believe that the immediate impact will be a continuation of substantial and increasingly diverse immigration.

For sustainability, diversification needs to work for the local population

Chart 31 : Qatar's non-energy GDP 1980 – 1Q10 annualised



Source: Qatar Information Exchange (QALM)

Case study 1: targeting tourism

Business (MICE) tourism currently accounts for 95% of Qatar's tourism market, but aims to build out particularly the transit and leisure tourism sectors. Related infrastructure development should provide significant financing opportunities for the banking sector.

The tourism industry punches above its weight

Tourism contributes disproportionately to its stated GDP impact, which tends to measure purely travel and accommodation spending. For example, the WTTC (World Travel & Tourism Council) estimates that total tourist spend amounted to 3.5x direct spend in the UAE. This outsized contribution makes it a cornerstone of the diversification strategy. As a result, the tourism sector is backed by strong infrastructure, cultural and leisure investments.

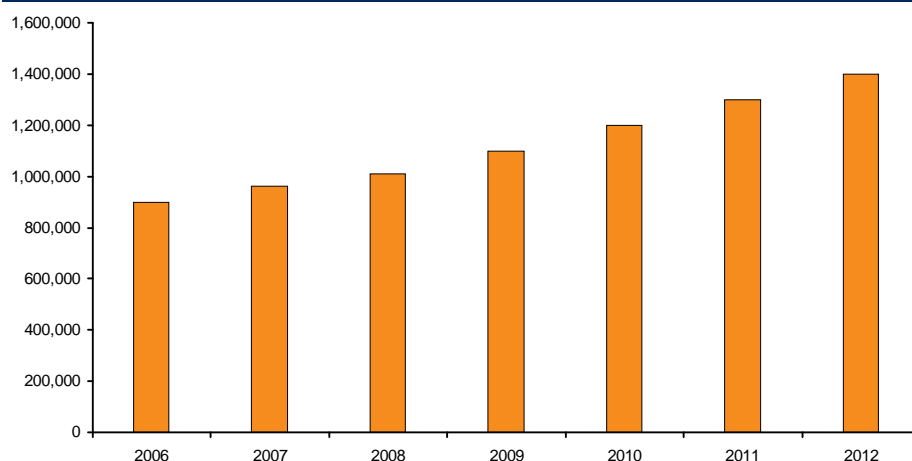
Building leisure tourism: beyond MICE and businessmen

With the trade and hotels industry contributing just 6% of GDP (1Q10 QR6bn) and 13% of non-energy GDP, we believe that the contribution from the tourism sector is set to rise. Over the next five years, US\$20bn will be invested in tourism related projects, with the New Doha International Airport (NDIA) accounting for US\$9bn, and luxury hotels and resorts the rest.

In addition to hard infrastructure, the shift from business tourism to leisure tourism also involves a shift in cultural and other amenities. To this end a number of new art galleries are planned, following on from IM Pei's iconic Museum of Islamic Art. Tourist numbers have been rising, but so far are still a fraction of the level to Dubai, which in 1H10 alone received 4.18m hotel visitors. Nevertheless, in terms of sporting-event tourism, Qatar seems to be leading the regional pack.

The government has set itself strong tourism related targets to achieve backed by US\$20bn of spending over five years

Chart 32 : Number of tourists



Source: Qatar Tourism Authority, DTZ Research

Case study 2: property and construction

Qatar's property and construction market splits into a healthy segment largely remote from domestic cash flow considerations (industrial production, infrastructure and tourism) and a segment for local consumption (residential, commercial and retail development). We expect long-term growth from the former, while the latter is generally oversupplied.

US\$150bn of projects under way, amounting to 150% GDP

Table 8 below highlights that the inflow of hydrocarbon dollars has strengthened the government's ability to spend on infrastructure projects, with Qatar accounting for 12% of total GCC project spend of US\$1.3trn). In 2010, many projects were delayed as the government grew more apprehensive about unnecessary negative cash-flow. However, we expect the non-energy capital expenditure to resume during 2011.

A further US\$61bn planned for Qatar metro and public works

In addition to the US\$150bn of industrial and infrastructure projects already under way, there is a further US\$61bn of projects on the drawing board. The two core pieces of this are a metro and ground rail network project, amounting to US\$42bn, and various public works, adding a further US\$19bn.

Part of the rail network is planned to be completed in phases until 2016 with the entire project divided into three segments – an intra-city metro network covering Greater Doha, over-ground railways covering the entire country and the rail link to the GCC neighbours, including the friendship causeway to Bahrain and potentially a link to Abu Dhabi. Although the original deadline for completion was 2026, it is likely that Qatar's successful bid for the World Cup will mean the government accelerates its plans to achieving at least 90% delivery of the network before the games.

Table 18 : Selected projects over US\$ 2bn

| Project | Sector | Value (US\$bn) | Year announced | Target completion |
|--------------------------------|----------------|----------------|----------------|-------------------|
| Qatar Bahrain Causeway | Infrastructure | 4 | 2008 | 2015* |
| New Doha Port | Infrastructure | 7 | 2008 | 2025 |
| New Doha International Airport | Infrastructure | 11 | 2004 | 2015 |
| Qatar Rail Network Program | Infrastructure | 42 | | 2020 |
| Barwa Al Khor | Real estate | 8.2 | 2007 | 2015* |
| Dohaland – Musheireb | Real estate | 5.5 | 2007 | 2015 |
| Lusail development | Real estate | 5.5 | 2005 | 2018 |
| The Pearl Qatar | Real estate | 14 | | 2013 |
| Qatargas 2 – LNG complex | Oil & gas | 12.8 | | 04-Nov |
| Qatargas 4 – LNG train | Oil & gas | 2 | | 02-Nov |
| Qatar North Gas Field Devpt. | Oil & gas | 20 | study | 2014 |
| Pearl GTL | Oil & gas | 18 | 2003 | 1Q11 |
| QP - Al Shaheen refinery | Oil & gas | 6 | 2007 | 2014 |
| Qafco V | Petrochemical | 3.2 | | 1Q11 |
| Qatalum aluminium smelter | Industry | 5.7 | 2007 | 1Q11 |
| Total value of select projects | | 164.9 | | |

*On hold.
Source: Zawya, CBQ, table includes selected data

The government has actively sought to engage the financial community in many of these infrastructure projects, and this policy has met with significant success. Although the MENA region had a 15% decline in FDI inflows in 2009 to US\$81bn, Qatar succeeded in attracting US\$9bn (10% of GDP), representing a hefty 30% yoy rise.

Non-energy capex to replace completed energy sector projects

Tourism infrastructure

The Qatar Tourism Authority (QTA) has been set up with a strategy avoiding mass tourism and focusing on business, cultural, sports, and educational tourism

The Qatar Tourism Authority (QTA) has been set up with a target of raising tourism numbers from 1.1m in 2009 to 1.4m in 2012 and 2.5m in 2015. Currently, 95% of tourists are business tourists (MICE – meetings, incentives, conventions and exhibitions), but the tourist authority is planning for future growth to be driven as much by cultural, event, and educational tourism, with internal targets suggesting a 30% contribution from leisure tourism. The authority is also targeting the transit business, aiming to divert 5% of transit traffic.

Table 19 : New Doha International Airport

| Phase | Development area | Annual pax capacity | Completion |
|---------|------------------|---------------------|------------|
| Phase 1 | 130,000 m2 | 12m | 2011 |
| Phase 2 | 219,000 m2 | 24m | 2013 |
| Phase 3 | 416,000 m2 | 50m | 2015 |

Source: Qatar Airways, QNB

Qatar is building the New Doha International Airport (NDIA), valued by Zawya at US\$15.5bn, scheduled to open in mid-2011

To facilitate the achievement of the targeted 15-20% CAGR in annual visitors, Qatar is building the New Doha International Airport (NDIA), scheduled to open mid-2011 with a capacity for 12m passengers per annum, expandable to 50m upon completion of the final phase in 2015. The new airport is expected to help Qatar compete with neighbouring Abu Dhabi International (12m passengers, expanding to 20m), and Dubai International (60m since October 2008) establishing Doha as a transport hub between Europe and Asia.

Table 20 : Qatar Airways, passenger numbers

| Year | Passengers carried (m) per annum | yoy growth |
|---------|----------------------------------|------------|
| 2003-04 | 3.3 | |
| 2004-05 | 4.6 | 39% |
| 2005-06 | 6 | 30% |
| 2006-07 | 8 | 33% |
| 2007-08 | 10 | 25% |
| 2008-09 | 12 | 20% |
| 2009-10 | 14 | 17% |

Source: Qatar Airways

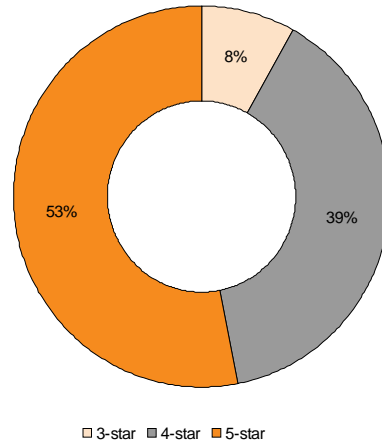
Qatar Airways expansion to drive tourist inflow

The NDIA is expected to be managed by Qatar Airways and will be the new hub of the expanding airline. The national airline, 50% owned by the government and rest by the royal family, has a staff size of 15,000 and is experiencing meteoric growth with a current fleet size of 85 (but with 200 additional planes on order, with a value of US\$30bn) compared to 50 in 2006.

Hotel rooms to rise by 50% over the next three years

In order to accommodate the rising tourist inflow, over the past three years, hotel rooms jumped to around 8,500 from 2,700, and were scheduled to reach 13,000 by the end of 2010, although many of these were actually pushed into 2011. According to DTZ Research and QTA, an additional 70 hotels and 48 hotel apartments are expected to open by the end of 2012 offering an additional 12,981 hotel rooms and 8,763 hotel apartment units. The government projects room numbers to exceed 30,000 by the end of 2013, but has plans for 90,000 by the World Cup.

Chart 33 : Existing hotel room supply



Source: Qatar Tourism Authority, DTZ Research

Residential/commercial property: oversupplied

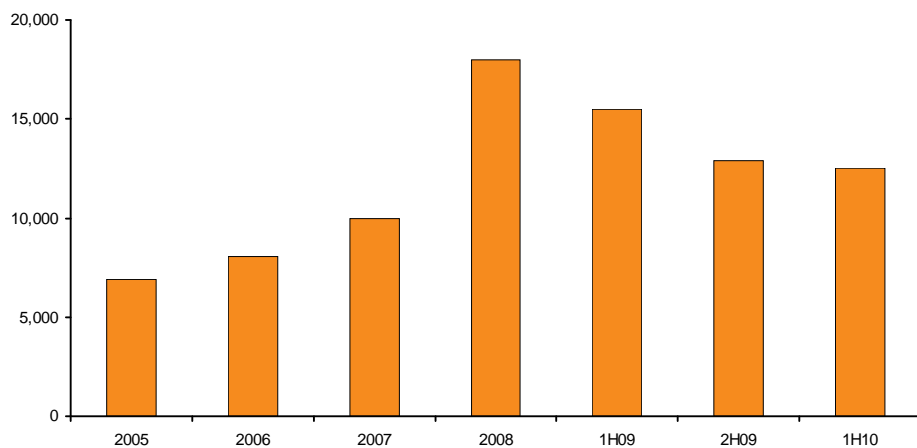
Landmark law supports 60% five year real estate loan CAGR

The real estate and related construction boom began in 2004 when Qatar, in line with its regional neighbours, opened its doors to foreign ownership in the real estate sector. Expatriates can now buy property in specified areas of Doha, including West Bay Lagoon, Qatar Pearl and Lusail City. Two years later, in 2006, a new law was passed that extended the right of expatriates to own property on a 99 year leasehold basis in 18 designated areas within downtown Doha. During the same year, the Minister of Interior also decided to issue an entry visa and residency permit to non-Qataris owning property. At the end of 2009, domestic real estate lending reached QR40bn, amounting to a 60% CAGR over 2005-09.

Residential and commercial segments over supplied

Residential and commercial segments remain over supplied, with low occupancy and declining prices. Qatar has been affected by a similar real estate overhang seen in neighbouring countries. However, property consultants such as DTZ see greater optimism than elsewhere. The freehold market predominantly consists of properties on The Pearl, a single large maritime development making for a relatively homogenous market. In addition, with immigration still a driver, transaction volumes are said to be rising. However, the continued delivery of freehold property throughout 2011 is certain to keep a lid on any pricing rebound.

Chart 34 : Freehold prices – The Pearl (QR/sqm)



Source: DTZ Research

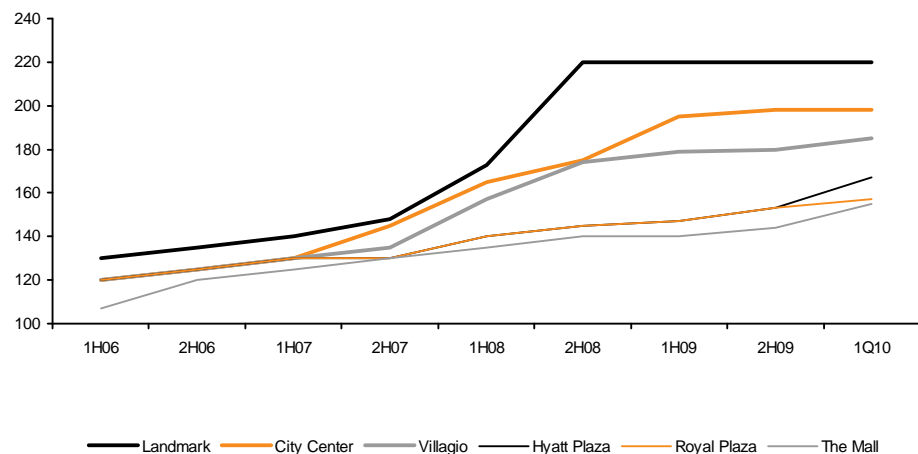
DTZ estimated total 1H10 commercial office stock in Doha to be 3.2m sqm with a vacancy rate of 20%, down from 22% in December 2009 and less than 5% at the end of 2008. However, the government accounts for 63% of office demand. Financial services makes up another 10%, IT and

communications (telecoms) add a further 10%, and the Oil & Gas sector rounds demand up past 80%. New demand comes mainly from the public sector and to a lesser extent financial services. Consequently, there is little sign at the moment that strong economic growth is driving sustainable strong office demand.

Market for retail space strong for now, pending fresh supply

The retail market, on the other hand, remains under served as organised retail stock has remained at 500,000 sqm of gross leasable area (GLA) since 2009. Average monthly rental rates have gone up to QR180-225/sqm as most existing malls have full occupancy with waiting lists of potential tenants. However, DTZ further estimates that the GLA per capita will rise from the current 0.6 to 1 sqm per capita as 230,000 sq m of additional organised retail stock is expected to be added between 2H10 and the end of 2011. In 2012, a further 400,000 sqm is expected to be added with Barwa Commercial Avenue being particularly of note, with nearly 300,000 in 2013, largely thanks to QIB's Northgate enterprise (see later).

Chart 35 : Retail rents (QR/sq m per month)



Source: DTZ Research

Conclusion for property and construction: a mixed market

We see the property market as a two-tier market, with residential and commercial already slack, while infrastructure and tourism is still moving ahead strongly, supported by strong government spending. The implications for the banks are similarly mixed, in our view. Increasing infrastructure spend is likely to be a growth area for the banks, partially directly and partially indirectly, as discussed earlier. Meanwhile the delivery of LNG and some petrochemical projects will mean that associated contractor lending will come to a close, but direct lending will only begin to tail off.

When it comes to residential and commercial property financing, in principle we would expect to see both direct and indirect financing looking stressed. However, the 2009 buyout of property loans means that the banks have already disposed of any high-risk exposure. In addition, as stated elsewhere the main developers are not cashflow constrained, and are therefore not passing on cashflow problems to suppliers and contractors. As such, stress in the property sector remains limited, in spite of the dramatic drop in prices.

Latest data on financing

Most of the banks had expected that infrastructure spend would trump property market weakness in terms of contractor financing. Although this was not true throughout 1H10, with a temporary hiatus in infrastructure spend, data in 3Q10 strongly reinforced the more positive view, with 22% qoq growth. Real estate lending, which we believe is more directly linked to residential/commercial property development, continues to be weak. We expect this pattern to continue until immigration soaks up the slack.

Qatar National Vision 2030: risks for long range economics

Investment multiplier

Significant public sector spending on long gestation activities such as R&D, and education and training facilities highlights the government's interest in long-term planning. However, if every Qatari riyal spent generates only the same value of GDP, the investment has not been very successful. We believe the aim will be to raise this multiplier as high as possible, until these investments are built into self-generating industries.

Inefficient investment

With capacity running far ahead of demand in some areas, clearly the concern is that demand never comes, cash flow never repays investment, houses, offices, hotels and infrastructure lie empty or underutilised. Could it happen? To some extent, if diversification fails to drive non-energy growth, if as a result the labour market fails to pick up and immigration drops away. Although it *could* happen, continued strong immigration of 7% suggests that this will be a question of timing. In addition, given the lack of leverage and the abundant access to capital, the implications would be considerably more minor than Dubai or elsewhere.

Our relative comfort with Qatar risk is primarily driven by the US\$ multi-trillion natural resource available to Qatar. Consequently, although spot gas prices have dropped dramatically from their peaks, we believe solid cash flow returns from the hydrocarbon sector are still secure. Secondly, given cheap feed stocks, petrochemical margins are likely to stay very healthy, while energy intensive industries such as metal refining will also have a competitive advantage. In addition, investment in local infrastructure will drive the non-energy economy well into the medium term.

What is less certain is the productivity of these infrastructure investments. On this issue, we believe the jury is still out. On issues such as tourism, logistics, financial services and health and education, Qatar is not even the regional leader much less a leading global competitor.

Downside risk is more limited

Unlike Dubai, Doha's downside risk is more limited. It is not reliant on foreign financing in either its basic industries or its property market. Nor strictly speaking will there be a substantial problem if consumer demand or tourism receipts fail to turn up in the numbers expected. Yes, returns would be substantially lower, but with the ability to absorb indefinitely large cash flow shocks, we do not expect this could ultimately result in a crisis.

Regional leader: Doha, Dubai, Bahrain or Abu Dhabi?

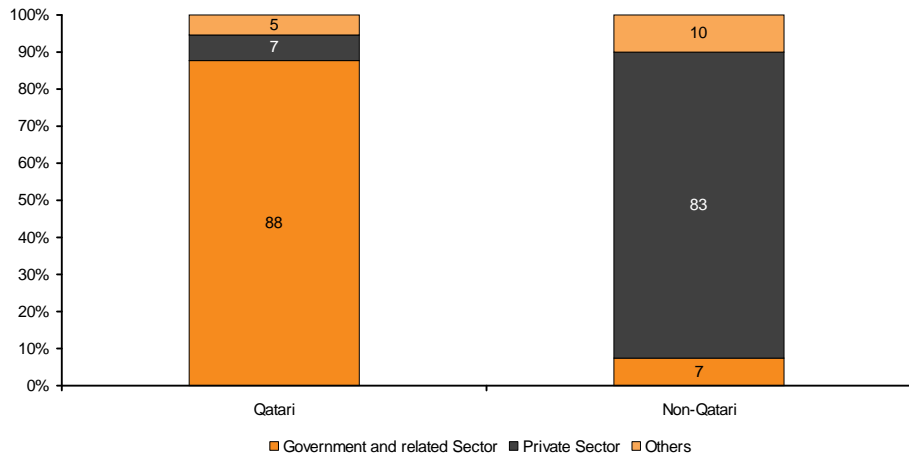
Although Doha is certainly financially more stable than Dubai, we believe Dubai has the advantages of an established brand and first mover advantage. Elsewhere in the GCC, regional competition remains robust with Bahrain being resurgent and even KSA competing as a regional petrochemical and manufacturing hub. Nevertheless, we do not believe it is a question of either/or, but expect most to get a measure of success. The difference for Dubai though is that there is no plan B, and that is likely to drive a greater level of determination to remain ahead.

Qatari participation rates risk policy reversal

Further, the lack of training and significant under investment in the education sector has resulted in private sector participation of the local Qatari population remaining extremely low.

Qatar is the only country which has achieved a significant improvement in its KE Index ranking followed by Saudi Arabia whereas Kuwait and Bahrain have declined in ranking

Chart 36 : Sector-wise economically active population



Source: Qatar Statistical Authority

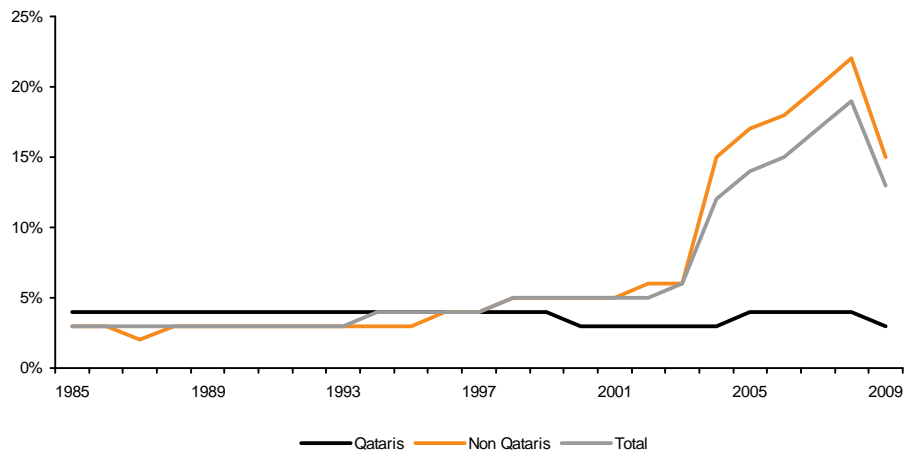
Implications for the labour market: slowing but still strong

Impact on the labour market

The rapid pace of real estate and construction activity has provided the country with one of the fastest population growth rates in the world (19% in 2008 and 13% in 2009)

The focus on urban development, large-scale investment projects and rising government expenditure has resulted in one of the fastest population growth rates in the world (19% in 2008 and 13% in 2009). Unsurprisingly and in line with its GCC counterparts, the shortfall in local human resource and technical expertise means that unskilled and skilled expatriates continue to form a majority (75%) of its 1.6m population base.

Chart 37 : Population growth rate



Source: Qatar Statistics Authority

Short-term population growth expected at 7%

We expect the population growth rate to remain above the pre-boom era of 5% driven by non-energy infrastructure related projects with our medium term growth rate forecasted at 7%

In the short term, we expect population growth to slow as large scale oil and gas related projects come to an end with real estate and construction related projects facing delays or cancelling their plans. The growth slowdown is occurring as the blue collar contract workers in the real estate and construction sector (forming about 25% of the population) are being repatriated. However, we expect the population growth rate to remain above the pre-boom era of 5% driven by non-energy infrastructure related projects with our medium term growth rate forecast at 7%.

Going forward the mix between skilled and unskilled labour is also important. Qatar's ambition to create a knowledge economy suggests an influx of significant quantities of skilled labour. If so, this will have a significant impact on personal lending. In the UAE, for example, up to 50% of personal lending is attributable to expatriates; in Qatar the banks claim this is limited to 10-20%.

Table 21 : Banking regulations

| | |
|--|---|
| Capital adequacy ratio | Central Bank requirement in accordance with Basel II is 10%. Tier II plus Tier III should not exceed 100% of Tier I capital. |
| Liquidity ratio | Must exceed 100%. Numerator: cash, QCB deposits, interbank deposits <1 year, intra-bank balances, negotiable instruments. Denominator: 25% of customer deposits and certificates, 45% interbank < 1year, and up to 50% of borrowed amounts including off-balance sheet amounts. |
| Credit ratio | Limited to 90%. Numerator: net loans & acceptances. Denominator: deposits, foreign borrowings & debt securities, tier 1 equity excluding TFA & investments. |
| Credit concentration | Single customer – credit facilities 20% SHF, total exposure 25% SHF. Shareholder – credit facilities 10% SHF. Associate – total exposure 25% SHF. |
| Reserve requirement | Banks have a mandated reserve requirement at the QCB of 4.75% of total deposits. |
| Real estate loans | Real estate loans to individuals or corporates are capped at 15% of customer deposits or 150% of equity, whichever is less. The bank financing should not exceed 65% of the purchasing cost. Qualifying government projects are excluded. |
| Consumer loans against salary | Instalments limited to 50% of customer's total monthly salary and related allowances, with a maximum repayment period of 7 years after a transitional period. Overall consumer loans are limited to QR2.5m. |
| Financing trading in securities | Financing should not exceed 50% of the market value of purchased securities or 40% of DSM-listed securities. The total credit for securities trading may not exceed 5% of the bank's equity. |
| Investments | Total investments limited to 30% of SHF. Single company investments limited to 5% of SHF, excluding subsidiaries. Total unlisted investments limited to 15% of SHF. Total investments in portfolios and mutual funds limited to 10% of SHF. |
| Foreign ownership limits | Foreigners are allowed to purchase up to 25% of equity in banks that are listed on the Qatar Exchange. Foreign banks require QCB license to open branches. |
| Taxation | Foreign Banks registered at QFC- 10%, Local banks – exempt. |

Source: Rasmala

Major residential projects

The Pearl – Qatar

The Pearl-Qatar, built by the local United Development Company, is a US\$2.5bn man-made island being built off the coast of the West Bay Lagoon area in Doha. The 988 acre (4m sqm) island, is Qatar's first international real estate venture and the country's first freehold development. Construction began in April 2004 and the first phase of development has been completed with the final phase to be completed by late 2010. Property owners of The Pearl have been promised local residency visas and will be granted freehold titles to their property.

The Pearl Qatar will provide over 40 sqkm (24.9 miles) of new coastline to the country and encompass 7,600 freehold residential units accommodating 40,000 residents. The residential units will be contained in twenty-one 20-storey towers with 3,116 apartments and 410 town houses/detached villas. The Pearl will also contain 10 themed districts, three luxury hotels, four marinas accommodating over 700 boats, leisure facilities, and 60,000 square meters of luxury retail and restaurant space.

Lusail

Lusail, built by Qatari Diar Real Estate Investment Company, is a US\$5.5bn waterfront city billed to be the largest domestic real estate development in the country. It covers an area of 35m sq m and is located north of Doha, just beyond The Pearl - Qatar. The master plan includes two marinas, residential areas, commercial districts, two golf courses, an entertainment district, shopping malls, mosques, schools and medical centres. Lusail City is expected to provide accommodation for over 200,000 people with its 25,000 residential units. It was announced in December 2005 and foreigners will be able to purchase property on a 99-year lease basis, although there will also be a small amount of freehold property.

Key developments in Lusail

- Entertainment City, under development by Abu Dhabi Investment House, is a US\$3bn project spread over an area of 1m sq m with a 1km long waterfront. The project is expected to be an integral focal point of the Lusail Development as well as a tourist engine for the Qatari state as a whole.
- Energy City Qatar (ECQ), launched in March 2006 with an estimated project value of US\$2.6bn, aims to be the first energy business hub in GCC with all oil and gas value chain players involved. ECQ aims to attract the world's leading oil and gas companies, support services, infrastructure and downstream activities, shipping and trading, market and resource data, and energy trading. An energy trading platform called the International Mercantile Exchange (IMEX) will also be set up as part of the ECQ. Basic infrastructure work is expected to be complete by the end of 2010, after which the developers are expected to begin construction at their sites. The city expects tenants to move in by 2012 and house ca. 200,000 people when complete.

West Bay Lagoon

West Bay Lagoon is a beach-front residential freehold development, located at the northern tip of the new CBD district. The project contains artificial land surrounded by artificial lagoons, extending more than 2km inland from the natural shoreline. It will be located at the entrance to The Pearl-Qatar and next to Lusail City to its north.

West Bay Lagoon will contain several hundred buildings that include residential towers (Lagoon Plaza), luxury hotels (Ritz Carleton, InterContinental, and Grand Hyatt), a commercial centre, recreational facilities and private clubs.

28 January 2011

Comm Bank of Qatar

Not just a corporate bank

Although CBQ is not positioned well for short-term growth, we believe it could inch its way into the public sector market, maintaining double-digit loan growth until the private sector recovers. It does have weak returns compared with peers, but in our view this is not sufficient to justify its discount valuation.

Initiation of coverage

Buy

Target price
 QR109.40

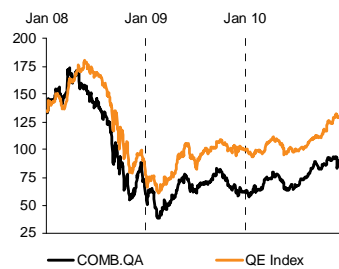
Price
 QR90.00

Short term (0-60 days)
 n/a

Market view
 No Weighting

Price performance

| | (1M) | (3M) | (12M) |
|----------------|-------|-------|-------|
| Price (QR) | 90.00 | 83.00 | 59.30 |
| Absolute (%) | 0.0 | 8.4 | 51.8 |
| Rel market (%) | -2.8 | -5.8 | 10.0 |
| Rel sector (%) | -4.4 | -8.0 | 1.3 |


Market capitalisation
 QR22.27bn (€4.49bn)

Average (12M) daily turnover
 QR20.50m

 Sector: QE Bank Index
 RIC: COMB.QA, CBQK QD
 Priced QR90.00 at close 24 Jan 2011.
 Source: Bloomberg

Key forecasts

| | FY09A | FY10A | FY11F | FY12F | FY13F |
|---------------------------|-------|-------|-------|-------|-------|
| Reported PTP (QRm) | 1,359 | 1,635 | 1,961 | 2,276 | 2,549 |
| Reported net profit (QRm) | 1,524 | 1,635 | 1,961 | 2,276 | 2,549 |
| Reported EPS (QR) | 6.57 | 7.05 | 8.06 | 8.97 | 10.00 |
| Normalised EPS (QR) | 5.84 | 7.05 | 8.06 | 8.97 | 10.00 |
| Dividend per share (QR) | 5.73 | 7.00 | 6.12 | 6.49 | 7.31 |
| Normalised PE (x) | 15.40 | 12.80 | 11.20 | 10.00 | 8.96 |
| Price/book value (x) | 1.91 | 1.87 | 1.72 | 1.63 | 1.55 |
| Dividend yield (%) | 6.36 | 7.78 | 6.80 | 7.21 | 8.13 |
| Return on avg equity (%) | 14.10 | 15.20 | 16.40 | 16.60 | 18.70 |

 Accounting standard: IFRS
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

The leading private sector corporate bank

CBQ is the country's second largest bank with a 10.4% market share in loans and a distribution network of 31 branches (23 conventional and eight Islamic). However, it is the leading private sector corporate bank, with limited exposure to the public sector (4Q10: 15% loan book) and personal lending (4Q10: 20%). Within the corporate sector, nearly half of loans are property market-related.

Loan growth returning, based on public sector expansion

Gross loan growth accelerated to an annualised 6% in 2010, primarily due to public sector lending. However with greater stability in corporate lending, we believe total lending will accelerate to 15-16% in 2011-12. Meanwhile, given the buyback of real estate loans by the government, and limited exposure to regional problem areas, the net NPL ratio has been limited to a well-controlled 2.4% in 4Q10 (vs 3.1% at the beginning of the year).

Low sector-relative returns driven by low gearing

CBQ's below-market returns (ROTCE of 14.0%) are driven primarily by its low levels of leverage. In part, low leverage is driven by the high tier 1 ratio, but in addition the bank's two large associates, United Arab Bank (of Sharjah) and National Bank of Oman, tie up 35% of capital, while supplying only 9.7% of earnings. Provisioning is less of an issue, given the provisioning margin of just 6.8% in 2010 – no worse than CBQ's long-term average.

Valuation and recommendation

CBQ trades at a 2011F PE of 11.2x and a 2010 PB of 1.87x, a discount to the Qatari banking sector of 3% and 25% respectively, based on our forecasts. We expect that in terms of growth, it will run a close third to QNB and QIB, and that its level of return is hit temporarily by its high level of capitalisation. We assume a 2013 exit ROTCE of 18% and a below-market growth rate of 14%. Using a three stage DDM with a discount rate of 10.7%, we ascribe a target price of QR109.4, suggesting 22% upside potential to the current share price. We rate the stock a Buy.

Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

| EPS | Ours | Cons | % diff |
|-------|-------|-------|--------|
| 2011F | 8.06 | 8.84 | -8.82 |
| 2012F | 8.97 | 10.16 | -11.70 |
| 2013F | 10.00 | 11.1 | -9.99 |

Source: Bloomberg, Rasmala forecasts

Catalysts for share price performance

We expect the primary catalyst for a re-rating to be proof that CBQ can operate in a growth environment dominated by public sector lending. Its Q410 results did demonstrate public sector loan growth of 85%, but this needs to be maintained over a longer period. In addition, we believe there may be operational advantages from an increased public sector focus, namely increased revenues with few allocable costs.

The other main issue is getting improved visibility in profit margins, for which there have been a number of issues, including the decline in fees and commissions in 2H10, the lack of significant investment gains apart from 3Q10, and volatility in provisioning, combined with the steady rise in NPLs. We expect recent increases in the latter to top out early in 2011.

Earnings momentum

In its 4Q10 results, earnings fell 45% qoq, driven primarily by end of year provisioning and investment losses, as well as by seasonal costs, and contributions for social responsibilities (not included in GAAP numbers). We expect a sharp bounce back in 2011, with headline earnings increasing 19.6% yoy. The primary driver is likely to be an improvement in investment income, for which the revaluation reserve is at last in positive territory. Lending volume increases may be offset by spread contractions, from peak 4Q10 levels, but we expect still to reach 9%, while we expect provisioning to decline by 18% yoy.

Rolling into 2012, we expect loan volume increases of 14.9% to be the main driver, resulting in headline net income growth of 16.1%. A continued decline in provisioning and improved investment income should be sufficient to offset any worsening of the cost-income ratio. Beyond 2012, we continue to expect double digit earnings growth, with further increases in the cost income ratio being attenuated by increases in non-interest income.

Valuation and target price

CBQ is the cheapest of the Qatari banks we cover, trading at a 2010 P/TB of 1.9x, representing a 25% discount to the Qatari Bank average. CBQ does have the twin problems of the second-lowest forecast growth rate (bar Doha Bank), and the lowest level of 2011F ROTCE at 16.0%.

Nevertheless, we put the latter down to having an excess build-up of capital, given that the Qatar Investment Authority capital injection cannot immediately be put to use.

Overall, we would not look at CBQ as the cheapest bank on a P/TB basis, albeit with sub-average growth and poor profitability, but rather as an inexpensive bank on a 2011F P/CE basis (11.6x), with near-average growth prospects and significant room for margin recovery. We also believe we have been appropriately cautious in our forecasts, for example assuming little in the way of fee and commission recovery from the plunge that began in 2Q10. We set a target price of QR109.4, which is based critically on a below-market ROTCE of 18% in the medium term and at the market discount rate of 10.7%. We also assume that CBQ will grow below the market average into the medium term, but this ultimately does not have a big impact on valuations.

How we differ from consensus

Our headline net profit forecast is 2% below Bloomberg consensus for 2011, but due to us being early to model the QIA capital injection, this leaves us 9% below Bloomberg consensus on an EPS basis. Similarly for 2012, although we differ little on the net profit side (1% below consensus), on the EPS front we are 12% below consensus. This can also be seen on the BVPS figures where our assumption of capital issuance results in us being 8% and 9% below consensus.

Risks to central scenario

We believe the main risk is in increased competition in large corporate banking, and CBQ's ceding market share in 2H10 is suggestive of this. In addition, we believe the QIA capital injection has been value dilutive to shareholders, although only to the tune of 3% (already factored in to our forecasts). Sensitivity to this issue seems low, but this could change. The Qatari government maintains a significant right of intervention in the banking sector, and while this has generally reflected a positive transfer of value, it need not always be so.

Forced ranking*

| Company | Rec | Upside / Downside |
|---------|------|-------------------|
| QNB | Hold | 8% |
| Doha | Hold | 1% |
| QIB | Hold | 5% |

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: Rasmala forecasts

Key events

| Date | Event |
|---------------|------------|
| 20 April 2011 | 1Q results |

Source: Company

Key assumptions and sensitivities

In our coverage, CBQ is the most sensitive to discount rate estimates, as a result of recovering growth rates and returns. A 1pp change in the discount rate would increase or decrease our fair value by 21.7% or 15.5%, respectively, all else being equal.

Discount rate is the main source of valuation uncertainty

We attribute a 1.60% stock spread for CBQ as part of the discount rate calculation, which makes its discount rate 60bp higher than the one we apply for QNB, but 60 and 40bp respectively below that for QIB and Doha bank. We believe this is justified by our relatively conservative forecasts, suggesting asymmetric risk on the upside and better transparency.

In terms of forecast sensitivity, the main issues are growth, capital and ROTCEs

- Our growth forecasts for CBQ are the weakest in our coverage universe bar Doha bank: like Doha Bank, CBQ is poorly positioned vis-à-vis the current round of public sector growth. However, unlike Doha Bank, we believe its underlying strengths in corporate lending can lend themselves well to public sector lending. We therefore assume some short-term benefit from public sector growth, carrying CBQ through until private sector growth picks up. Overall, that makes for a steady growth forecast of roughly 15% from 2011 to 2024. Sensitivity to the growth rate is relatively small at 1.4% per percentage point, reflecting our lower assumption for ROTCE.
- CBQ is already the best capitalised bank in our Qatari banks universe, with an 18.5% total capital ratio as at 4Q10. Consequently, in CBQ's case the QIA capital injection seems redundant, as well as being dilutive. Longer term, we assume an 11% TBV (ex-associates) to RWA ratio, although the sensitivity to that is difficult to measure, as increased capital gearing would also suggest changes to sustainable ROTCE.
- In the short term, we forecast a 14.0% ROTCE rising to 17.7% in 2013. In the long term (2014-24), we assume a potentially higher level of gearing will enable a higher ROTCE of 18%. Our 18% forecast stands at a 5% discount to QNB, a 4% discount to Doha Bank and a 2% discount to QIB, with each percentage point having a 5% impact on our valuation. Although this suggests the lowest level of returns of the four banks over all time periods, we believe that risk is skewed to the positive.

Terminal value assumptions

- We set a standard 12% ROTCE and 5% growth rate across the sector in the very long term (2024+), effectively lowering the exit book value multiple to a little over 1x tangible book. In principle, a one percentage point change has a 9% impact on our valuation, but we do not pretend to differentiate between the banks over this time period.

Executive summary

CBQ is the cheapest bank in our sector universe on a 2010 PB basis, but with weak returns and below market growth prospects, in our opinion. We believe that CBQ can close the gap on the latter two issues, prompting a re-rating on the former.

No value trap

Discount valuation assumes continued weak returns

In spite of a sharp rise in the share price, CBQ remains the cheapest bank in Qatar, based on a PB ratio of 1.9x, a discount of 25% to the average of the Qatari banks under our coverage. However, on an earnings basis it is only a 4% discount to its peers, reflecting the weak ROTCE of 14.0%. Consequently, the two questions that need to be asked are (i) is it a value trap; and (ii) what is the book value multiple capturing that the earnings multiple is not. We do not think it is a value trap, and anticipate a certain amount of earnings recovery. We also believe that risks are skewed to the upside, and that the low level of leverage provides capital to finance earnings growth and dividends for the longer term, especially after the proposed QIA injection.

No value trap – growth should come from the public and private sector

Public sector loan growth 85% in 2010

Although CBQ is poorly positioned for current market growth, we believe its strengths in corporate banking will stand it in good stead for capturing a portion of the current public sector business available. This could be seen in 2010 results, when public sector loan growth reached 85%. We forecast that CBQ will continue to capture around 5% market share of new public sector business, resulting in a high growth rate, albeit diminishing due to the base effect. As public sector growth declines though, we expect a reversion to greater private sector growth from 2012 onwards. We expect the result to be fairly steady growth throughout and beyond our forecast period.

Earnings recovery

The most obvious potential source of turnaround is in market-related revenues, where impairments are still outweighing revenues. We believe more stable markets in 2011 may allow a reversion to positive territory. We also forecast some recovery in fees and commissions, at least from 2H10 levels, which were depressed by low growth rates, regulations and competition. Other areas of recovery include provisioning and associate contributions, where UAB and National Bank of Oman are below peak profitability.

We see risk asymmetry to the upside

Our forecasts leave scope for increased F&C contribution and reduced costs

We also believe there are a number of areas where we could have been more positive and that offer additional upside potential. The key one is faster recovery of the private corporate sector, which may happen in 2011, although we assume 2012, and only a mild recovery then. There are other areas more directly related to our CBQ forecasts, however.

Our forecasts for fees and commissions suggest a recovery to 1.6% of loans, against a trough (4Q10) of 1.13%, and a 2007-9M08 pre-crisis average of 3.22%. Although lower growth rates, new regulation and increased competition all negatively impact current numbers, banks tend to be good at finding alternative ways to charge for the same services. In addition we believe that cost investment is going towards new revenue streams, such as insurance and brokerage, which may improve fees, although we do not yet have sufficient visibility to factor this into our forecasts.

In addition, for now we make few assumptions about improving cost numbers, although there are a number of arguments for having better numbers. An increasing penetration of the public sector should in principle mean improving revenues with a relatively fixed cost base, which would of course be one area. In addition, with cost investment in areas such as brokerage and insurance yet to deliver returns, we might expect either investment costs to decline or revenues to rise.

DDM valuation best captured by the P/TB ratio

Narrowing ROTCE differential suggests discount to narrow

Looking at the traditional multiples, CBQ is manifestly cheap on a P/TB basis (2010: 1.9x) as well as a dividend yield basis (2010: 7.8%), but not obviously so on a P/CE basis (P/CE: 11.2x). So why the discrepancy? We believe the P/CE fails to capture two elements of the DDM valuation, namely the overcapitalisation, particularly following the pending QIA capital injection, and the risk asymmetry (which we incorporate with an adjustment to the discount rate). By contrast, the P/TB assumes a bit too much in terms of ROTCE recovery, but the 25% discount to the sector average and 47% discount to QNB seem excessive. We rate the stock Buy with a target price of QR109.4.

Figure 1 : Dupont analysis

| STAGE ONE | STAGE TWO | STAGE THREE | STAGE FOUR | STAGE FIVE | ADDITIONAL COMMENTS |
|-------------------------|-------------------------|-------------------------------|------------------------------|-----------------------------------|-------------------------|
| ROTCE | Gearing | Tier 1 ratio | TCR | | |
| '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| 14.5% 14.0% 16.0% 16.7% | 5.37 5.73 5.44 5.77 | 17.2% 16.6% 17.1% 15.6% | 18.9% 18.5% 18.2% 16.5% | | |
| 18.9% 18.5% 18.8% 18.8% | 7.36 7.87 6.49 6.49 | 14.8% 15.1% 18.0% 16.9% | 15.9% 16.2% 18.8% 17.6% | | |
| | ROAA | IEA / TA | Loans / IEAs | | |
| | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| | 2.50% 2.75% 2.87% 2.97% | 82.6% 76.5% 79.8% 80.7% | 67.5% 70.2% 69.2% 70.7% | | |
| | 2.79% 2.68% 2.69% 2.69% | 81.9% 78.2% 83.3% 84.2% | 70.5% 72.1% 69.4% 70.4% | | |
| | | Revenue / average IEAs | Interest Margins | Spreads | |
| | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 5.53% 4.99% 5.11% 5.28% | 3.37% 3.80% 3.72% 3.78% | 3.24% 3.71% 3.70% 3.70% | |
| | | 4.91% 4.62% 4.79% 4.79% | 3.57% 3.86% 3.69% 3.69% | 3.52% 3.88% 3.70% 3.70% | |
| | | | Non II / average IEAs | F&C to ave IEAs | |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | | 1.75% 1.35% 1.56% 1.61% | 1.54% 1.08% 1.08% 1.11% | |
| | | | 1.46% 1.21% 1.30% 1.30% | 1.03% 0.84% 0.87% 0.90% | |
| | | | | Other revenues to ave IEAs | |
| | | | | '09 '10 '11 '12 | |
| | | | | 0.21% 0.27% 0.48% 0.50% | |
| | | | | 0.44% 0.37% 0.43% 0.45% | |
| | | Net Profit Margin | Op. Margin | Cost-Income Ratio | |
| | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 61.3% 65.7% 68.5% 68.1% | 68.8% 67.7% 68.0% 67.0% | 31.2% 32.3% 32.0% 33.0% | |
| | | 66.5% 64.3% 67.2% 67.2% | 70.8% 72.3% 72.0% 71.5% | 29.2% 27.7% 28.0% 28.0% | |
| | | | Provn Margin | Net Provisioning | NPL ratio |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 |
| | | | -19.0% -6.8% -4.9% -4.3% | 1.35% 0.51% 0.40% 0.35% | 3.05% 2.40% 2.00% 1.60% |
| | | | -8.3% -8.0% -5.5% -4.5% | 0.58% 0.60% 0.44% 0.44% | 1.78% 1.76% 1.75% 1.75% |
| | | | XYZ Margin | | |
| | | | '09 '10 '11 '12 | | |
| | | | 11.5% 4.9% 5.4% 5.4% | | |
| | | | 4.0% -0.1% 0.7% 0.5% | | |

Source: Company Rasmala forecasts

The key to value

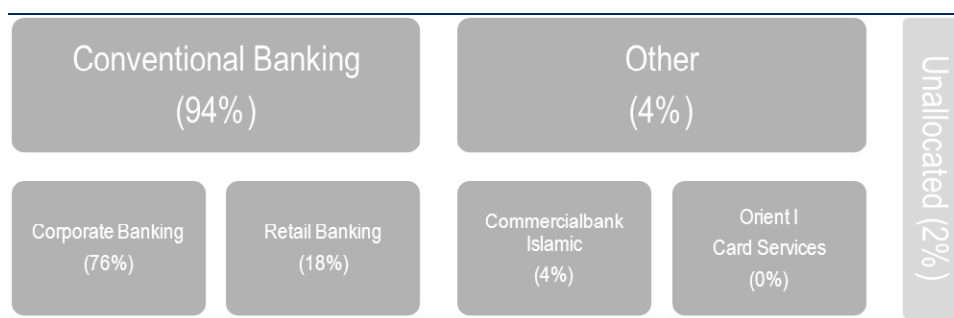
CBQ is the largest bank focusing on private sector lending in Qatar. The bank has significant retail and Islamic operations, but for now its profitability comes mostly from within its corporate division.

Banking on the private sector

Still very much a corporate bank

Commercial Bank of Qatar (CBQ) is the country's second largest bank with an asset market share of 12% by value and a distribution network of 32 branches (24 conventional and eight Islamic). With a market capitalisation of QR21bn, the stock has a 77% free float with 9.1% held by the QIA. Foreign ownership has now risen to 16.7%, still short of the 25% limit.

Figure 2 : CBQ organogram, split by 2010 revenue, %



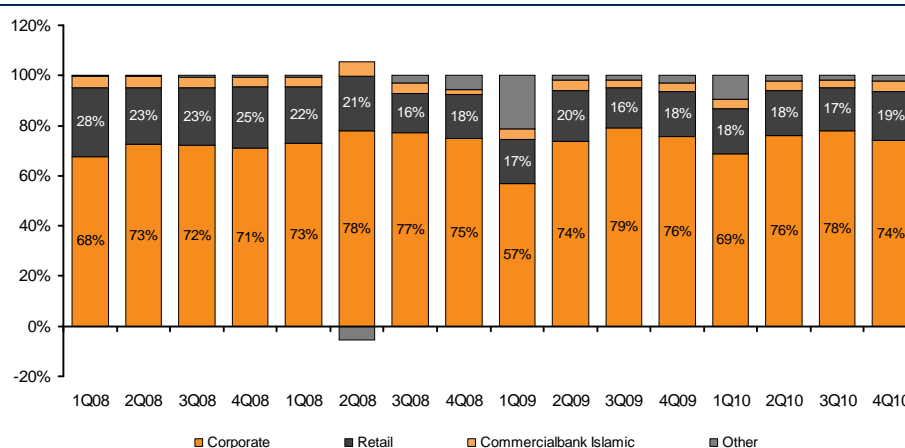
Source: Company reports

Although the bank provides retail, Islamic, and investment banking services, 76% of its revenues come from corporate banking, and indeed this portion has increased in recent quarters, in spite of the decline in fee income. Meanwhile, retail revenues have been on a declining trend since peaking in 4Q08, matching the 14% reduction in assets over the same period.

Minor other divisions

CBQ also has two other smaller divisions: Commercialbank Islamic and Orient 1 – a Diners Card operation in Qatar, Bahrain and Oman. Combined, these contributed 4% of revenues in 2010. After failing to get the traction of its bigger rival QNB al Islami over the last few years, Al Safa Islamic was recently rebranded to the current name to reflect the closer integration with the main group.

Chart 1 : Revenue split by division



Source: Company reports

Associates also increasingly important

Aside from the core operations, CBQ also has a number of associates whose combined book value comes to 35% of total common equity. The most important of these are the 40% stake in UAE-based United Arab Bank (UAB) and a 34.9% of National Bank of Oman (NBO). In both cases we believe it is likely that CBQ would have liked to have majority stakes, although this was constrained by the local regulators in each market. CBQ actively seeks inorganic growth within the MENA region.

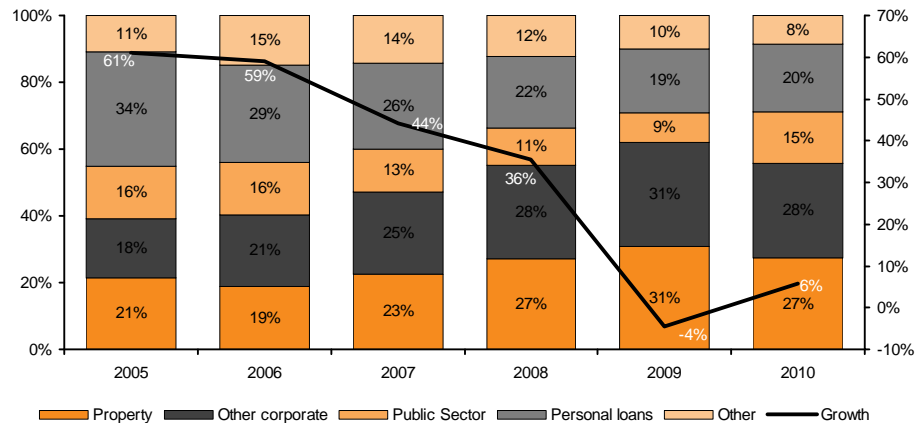
Recent trading: slow growth, but profitability sustained

Growth declines from a 46% CAGR over 2005-08 to 0% over 2009-10

Recent growth has been minimal

With loan growth rates peaking at 60% in 2005-06, and remaining above 36% until 2008, the boom period certainly saw rapid development for CBQ. The bulk of this growth was in the property and other corporate sectors, with real estate and commercial lending accounting for more than a third of all growth during the period. Personal and public sector lending CAGRs of 25% and 30% from 2005-08 failed to keep pace.

Chart 2 : Loan book split



Source: Company reports

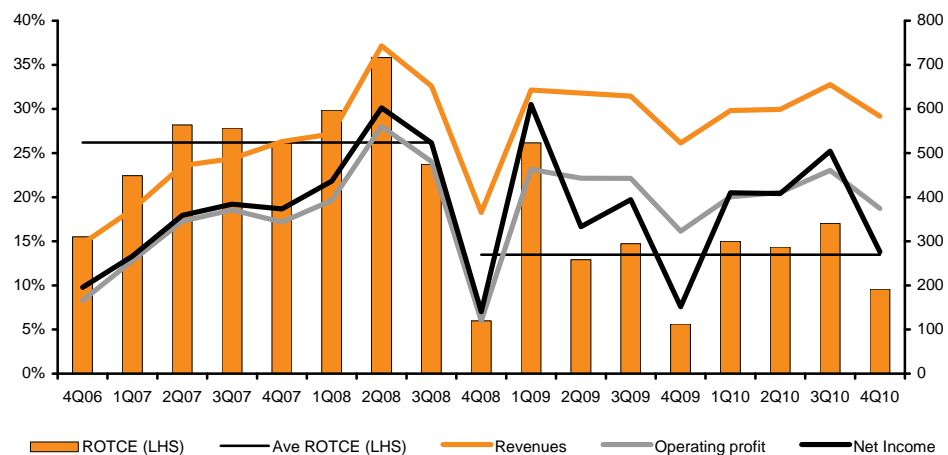
Following the onset of the crisis, growth rates collapsed dramatically, with contracting loans understandably going into reverse and lending for commerce declining. Strong real estate lending continued, and lending to the service sector also expanded. However in 2010, with 128% of banking sector yoy credit growth coming from the public sector, and a further 15% coming from the closely aligned contracting businesses, it is clear that CBQ refocused on gaining its share of public sector business.

Returns resilient

Returns have been steady in the low teens

Although returns have come down sharply from the 36% peak ROTCE seen in 2Q08, they have actually held up reasonably well. Averaging a fairly steady 13.5% over the last nine quarters, they have only dipped significantly below that in 4Q08 (due to especially large investment impairments) and 4Q09 (due to provisioning) and 4Q10 (impairments and provisioning). Indeed, given 2010 net income has been only 15% below that for 2008, the main cause of lower returns has been the 115% increase in common equity since 4Q07.

Chart 3 : Decline in ROTCE post crisis vs pre-crisis, %



Source: Company reports

Strategic priorities for growth and ROTCE

In terms of growth, the main issue is whether CBQ will end up losing market share, as a result of having a weak position in public sector lending. For returns, the main challenge is to get ROTCE back towards the 20% mark.

CBQ has stated that it has four key strategic priorities (slightly paraphrased):

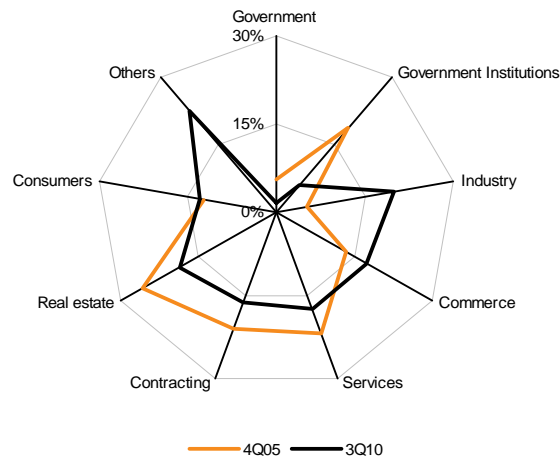
- domestic business: focusing on profitable growth
- regional expansion: focused and controlled expansion across the GCC
- franchise maximisation: coordination across the banks and its associates; and
- Islamic banking: Enhance its business and product offering

Profitable growth in the domestic business

Public sector lending dominating sector growth

While a focus on the private corporate sector has been the primary driver of a 38% gross loan CAGR from 2004-09, the near absence of private sector loan growth in 2010 has prompted a rethink. Indeed, for the system as a whole, public sector loan growth of 59% in the year to November 2010 dwarfs the 8% growth rate for other categories of lending. What is more, the fastest areas of growth within the private sector have been contracting, with its significant links to public sector spending and international lending.

Chart 4 : Market share, by lending category, 3Q10, %



Source: Company reports, Central Bank statistics

Corporate banking – holding position in a slow market

Corporate Banking an area of strength for CBQ

We believe CBQ has the highest quality corporate banking franchise in Qatar, as well as having the highest exposure to large corporates with corporate lending contributing 29% of the loan book. CBQ also has a leading position in trade and project finance, club and syndicated lending, with strong syndicated and structured financing teams. We do expect competition to increase in this area, but other than QNB we don't believe there are currently serious challengers at the top end of the corporate banking industry.

During 2010, CBQ's corporate lending volumes contracted, resulting in market share shrinking from 18% to an estimated 14%. This, however, was primarily due to a sharp, and we believe one-off, reduction in contracting loans during 1H10, although the company also highlighted prepayments as a driver of 4Q10 declines. Going forward, we expect CBQ to grow substantially in line with the market.

Of greater concern for CBQ is the rate of growth in corporate lending as a whole. Growth 2008-10 has been focused in only the three smallest sectors: industry, contracting and others. Going forward, we continue to expect modest recovery in private sector lending, with loan growth for CBQ reaching 16% in 2011, and staying at roughly that level for the following three years.

Islamic lending rebounding to 14% yoy

Rebranding Commercialbank Islamic may help it to pull its weight

Al Safa Islamic banking (now Commercialbank Islamic) has been in operation since 2005, but by 4Q10 this operation had only grown to 8% of the group loan book, significantly underperforming its peer QNB Al Islami. The main reason for Al Islami's success has been its focus on government and associated commercial business. By contrast, the banks that have focused on private sector Islamic banking have made more limited headway.

In recognition of the fact that Al Safa Islamic banking has not really successfully carved out its own niche, CBQ is part-way through a relaunch, aiming to position the Islamic business closer to the operations of the group. The most noticeable element of this is the rebranding of the operation to Commercialbank Islamic. After negative growth in 2009, yoy loan growth in 2010 rebounded to 14%, outperforming the conventional business, although that still represents loss of market share. For now, we do not believe Islamic banking will be a major driver of growth, but we expect it to be a more useful defensive tool than it has been in the past.

Public sector banking, underpenetrated, but increasingly an area of focus

As private sector lending has begun to lag public sector growth, CBQ has shifted its focus to building up its public sector exposure, an area in which it is manifestly under-represented. We believe CBQ has some structural disadvantages compared with QNB, such as the strength of contacts and the deeper integration with the government and public sector enterprises. However, the differential in terms of the size of the balance sheet is not as severe as it is for its competitors, and as the foremost corporate bank, CBQ is well-placed to provide specialist financing solutions.

Although taking on QNB in its core market may seem like a challenge, CBQ has met with some success in 2010, growing the segment by 85%, bouncing back from a 24% decline during 2009. Nevertheless, this increase represents only a 6% share of the flow of net new public sector lending. Consequently, we believe CBQ can achieve at least this level going forward as public sector loan growth accelerates around 2012-13. Even at these levels, this would still represent a strong area of growth for CBQ.

Consumer banking seeing limited growth opportunity

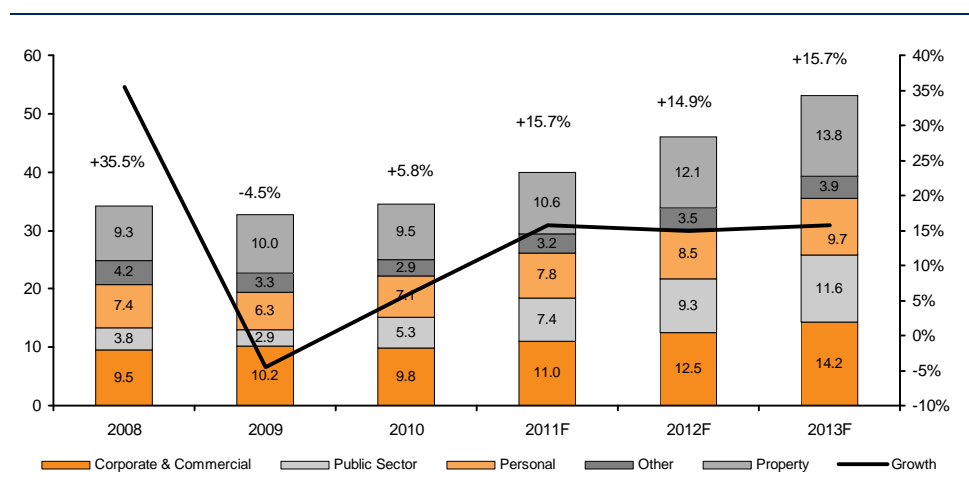
CBQ has seen the contribution of retail loans to its loan book decline sharply over the last few years, from 34% of the loan book as at year end 2005 to 20% in 2010. We believe that the local Qatari population accounts for around 80% of loans in this category, and given this segment is nearly at saturation point, further growth is likely to be limited to population expansion, and at the margin increased leverage amongst expatriates and immigration. However, until public sector salaries are once again on the move, the capacity for growth in the segment is limited.

Overall, steady loan growth over the next four years

It is hardly surprising that CBQ intends to take a bigger share of public sector lending going forward. Overall, we expect CBQ to maintain a fairly flat gross loan growth rate of 15-16% over 2011-13. However, in the near term (2011-12) we expect this to come predominately from strong growth in public sector lending, while we believe corporate lending will be a greater feature beyond the near term.

Limited growth in consumer banking

Chart 5 : Loan growth forecasts, QRbn



Source: Company reports, Rasmala forecasts

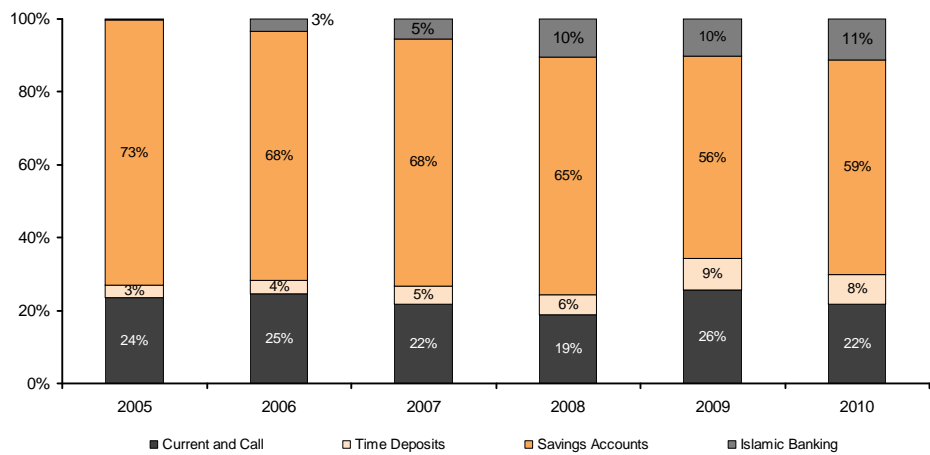
We believe CBQ has ample access to wholesale funding if necessary

Balance sheet structure stretched but not strained

The loan to deposit ratio of 98% (4Q10) reflects an improvement from post-crisis levels of 100-120%, reflecting a shortage of deposits. However this seeming shortage of deposits was partially the result of CBQ issuing US\$1.6bn of senior and subordinated debt in November 2009, with the intention of paying down a maturing US\$380m syndicated loan, but also of paying down high cost deposits (and rebuilding capital after the change in calculation methodology). As of 4Q10, total capital market funding for CBQ amounted to 18% of the total balance sheet, putting it at the top end of the Qatari range.

Although there may be constraints in substantially raising the proportion of capital market funding on the balance sheet, we do not expect this to impact loan growth, due to the generally liquid balance sheet. Net interbank balances are in positive territory, while CBQ has QR8.7bn of cash balances and QR10.0bn of financial investments (of which nearly 80% consists of public sector Qatari bonds), together amounting to 30% of the total balance sheet. In addition, refinancing risk is limited, with just US\$500m falling due in 4Q11, and a further US\$650m in 4Q12.

Chart 6 : Deposit book, split by type %

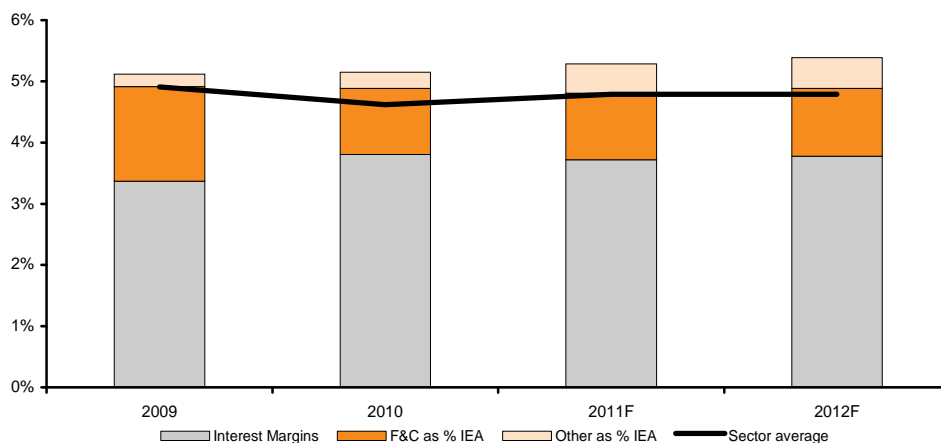


Source: Company reports

Revenue margins under pressure

Revenue returns on interest-earning assets have broadly matched the sector average, thanks to a high proportion of non-interest income.

Chart 7 : Revenue margins as % of IEA, vs sector average



Source: Company data, Rasmala forecasts

Spreads and margins: likely at a peak

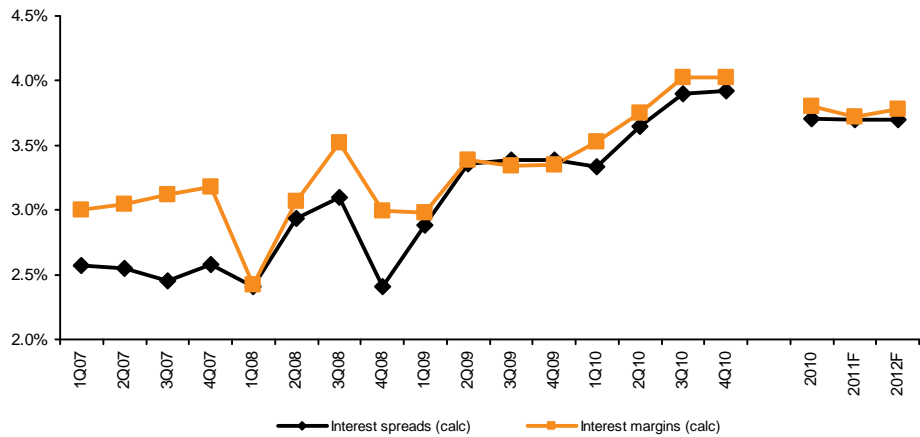
We assume interest spreads peaked in 2H10, and will decline from here

With significant capital market funding and low level of retail funding, it is no surprise that spreads have been narrower at CBQ than its peer group average. However, with a limited amount of public sector business, spreads are also not significantly lower, particularly in 2010, where calculated spreads jumped to 3.71%, compared with a sector average of 3.88%. This increase represents a 118 basis point jump from 2007 levels.

Although the jump in spreads is partially due to calculation limitations, such as the increase in cash balances and decrease in equity portfolio, spreads also benefited from underlying trends. In particular, spreads have been elevated since the beginning of the crisis, benefiting from higher risk pricing. In addition, the higher liquidity in 2010 allowed funding rates to fall, without any significant change in lending rates.

Not all of the improvement has been driven by external factors, however. CBQ has been able to give up some of its high-cost deposits as it has built up liquidity, partially with the help of bond issuance in 4Q09. The impact of this was offset by the relatively high cost of paper, with a senior note being issued at 5.0% and a subordinated note at 7.5%.

Chart 8 : Spread and margin development



Source: Company reports, Rasmala forecasts

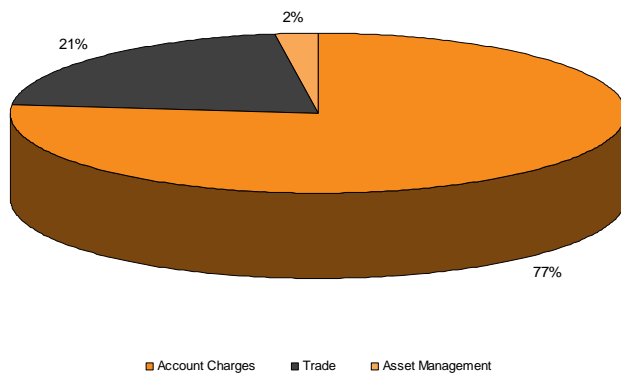
Going forward, we expect a near-term decline in asset yields, reflecting the decline in interbank rates. However, we would also expect the increase in private sector competition, which has so far only really affected lending fees, to also put a cap on yields. Overall, we expect a negative mix effect from a likely increase in public sector business over the next three years. With this in mind, we forecast an easing of spreads over the next three years. We also assume a lower level of cash, contributing to calculated spreads declining to 365bp in 2012F from a 2010 high of 371bp.

Fee income: plans for expansion offsetting competition

Fee & commission income suffering from regulation and competition

While interest margins have been buoyant through 2010, the opposite has been true of fees and commissions, which we expect to have suffered a 22% decline yoy in 2010. CBQ has emphasised that this is primarily due to a decline in loan growth, although since net loans have been flat since 2008, and there has also been little change in gross loans issuance, a link to volumes issued does not seem supported. Instead, we believe the primary impact is due to the higher level of competition as an indirect result of lower growth rates.

Chart 9 : Gross fees and commissions, 2010, %



Source: Company reports

Lower growth driving higher competition is not the only factor driving fees and commissions though. In addition, CBQ highlights a 1Q10 cap on various account related fees. Also CBQ's trade volumes have been hit by competition, with LCs and LGs both contracting sharply (2010: 24% and 20% yoy respectively), against a generally flat market (indirect credit facilities for Qatar down just 3% yoy). This may have been down to a squeeze between Doha Bank at the smaller end of the market and QNB at the upper end eating into CBQ's market share.

CBQ does not expect a sharp rebound in fee and commission rates in the near future. Instead, the bank highlights increased revenue from two main sources: insurance and brokerage. For now, we believe that the opportunity in both areas is limited. We believe it will be a challenge for CBQ to break out from merely providing insurance as an adjunct to financing transactions (as in mortgage

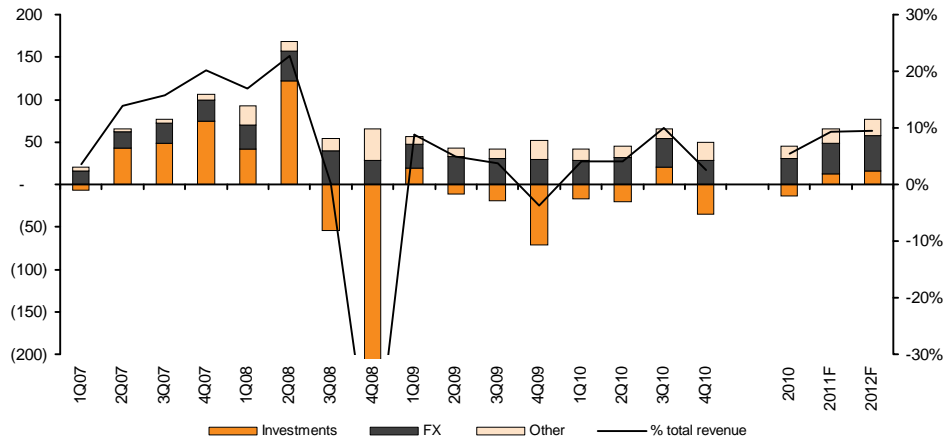
financing). In brokerage, we believe that CBQ will capture its natural market share, but do not yet expect this to be more successful than Doha Bank's operation, which contributed just 1% of 2009 fees & commissions. Nonetheless, these should provide incremental revenues, and opportunities for future growth.

Other income – dominated by foreign currency transactions

Other income more limited, less volatile than in the past

There are three main sources of other income, setting aside exceptional profits from asset disposals and associate income (discussed later). The most important of these in the past has been investment income, accounting for not only the bulk of returns, but also the bulk of volatility in returns. However, with the investment portfolio shifting towards public sector Qatari bonds, current returns are coming much more from foreign currency transactions. Other 'other income' (from which we have excised out the 1Q09 asset disposal), largely represents rental income.

Chart 10 : Other income, including investment and FX income

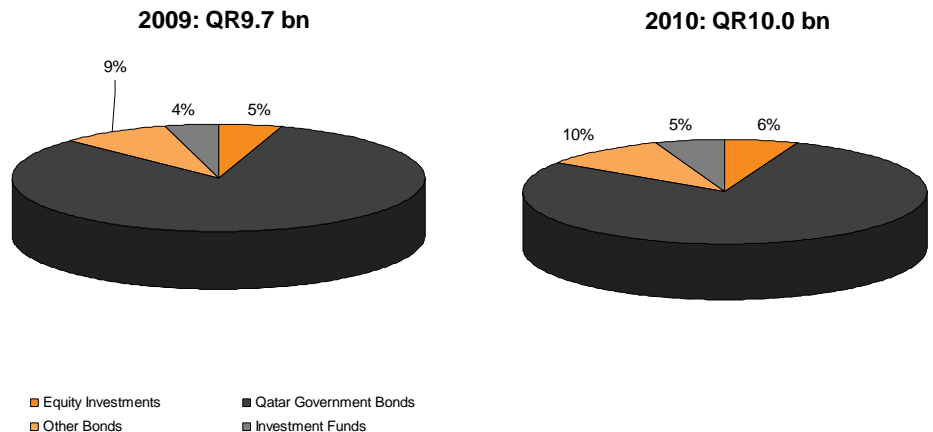


Source: Company reports, Rasmala forecasts

Majority financial investments remain secure

There has been a strong drive to de-risk the investment portfolio, starting with the buyout of the DSM-listed equity portfolio. In 2008, equity investments accounted for 27% of the portfolio, while Qatar government bonds accounted for 43%. By the end of 2009, equity investments had declined to 5% of the portfolio, while Qatar government bonds had risen to 82%, and this has remained the structure ever since. Indeed, CBQ highlights that the next structural change in the investment portfolio is likely to be the disposal of its international equity portfolio, should the opportunity present itself.

Chart 11 : Investment portfolio as of 2010



Source: Company reports

Mark-to-market risk appears limited

The fair value revaluation reserve is now in positive territory, with a positive fair value on available for sale investments of QR57mn, which we believe mostly relates to equities and investment funds. We note that the FTSE-100, the DJIA and the Dax were up 6%, 9% and 14% respectively in the first 11 months of 2010, likely improving the associated revaluation reserve.

Investment returns also likely to be fairly limited

With 89% of the investment book invested in bonds, it is clear that returns will be overwhelmingly reported within interest income. Investment returns on a recurring basis are likely to be limited to 5-8% on the 11% of the portfolio not invested in bonds, or around 60bp. Should the international equity portfolio be sold down, we would expect this to decline further, although depending on the use of funds generated, it may be compensated with better net interest returns.

FX returns stable

While the magnitude and volatility of investment returns has collapsed, profit from foreign currency transactions has remained pretty stable, at an annualised rate of 39bp over the last five years, and a standard deviation calculated on a quarterly basis of just 5bp. Most banks suggest that FX returns are more 'fee-like' than 'trading-like', and this level of stability certainly supports that assumption. We expect FX-related income to contribute approximately 5% to revenues going forward.

Revenues flat in 2010 at QR2.4bn

Excluding the 1Q09 real estate gain on disposal, amounting to QR165m, revenues were flat in 2010. Net interest income rose 7% yoy on the back of the strong positive trend in spreads, although volumes remain weak. By contrast non-interest income declined 15% yoy on the back of weak fees and commissions, impacted by competition and increased buyer power from the better quality counterparties.

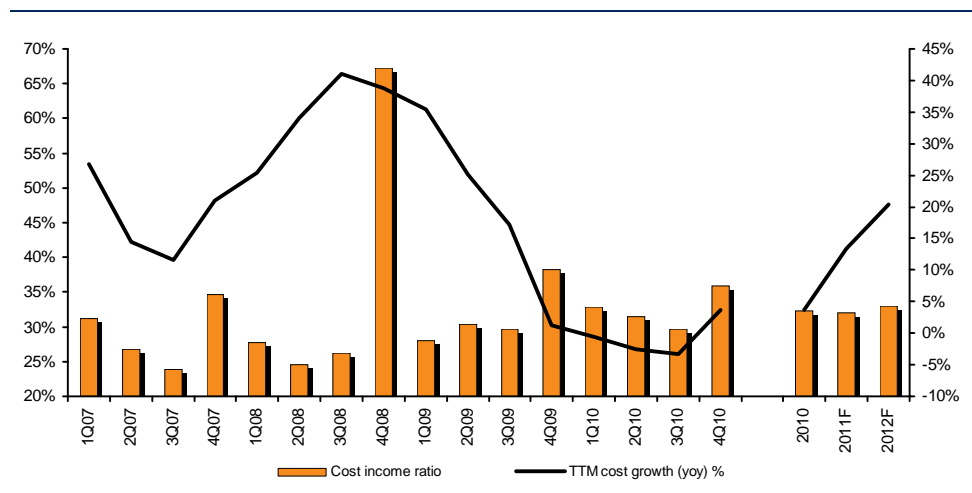
In 2011, we expect stronger revenue trends, with total banking income rising 15% yoy. Net interest income should benefit from faster balance sheet growth, but may be offset by spread pressure. We expect non-interest income to fare better, rising 30% yoy, with organic growth in fees and commissions and FX income boosted by the normalisation of investment income. Beyond 2012, we expect revenue growth to be more symmetric, with the rising proportion of private sector lending offsetting residual spread erosion.

Cost-income ratio expected to remain 30%+

At 31.2% in 2009 and 32.3% in 2010, CBQ has one of the highest cost income ratios of the Qatari banks we cover, although by international standards the ratio is still very low. Recent cost control has been good, rising just 4% yoy for 2010, with a small reduction in headcount being a critical factor. Two new branch openings expected in 2010 have now been pushed into 2011, and we expect this combined with the addition of a new bancassurance operation to add modestly to the cost.

High costs likely to endure, but offer potential upside

Chart 12 : Cost-income ratio, cost growth



Source: Company reports, Rasmala forecasts

Going forward, we expect CBQ will have to work harder for its revenue, implying an upward bias to the cost-income ratio. Bancassurance and brokerage are both cost-intensive operations, and these replace lost revenue from competition and regulatory competition. In addition, a return to growth – while welcome – would bring back further cost investment. As a result, we expect the cost-income ratio to rise by 1% in each of 2011 and 2012.

The main potential positive for CBQ is the increased public sector business. Those banks with greater public sector exposure generally have lower cost income ratios. However, at present we do not know whether this applies to CBQ, as we expect the type of public sector lending to be more labour intensive than some of its competitors.

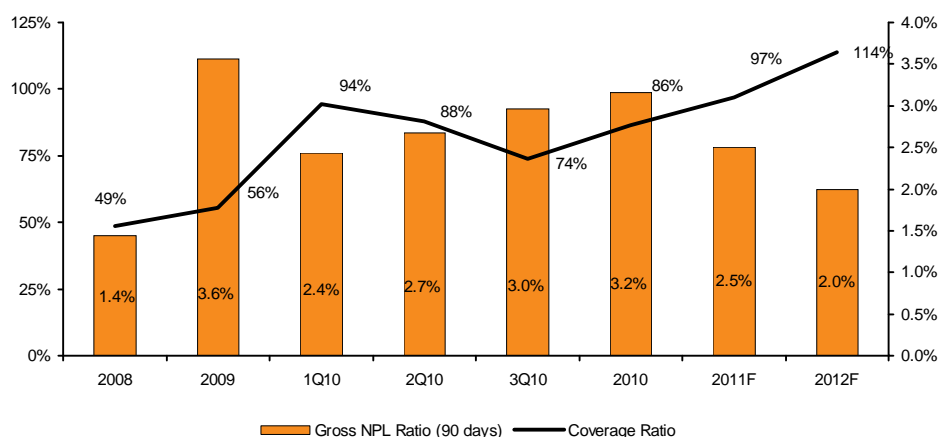
Declining loan provisions to push ROTCE higher

With its low public sector exposure, it is no surprise to see that CBQ's NPL ratio is well above the average, and indeed we expect it to remain so. Retail lending accounts for 65% of NPLs in 2010, up steadily from 2009 levels of 53%. However, with perhaps 80% of these loans going to Qatari nationals, we believe the ultimate default rate is and will continue to be significantly lower than NPLs would suggest.

The corporate book, which constitutes 56% of the loan book, accounts for 28% of overall NPLs. We believe that the most exposed sectors are commercial, services and contracting, although the latter is primarily exposed to industrial development, rather than residential or commercial. Combined, these segments amount to 32% of the loan book. However, even if all corporate NPLs came from just this section of the loan book, this would amount to an NPL ratio in this lending category of no more than 2.8%.

Loan provisioning to decline, pushing ROTCEs higher

Chart 13 : NPL and coverage ratio



Source: Company reports, Rasmala forecasts

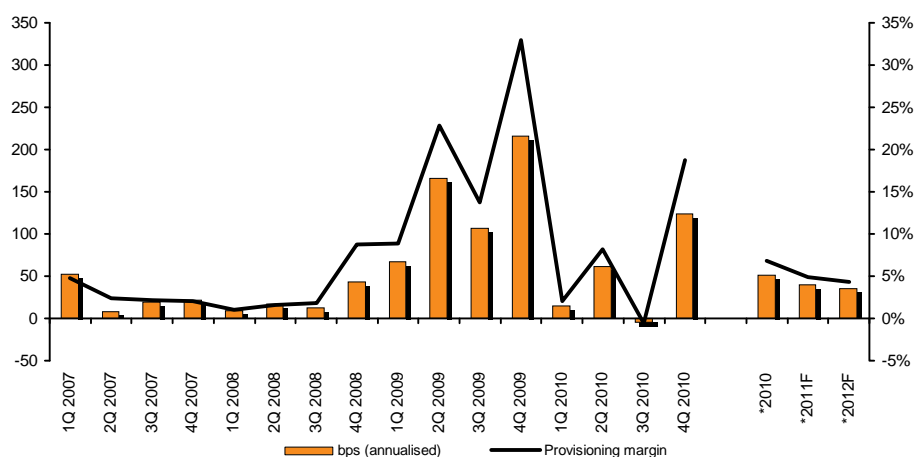
For Islamic lending (which we ignored in the above estimates), the overall NPL ratio is a relatively high 5.2% as at 4Q10. Since there is no inherent reason why NPL ratios for Islamic operations should be any more risky than conventional, we believe this is primarily down to the business mix, which has a small bias towards consumer lending, and away from public sector lending, but more importantly potentially also a greater focus on SME lending.

Retail and Islamic loans dominate NPLs

During 2009, CBQ made a provision for a commercial loan of around QR170m, and disclosed this within NPLs. This was gradually reversed in 2010, with 70% written back in 3Q10. In 4Q10, we expected that the final QR60m or so would be written back onto the books and removed from NPLs.

The coverage ratio rose to 86% in 4Q10 (adjusted to exclude interest in suspense). The lower historic coverage ratios were probably due to the bank not focusing on past-due loans in the 90-180 day bucket. More recently, we believe that the NPL ratio was distorted by the large corporate loan mentioned above. Consequently, NPLs were inflated, and coverage ratios deflated compared to the situation after the change in regulation and resolution of the loan.

Chart 14 : Loan provisions QRM

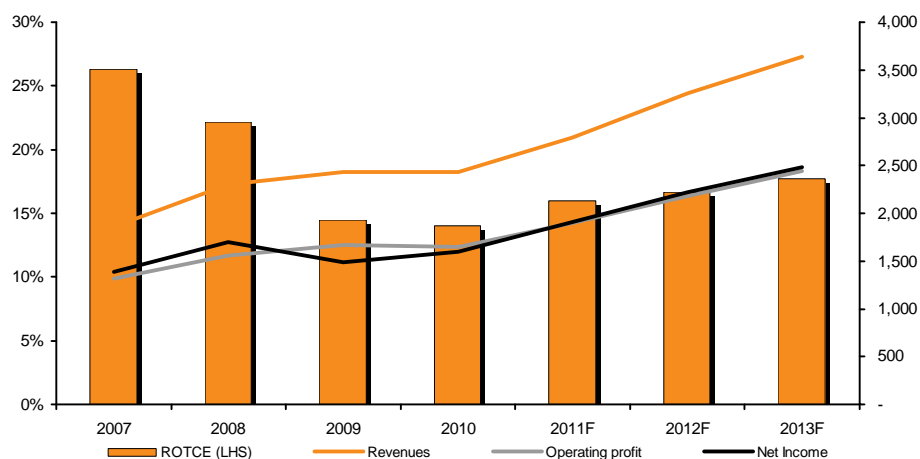


Source: Company reports, Rasmala forecasts

Bottom line rose 7% to QR1.6bn, ROTCE of 14%

CBQ's bottom line rose 7% yoy in 2010 to QR1,635m. The main negative contribution has been the 15% decline in non-interest income driven partially by the weakness of fee income and partly by investment losses. This has been compensated by a decline in loan provisioning, however, suggesting that it is not revenue weakness that has led to the decline of ROTCE to 14%. Rather it is the reduction in leverage as a result of the last QIA capital injection and subsequently the change in capital adequacy regulation. Consequently, although some earnings recovery and increase in leverage is still likely, we believe the ROTCE recovery is capped.

Chart 15 : Income statement, ROTCEs



Source: Company reports, Rasmala forecasts

Associate performance remains stable

Two main associates stable: UAB and NBO

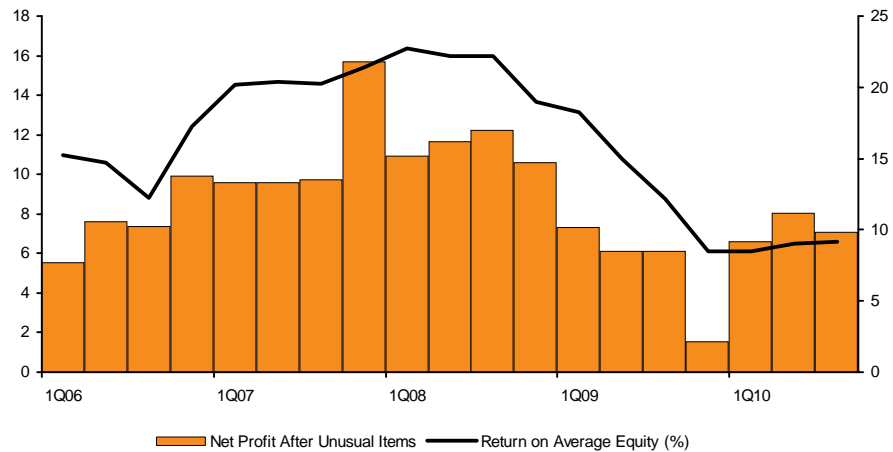
CBQ currently owns a 35% stake in National Bank of Oman (NBO) and 40% of UAE-based United Arab Bank (UAB), but has shown little sign of further international expansion plans. We assume CBQ would like to fully consolidate the operations, but regulatory constraints limit its holdings to minority stakes. Nevertheless, with management contracts in place, CBQ maintains effective control over these entities. CBQ is contributing to these businesses strategically, helping to develop new business areas, such as affluent and Islamic banking, but is also more broadly looking for cost and revenue synergies. CBQ recently announced that it will end its management contract with NBO, but it is uncertain currently what the implications may be.

NBO – a steady performer

NBO's share price dropped to a low of OMR0.245 on 22 Jan 2009, but has recovered to a level approximately 38% above its lows, as fears of ROE erosion have abated. NBO now trades at a

trailing 2009 P/B of 1.41x (25 Jan 2011), valuing CBQ's 35% stake at approximately QR1.3bn, in line with its current book value on CBQ's balance sheet.

Chart 16 : NBO net profit (OMR m), ROAE (RHS)



Source: Zawya Dow Jones

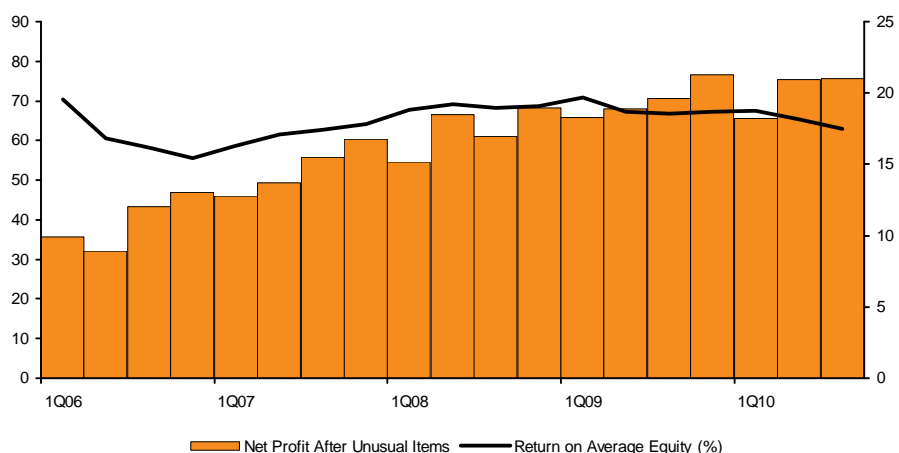
Recent developments at NBO have included the new brand identity as of March 2009, followed by branch renovation and the addition of a number of new branches. The recent addition of 10 branches has enabled NBO to maintain its position as the second largest bank in Oman with 64 branches, as well as five branches in Egypt and one in Abu Dhabi.

UAB – more recent acquisition

UAB is a more recent acquisition than NBO, with the 40% stake put on the books for the first time in 4Q07. Although the stake currently has a market value of Dh2.3bn (24 Jan 2011) in line with the Dh2.3bn book value, the stock is illiquid and the market capitalisation, which suggests a BV multiple of 3.4x, may not be representative of its value.

Based on a comparison with peer National Bank of Abu Dhabi, which trades on a trailing 2009 PBV multiple of 1.7x, UAB looks expensive. There is some justification for a premium valuation, given a sustainable ROAE in the high teens, and solid loan growth even in the current circumstances of 14% ytd (9M10). Nevertheless, we cannot justify the current valuation. UAB operates through 12 branches in the UAE.

Chart 17 : UAB performance (Dhm)



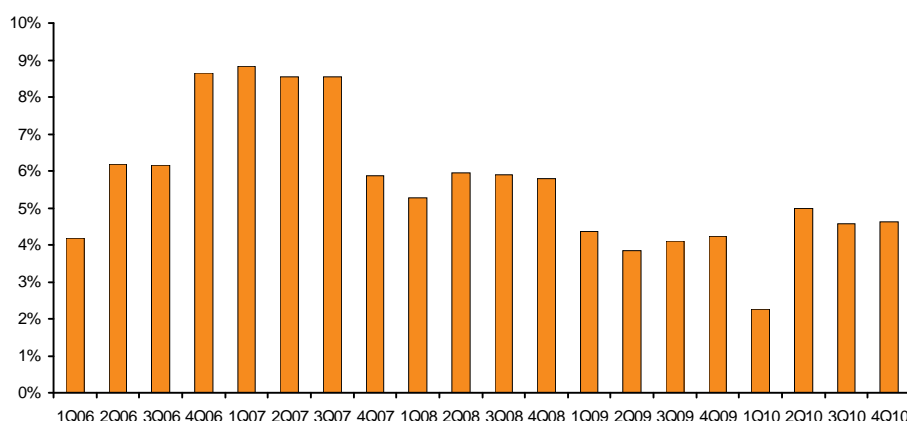
Source: Zawya Dow Jones

Impact of associates on valuations

Associates are recorded at cost rather than book value, and therefore include substantial goodwill. As a result, we believe that the value recorded in the balance sheet is generous, and the returns on book value for the business are unduly low. Associate returns are significantly lower than the returns on equity of the individual entities.

Significant goodwill in associates limits return on investment

Chart 18 : Associate returns on book value



Source: Company reports, Rasmala forecasts

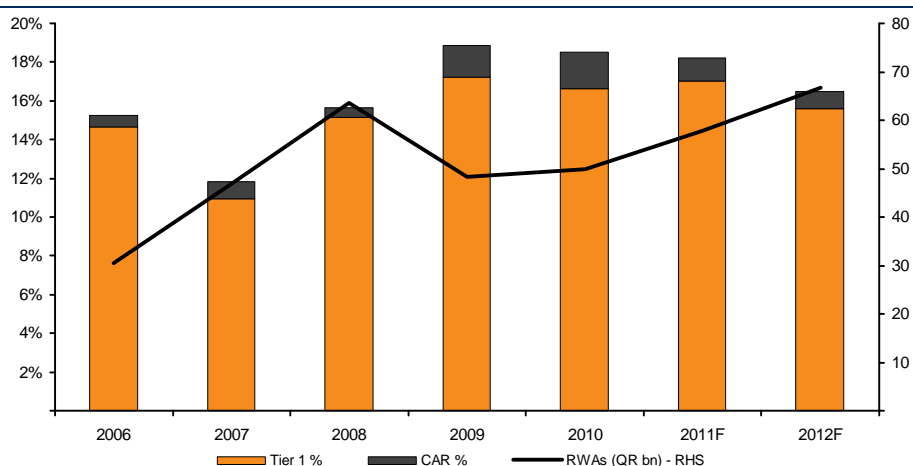
Going forward, we would expect the likely recovery in NBO profitability to flow through to associate income, but that this will certainly not take returns above the 10% level. In the longer term, of course, goodwill should be a smaller proportion of book value, and returns may cross the 10% mark.

Dividend and capital

Ample capital in spite of high dividend payout

CBQ's capital adequacy ratio fell dramatically in 4Q09 as Qatar shifted from the inclusion of financial associates on a pro-rata basis to their complete exclusion. With the book value of associates amounting to 35% of equity at the time, and with tier 2 capital in the associates also excluded, this had a substantial impact on the amount of regulatory capital available. It did, however, have a less severe impact on the tier 1 ratio, as risk-weighted assets declined 24% yoy, against only a 6% yoy decline in net loans, largely due to the same factors.

Chart 19 : Capital adequacy



Source: Company reports, Rasmala forecasts

While regulatory changes negatively impacted capital adequacy, the 10% private placement to QIA significantly boosted the ratio in 1Q09 and 4Q09. Tier II capital was also enhanced with a subordinated debt issue in November 2009. As a result, 4Q10 capitalisation levels are high, at 16.6% for tier 1 and 18.5% for total capital ratio, and in the short term, further capital raising would not be necessary, even without the QIA capital injection.

Since 2005, CBQ has generally aimed for a high payout ratio, although it has varied considerably between a low of 41% in 2007 to a high of 114% in 2006, with the last two years being towards the top end of the range. We believe CBQ aims to strike a balance between the capital needs of the business and the cash requirements of investors. In 2008-09, the high payout ratios were combined with a secondary offering of GDRs and then a staggered private placing in favour of QIA.

Going forward, we expect the payout ratio to remain high, hovering around the 50-90% level. On our numbers, this results in only a 4% CAGR for capital in the 2010-13 period, while RWAs are expected to grow at 15%. By 2013F, this would result in a decline of the total capital ratio to 14.8%, still ample for maintaining the dividend.

Longer-term considerations

Returns struggling to move beyond high teens

CBQ has had a tough crisis by Qatari standards, with ROTCE dropping below 15% in 2009. This was due to a drop in ROA, as well as a sharp decline in leverage.

On the ROA front, the decline was primarily due to the pick-up in provisioning in 2009, with one particular commercial loan doing a substantial part of the damage. Given provisions for this loan have substantially reversed in 2010, much of the drop in ROA has been addressed.

The decline in leverage, however, is of a more structural nature. The capital-raising exercise in 2008 followed by the QIA equity injection greatly increased capital and reduced leverage from an already below-market 7.2x to 5.4x. However, it looks like this lower level of leverage is in part here to stay, following the rule change deducting associates from capital. We assume a level for ROTCEs of 18% in the medium term, in line with the level of profitability in 2013F.

Growth is more difficult to assess. In 2010, growth surprised the market on the downside in 4Q10, bringing the total for the year to just 6%, as a result of 'early prepayments'. We do expect this to accelerate, partly as loan growth expands into the private sector, but more especially as CBQ expands into the public sector. In our exit year, 2013, we assume that loan growth is led primarily by a 15% CAGR in corporate and commercial lending. As a result, we assume loan growth is sustainable at a 14% CAGR beyond 2014.

Our assumed discount rate of 11.6% is based on a basic discount rate for Qatari banking of 9.6%, with a spread of 2.0% for CBQ. Critical areas of uncertainty justifying this are the extent of any benefit the banks may get from current and future public sector spending plans.

Valuation and recommendation

CBQ is the main valuation opportunity in Qatar in our opinion. It has a discount valuation reflecting current poor positioning, but if we believe it can close the gap on growth, then even on moderate ROTCE assumptions of 18% it still has positive upside potential of 22%.

CBQ appears inexpensive in our coverage universe, trading at a 2011F PE of 11.2x and a 2010 PB of 1.87x. This represents a 3% and a 25% discount to the sector average, respectively. We believe this discount is, however, justified by the structurally lower ROTCE, which in turn is a result of the conservative methodology for calculating the level of regulatory capital.

On the other hand, CBQ has been quite successful on the public sector growth front, and we believe this is likely to continue. We assume a discount rate across the period of 10.7%, based on a 1.6% stock spread, putting CBQ's discount rate at the middle of the range for Qatari banks. On this basis, we calculate a three-stage DDM valuation of QR109.4, suggesting 22% upside from the current share price.

Figure 3 : Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|------------------------|--------|---------------------|--------|---------------|--------|
| Explicit Dividends | Net CF to shareholders | | 1,588 | 1,515 | 1,605 | 1,810 |
| | NPV Stage 1 | 5,603 | 5,603 | 4,443 | 3,241 | 1,810 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 790 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 5,644 | 18% | 14% | 13,608 | 77,249 |
| | NPV Stage 2 | 4,748 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 62,391 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 16,720 | 12% | 5% | 50,447 | |
| Total NPV | | | COE | | | |
| | Stage 1 (2010-2013) | 5,603 | US RFR | | | 2.56% |
| | Stage 2 (2014-23) | 4,748 | Country Risk Spread | | | 4.00% |
| | Stage 3 (2024+) | 16,720 | Sector Risk Spread | | | 2.50% |
| | NPV | 27,071 | Stock Spread | | | 1.60% |
| | Shares | 247 | Discount Rate | | | 10.66% |
| | Price Target | 109.40 | | | | |
| | Price | 90.00 | | | | |
| | Upside/(Downside) | 22% | | | | |

Source: Company data, Rasmala forecasts

Primary risks

Impairment risks

We believe the most significant short-term downside risks come from NPLs and so provisioning, given the substantial corporate and particularly real estate exposure. With the consumer, real estate and construction sectors accounting for 20%, 20%, and 8% of the loan book, respectively, CBQ is geared into asset quality. We forecast 40bp of provisioning in 2011, falling to a normalised level of 35bp, which may prove too optimistic. Given the low provisioning margin of 5.2% in 2011, however, sensitivity to this should be limited.

From a longer-term point of view, we believe CBQ's ability to build a premium ROTCE is driven primarily by fees and commissions, with this in turn driven by specialist financing and product teams. As such, we believe this is relatively defensive, but should this come under pressure, the premium performance we are currently forecasting may become more of an issue. Lastly, deteriorating market conditions could hamper UAE-based UAB's profitability, thus lowering CBQ's overall ROE prospects.

Given we have already used a certain amount of reversion to the mean, the positive risks tend to be the converse of the negative ones: if CBQ can sustain premium ROTCEs over the medium term, we certainly see further upside potential. We currently estimate only an 18% ROTCE in the second period of our valuation, which compares with an exit 2013F ROTCE of 19%.

Will CBQ gain more of the public sector business than it loses in private sector business?

Business risks

One of the main areas of uncertainty is the degree to which CBQ will successfully penetrate the public sector business. So far it has been remarkably successful. Nevertheless, can it sustain this growth, and, if it can, could it match QNB's level of profitability in this area? For now we give it the benefit of growth, without yet assuming much in the way of an ROTCE uplift. Conversely, it also appears as if other banks are overspilling their traditional focal areas, with QNB growing particularly in Corporate Banking. As a result, this increased willingness for banks to compete head to head could provide both upside and downside potential.

In the longer term, as growth shifts back towards the private sector, we have not significantly differentiated the banks in terms of growth, assuming that symmetric sectoral growth would bring back more equal growth rates. CBQ has proven its ability to outperform in terms of growth, but emergent more aggressive competition may well limit CBQ's ability to do so.

We are less concerned about the possibility of a write-down of associates. Although that would have a negative impact on earnings, this would be counterbalanced by a rise in ROTCE, reflecting the fact that cash flows would be unaffected. The greater uncertainty would be over the possibility of full consolidation should the relevant governments allow an increased stake. We also know little about the operations of UAB in particular, and profitability there may be depressed for longer than expected.

Perhaps the largest short-term risk is over NPLs and provisioning. A double dip seems an unlikely scenario, given the aggressive government spending plans and resumed project spending. Nevertheless, we may have underestimated the stress that corporates in Qatar are currently undergoing, and it is possible that a slow recovery in certain areas of the economy may drive further provisions.

Versus consensus

Our 2011-12 forecasts for headline net profit are 2% and 1% below Bloomberg consensus estimates. However, on an EPS basis our forecasts are 9% and 12% below consensus, probably as a reflection of the dilution due to QIA shares, which we have factored in already. We believe that consensus forecasts are likely to decline after year end results, due to weak growth and fee income. However, we believe that CBQ's franchise is well-placed to take a share of the opportunity facing the Qatari banks.

Key sensitivities

Table 1 : Sensitivity to key input variables, based on +/- 1 percentage point

| | +1 pp | -1 pp |
|---------------|--------|-------|
| Phase 2 | | |
| ROTCE1 | 4.6% | -4.6% |
| Growth | 1.6% | -1.5% |
| Discount Rate | -15.5% | 21.7% |
| Phase 3 | | |
| ROTCE2 | 8.8% | -8.8% |
| Growth | 0.7% | -0.5% |

Source: Rasmala estimates

Income statement

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Net interest income | 1661 | 1778 | 1938 | 2266 | 2504 |
| Non-interest income | 770.1 | 656.4 | 852.8 | 991.6 | 1138 |
| Total income | 2431 | 2434 | 2791 | 3258 | 3641 |
| Operating costs | -759.5 | -787.3 | -893.2 | -1075 | -1202 |
| 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 |
| <u>Pre-prov operating profit</u> | 1671 | 1647 | 1898 | 2183 | 2440 |
| Provisions charges | -465.6 | -166.5 | -137.1 | -139.2 | -160.2 |
| <u>Post-prov op prof</u> | 1206 | 1480 | 1761 | 2043 | 2280 |
| Associates (pre-tax) | 152.9 | 155.2 | 199.7 | 232.3 | 269.5 |
| Other pre-tax items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported PTP | 1359 | 1635 | 1961 | 2276 | 2549 |
| Taxation | -34.2 | -36.7 | -49.0 | -56.9 | -63.7 |
| Minority interests | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Preference dividends | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other post-tax items | 198.9 | 36.6 | 49.0 | 56.9 | 63.7 |
| Reported net profit | 1524 | 1635 | 1961 | 2276 | 2549 |
| Tot normalised items | 164.8 | -0.20 | 0.00 | 0.00 | 0.00 |
| Normalised PTP | 1359 | 1635 | 1961 | 2276 | 2549 |
| Normalised net profit | 1359 | 1635 | 1961 | 2276 | 2549 |

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Net loans to customers | 31929 | 33567 | 38999 | 44927 | 52047 |
| Other int earn assets | 15391 | 14261 | 17355 | 18645 | 19518 |
| Goodwill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Oth non-int earn assets | 5623 | 5989 | 6436 | 7099 | 8474 |
| Total assets | 57317 | 62520 | 70590 | 78757 | 88887 |
| Total customer deposits | 26639 | 34188 | 39394 | 45472 | 52782 |
| Oth int-bearing liabs | 17316 | 14547 | 15214 | 16200 | 17785 |
| Non int-bearing liab | 2685 | 2873 | 2996 | 3424 | 3921 |
| Total liabilities | 46640 | 51608 | 57604 | 65096 | 74488 |
| Share capital | 10677 | 10912 | 12985 | 13661 | 14398 |
| Reserves | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total equity (excl min) | 10677 | 10912 | 12985 | 13661 | 14398 |
| Minority interests | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total liab & sh equity | 57317 | 62520 | 70590 | 78757 | 88887 |
| Risk weighted assets | 48240 | 49821 | 57884 | 66681 | 77249 |
| Est non-perf loans | n/a | n/a | n/a | n/a | n/a |
| Specific provisions | -549.4 | -709.8 | -775.9 | -837.6 | -914.0 |
| 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 | 48240 | 49821 | 57884 | 66681 | 77249 |
| Reported net profit | 1524 | 1635 | 1961 | 2276 | 2549 |
| Opening risk assets | 63582 | 48240 | 49821 | 57884 | 66681 |
| Closing risk assets | 48240 | 49821 | 57884 | 77249 | 0.00 |
| Change in risk assets | -15342 | 1581 | 8063 | 19366 | -66681 |
| Capital required | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Free capital flow | 1524 | 1635 | 1961 | 2276 | 2549 |
| Ordinary dividend paid | -1299 | -1588 | -1515 | -1605 | -1810 |
| Share buy back/spec div | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Equity / preference issue | 1615 | 0.00 | 1615 | 0.00 | 0.00 |
| Cash flow from financing | 315.5 | -1588 | 99.9 | -1605 | -1810 |
| Net capital flow | 1839 | 47.5 | 2060 | 670.2 | 739.5 |
| Tier 1 capital | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Company data, Rasmala forecasts

year to Dec

| Standard ratios | Comm Bank of Qatar | | | | | QNB | | | QIB | | |
|---------------------------|--------------------|--------------|--------------|--------------|--------------|--------------------------|--------------|--------------|--------------|--------------|--------------|
| Performance | FY09A | FY10A | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F |
| Non-int inc/gr op inc (%) | 31.7 | 27.0 | 30.6 | 30.4 | 31.2 | 23.9 | 24.3 | 24.9 | 27.3 | 27.7 | 27.0 |
| Cost/income (%) | 31.2 | 32.3 | 32.0 | 33.0 | 33.0 | 18.6 | 19.6 | 20.6 | 25.9 | 26.4 | 26.9 |
| Costs/average assets (%) | 1.28 | 1.31 | 1.34 | 1.35 | 1.53 | 0.63 | 0.65 | 0.80 | 1.06 | 1.02 | 1.21 |
| Net income growth (%) | -12.5 | 7.33 | 19.6 | 16.1 | 12.0 | 18.2 | 25.4 | 14.9 | 20.4 | 20.5 | 14.9 |
| Net cust loan growth (%) | -5.81 | 5.13 | 16.2 | 15.2 | 15.8 | 19.5 | 19.9 | 20.2 | 18.3 | 19.1 | 18.3 |
| Cust deposit growth (%) | -19.2 | 28.3 | 15.2 | 15.4 | 16.1 | 17.9 | 19.0 | 18.3 | 15.9 | 19.1 | 18.3 |
| Net interest margin (%) | 3.29 | 3.69 | 3.67 | 3.50 | 3.89 | 3.00 | 2.78 | 3.25 | 3.62 | 3.35 | 3.92 |
| Return on avg assets (%) | 2.29 | 2.73 | 2.95 | 2.87 | 3.24 | 2.74 | 2.65 | 3.07 | 2.84 | 2.72 | 3.15 |
| Return on avg equity (%) | 14.1 | 15.2 | 16.4 | 16.6 | 18.7 | 21.8 | 18.2 | 21.1 | 17.2 | 17.1 | 19.6 |
| RORWA (%) | 2.43 | 3.34 | 3.64 | 3.38 | 3.82 | 5.49 | 5.20 | 6.20 | 3.87 | 3.62 | 4.19 |
| | | | | year to Dec | | | year to Dec | | | year to Dec | |
| Valuation | | | | | | | | | | | |
| Normalised EPS growth (%) | -35.0 | 20.7 | 14.4 | 11.2 | 12.0 | 18.2 | 25.4 | 14.9 | 16.4 | 15.4 | 14.9 |
| Reported PE (x) | 13.7 | 12.8 | 11.2 | 10.0 | 8.96 | 11.9 | 9.46 | 8.23 | 12.3 | 10.7 | 9.30 |
| Normalised PE (x) | 15.4 | 12.8 | 11.2 | 10.0 | 8.96 | 11.9 | 9.46 | 8.23 | 12.3 | 10.7 | 9.30 |
| Price/book value (x) | 1.91 | 1.87 | 1.72 | 1.63 | 1.55 | 1.98 | 1.70 | 1.47 | 1.91 | 1.78 | 1.66 |
| 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 (%) | 6.36 | 7.78 | 6.80 | 7.21 | 8.13 | 2.49 | 2.47 | 2.75 | 5.54 | 5.56 | 6.82 |
| | | | | year to Dec | | | year to Dec | | | year to Dec | |
| Per share data | FY09A | FY10A | FY11F | FY12F | FY13F | Solvency | FY09A | FY10A | FY11F | FY12F | FY13F |
| Tot adj dil sh, ave (m) | 226.8 | 226.8 | 237.1 | 247.4 | 247.4 | Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Pre-prov prof/share (QAR) | 7.37 | 7.26 | 8.00 | 8.82 | 9.86 | Total CAR (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported EPS (QAR) | 6.57 | 7.05 | 8.06 | 8.97 | 10.0 | Equity/assets (%) | 18.6 | 17.5 | 18.4 | 17.3 | 16.2 |
| Normalised EPS (QAR) | 5.84 | 7.05 | 8.06 | 8.97 | 10.0 | Net cust loans/dep (%) | 119.9 | 98.2 | 99.0 | 98.8 | 98.6 |
| Book value per sh (QAR) | 47.1 | 48.1 | 52.5 | 55.2 | 58.2 | Rep NPL/gr cus adv (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend per share (QAR) | 5.73 | 7.00 | 6.12 | 6.49 | 7.31 | Tot prov/rep NPLs (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend cover (x) | 1.05 | 1.03 | 1.29 | 1.42 | 1.41 | Bad debts/advances (%) | 1.42 | 0.49 | 0.34 | 0.30 | 0.30 |
| | | | | year to Dec | | | | | | year to Dec | |

Priced as follows: COMB.QA - QR90.00; FGB.AD - Dh17.80
Source: Company data, Rasmala forecasts

Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|--------------------------|---------------|----------------------|--------|---------------|--------|
| Explicit Dividends | Net CF to shareholders | | 1,588 | 1,515 | 1,605 | 1,810 |
| | NPV Stage 1 | 5,603 | 5,603 | 4,443 | 3,241 | 1,810 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 790 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 5,644 | 18% | 14% | 13,608 | 77,249 |
| | NPV Stage 2 | 4,748 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 62,391 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 16,720 | 12% | 5% | 50,447 | |
| Total NPV | Stage 1 (2010-2013) | 5,603 | COE | | | |
| | Stage 2 (2014-23) | 4,748 | US RFR | 2.56% | | |
| | Stage 3 (2024+) | 16,720 | Country Risk Spread | 4.00% | | |
| | NPV | 27,071 | Sector Risk Spread | 2.50% | | |
| | Shares | 247 | Stock Spread | 1.60% | | |
| | | | Discount Rate | 10.66% | | |
| | Price Target | 109.40 | | | | |
| | Price | 90.00 | | | | |
| | Upside/(Downside) | 22% | | | | |

Source: Company data, Rasmala forecasts

Company description

Commercial Bank of Qatar (CBQ), established in 1975, is the country's second largest bank with a loan market share of 11% by value and a distribution network of 32 branches (24 conventional and eight Islamic). Although the bank provides retail, Islamic, and investment banking services, the bulk of its revenues continue to come from corporate banking. The bank actively seeks inorganic growth within the MENA region and currently owns 40% of UAE based United Arab Bank (UAB) and 34.9% of National Bank of Oman (NBO), as well as operating exclusive Diners Club franchises in Qatar, Oman and Egypt.

Buy Price relative to country



Strategic analysis

Average SWOT company score: **3**

Revenue split FY10

Strengths **4**

An established brand, physical franchise and strong corporate relationships are key strengths of CBQ. We believe that CBQ has the best corporate banking product team in Qatar. It has also long experience (with NBO) of exporting expertise to associates.

Weaknesses **3**

CBQ is poorly positioned for growth, with weak exposure to the public sector. In addition, with consumer, real estate and construction accounting for 50% of the loan book, CBQ is one of the more cyclical stocks in Qatar.

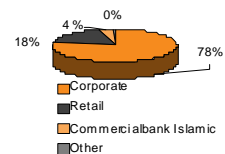
Opportunities **3**

The primary issue is whether CBQ can capture public sector growth, using its strengths in loan structuring to offset its weakness in relationship banking. In addition, utilisation of excess capital to fund future loan growth, increasing associate revenue synergies are main opportunities.

Threats **3**

The main challenge for CBQ is to make sure it gets its share of growth. To this end, it is currently aiming to take a slice of public sector lending. Meanwhile, QNB is expanding its operations into CBQ's home patch.

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



Source: Company report

Market data

Headquarters

Commercial Bank Plaza, 380 Al Markhiya street, 60 Al Dafna Area, P.O. Box 3232, Al Doha, Qatar

Website

www.cbq.com.qa

Shares in issue

247.4m

Freefloat

85%

Majority shareholders

Qatar Investment Authority (9%), Qatar National Bank (3%), Ali Hussein Al Fardan (2%)

Competitive position

Average competitive score: **3+**

Broker recommendations

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 local Government ownership in most banks coupled with branch limits for foreign banks keeps barriers to entry high.

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 on the rise, but it is currently unclear to what extent Qatar will favour its own banking system.

Rivalry **4+**

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

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



Source: Bloomberg

28 January 2011

Initiation of coverage

Hold

 Target price
 QR63.19

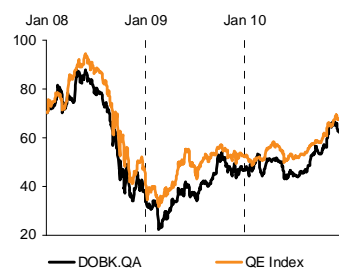
 Price
 QR62.60

 Short term (0-60 days)
 n/a

 Market view
 No Weighting

Price performance

| | (1M) | (3M) | (12M) |
|----------------|-------|-------|-------|
| Price (QR) | 64.90 | 53.80 | 47.70 |
| Absolute (%) | -3.5 | 16.4 | 31.2 |
| Rel market (%) | -6.3 | 1.1 | -4.9 |
| Rel sector (%) | -7.7 | -1.2 | -12.4 |


Market capitalisation

QR12.94bn (€2.61bn)

Average (12M) daily turnover

QR16.38m

 Sector: QE Bank Index
 RIC: DOBK.QA, DHBK.QD
 Priced QR62.60 at close 24 Jan 2011.
 Source: Bloomberg

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Doha Bank

Seeking growth

Given Doha Bank's primary exposure to the overleveraged Qatari retail segment, it is no surprise that Doha Bank is facing growth challenges. We believe it will have some success in diversifying revenues and that it will gain from renewed private sector growth, but not enough to justify a higher rating.

Key forecasts

| | FY09A | FY10A | FY11F | FY12F | FY13F |
|---------------------------|-------|-------|-------|-------|-------|
| Reported PTP (QRm) | 974.5 | 1,013 | 1,203 | 1,450 | 1,657 |
| Reported net profit (QRm) | 973.6 | 1,054 | 1,203 | 1,450 | 1,657 |
| Reported EPS (QR) | 5.01 | 5.20 | 5.90 | 6.82 | 7.79 |
| Normalised EPS (QR) | 5.01 | 5.20 | 5.90 | 6.82 | 7.79 |
| Dividend per share (QR) | 4.77 | 5.00 | 4.30 | 5.04 | 4.66 |
| Normalised PE (x) | 12.50 | 12.00 | 10.60 | 9.18 | 8.04 |
| Price/book value (x) | 2.41 | 2.33 | 2.12 | 2.00 | 1.82 |
| Dividend yield (%) | 7.62 | 7.99 | 6.87 | 8.06 | 7.44 |
| Return on avg equity (%) | 21.70 | 21.10 | 21.50 | 22.10 | 25.60 |

Accounting standard: IFRS

Source: Company data, Rasmala forecasts

year to Dec, fully diluted

Returns reach sector average, but assisted by higher levels of gearing

Doha Bank's ROTCE of 18.2% in 2010 is in line with the sector average of 18.5%, albeit assisted by higher gearing. However, we believe ROAs are likely to remain below average (at 2.35% in 2011), due to a higher-than-sector cost-income ratio and provisioning margin – an occupational hazard for more consumer-focused banks (32% loans in 2010). This has been only partly offset by stronger spreads, and fee and commission income.

Loan growth and asset quality to improve during 2011F

Loan growth in 2009-10 was driven by commercial and contracting loans, with the bank's main sectoral exposures, personal and real estate lending (2008: 59% of the loan book) declining. We expect growth prospects for Doha Bank to remain fairly limited, although the bank aims to broaden its proposition into the growth areas associated with government spending. We expect 4% loan growth in 2010 to be followed by just 10% in 2011.

Balance sheet concerns limited to capital adequacy

Doha Bank's NPL ratio is significantly above the average of its peers, at 3.0% on a net basis, and we expect it to remain above this level throughout 2011 – this with a coverage ratio of just 68%. Nevertheless, with little in the way of new NPLs or write-offs, loan quality seems to be under control. Other balance sheet issues include the announced plans for US\$750m of debt issuance in 1Q11.

Valuation and recommendation

Doha Bank trades at a discount to the market, with price multiples of 2.3x 2010 book and 10.6x 2011F earnings. Although Doha Bank has a strong stable ROTCE, the lower growth rate it is likely to face remains a key impediment for a further rerating, in our view. The stock offers investors a strong dividend yield (8.0% 2010). For our DDM valuation, we assume a discount rate of 11.1% and an exit ROE of 22%, and calculate a target price of QR63.2, suggesting less than 1% potential upside from the current price of QR62.60.

Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

| EPS (QR) | Ours | Cons | % diff |
|----------|------|------|--------|
| 2011F | 5.90 | 6.65 | -11.28 |
| 2012F | 6.82 | 7.86 | -13.26 |
| 2013F | 7.79 | 8.61 | -9.52 |

Source: Bloomberg, Rasmala forecasts

Catalysts for share price performance

We believe the main catalyst is likely to be greater visibility of private sector recovery, to which Doha Bank is primarily exposed. The loan growth rate for 2010 was just 4%, and any progress for the share price is likely to be contingent on visibly getting this back into decent double digits for 2011F. According to a government announcement, we are also likely to see a bond issue and a capital raising (private placing) in 1H11, with the latter resulting in some dilution.

Earnings momentum

Our primary forecast is for modestly rising ROTCE from 2010 to 2012, reflecting a recovery in ROATA, but a decrease in leverage as a result of a capital raising, due to the announced Qatar Investment Authority (QIA) 10% capital injection. The increase in ROATA, though, is primarily due to an expected reduction in the provisioning margin and higher non-interest income as revenue diversification gains some traction. Consequently, with ROTCE stable at 20%, we believe the primary driver of earnings momentum will be balance sheet growth.

In detail, for 2011 we expect the benefit of falling interest rates to come to an end, resulting in net interest income growth slipping to 7%. However, we expect a small recovery in investment income and a substantial decline in provisioning to drive a 14% increase in earnings. Going into 2012-13, we expect 20% and 14% net income increases, aided somewhat by a decline in the provisioning margin in 2012F.

Valuation and target price

Doha Bank is the second most expensive bank in Qatar at a 2010 PB of 2.3x, although that still puts it together with the main pack with all the banks trailing Qatar National Bank (QNB) by some margin. Given its superior ROTCE, however, it is the cheapest bank on a 2011F PE basis, at 10.6x. Our long-term forecasts (2014-24) for Doha Bank are actually for higher returns than the sector (at a sustained ROTCE of 22%), but our lower expected growth rate is limiting the upside potential. In addition, at the margin we expect the announced QIA capital injection to erode value. We believe the stock is broadly fairly valued, and assign a target price of QR63.2, indicating less than 1% potential upside from the current share price.

We calculate our target price based 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 GGM. We assume a discount rate of 11.1% and an exit ROE of 22%, which gives us a target price of QR63.19.

How we differ from consensus

We are 11% and 13% below the Bloomberg EPS consensus for 2011-12. However, the latter is affected by the QIA private placement, which we do not believe has yet been reflected in consensus forecasts, and the net profit differential in our forecasts vs consensus is limited to just 1% in both years.

Risks to central scenario

We believe the main positive risk for share price performance would be that Doha Bank can demonstrate rapid growth without damaging or while enhancing profitability. The key to rapid growth would be a much stronger recovery of private sector lending than expected or significant success in penetrating the public sector. In addition, Doha Bank has implemented a number of self-help strategies to diversify its revenue base, and these could in principle be much more successful than we currently forecast.

On the downside, our concern is that the profitability of retail banking could be undermined by increased competition in a low-growth environment. In addition, trade finance is an important source of revenue for Doha Bank and, while it has been strengthening its operations in the area, better funded competitors may make this a target area.

Forced ranking*

| Company | Rec | Upside/downside |
|---------|------|-----------------|
| QNB | Hold | 7% |
| QIB | Hold | 8% |
| CBQ | Buy | 22% |

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: Rasmala forecasts

Key events

| Date | Event |
|----------|--------------|
| 19/04/11 | 1Q11 results |

Source: Company

Key assumptions and sensitivities

Of course it is the discount rate which our valuation is most exposed to, but forecast uncertainty is a greater differentiator – particularly the lower growth rates, higher capital efficiency and higher level of underlying profitability.

Discount rate is the main source of valuation uncertainty

The discount rate is by far the greatest cause of valuation uncertainty, with a 1 percentage point change in the discount rate driving up the price target by 15.3% or down by 11.2%, in our model. We attribute a 2% stock spread for Doha Bank as part of the valuation, which makes its discount rate 1% higher than QNB's, and a negative impact for valuations, although we think the difference is justified by the greater volatility of earnings.

For forecasts, the main factors are growth, capital and ROTCEs

- **Growth** – Our loan growth forecasts for Doha Bank are the weakest in the sector; we forecast a growth rate of 10% and then 14% for the time periods 2011 and 2012-23, reflecting primarily Doha Bank's weaker position in public sector lending. Taking as our benchmark a growth rate of 15% throughout the period, this would suggest an underperformance of a cumulative 15%, weighted towards the near term. As a rough estimate, this lower growth rate has about an 8% impact on our target price.
- **Capital** – Capital adequacy is quite tight at Doha Bank, and this is exacerbated by the high payout ratio. We believe the QIA 10% capital injection in 2Q11 should be enough to see the stock through to 2013, but announcements indicate this will be done at the original price, or a 35% discount to the current market value. Should this happen at the current market value, this would add 3% to our target price. In the longer term, we assume an 11% equity-to-RWA ratio, although the sensitivity to that is difficult to measure, as increased capital gearing would also suggest changes to sustainable ROTCE.
- **ROTCE** – In the short term, we forecast roughly a 20% ROTCE, broadly unchanged from current levels. In the long term, we assume a higher potentially level of gearing will enable a higher ROTCE of 22%. The valuation is not really sensitive to this issue of the gearing/ROTCE balance, but is sensitive to the absolute level of profitability for a fixed gearing level. Our 22% forecast stands at a 1ppt discount to QNB, a 2ppt premium to Qatar Islamic Bank (QIB) and a 4ppt premium to Commercial Bank of Qatar (CBQ), with each percentage point correlating to a 3% impact on the target price.

Terminal value assumptions

We set a standard 12% ROTCE and 5% growth rate across the sector in the very long term (2024+), effectively lowering the exit book value multiple to a little over 1x. A 1ppt change in ROTCE would have a 5% impact on the target price, but we do not differentiate between the banks over this time period.

Executive summary

Other than QNB, Doha Bank is the most profitable of the four Qatari banks we cover, as a result of its higher gearing. However, it looks poorly positioned to take advantage of public sector growth, and the valuation already reflects the higher profitability.

Critical assumptions and value

Doha Bank's higher ROTCE driven by greater leverage

There are certainly things to like about Doha Bank, chief of which is the high level of profitability, driven particularly by strong revenue margins and a structurally higher level of leverage due to the absence of substantial associates. Nevertheless, we see Doha Bank as being in an awkward position waiting for growth, without the ability to aggressively pursue public sector opportunities. We already see some earnings recovery (ROA rising from 2.18% in 2010 to 2.76% in 2012) and an increase in ROTCE (18.2% in 2010 to 22.4% in 2012F) even after the QIA capital injection, but we believe these are already priced in, driving our Hold recommendation.

Growth assumptions weak

Retail and SME bank

Of the Qatari banks we cover, we are least optimistic about growth for Doha Bank. This is driven primarily by Doha Bank being very significantly exposed to the personal lending market and mid-tier corporates. We believe the former is dependent on government salaries and regulation, which have been on a tightening trend, while the latter will be dependent on the trickle-down of public sector spending. As a result, we expect loan growth to rise to just 10% in 2011, significantly below its peers, after just 4% growth in 2010.

Returns stable at a high level

Declining provisioning likely to boost ROTCE

Although we have some concern that lower growth and reduced risk may mean increased competition in the retail and mid-tier corporate segments, we expect an improvement in core earnings lines, such as fees and commissions. The other area of potential improvement in the medium term is the provisioning margin, which we expect to nearly double the Qatar average in 2011F at 9.9%, but we think it should show declines after that.

Calculated spreads, by contrast, were very strong throughout 2010, rising to 4.56% for FY10, against 3.16% in 2008 and 3.60% in 2009. We believe this is driven by risk-based asset pricing, timing effects and the modelling complications of a build-up in cash, which may well be reversed. Consequently, we expect declines going forward. On balance, we assume the positive issues are likely to dominate, and overall we see a stable to rising ROTCE in spite of the QIA capital injection.

Balancing upside growth risk, against downside return risk

The most likely area where we may have been too conservative is in our growth forecasts. We forecast slow growth not only in the short term, but also at a below-market rate of 14% until the end of stage 2 of our three-stage DDM (2024). We do not see any reason why Doha Bank should outperform the market when it comes to growth, though, aside from the possibility that the government may decide to increase self-finance and reduce public sector leverage.

Current benefits of high gearing and superior spreads may not be sustainable differentials

Meanwhile, we do have some concerns about ROTCE. The ROATA is currently significantly below the average for the sector, but as outlined earlier should rise to around the sector average, with high revenue margins being offset by higher costs and higher mid-cycle provisioning levels. Consequently, the superior ROTCE is driven by the higher gearing level, and we expect this differential to narrow over coming years with, for example, CBQ using its excess capital to fund growth. In addition, if spreads were to decline to 2007 levels, we estimate the impact on 2012 or 2013 earnings would be to lower them by 20%.

Valuation and conclusion

On our forecasts, cheap on earnings multiples, expensive on book multiples

Doha Bank is the cheapest bank we cover on a 2011F PE basis, with a forecast sustainable 20%-plus ROTCE as well as the highest 2010 dividend yield (8.0%). Nevertheless, we believe Doha Bank's higher leverage flatters its returns, and the bank looks structurally disadvantaged when it comes to growth. In addition, we have some concerns about the sustainability of spreads, as well as the more cyclical nature of the bank, leading us to ascribe a slightly higher discount rate. Although a faster growth recovery may well indicate upside from current valuations, we need greater visibility on this, spread sustainability and revenue diversification before reviewing our forecasts. Our recommendation is Hold, with a QR63.2 target price.

Figure 1 : Dupont analysis

| STAGE ONE | STAGE TWO | STAGE THREE | STAGE FOUR | STAGE FIVE | ADDITIONAL COMMENTS |
|-------------------------|-------------------------|-------------------------------|------------------------------|-----------------------------------|-------------------------|
| ROTCE | Tangible Gearing | Tier 1 ratio | TCR | | |
| '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| 19.5% 18.2% 20.9% 22.4% | 9.34 9.28 7.92 8.28 | 11.5% 11.0% 12.1% 11.2% | 14.4% 13.6% 14.1% 13.1% | | |
| 18.9% 18.5% 18.8% 18.8% | 7.36 7.87 6.49 6.49 | 14.8% 15.1% 18.0% 16.9% | 15.9% 16.2% 18.8% 17.6% | | |
| | ROATA | IEA / TA | Loans / IEAs | | |
| | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| | 2.20% 2.18% 2.45% 2.77% | 74.2% 74.9% 82.8% 85.0% | 75.9% 75.0% 72.5% 72.5% | | |
| | 2.79% 2.68% 2.69% 2.69% | 81.9% 78.2% 83.3% 84.2% | 70.5% 72.1% 69.4% 70.4% | | |
| | | Revenue / average IEAs | Interest Margins | Spreads | |
| | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 4.49% 5.09% 5.45% 5.67% | 3.48% 4.33% 4.34% 4.41% | 3.60% 4.56% 4.50% 4.40% | |
| | | 4.91% 4.62% 4.79% 4.79% | 3.57% 3.86% 3.69% 3.69% | 3.52% 3.88% 3.70% 3.70% | |
| | | | Non II / average IEAs | F&C to ave IEAs | |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | | 1.32% 1.28% 1.40% 1.48% | 1.05% 0.98% 1.02% 1.09% | |
| | | | 1.46% 1.21% 1.30% 1.30% | 1.03% 0.84% 0.87% 0.90% | |
| | | | | Other revenues to ave IEAs | |
| | | | | '09 '10 '11 '12 | |
| | | | | 0.27% 0.30% 0.38% 0.39% | |
| | | | | 0.44% 0.37% 0.43% 0.45% | |
| | | Net Profit Margin | Op. Margin | Cost-Income Ratio | |
| | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 53.9% 48.1% 53.1% 55.2% | 62.6% 64.7% 64.5% 65.0% | 37.4% 35.3% 35.5% 35.0% | |
| | | 66.5% 64.3% 67.2% 67.2% | 70.8% 72.3% 72.0% 71.5% | 29.2% 27.7% 28.0% 28.0% | |
| | | | Provn Margin | Net Provisioning | NPL ratio |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 |
| | | | -7.2% -15.2% -9.9% -8.2% | 0.52% 1.18% 0.80% 0.70% | 2.28% 3.02% 3.20% 3.00% |
| | | | -8.3% -8.0% -5.5% -4.5% | 0.58% 0.60% 0.44% 0.44% | 1.78% 1.76% 1.75% 1.75% |
| | | | XYZ Margin | | |
| | | | '09 '10 '11 '12 | | |
| | | | -1.5% -1.4% -1.5% -1.6% | | |
| | | | 4.0% -0.1% 0.7% 0.5% | | |

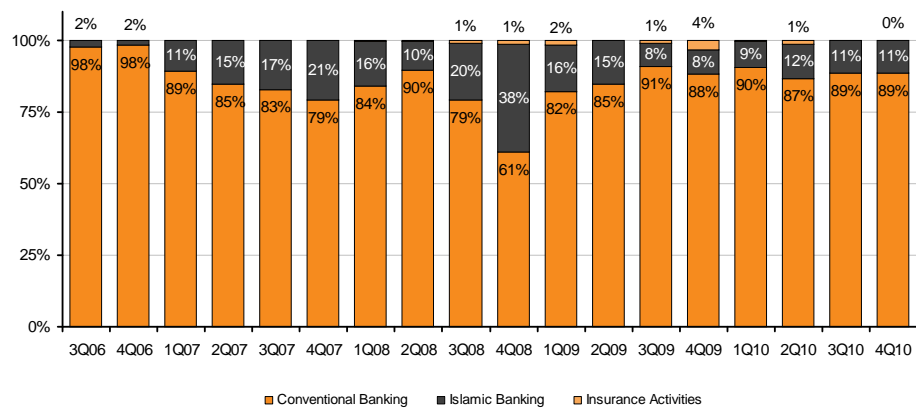
Source: Company data, Rasmala forecasts (FY11-12)

Diversified retail bank

With the loan book being skewed to the weak retail and SME sectors, Doha Bank will have to look elsewhere for short-term growth in its core business. Secondary divisions include Islamic banking and insurance, although the contribution remains limited.

Doha Bank is Qatar's fourth largest bank with an 8.2% market share (4Q10) of customer loans. Its operations relate primarily to conventional banking. However, it also includes an Islamic Banking division, known as Doha Islamic, and an insurance operation, which combined contribute about 11% to pre-tax profit. Doha Bank operates through 36 domestic branches, including four Islamic banking branches serving 160,000 retail and 3,000 corporate customers.

Chart 1 : Pre-tax profit, split by division



Source: Company data

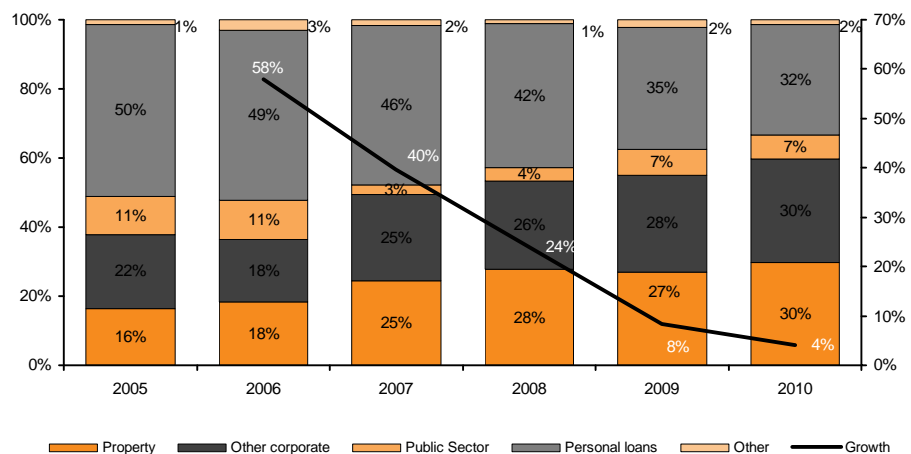
High personal lending exposure

In terms of balance sheet exposure, personal lending accounts for 32% of customer loans. Although this is much reduced from 2005 levels of 50%, nevertheless Doha Bank's exposure to the segment is still more than 50% higher than that of the larger Qatari banks that we cover. We believe the weaker growth of personal lending over recent years has been a significant factor limiting expansion for Doha Bank.

SME product line also a differentiator

The other significant differentiator for Doha Bank from its peers has been the dedicated small and medium-size enterprise (SME) offering within its wholesale banking operation. Most recently, Doha Bank has sought to expand in this area, launching a supply chain financing initiative to supplement its already well-established trade finance operations. We believe this will be an area of above-market growth, but ultimately the contribution of SME lending will always be limited.

Chart 2 : Loan book split, loan growth



Source: Company data

Indian brokerage operations was the first step in internationalisation

Beyond domestic banking operations, Doha Bank owns a 49% stake in Doha Brokerage & Financial Services of India, which it acquired in 2007 as a first step in a now shelved QR1bn financial services acquisition spree. In addition, the commercial banking operation has three international branches in the UAE, Kuwait and the US. These and the six rep offices provide support for Doha Bank's estimated 17% market share in trade finance, as at end-2010.

New strategic direction

Given the continued weakness of loan growth in Doha Bank's preferred sectors, we believe it is clear the bank needs to expand beyond its core franchise. In addition to attempts to gain a foothold in public sector lending, Doha Bank has emphasised an interest in developing SME financing, high net worth (HNW) banking, and expanding its international network. Doha Bank is also aiming to find its feet in the elusive Islamic banking market, in which it has so far failed to gain traction.

SME financing

In 2009, Doha Bank launched Tatweer, its SME financing solution, with a targeted focus on supply chain financing. In particular, Doha Bank has focused on providing products such as invoice discounting, and further strengthening its trade finance operations, although the bank already punches above its weight with an estimated 17% market share for 2010. Other banks competing in the space include Qatar's National Development Bank and Qatar National Bank (QNB), although it is a small operation within QNB.

The SME sector has been poorly served, in our view

The SME sector has generally been poorly served, in our view, as there are structural issues preventing an adequate level of service, such as weak contract structures and poor business visibility. Nevertheless, in anticipation of the SME sector absorbing a portion of the labour market, we believe it has political backing. In addition, we expect lending to the segment to be highly profitable, although this profitability may also prove to be more cyclical.

Early indications have been positive, with a 2008-10 commercial lending CAGR of 29% yoy, amounting to 77% of total loan growth over the two-year period. However, this may be a growth spurt reflecting the underserved nature of the market place. Although commercial lending does not necessarily equate to SME lending, we believe there is a degree of correlation.

Building the Al Riyada Private Banking operation

Private Banking is also an area of expansion

Keen on leveraging its retail brand name, branch network and relationship managers, another area of development is the HNW segment. The private banking division promises to offer a tailor-made wealth management service with the introduction of various new investment schemes. So far Doha Bank has not announced much more than a platinum credit card. However, the stated plan is certainly to move beyond vanity products with red carpet service, and build a full wealth management product portfolio targeting Qatari nationals and expatriates with at least US\$1m of investible assets.

Doha Islamic focuses on building a brand image

Doha Islamic yet to find real traction

Doha Islamic has a total of four Islamic branches and now contributes 11% of the total consolidated loan book. Despite the Islamic unit maintaining above-sector average ROE and ROA, we believe it continues to suffer from a lack of brand identity in the local market. With its peers gaining market share, launching new products and going international, Doha Islamic has been slow in capitalising on the opportunity and is now focused on the necessary restructuring, creating a brand, while also partnering with other Islamic institutions for the development of new Islamic products.

International expansion to spur off-balance-sheet growth

International exposure mostly a driver of outsized trade finance operations

Doha Bank's international footprint encompasses representative offices in Turkey, Singapore, Romania, Japan, China, South Korea and the UK (London), in addition to branches in Kuwait, Dubai and the US (New York). The strategy is to grow the off-balance-sheet book by capitalising on the opportunity to foster business with countries that have trade links with Qatar and the Gulf Cooperation Council (GCC). Doha Bank is now seeking banking licences in Saudi Arabia and Bahrain. In addition, we believe an expansion into the Indian banking market through its existing brokerage network remains a possibility, although management has not definitively confirmed this.

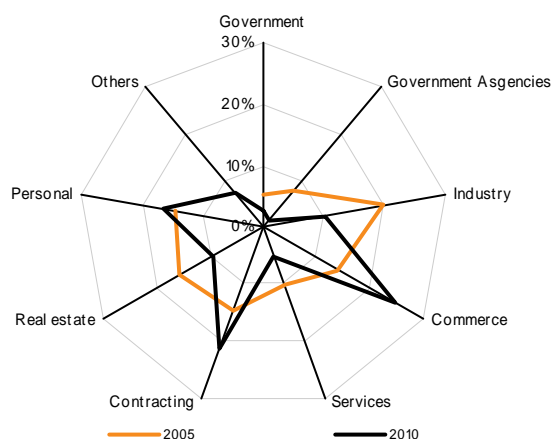
Structural growth issues for Doha Bank

Consumer lending exposure has not been a positive for growth

Exposed to slower growth retail and property segments

Given retail lending for the system as a whole has grown only 53% cumulative across 4Q05-3Q10, Doha Bank's strong position in the segment has not stood it in good stead. Initially, Doha Bank made up for this with its rapid expansion into property lending. However, this diversification counted against it in 2009, with personal lending and real estate lending (combined amounting to 50% of the loan book) declining by 8.8% and 11%, respectively. As a result, Doha Bank has seen its market share shrink from 11.9% in 2005 to 8.2% as at 4Q10.

Chart 3 : Market share, by loan category



Source: Company data, Central Bank monthly indicators

Islamic banking not yet found its niche

Islamic operation not adding significantly to growth

Other initiatives have included international expansion, as well as the still relatively new Islamic banking operation. However, both of these have met with limited success. We believe Islamic banking is primarily a defensive strategy, and there is only limited demand from Doha Bank's client base. Islamic loans have grown in line with the balance sheet in 2010 (5% yoy), and we do not expect this to be a longer-term driver of growth.

Trade business enabled by international branches and rep offices

International branches are focused on trade business

The primary role of the international branches is to develop the trade finance business. Consequently, although the Dubai and Kuwait branches also offer personal and corporate banking products, the total size of the international loan book amounts to just 7% of the total (QR1.7bn), as at 4Q10.

Not a primary beneficiary of current public sector growth trends...

Recent trading: prioritising profitability over growth

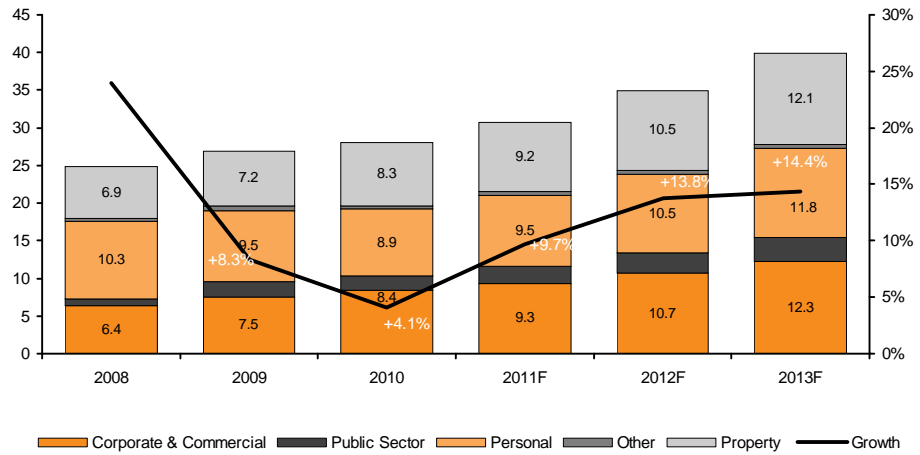
As for most of the banking sector, Doha Bank has focused on maintaining asset quality, increasing the focus on debt collection and maintaining higher interest spreads through the recent financial crisis. Loan growth has continued to slow throughout 2010, with growth slipping to 4.0% in 2010.

... although Doha Bank will benefit from any trickle through

We do expect some level of recovery in 2011, as trickle-down continues and immigration resumes, but ultimately we do not think Doha Bank will be the first beneficiary of recovering loan growth. We are hopeful that the SME initiatives in particular will find unmet need, but we remain uncertain about the scope of the opportunity.

Beyond 2010-11, we expect growth to return to a more symmetrical path. We expect public sector growth to continue, although we expect to see some private sector growth recovery as returns to the labour market, immigration picks up and wages begin to make further progress. We also believe that some parts of the retail client base are currently mid-way through a two- to three-year deleveraging process. As those segments work through their over-leveraging issues, underlying growth in other areas should be more evident.

Chart 4 : Loan growth (QRbn)



Source: Company data, Rasmala forecasts

Funding no restriction

Capital market funding still has substantial room to grow

We expect US\$500m wholesale funding during 1Q11

In spite of the high level of liquidity, Doha Bank announced a global road show for early 2011 in advance of a US\$500m bond issue. We believe the primary intention of the issue is to lengthen the duration of the funding base and diversify it.

The bank's capital market debt currently amounts to just QR825m, after repurchases of QR405m, equivalent to 3% of the balance sheet. The debt is cheap, particularly for subordinated debt with a coupon of 3m-USD Libor +82bp with a 50bp step-up in December 2011. We believe this is hedged with an interest rate swap which expires on the same date, potentially suggesting an intention to buy back this bond in 2011, before the step-up clause.

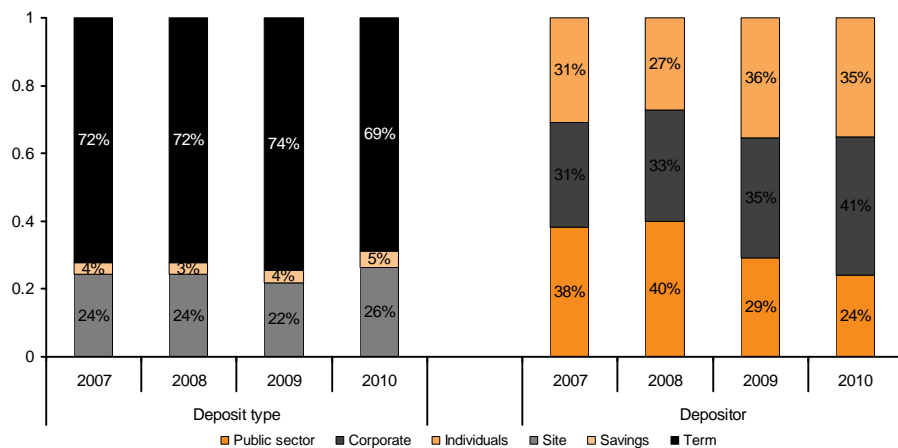
We expect Doha Bank to continue to issue debt. Although as a proportion of funding, the 1Q11 issuance will raise capital market debt to 5% of the balance sheet, there may be scope for a doubling of capital market funding, should the need arise. The more stringent central bank rules and the high level of domestic liquidity may, however, limit the practicality of this.

Deposits free to focus on lowering cost of funding

High liquidity enables a focus on low cost funding

Given the substantial cash pile at Doha Bank, amounting to 22% of the total balance sheet as at 4Q10, it is clear that funding is not likely to be any constraint on loan growth, and this is further emphasised by the 86% LDR. Consequently, the bank aims to make progress on the twin objectives of lowering the cost of funding and improving the duration of funding. The low proportion of demand deposits (relative to the system level of 30%) is likely to mean a higher cost of financing, but the high level of liquidity should enable the bank to look at addressing this.

Chart 5 : Deposit structure



Source: Company data

Higher spreads driving revenue growth

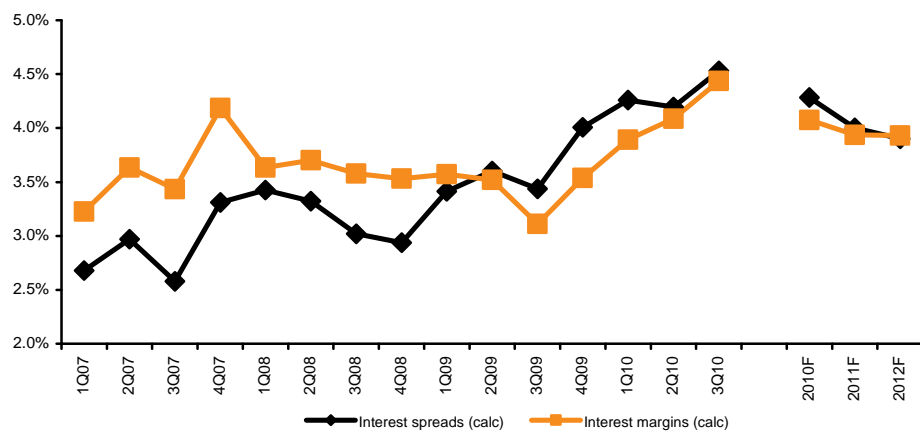
Spreads and margins

Spreads and margins are the highest in the sector, driven by consumer lending

As for the rest of the sector, the past couple of years have seen stable to rising asset yields, while liability yields have been re-priced downwards. The result has been that spreads and margins have increased rapidly. We believe this is primarily due to a temporary improvement in pricing power, as banks move to a more holistic approach of risk-based pricing, while the central bank ensures that there is sufficient liquidity in the system. Also, falling interbank rates are likely to have a positive impact on spreads as liabilities re-price downwards more quickly than assets.

Doha Bank's spreads are the highest among the banks in our coverage universe. We believe this reflects mainly the low proportion of public sector business that Doha Bank has undertaken, and the high proportion of consumer, SME and property sector business. It is also likely to be due partially to the short-duration liabilities (with long-term funding being floating rate). The largest reason, however, may relate to the modelling implications of the rapid build-up of cash balances (which are excluded from the calculation, but any returns from which are included as interest income).

Chart 6 : Spreads and margins



Source: Company data, Rasmala forecasts

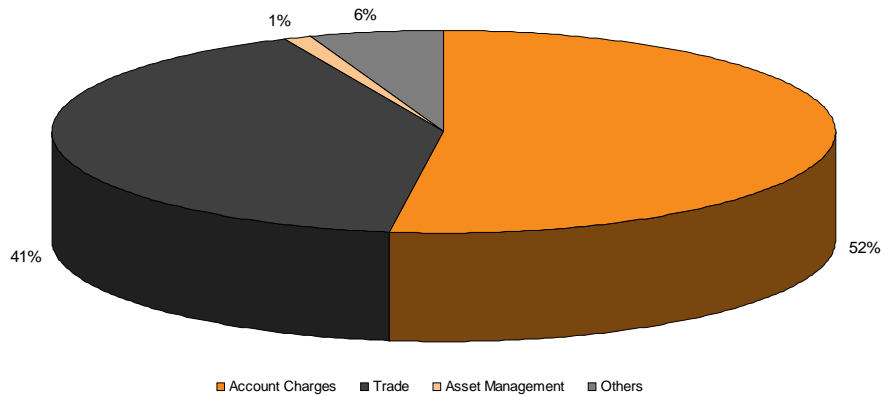
Going forward, we believe the current elevated spreads will be unsustainable. Interest income jumped sharply in 3Q10, rising 9% qoq, and this was followed by a further 3% qoq rise in 4Q10. Nevertheless, in our view, the larger issue is that as risk premiums ease, spreads may begin to slip, particularly if competition for growth intensifies. We forecast a 6bp decline in 2011, followed by a 10bp annual decline over the following two years.

Poor 2H10 fees and commissions potentially an issue

Account fees fell in 2010, although trade related fees remain strong

Fee income has been similar for all the banks barring QNB, amounting to a little over 1% of average interest earning assets. However, beyond the standard 65% or so coming from account charges (52% for Doha Bank), the source for the remainder varies considerably. In Doha Bank's case, the bulk of the remainder comes from trade finance, in line with the higher penetration of trade letters. This justifies the additional cost of four foreign branches and six rep offices.

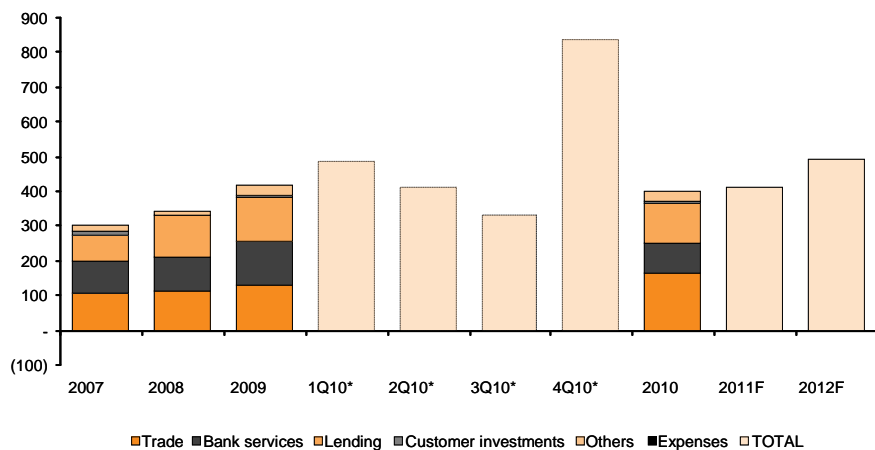
Chart 7 : Gross fees and commissions breakdown, 2010



Source: Company data

While fees and commissions have had a reliable relationship with the balance sheet in annual data, the same cannot be said of quarterly data. Fees and commissions declined 21% qoq in 3Q10, with little in the way of recovery in 4Q10. We believe this may have been driven partially by capital market fees in previous quarters, but also by weak loan arrangement fees, reflecting lower activity levels across a range of products in 3Q10. However, other competitors have noted the impact of new regulations on fees, as well as an increase in competition, suggesting to us greater longevity to the current weakness.

Chart 8 : Fees and commissions breakdown (QRm)



*quarterly data at annual rate

Source: Company data, Rasmala forecasts

We expect price regulation and higher levels of competition to affect fees going forward. Nevertheless, higher activity levels and much improved trade finance are likely to go some way to offset weakness elsewhere. Rather, the risk seems to be on the positive side that strong growth in trade letters in 2H10 will be reflected in strong trade-related fee income in 2011.

Various options for raising fee income include services and specialist financing

Further out, besides an improvement in loan origination, we believe the expansion of the SME proposition, progress in wealth management and an increase in brokerage income may offer some support to the level of fee income. We expect fees and commissions to amount to 1.5% of customer assets in 2011-12.

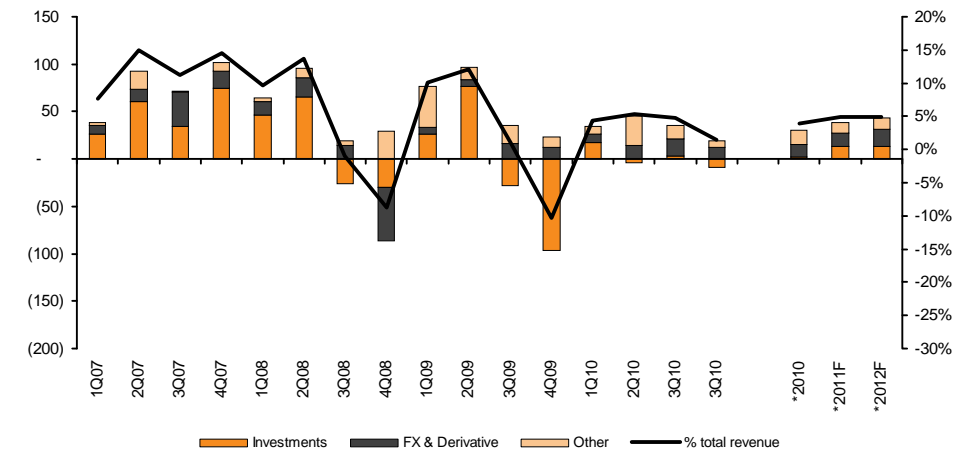
Other revenues now of even less interest

Historically, non-interest, non-fee income has been a significant contributor to revenues, amounting to more than 20% of the total in most of the 14 quarters leading up to the onset of the financial crisis. However, investment income was the primary driver of this in nearly every quarter, with gains on foreign exchange being offset largely by hedging losses on interest rate swaps (derivate losses).

Derivative losses generally obscuring FX revenues

The hedging losses are likely to continue, as suggested by the QR50m negative on the hedging reserve, although this should be compensated for by a positive on the statement of comprehensive income. Beyond 2011, however, we expect an end to derivative losses, allowing FX income to be a little more visible.

Chart 9 : Other non-interest income (QRm)



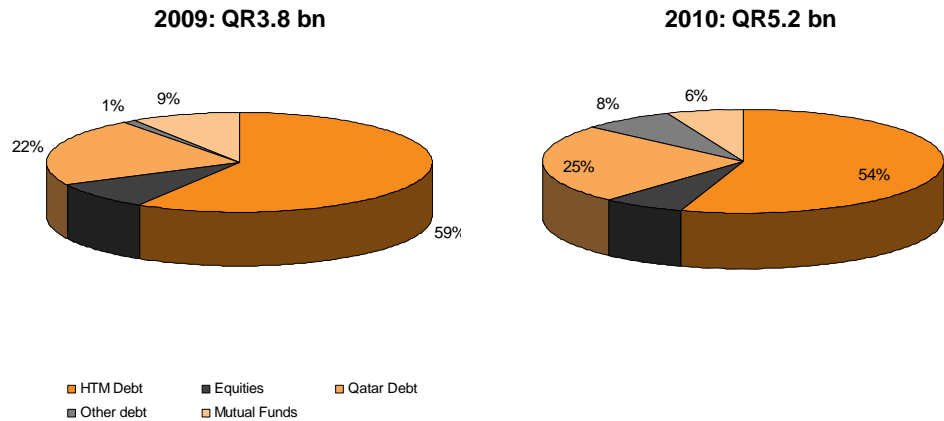
*Annual data at quarterly rate
Source: Company data, Rasmala forecasts

We see little to cause excitement in the investment book

Majority of the financial investments are low-risk, low-return

Doha Bank's financial investments book remains similar to that of CBQ with held-to-maturity (HTM) investments now accounting for 55% of the portfolio and public sector Qatari debt within the available for sale (AFS) portfolio accounting for a further 25%. Meanwhile, the equity portfolio has shrunk to just 7% of the book and mutual funds make up a further 6% only.

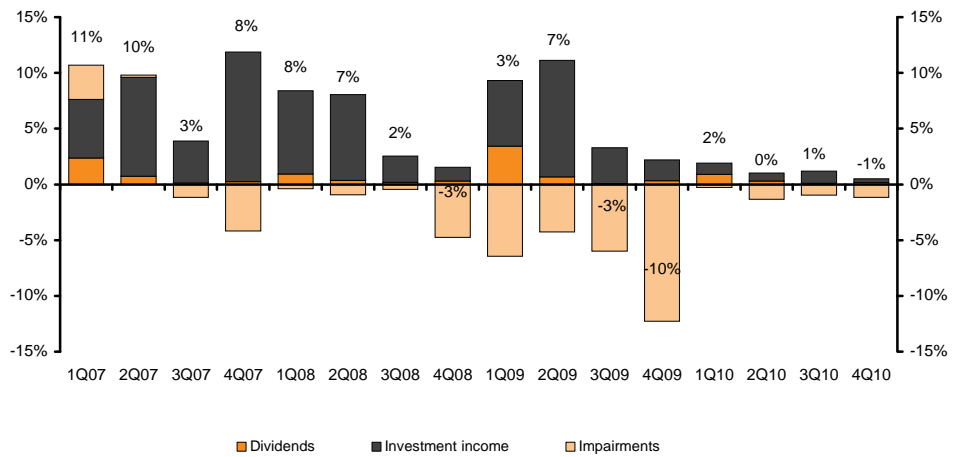
Chart 10 : Investment portfolio, HTM and AFS



Source: Company reports

With so little of the book exposed to the equity market, and even less affected by credit prices, Doha Bank had four quarterly impairments in 2009, and that really leaves little volatility in the portfolio. The fair value reserve, however, has now nearly reached breakeven, after dipping to QR492m in 4Q08 or even QR246m in 1Q09, after the equity bailout.

Chart 11 : Non-interest returns on financial assets, % (total in figures)



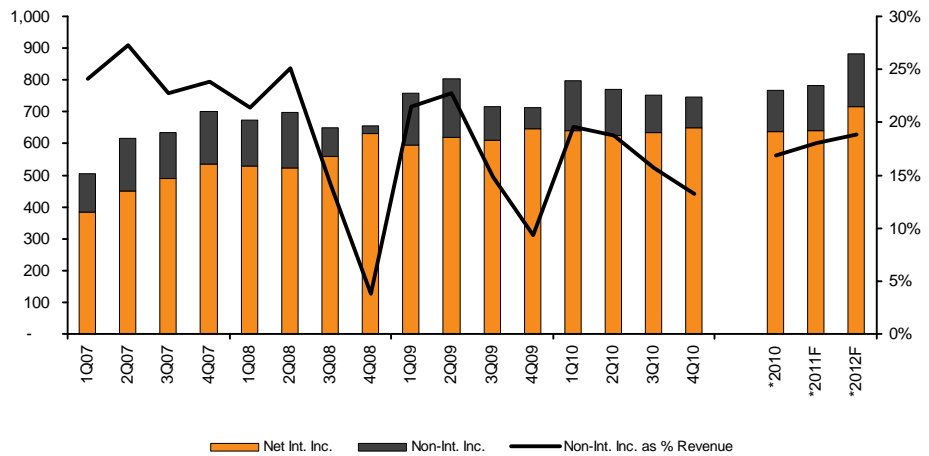
Source: Company data

Revenue structure

Non-interest income shifting from risk-based revenues to service-based revenues

For the rest of the Qatari banking sector, the majority of revenue comes from interest income. Historically, non-interest income has comprised about 25% of revenue, but much of this was risk-based revenue. Since the onset of the crisis, risk positions have been reduced sharply and the challenge has been to shift more revenues towards service-based areas. However, we still expect improved fees and commissions penetration, and foreign exchange and derivative income.

Chart 12 : Revenue split (QRm)



*Annual data at quarterly rate
Source: Company data, Rasmala forecasts

Costs remain out of line with our sector coverage universe

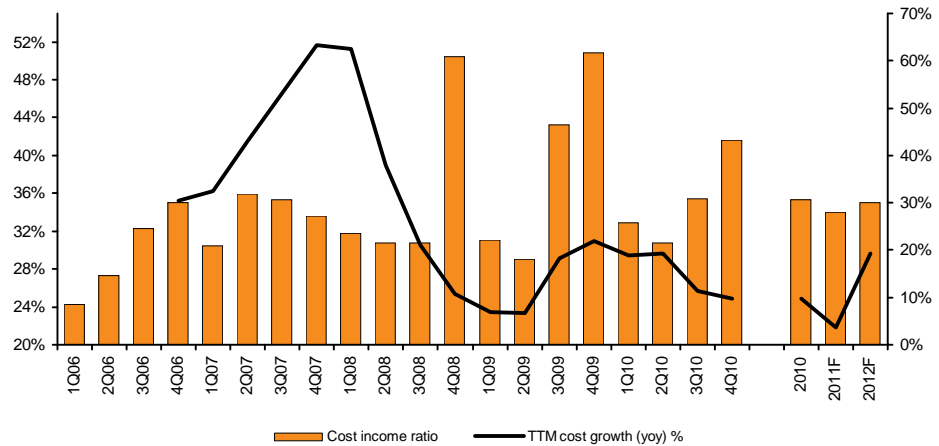
High costs driven by the high proportion of consumer lending

Doha Bank's cost-income ratios have been on the rise since 2005, although this reflects primarily a gradual decline in net investment revenue, which declined in importance from 38% of all revenue to net losses in 2009 and breakeven in 2010. Nevertheless, the cost base stands at a premium to the rest of the sector on both a cost-income basis (2010: 35.3% vs 27.7% for the sector) and a cost-to-average-assets (2010: 2.76% vs 1.64%) basis, although in both cases QNB biases those sector averages downwards. One reason is the investment in delivery channels, particularly the large branch network – a necessary evil for a smaller bank with a developed retail franchise.

Cost-income ratio to move higher

Doha Bank's cost control in 1H10 was impressive, with costs rising just 1.5% yoy and the bank highlighting a strategy of branch rationalisation over branch openings. Nevertheless, costs jumped again in 3Q and, following its well-established precedent of tail-end loading costs, there was a further spike in 4Q10. Consequently, although Doha Bank managed to achieve a respectable cost-income ratio of 31.8% in 1H, the figure for the full year was a rather less flattering 35.3%.

Chart 13 : Cost-income ratio, cost growth



Source: Company data, Rasmala forecasts

Particular areas of cost investment are likely to include the development of the private banking operation, the expansion of SME, and perhaps also product teams for servicing some of the larger clients. Franchise in-fill – building up its back-office and infrastructure capabilities – is also likely to be an issue, for which the installation of the Kondor trading system is a good example.

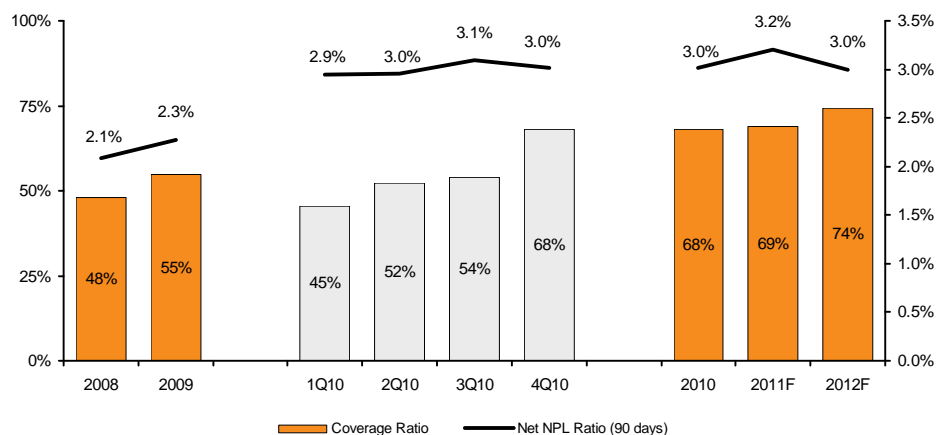
Costs to remain the highest in the sector

We don't expect to see particularly strong cost growth over the coming two years, at 8% for 2011 and 14% for 2012. Nevertheless, this represents increasing cost intensity given the low level of balance sheet growth, and we expect the cost-income ratio to remain the highest in the sector. Overall, we believe Doha Bank's cost-income ratio is a reflection of a structurally disadvantaged position, rather than a temporary anomaly.

Focus still on asset quality

Doha Bank has the highest net NPL ratio in our Qatar banks peer group, amounting to 3.0% as at 4Q10, with an estimated two-thirds relating to retail loans. NPLs have risen in fits and starts since 1Q09, although most of the deterioration occurred in 1Q10. On the positive side, retail NPLs tend to crop up early in the cycle and, consequently, it may be that the NPL ratio is nearing a peak, with retail NPLs declining into 2011.

Chart 14 : NPL and coverage ratio

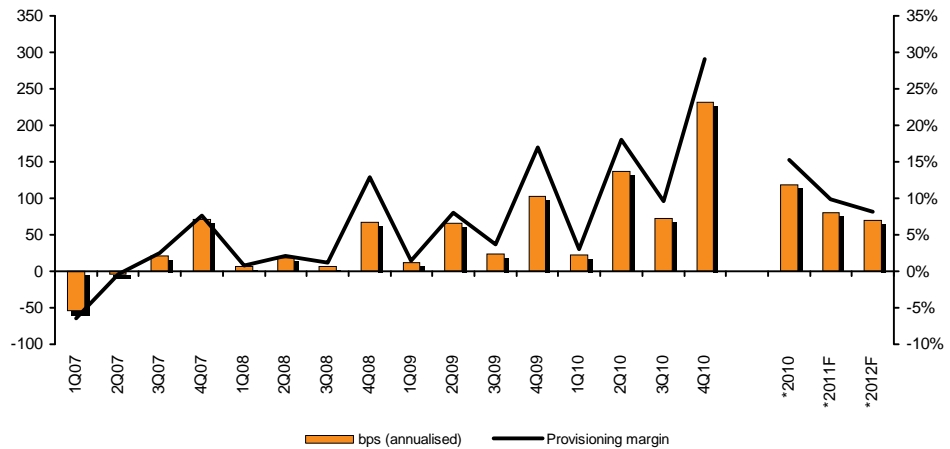


Source: Company data, Rasmala forecasts

With NPLs rising, we would have expected a sharp rise in provisioning also, and compared to the negative provisioning seen in 2006 and 9M07, that is certainly the case. Nevertheless, by international standards, a peak in provisioning of about an annualised 80bp appears to be a very mild cycle. Although this appears to be an anomaly, particularly given the coverage ratio is hovering around the 50% level, this is also a reflection of the very low level of ultimate default and, consequently, the write-off rate.

In the years ahead, we believe better loan growth and healthier economic conditions will keep NPL growth muted, with our 2013F ratio falling to 2.80%. Over the longer term, we expect NPLs and provisioning to decline only gradually, with provisioning averaging 70bp over the three years to 2013.

Chart 15 : Net provisioning, annualised bp



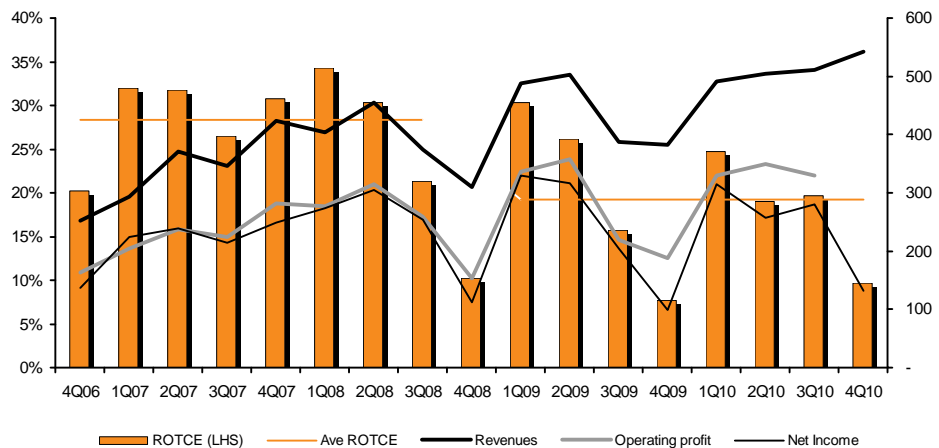
*Annual data at quarterly rate
Source: Company data, Rasmala forecasts

High ROTCE driven by leverage

Strong revenues offset by high costs: leverage driving high ROTCE

For all the discussion on performance, the primary driver of Doha Bank's higher-than-average ROTCE vs other Qatar banks we cover is leverage. Its non-interest margin (as a percentage of interest-earning assets, or IEA) is above average, thanks to a focus on trade revenues, which also boosts foreign exchange gains. In addition, net interest margins are above average, in spite of the distortions of QIB's numbers, due to the large retail exposure. Combined, this means revenue margins are impressive, averaging 20bp above the sector average over 2010-12F, on our estimates.

Chart 16 : Income statement, ROTCE



Source: Company data

Although the revenue picture is pretty positive, this is balanced out by a weaker net profit margin. Sustainably higher costs provide a lower operating margin (2010: 64.7% v 72.3% sector average). The high provisioning margin, as a result of greater private sector exposure, is also an issue, and all the more so given the low coverage ratio.

On a net basis, we believe these two broad factors largely cancel each other out. The ROATA is actually below average at 2.18% for 2010 vs a sector average of 2.68%. Consequently, it is down to the level of gearing to really drive the above-average returns. In turn, the level of gearing is obtained by using Tier-2 capital and having less capital tied up in associates. With loan growth, asset quality and associated coverage ratio improving in the years ahead, we are forecasting higher returns, with 2013F registering a ROTCE of 22%.

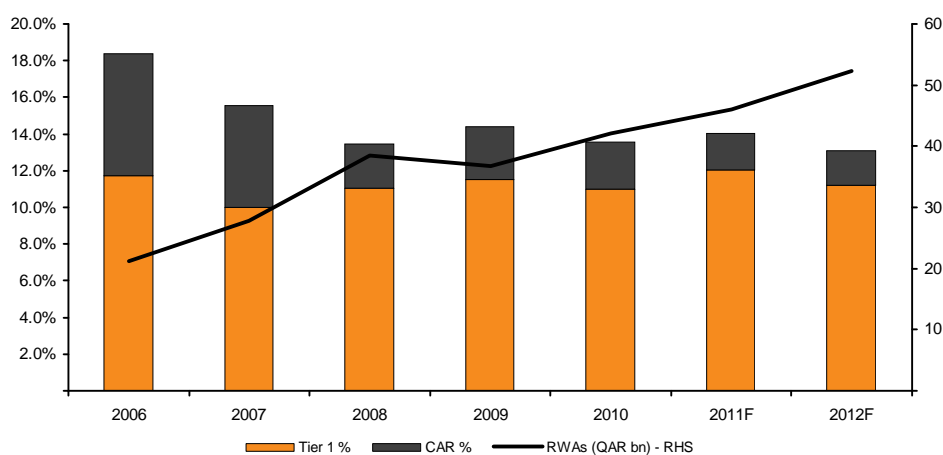
Dividend and capital

Like its peers, Doha Bank has maintained a high payout ratio through the crisis, rising to 96% in 2010 to give a record absolute dividend of QR5.0 per share. As a result capital build has been modest, with the exception of the QIA capital injection in 2009, which stabilised capital adequacy ratios for a year at 11.5% Tier-1 and 14.4% Tier-2. Nevertheless, by year-end 2010, Doha Bank's capital adequacy ratios were looking close to the limit at 11% Tier-1 and 13.6% total capital ratio.

QIA capital injection postpones other capital raising to 2013F

We expect Doha Bank to maintain a relatively high payout ratio, perhaps around 75%. Consequently, in spite of lower growth, a capital-raising exercise seemed inevitable before the end of 2012. We initially assumed a rights issue at some point in 2011, but following the announcement of a further capital injection from QIA, we believe Doha Bank has sufficient capital to last until 2013 without cutting the dividend.

Chart 17 : Capital and RWA



Source: Company data, Rasmala forecasts

Valuation and recommendation

Price justified, in our view, but limited upside potential without growth

Our DDM for Doha Bank assumes a sustainably high ROTCE of 22% in the medium term. With Doha Bank falling behind on loan growth, we would need to see better prospects for capital deployment to turn more positive.

Doha Bank trades at a 2011F PE of 10.6x and a 2010 PB of 2.3x, a 9% and 2% discount to our Qatari banking sector averages, respectively. Given Doha Bank's high and historically reliable ROTCE, this may be surprising. However, we expect a lower growth rate and, therefore, see it as less of a near-term thematic play.

From a DDM point of view, we assume a higher discount rate than peers and a lower growth rate in the medium term. On this basis, we calculate a target price of QR63.19, which rates the stock as already fairly valued. With a wealth of coverage over the past six months driving the stock up 38%, this is only to be expected. On this basis, we have a Hold recommendation.

Versus consensus

Our 2011-12 EPS forecasts are 11% and 13% below Bloomberg consensus estimates, with the difference being due primarily to the number of shares for the QIA rights issue, which we have updated already. Consensus is based on estimates from 13 analysts, of whom 10 have a Buy recommendation on the stock and three a Hold.

Figure 2 : Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|------------------------|--------|---------------------|--------|---------------|--------|
| Explicit Dividends | Net CF to shareholders | | 947 | 152 | 1,043 | 963 |
| | NPV Stage 1 | 2,633 | 2,633 | 1,872 | 1,910 | 963 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 509 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 6,842 | 22% | 10% | 6,609 | 59,931 |
| | NPV Stage 2 | 5,366 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 19,800 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 5,063 | 12% | 5% | 17,141 | |
| Total NPV | | | COE | | | |
| | Stage 1 (2010-2013) | 2,633 | US RFR | | | 2.56% |
| | Stage 2 (2014-23) | 5,366 | Country Risk Spread | | | 4.00% |
| | Stage 3 (2024+) | 5,063 | Sector Risk Spread | | | 2.50% |
| | NPV | 13,062 | Stock Spread | | | 2.00% |
| | Shares | 207 | Discount Rate | | | 11.06% |
| | Price Target | 63.19 | | | | |
| | Price | 62.60 | | | | |
| | Upside/(Downside) | 1% | | | | |

Source: Company data, Rasmala forecasts

Primary risks

Impairment risks

Limited balance sheet or liquidity risks

There is little in the way of impairment risks, in our view. The total equity portfolio amounts to just QR342m (6% of equity), while the mutual fund exposure amounts to QR353m as at 4Q09, with the bulk being listed and therefore marked-to-market through the fair value reserve. The investment in associate is negligible (QR14m).

Liquidity risks

With subordinated debt maturing in 2016 there isn't much in the way of liquidity risk either, with the step-up clause at the end of 2011 being a minor issue. We believe there is some chance that Doha Bank will buy this debt back, especially if it successfully launches a bond during 1Q11.

Business risks

With its large retail exposure and lack of public sector exposure, Doha Bank currently suffers from much lower growth than its peers in our coverage. A return to more symmetric growth should strongly positively impact Doha Bank's operations. The downside possibility is really that the current growth spurt bypasses the bank, focused as it is on the public sector. Then, as growth reverts to the private sector, first, there is no guarantee that Doha Bank will be correctly positioned, and second, it may turn out that the bigger players are better able to penetrate Doha Bank's core market franchise more successfully than the bank has been able to penetrate the public sector space.

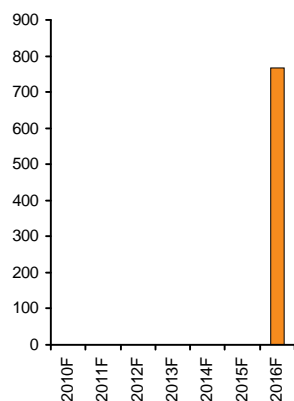
From a returns point of view, the main concern is that Doha Bank is likely to be more cyclical than its peers due to the high retail exposure. With the government acting as backstop on this, it already appears as if we are looking from the bottom of the cycle. Nevertheless, recovery may be slower than we forecast, particularly as the coverage ratio is so low (68% in 4Q10).

Finally, as with all the banks in Qatar, we believe there is some regulatory risk. In the past, the government has effectively gifted value to the banks through the buyout of the share portfolio, the loan book and the capital injections at a premium (as well as the waiver of dividends on those shares). Although these have all been positive for the local banks, the decision to cancel the banks call option on their share portfolios and the current possibility of a capital injection at a discount illustrates that the banks do not always get their own way.

Long-term drivers

Throughout the financial crisis, Doha Bank has maintained a solid ROTCE, with the ratio dipping to a low of 18.2% in 2010 in line with the sector average of 18.5%. Revenue margins (revenue to average interest earning assets) have been broadly in line with the market, but profit margins have been affected by higher costs and higher provisioning – both features of a higher proportion of retail business. Consequently, the main driver of higher returns has been the higher level of gearing at Doha Bank. This higher gearing is also reflected in the Tier-1 ratio, although the Tier-2 ratio benefits from the use of subordinated capital.

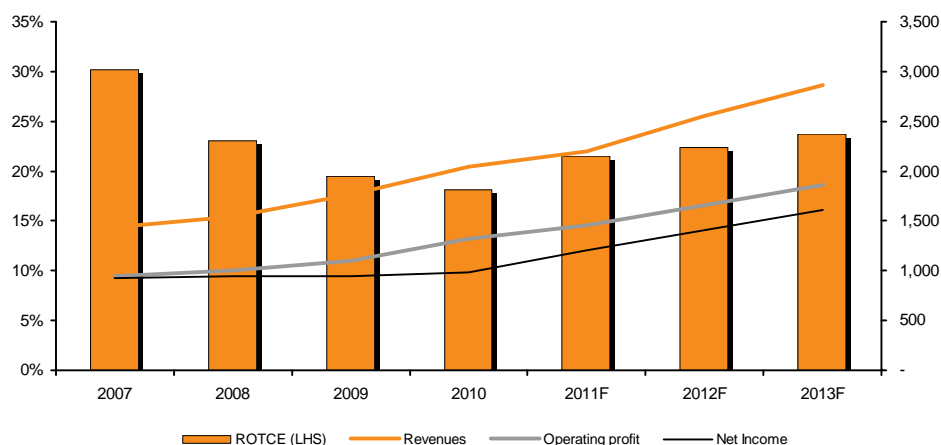
Chart 18 : Debt maturity (QRm)



Source: Company, Rasmala forecasts

We assume superior ROTCE assumed throughout life of the bank, but lower growth

Chart 19 : Income statement, ROTCE, QRm



Source: Company data, Rasmala forecasts

To some extent, the higher level of gearing appears structural rather than the result of a capital decision. The lack of substantial Tier-1 deductions due to the absence of substantial associates definitely allows for a higher gearing level. Similarly, good revenue margins are mostly the result of asset spreads, high fees and commissions from trade finance and a degree of uplift from bancassurance.

The same structural issues are also true on the net profit margin. Retail banking is cost-intensive and has higher and more cyclical provisioning than most of the Qatari economy. We do see some improvement in ROTCE over the coming three years (from 18.2% in 2010 to 22.4% in 2012), driven by increased penetration of fees and commission, and modest declines in provisioning.

What appears less certain is the level of growth. Growth in core areas is likely to remain low in the short term due to the retail market being fully penetrated. Nevertheless, as World Cup preparations pick up, there may be more opportunities for small businesses and resurgent immigration. Both should bring growth opportunities for Doha Bank. However, another possibility is that the bank becomes frustrated at its more limited growth opportunities and goes on the acquisition trail.

We assume a 14% RWA CAGR during the trend forecasting period between 2014 and 2023, which we expect will be the weakest in the sector. During the same period, we assume a premium level of returns of 22%, reflecting Doha Bank's high exit ROTCE, in turn driven by a structurally higher level of gearing.

We assume a higher-than-average discount rate of 11.6%, due to the more pro-cyclical nature of its business. Nevertheless, in our view, with growth uncertainty biased to the upside should the private sector pick up more rapidly than we expect or Doha Bank gain transaction in the public sector, we limit this to a 2% stock-specific spread.

Key sensitivities

Table 1 : Sensitivity to key input variables, based on +/-1ppt

| | +1ppt | -1ppt |
|----------------|--------|-------|
| Phase 2 | | |
| ROTCE1 | 2.9% | -2.9% |
| Growth | 1.7% | -1.6% |
| Discount rate | -11.2% | 15.3% |
| Phase 3 | | |
| ROTCE2 | 5.0% | -5.0% |
| Growth | 0.9% | -0.7% |

Source: Company data, Rasmala forecasts

The key sensitivity is of course to the discount rate, where a 1ppt could drive the share price down by 11% or up by 15%, on our estimates.

Income statement

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|----------------------------------|--------------|-------------|-------------|-------------|-------------|
| Net interest income | 1241 | 1532 | 1637 | 1885 | 2107 |
| Non-interest income | 519.3 | 516.2 | 565.7 | 665.8 | 755.2 |
| Total income | 1760 | 2048 | 2203 | 2551 | 2862 |
| Operating costs | -658.5 | -723.2 | -782.0 | -892.9 | -1002 |
| 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 |
| <u>Pre-prov operating profit</u> | 1102 | 1325 | 1421 | 1658 | 1860 |
| Provisions charges | -126.3 | -311.8 | -218.3 | -209.3 | -204.2 |
| <u>Post-prov op prof</u> | 975.2 | 1013 | 1202 | 1449 | 1656 |
| Associates (pre-tax) | -0.69 | 0.20 | 0.81 | 0.85 | 0.89 |
| Other pre-tax items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported PTP | 974.5 | 1013 | 1203 | 1450 | 1657 |
| Taxation | -25.3 | -28.5 | -33.9 | -40.8 | -46.7 |
| Minority interests | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Preference dividends | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other post-tax items | 24.3 | 69.4 | 33.9 | 40.8 | 46.7 |
| Reported net profit | 973.6 | 1054 | 1203 | 1450 | 1657 |
| Tot normalised items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Normalised PTP | 974.5 | 1013 | 1203 | 1450 | 1657 |
| Normalised net profit | 973.6 | 1054 | 1203 | 1450 | 1657 |

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Net loans to customers | 25896 | 26547 | 29010 | 33013 | 37814 |
| Other int earn assets | 8225 | 8851 | 11024 | 12545 | 13613 |
| Goodwill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Oth non-int earn assets | 1121 | 1453 | 1618 | 1746 | 1889 |
| Total assets | 45996 | 47230 | 48325 | 53576 | 59366 |
| Total customer deposits | 27890 | 30822 | 31476 | 35324 | 39894 |
| Oth int-bearing liabs | 11314 | 9451 | 8913 | 9682 | 10197 |
| Non int-bearing liab | 1870 | 1869 | 1831 | 2099 | 2157 |
| Total liabilities | 41074 | 42142 | 42220 | 47105 | 52248 |
| Share capital | 4922 | 5087 | 6105 | 6471 | 7118 |
| Reserves | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total equity (excl min) | 4922 | 5087 | 6105 | 6471 | 7118 |
| Minority interests | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total liab & sh equity | 45996 | 47230 | 48325 | 53576 | 59366 |
| Risk weighted assets | 36804 | 42074 | 45978 | 52321 | 59931 |
| Est non-perf loans | n/a | n/a | n/a | n/a | n/a |
| Specific provisions | -466.9 | -739.0 | -894.4 | -1028 | -1144 |
| 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 | 36804 | 42074 | 45978 | 52321 | 59931 |
| Reported net profit | 973.6 | 1054 | 1203 | 1450 | 1657 |
| Opening risk assets | 38461 | 36804 | 42074 | 45978 | 52321 |
| Closing risk assets | 36804 | 42074 | 45978 | 59931 | 0.00 |
| Change in risk assets | -1657 | 5270 | 3904 | 13953 | -52321 |
| Capital required | -165.7 | 527.0 | 390.4 | 1395 | -5232 |
| Free capital flow | 1139 | 527.3 | 812.9 | 54.5 | 6889 |
| Ordinary dividend paid | -904.3 | -947.4 | -889.2 | -1043 | -963.3 |
| Share buy back/spec div | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Equity / preference issue | 368.6 | 0.00 | 737.2 | 0.00 | 0.00 |
| Cash flow from financing | -535.7 | -947.4 | -152.0 | -1043 | -963.3 |
| Net capital flow | 603.6 | -420.1 | 660.9 | -988.2 | 5926 |
| Tier 1 capital | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Company data, Rasmala forecasts

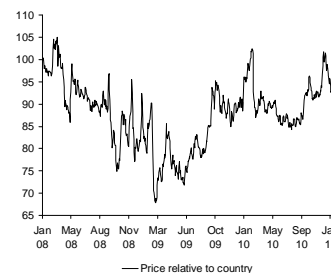
year to Dec

Company description

Hold

Price relative to country

Doha Bank (DB), incorporated in 1978, is the fourth-largest bank in Qatar, with 8% asset market share in lending. It provides a comprehensive range of wholesale and Islamic banking products while maintaining its core focus on retail, treasury, investments and bancassurance divisions. The bank serves its 160,000-plus retail and c3,000 corporate clients with 28 conventional branches, four Islamic branches, 11 e-branches, 11 pay offices, two mobile units in Doha and one mobile unit in Dubai, with 117 ATMs.



Strategic analysis

Average SWOT company score:

3

Net profit before taxes, FY10

Strengths

3

Doha Bank is the fourth-largest bank in Qatar, with its strong foothold in the retail banking segment. As a result, the bank has the second-largest physical franchise in Qatar and maintains the highest interest spreads among the conventional banks.

Weaknesses

2

From a growth perspective, Doha Bank is over-reliant on the retail sector, which is going through a period of deleveraging. Weaknesses for Doha Bank include retail lending concentration (35% of loans) and a higher-than-universe average cost-income and NPL ratio.

Opportunities

2

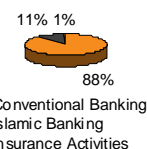
Key opportunities for Doha Bank are SME and HNW penetration, capturing the Islamic banking market share by re-branding Doha Islamic and generating higher off-balance-sheet fee income supported by the robust international expansion plans.

Threats

3

The main threat is that spreads will be affected by higher competition. Doha Bank is the highest cost competitor and is therefore the most leveraged to declining prices.

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



Source: Company data

Market data

Headquarters

Doha Bank Building, Grand Hamad Street, P.O. Box 3818, Al Doha, Qatar

Website

www.dohabank.com.qa

Shares in issue

206.7m

Freefloat

84%

Majority shareholders

Qatar Investment Authority (9%)

Competitive position

Average competitive score:

4+

Broker recommendations

Supplier power

5+

The lack of significant regulatory 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 local government ownership in most banks, coupled with branch limits for foreign banks, keeps barriers to entry high for this sector.

Customer power

4+

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

Substitute products

2+

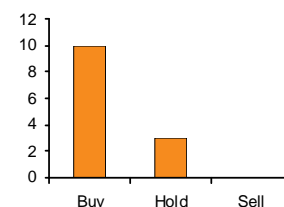
We believe the availability of substitute products (capital markets and wholesale lending) is on the rise, but it is currently unclear to what extent Qatar will favour its own banking system.

Rivalry

4+

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

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



Source: Bloomberg

28 January 2011

Qatar Islamic Bank

Initiation of coverage

Hold

Target price
 QR87.97

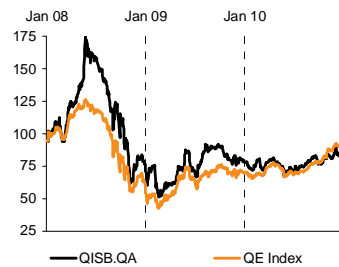
Price
 QR84.00

Short term (0-60 days)
 n/a

Market view
 No Weighting

Price performance

| | (1M) | (3M) | (12M) |
|----------------|-------|-------|-------|
| Price (QR) | 80.90 | 77.80 | 72.70 |
| Absolute (%) | 3.8 | 8.0 | 15.5 |
| Rel market (%) | 0.9 | -6.2 | -16.3 |
| Rel sector (%) | -0.7 | -8.4 | -22.9 |


Market capitalisation
 QR19.85bn (€4.00bn)

Average (12M) daily turnover
 QR18.21m

 Sector: QE Bank Index
 RIC: QISB.QA, QIBK QD
 Priced QR84.00 at close 24 Jan 2011.
 Source: Bloomberg

Analyst

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Needing visibility

QIB, as the leading Islamic bank in Qatar, looks well placed to take advantage of the current public sector financing opportunity. However, the stock has run up sharply and, with this in mind, we focus more on QIB's substantial associates, which have weaker returns and low leverage.

Key forecasts

| | FY09A | FY10A | FY11F | FY12F | FY13F |
|---------------------------|-------|-------|-------|-------|-------|
| Reported PTP (QRm) | 1,284 | 1,362 | 1,599 | 1,927 | 2,214 |
| Reported net profit (QRm) | 1,322 | 1,335 | 1,583 | 1,905 | 2,189 |
| Reported EPS (QR) | 6.10 | 5.85 | 6.81 | 7.86 | 9.03 |
| Normalised EPS (QR) | 6.10 | 5.85 | 6.81 | 7.86 | 9.03 |
| Dividend per share (QR) | 5.45 | 5.00 | 4.66 | 4.67 | 5.73 |
| Normalised PE (x) | 13.80 | 14.30 | 12.30 | 10.70 | 9.30 |
| Price/book value (x) | 2.33 | 2.26 | 1.91 | 1.78 | 1.66 |
| Dividend yield (%) | 6.49 | 5.95 | 5.54 | 5.56 | 6.82 |
| Return on avg equity (%) | 19.50 | 16.80 | 17.20 | 17.10 | 19.60 |

 Accounting standard: IFRS
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

QIB: Qatar's leading Islamic bank

Qatar Islamic Bank (QIB) is the country's most successful Islamic bank, with a 28% market share in Islamic lending and 9.1% in total lending. It is also the only one of the top four banks to have maintained its market share since 2005 in the face of competition from new entrants. Within Islamic lending, QIB is dominant in the large corporate area and has strong links to the housing market. It also has a strong retail franchise, with its 26 local branches giving it the broadest Islamic banking franchise in Qatar. In addition, it owns a majority stake in the UK's European Finance House and a minority stake in Malaysia's Asian Finance Bank.

Returns recovering, but likely to remain below sector average

QIB's 2010 ROTCE of 15.3% was well below our Qatari coverage universe mean, bettering only that of Commercial Bank of Qatar. The weak return was the product of low gearing and a return on assets no better than average. We believe low gearing is partly a structural issue, although the current 17.4% Tier-1 ratio is also a clear indicator of under-leveraging, in our view. Nevertheless, we believe limited future gains in ROTCE depend on a recovery in fees and commissions, more stable investment income and, to a minor extent, lower provisioning.

Underlying loan growth is strong

Despite a 3Q10 hiccup, 2010 full-year loan growth of 31% stemmed from growing public sector exposure, combined with increasing exposure to housing and personal loans. We expect QIB to continue to outperform, delivering a loans CAGR of 18% for 2011-13F, and then 16% over 2014-23F.

Valuation and recommendation

We initiate coverage with a Hold recommendation. Our target price is QR87.97, based on our DDM analysis using a discount rate of 11.3% and suggesting upside potential of 5% from the current price. QIB trades on 12.3x 2011F PE and 2.3x 2010 PB, a 7% premium and a 9% discount to the sector, respectively. Despite its strong market position, we believe the key issue is the uncertainty around QIB attaining a premium ROTCE. We therefore believe it should trade at a discount.

Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

| EPS (QR) | Ours | Cons | % diff |
|----------|------|------|--------|
| 2011F | 6.81 | 7.9 | -13.76 |
| 2012F | 7.86 | 9.3 | -15.50 |
| 2013F | 9.03 | 10.8 | -16.39 |

Source: Bloomberg, Rasmala forecasts

Forced ranking*

| Company | Rec | Upside/downside |
|---------|------|-----------------|
| QNB | Hold | 7% |
| CBQ | Buy | 22% |
| Doha | Hold | 1% |

*By difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: Rasmala forecasts

Key events

| Date | Event |
|-------------|--------------|
| 14 Apr 2011 | 1Q11 results |

Source: Company

Catalysts for share price performance

We believe the key catalyst for share price performance is better growth or a sustainably higher RoTCE, especially if this is generated more by raising earnings than by improving capital efficiency. Growth opportunities should be driven by public-sector opportunities but, as an Islamic bank, QIB may also be able to demonstrate growth in unlikely areas, such as consumer lending, which is an area of contraction for the market as a whole. We still see room for fee-driven businesses, such as QIB Capital, to expand.

Other issues for QIB are developments related to Bawabat Al Shamal, its main property asset, and potential expansion of its international operations. We have little information on reorganisation of the joint venture, and have therefore not yet factored it into our forecasts. However, we may revisit these if further data becomes available. Regarding international operations, QIB increased its stake in Asian Finance Bank, and this may be a prelude to further expansion of its international holdings – a possibility confirmed by the bank. Finally, we believe capital injection by the Qatar Investment Authority (QIA) is value-accretive for QIB shareholders again, given that we expect an acquisition price equivalent to the last QIA-financed capital injection.

Earnings momentum

FY10 headline net income was down 4% yoy, mostly due to QIB's first-time contribution to the social and sports fund levy, although revenue growth of just 5% yoy also played a part, thanks in turn to a sharp spread/margin contraction. Net investment income was actually strong, partly aided by investment-provisioning reversals.

Consequently, going into 2011, QIB faces almost the reverse of the situation at other banks and we are concerned about the sustainability of its investment income. We believe the bank's spreads have not benefited from shifts in the yield curve. However, we expect the boost in liquidity to bring down spreads closer to 4Q10 levels. We also see little room for loan-loss provisioning improvements given the 22bp reported in 2010. Consequently, we forecast a 22% increase in revenues, driving a 17% increase in the bottom-line (GAAP) number.

Rolling into 2012, the principal change we foresee is an improvement in property-related returns, although that will be subject to changes at Bawabat Al Shamal. We also expect some fee and commission improvement, driving headline earnings growth of 19%.

Valuation and target price

QIB trades on 12.3x 2011F PE and 2.3x 2010 PB, making it the most expensive bank on a PE basis in Qatar, but placing it 9% below the average PB multiple. We forecast above-average growth for QIB throughout 2010-24. However, we are more sceptical about returns, forecasting a slow recovery from 15.3% in 2010 to 18.5% in 2013, and then 20% each year beyond that. This places QIB above only Commercial Bank of Qatar (CBQ) in our coverage universe in terms of its returns. In addition, we believe QIB is less transparent, hence a discount rate of 11.3%, which is slightly higher than for our coverage universe and which results in our DDM-based target price of QR87.97, a 5% premium to the current share price.

How we differ from consensus

Our EPS forecasts are 14%, 15% and 16% below Bloomberg consensus headline numbers for 2011-13, respectively. We believe this may be partly because we already incorporate our estimate of the QIA capital injection. We believe this is mildly accretive to BVPS, but we expect it to be dilutive to EPS in the short term. However, we also believe consensus forecasts are declining.

Risks to central scenario

Of the stocks in our coverage universe, we apply the highest discount rate to QIB, based on the current absence of a CEO, the bank's slightly more opaque reporting structure and the lack of clarity about the sustainability of its strong growth. The appointment of a new CEO, combined with a clearer idea of competitive advantage and improved disclosure would provide scope for us to undertake some positive re-rating. In addition, the movement in spreads has been volatile. We assume a mild deterioration from 1Q11, and this may well be a significant driver across the year, in our view. In the short term, we also forecast a recovery in fees and commissions, and in investment income, which is likely to create downside pressure if it fails to materialise.

Key assumptions and sensitivities

Discount rate is the main source of valuation uncertainty

QIB is more sensitive to the discount rate than many of its competitors, due partly to its higher loan growth rate, but also to the gradual increase in its ROTCE, which makes earnings particularly tail-end loaded. A 1 percentage point change in the discount rate would drive our target price up 20.8%, or down 15.2%. We attribute a 2.25% stock spread for QIB as part of our discount rate calculation, which makes its discount rate 1.25% higher than that for Qatar National Bank (QNB). We believe this is justified by the lower visibility of QIB's earnings and the current absence of a CEO.

In terms of forecast sensitivity, the main issues are growth, capital and ROTCEs

- **Growth forecasts strongest bar QNB** – Following on from above-market growth of 31% in 2010, we forecast 18% in 2011, 19% in 2012 and 18% in 2013, before settling on a steady 16% for 2013-24. Growth in 2010 depended on the public sector and QIB's strong market share gains in consumer financing. Housing (probably contracting) was also an area of growth. Taking as our benchmark a median growth rate of 15% throughout the period suggests outperformance of a cumulative 19%, weighted towards the near term. As a rough estimate, this higher growth rate would have about a 10% impact on our target price.
- **Capital** – Capital adequacy jumped to 17.4% in 4Q10, from 13.3% as of 2Q10 (the last previously reported figure) and 13.9% in 3Q10 (according to Fitch calculations). This is primarily the result of a decrease in average risk weighting, and only partly explained by a higher public-sector business. This, combined with the QR1.9bn QIA capital injection, should be enough to see the stock through to 2013. Since we expect the placement to be priced at a premium, we assume a transfer of value to shareholders of 1%, which is already in our forecasts. Longer term, we assume an 11% ratio of book value (ex associates) to risk-weighted assets (RWA), although we find the sensitivity to that is difficult to measure, as increased capital gearing would also suggest changes to sustainable ROTCE.
- **ROTCE** – In the short term, we forecast a 15% ROTCE, rising to 18% in 2013. In the long term, we assume a higher potential level of gearing will enable a higher ROTCE of 20%. Our valuation is not really sensitive to this issue of the gearing/ROTCE balance, but it is sensitive to the absolute level of profitability for a fixed gearing level. Our 20% forecast puts QIB at a 3% discount to QNB, a 2% discount to Doha Bank and a 2% premium to CBQ, based on our estimates, with each percentage point correlating to a 5% impact on our target price.

Terminal value assumptions

- We set standard 12% ROTCE and 5% growth rates across the sector in the very long term (2024+), effectively lowering the exit book value multiple to a little over 1x. A 1 percentage point change would have a 9% effect on our target price, but we do not differentiate between the banks over this period.

Executive summary

QIB is the largest and most successful Islamic bank in Qatar. It continues to grow strongly, but we are concerned about its lower current and expected profitability and the likelihood that its growth differential may narrow.

Growth story – migrating towards public-sector lending

QIB historically has gained most of its growth from three areas – trading, housing and consumer finance. This remained true even in 2009 when, combined, these accounted for 75% of all QIB's growth, despite housing sector loans nearly stalling. As a result, QIB continued to grow its market share even in a tough market. In 2010, things were different. The only significant area of banking system asset growth was in public sector loans. Nevertheless, QIB managed to maintain its growth trajectory by increasing its personal lending (through market share gains) and expanding into public-sector lending.

Change in regulations means QIB is capital-heavy

As part of its countdown to Basel III and as a way of bolstering capital in the banks, the central bank has increased Tier-1 deductions for associates. The result has been that, despite tangible book value increasing 38% over 4Q08-4Q10, Tier-1 capital rose only 19% over the same period, while total regulatory capital grew just 14%. We believe the implication of this is that QIB will maintain higher levels of capital than it would otherwise have and will therefore find it harder to achieve and maintain ROTCE above 20%.

Recovering ROTCE closer to long-term 20% level

With QIB reaching a 15.3% ROTCE in 2010, and that assisted by strong 4Q10 investment gains, achieving a 20% ROTCE looks like a challenge. However, we forecast a recovery in fees and commissions (from 1.08% of customer assets in 2010 to 1.20% in 2013), and other non-interest income should benefit from an eventual recovery in property revenues. Combined with stability in the already-modest provisioning margin (from 2.6% to 3.2%), this should push ROTCE above 18% by 2013, and an improved capital structure may help it towards 20%.

Doubts remain

The problem we see with QIB, though, is that there is always a lack of solidity behind the figures. Its reporting clarity seems to us to be weaker than that of its peers – interbank returns, for example, are incorporated in profit from investing activities (and are therefore impossible to split out on a quarterly basis), and we think the link between shareholders' funds and Tier-1 capital is weak, while the key revenue lines (net Islamic returns, fees and commissions) seem to us far more volatile than elsewhere in the sector.

As well as a lack of reporting opacity, we believe the absence of a CEO following the departure of ex-CEO Salah Jaidah is a source of uncertainty. Although QIB maintains that its strategy is unchanged and that a replacement will be found shortly, this remains an area of short-term risk. Finally, in our view, QIB has yet to show that it can make value-accretive acquisitions.

Overall, we do not believe this adds up to a Buy recommendation

QIB plays well to the theme of Islamic banks having greater growth rates, but we find its lower returns and higher uncertainty, and hence its discount rate, do not add up to a compelling story. This, combined with the highest earnings multiple in the sector (albeit a lower asset multiple) means we see better opportunities in Qatar's banking sector at the moment. Until we believe the stock can command a 20%-plus ROTCE, we can see no additional potential upside.

Figure 1 : Dupont

| STAGE ONE | STAGE TWO | STAGE THREE | STAGE FOUR | STAGE FIVE | ADDITIONAL COMMENTS |
|-------------------------|-------------------------|-------------------------------|------------------------------|-----------------------------------|-------------------------|
| ROTCE | Gearing | Tier 1 ratio | TCR | | |
| '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| 18.2% 15.3% 16.9% 17.2% | 5.02 6.45 5.84 6.30 | 17.3% 17.4% 20.0% 18.1% | 17.3% 17.4% 20.0% 18.1% | | |
| 18.9% 18.5% 18.8% 18.8% | 7.36 7.87 6.49 6.49 | 14.8% 15.1% 18.0% 16.9% | 15.9% 16.2% 18.8% 17.6% | | |
| | ROAA | IEA / TA | Loans / IEAs | | |
| | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | | |
| | 3.76% 2.89% 2.77% 2.84% | 80.4% 80.6% 82.1% 82.8% | 71.8% 70.2% 69.7% 71.0% | | |
| | 2.79% 2.68% 2.69% 2.69% | 81.9% 78.2% 83.3% 84.2% | 70.5% 72.1% 69.4% 70.4% | | |
| QIB | | Revenue / average IEAs | Interest Margins | Spreads | |
| Sector Average | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 6.2% 4.6% 4.8% 4.9% | 4.68% 3.84% 3.65% 3.67% | 4.58% 3.79% 3.60% 3.60% | |
| | | 4.9% 4.6% 4.8% 4.8% | 3.57% 3.86% 3.69% 3.69% | 3.52% 3.88% 3.70% 3.70% | |
| | | | Non II / average IEAs | F&C to ave IEAs | |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | | 1.77% 1.33% 1.32% 1.35% | 0.89% 0.70% 0.75% 0.74% | |
| | | | 1.46% 1.21% 1.30% 1.30% | 1.03% 0.84% 0.87% 0.90% | |
| | | | | Other revenues to ave IEAs | |
| | | | | '09 '10 '11 '12 | |
| | | | | 0.88% 0.64% 0.57% 0.60% | |
| | | | | 0.44% 0.37% 0.43% 0.45% | |
| | | Net Profit Margin | Op. Margin | Cost-Income Ratio | |
| | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 | |
| | | 73.4% 67.1% 67.7% 67.8% | 73.0% 74.7% 74.1% 73.6% | 27.0% 25.3% 25.9% 26.4% | |
| | | 66.5% 64.3% 67.2% 67.2% | 70.8% 72.3% 72.0% 71.5% | 29.2% 27.7% 28.0% 28.0% | |
| | | | Provn Margin | Net Provisioning | NPL ratio |
| | | | '09 '10 '11 '12 | '09 '10 '11 '12 | '09 '10 '11 '12 |
| | | | -1.7% -2.6% -3.9% -3.2% | 0.16% 0.22% 0.35% 0.25% | 1.22% 0.88% 1.00% 0.98% |
| | | | -8.3% -8.0% -5.5% -4.5% | 0.58% 0.60% 0.44% 0.44% | 1.78% 1.76% 1.75% 1.75% |
| | | | XYZ Margin | | |
| | | | '09 '10 '11 '12 | | |
| | | | 2.1% -5.0% -2.5% -2.5% | | |
| | | | 4.0% -0.1% 0.7% 0.5% | | |

Source: Company reports, Rasmala forecasts

Taking its share

Once primarily a retail and housing-sector bank, QIB has recently been expanding into the trading sector. In addition, it has broadened its product base and geographical reach through associate investments. The chief challenge now is rebuilding a 20% ROTCE.

Business description

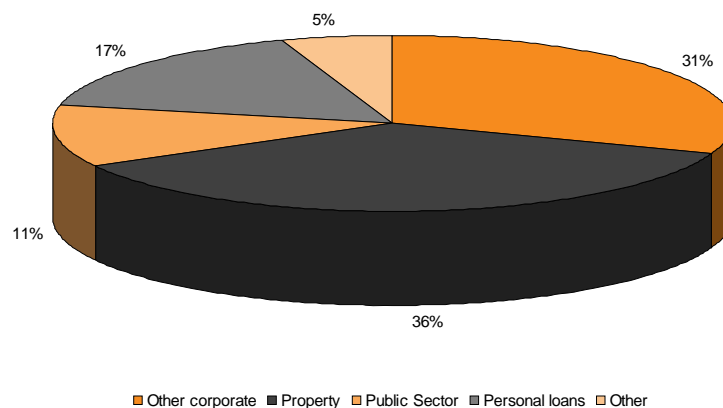
QIB: Qatar's leading Islamic bank

QIB is the largest Islamic bank in Qatar, with an estimated 28.3% market share in Islamic lending and 9.1% in total lending, as of 4Q10. The bank provides a range of Shariah-compliant products across retail, private banking, corporate and investment banking, distributed through its 26 local branches. The bank provides no functional divisional breakdown. Nevertheless, the recent sukuk (Islamic bond) prospectus indicates the breakdown of 1H10 operating profits as: 36.7% corporate banking and 21% retail banking, with the remainder from QIB Capital and International operations.

Initially a retail bank, but expanding into real estate lending

Initially primarily a retail bank, QIB underwent a rebranding and organisational restructuring in 2006, following which it expanded rapidly into the corporate and investment banking segments. Nevertheless, most of its loan book is still relatively narrowly focused, coming from retail and real estate activities.

Chart 1 : Loan book split, 2010



Source: Company reports

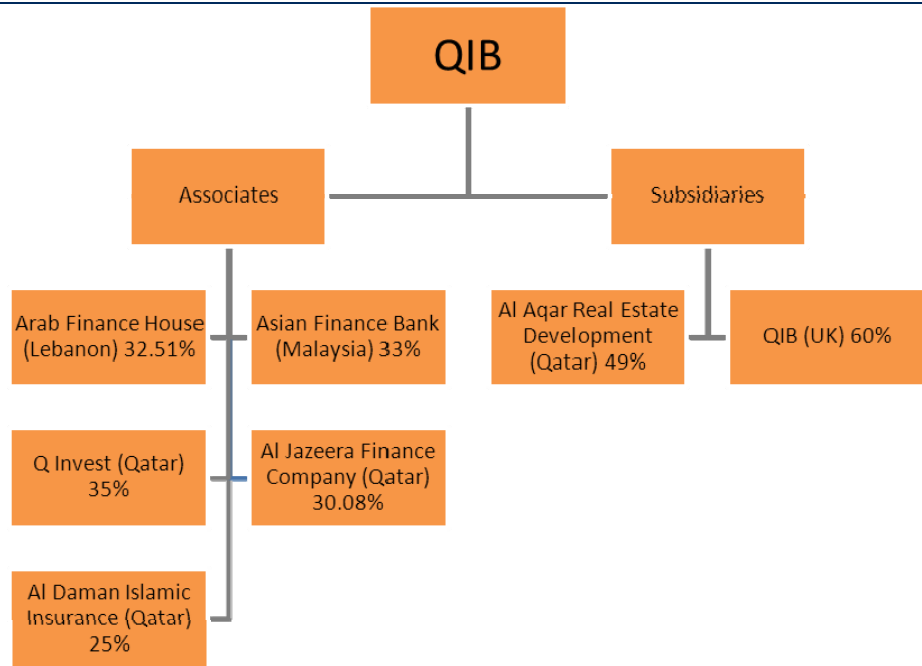
Within the loan book, corporate banking has been the main source of growth since 2007, with the trading sector accounting for 41% of all loan growth over 2007-09. This shifted somewhat in 2010, due primarily to three sectors: public sector lending, consumer financing and construction loans (Istisna'a).

International operations extend to the UK, Malaysia and Lebanon

International reach spans the Arab world, and much besides

Internationally, QIB has sought to expand through partial acquisitions. These now include Arab Finance House (Lebanon), Asian Finance Bank (Malaysia) and European Finance House (UK). Locally, the bank has significant investments in QInvest, Al Jazeera Islamic Company and Aqar Real Estate Development and Investment.

Figure 2 : Company associates and subsidiaries (ownership %)



Source: Company reports

Of these associates, the only two that currently make significant contributions are the domestic operations, QInvest and Al Jazeera Islamic. QInvest continued to expand its balance sheet through the crisis, although its profits dipped sharply in 2009. However, recent announcements suggest Asian Finance Bank may expand significantly, through an Indonesian or other acquisition.

Mid-way through 2008-12, strategic diversification plans

QIB is dominant in private-sector Islamic Banking

In terms of Islamic finance, three main banks each account for about one-quarter of the market: QNB Al Islami, Masraf Al Rayan and QIB. However, with both its main rivals focusing on government or GRE (government related enterprise) business, we believe QIB can fairly be described as the dominant player in private-sector Islamic banking.

As such, QIB's three avenues for growth are to grow private-sector Islamic banking, to gain market share in public and GRE business, and to expand beyond Qatar. In addition, QIB aims to expand its service-driven (fee) proposition. Other areas of interest include SME banking, although this segment is limited in Qatar at present and is therefore a fairly limited opportunity for now, constituting just 1% of the loan book.

Taking share in public-sector/GRE lending

Public-sector lending a new area of expansion

Given the possibilities for expansion in housing lending have been hit by the collapse in property prices and the related slowdown in housing market activity, QIB has partly turned to getting its fair share of the public sector and Q-company business, which mostly goes to QNB or Masraf al Rayan. Public-sector growth was a significant factor in 2010 lending growth, and one we expect to continue.

International expansion

International expansion has generally involved making small investments in frontier countries

QIB has made a number of forays abroad, but has generally preferred to do so by taking minority stakes, as in Lebanon (Arab Finance House) and Malaysia (Asian Finance House). The main exception to this has been the recently renamed QIB UK (previously known as European Finance House), which, according to management, aims to be the leading Islamic Bank in the UK and Europe.

Neither has QIB been shy about mentioning the possibility of organic or inorganic expansion elsewhere. In particular, the bank has mentioned potential strategic alliances in Asia, Oman, Turkey and Libya, as well as in a French retail/SME banking operation. In addition, the possibility of expanding more broadly into Asia (particularly Indonesia) has been raised. However, Qatar's new capital adequacy regulations are likely to limit QIB's ability to take associate holdings going forward.

Life beyond loan growth

QIB Capital to drive unfunded income

Much of the focus beyond loan growth is centred on softer issues, such as maintaining a balanced financial position and improving risk management. However, a further strategic target is for the bank to expand its product offering. In particular, QIB is now developing a private-banking platform and building out its own investment banking arm, QIB Capital.

Bawabat al Shamal an unknown quantity

In addition, outside its core financial services business, QIB has been putting its property portfolio back to work, announcing a QR6bn joint venture for a residential and entertainment centre to be known as North Gate, or Bawabat Al Shamal. In other developments, QIB has supported the recent expansion of QInvest, in which it holds a 35% stake, as QInvest has sought to develop itself into a leading Shariah-compliant investment bank across the MENASA region.

Short-term and medium-term targets

QIB is the only bank in our coverage universe that remains comfortable publishing its short- and medium-term targets. Management highlights that it has clear visibility on the growth prospects of the bank, backed by strong domestic lending.

Targets for 2010 achieved

- 20% annual growth in assets.
- 30% annual growth in deposits.
- Keeping cost-income ratio close to 25%.

Targets up to 2012

- Increasing fee income by growing QIB Capital.
- Keeping cost-income ratio close to 30%.
- NPL ratio below 2%.
- Maintaining ROE between 20% and 25%.
- Assets to reach 8x equity compared to 5.4x in 2009.

Only leverage and ROTCE look challenging, in our view

QIB succeeded in all of its specific 2010 targets. Looking ahead, we don't believe QIB's cost-income ratio is particularly challenging, unless price pressure picks up much more sharply than we expect. With a fully developed retail franchise, we believe the heavy lifting in terms of costs has already taken place.

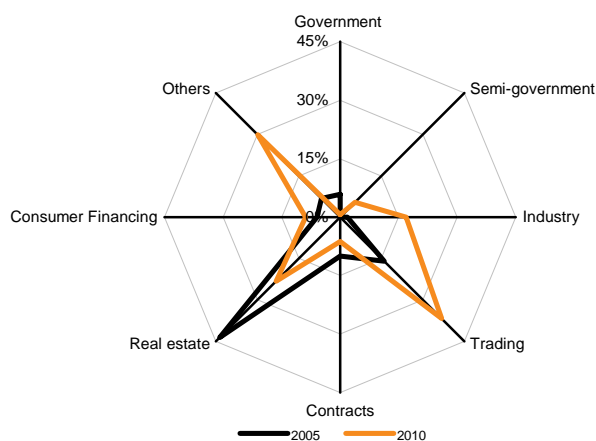
However, the ROE target looks more challenging. We expect a 2010 ROTCE of 15.3%, rising 330bp to 18.5% by 2013. QIB could still improve its gearing with low levels of capital retention, but we believe that pushing into the middle of the range will be a difficult target – largely because of the drag from QIB's associates. We believe a gearing level of 8.0x will not be achievable unless equity to regulatory capital is below 0.9x, whereas the bank's current level is 1.26x (4Q10). Although Tier-2 capital would help, the basic difficulty is the QR1.7bn of equity deductions to Tier-1 capital. These relate primarily to the QR1.5bn of QIB's investments in associates.

Loan growth: finding new directions

Driving loan growth beyond housing loan growth

In 2005, QIB's loan book was dominated by housing loans (corporate loans in the residential property sector) and consumer financing, which together accounted for nearly two-thirds of the book. Since then, QIB has tried to diversify its loan book in line with the changing structure of the market. Consequently, despite both segments more than doubling in size, they both contributed significantly less to QIB's book in 2010 than in 2005. Although housing loans did grow sharply in 2010, we believe this may have been related to recategorisation rather than to growth.

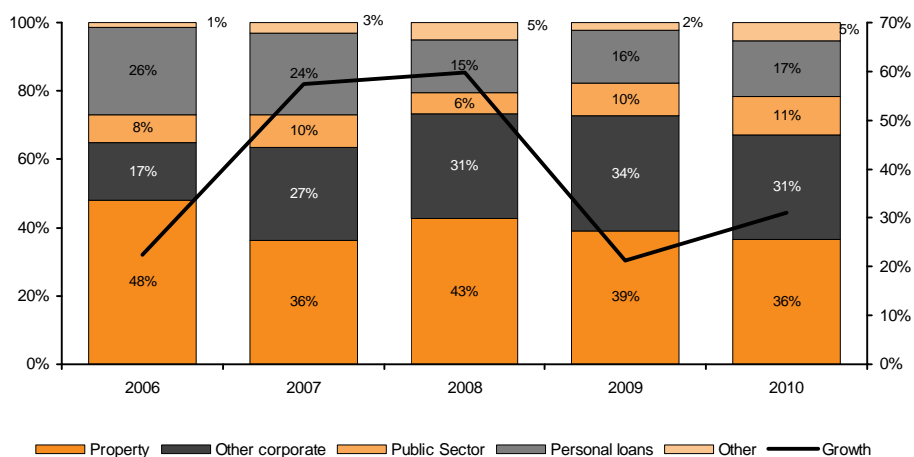
Chart 2 : Market share, by loan category



Source: Company reports, Central Bank Monthly statements

Corporate lending, on the other hand, drove growth during the same period, with the segment now accounting for 31% of the loan book, up from 16% in 2005, as various new Shariah-compliant trade financing and cash-management products were introduced in 2007 and 2008. In particular, QIB has increased lending to contractors and trading loans fivefold as it has come to grips with lending not based on real estate.

Chart 3 : Loan growth, changing components of the loan book



Source: Company reports

Going forward, we believe the residential real estate segment will continue to go through a period of weakness. This may incur some concerns for QIB given real estate accounts for 36% of its loan book. Consequently, the bank has been keen to enhance its project-finance capabilities and is seeking clients in other segments, such as energy, transport, health care, utilities and maritime shipping.

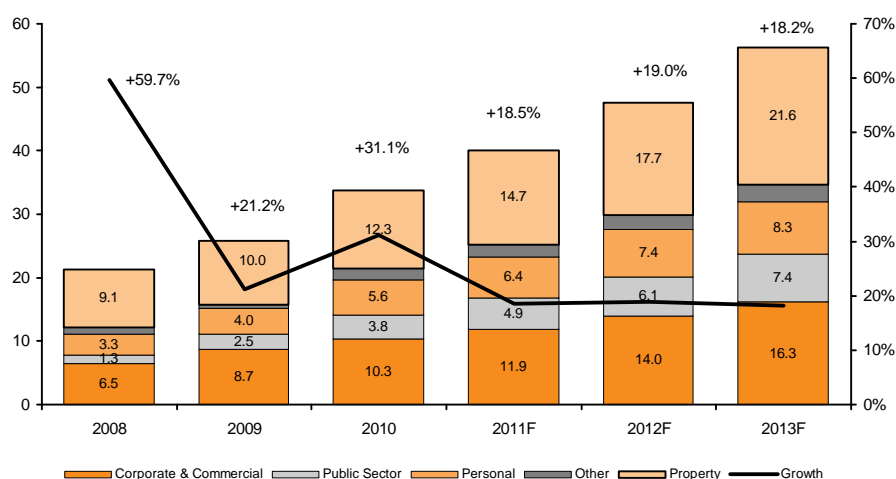
Diversifying from real estate lending

In the retail segment, we believe new product launches covering seasonal or one-off expenditures such as education, weddings and holidays will enable QIB to penetrate its client base further. This may account for the sharp rise in consumer lending in 2010, although recategorisation may also have played a part. However, we also believe that leverage for the national population is already near capacity and, in the absence of government wage increases, consumer financing is unlikely to be a leading growth area over the coming five years.

SME sector an opportunity, but likely to be limited

QIB highlights the SME sector as a major area for development, but we remain sceptical. The SME sector is small in Qatar and while it is generally regarded as being under-banked, in many cases this is not without good reason. Furthermore, small businesses frequently rely on cash-cycle products, which may be difficult to replicate efficiently within a Shariah context. It is possible that QIB could approach the SME sector with something closer to a PE-led strategy, but so far there hasn't been a strong indication of this being its intended plan.

Chart 4 : Loan growth (QRbn)



Source: Company reports, Rasmala forecasts

Infrastructure and public-sector lending likely to remain the key for loan growth outperformance

Above-peer-average loan book expansion

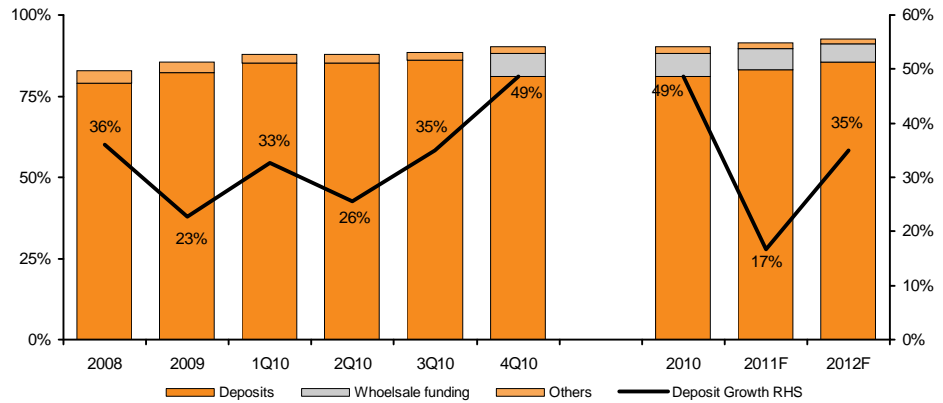
Growth in 2010 was impressive and above the peer average, with the loan book expanding 31% yoy. Consequently, QIB gained market share during the year – particularly with its expansion in public-sector lending. We believe this trend will continue. We think QIB has the best customer franchise of the Islamic banks and we believe it can increase its penetration beyond its core markets of retail and housing. It has been the most successful bank in terms of gathering private-sector Islamic loans and, with infrastructure spend being the key driver of growth going forward, we believe QIB will obtain a large share of the non-government sector business and even a small share of government-related business.

Liquidity has been high

Funding: deposit gathering strong, but tapping wholesale funding too

Given substantial equity financing and the steady downward trend in QIB's loan-to-deposit ratio, which reached 97% as of 4Q10, liquidity has been high and rising at QIB. Interbank balances as of 4Q10 amounted to QR12.4bn on a gross basis and are still in positive territory on a net basis. In addition, QIB holds QR3.5bn of financial investments available for sale, most of which are sukuk. We believe this provides a substantial source of liquidity for loan growth.

Chart 5 : Liability split, deposit growth



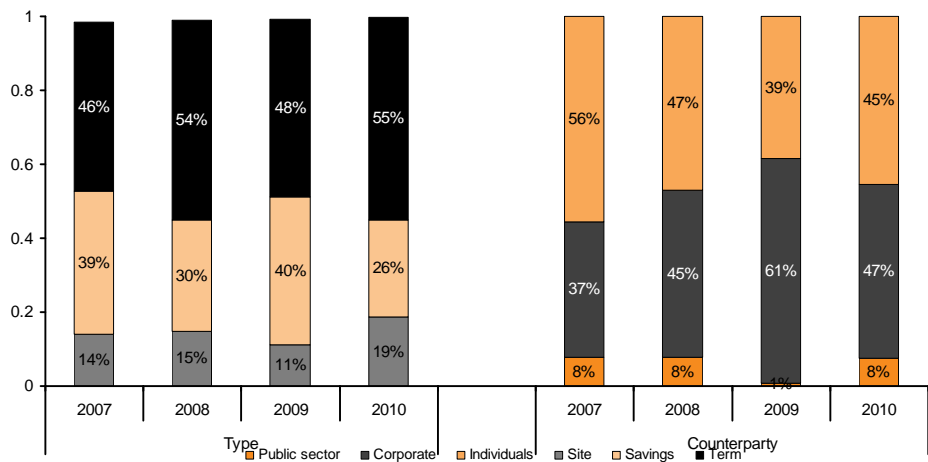
Source: Company reports, Rasmala forecasts

In addition, QIB decided to tap the wholesale market for the first time in 4Q10, launching a US\$750m sukuk. This was generally well received by the market, being priced at 237bp over mid swaps and eight times oversubscribed. Consequently, although Islamic banks tend to be generally less comfortable with capital market funding, we believe QIB may look to tap this facility again.

Strong liquidity further enhanced with 4Q10 sukuk

However, deposits are the mainstay of the funding base. Almost all QIB's new deposits have been sourced from corporates, in line with the faster growth for this segment at the system level. Although individual deposits have also grown at the system level, we believe this may have been focused on the upper tier, in which QIB has less of a presence. It may also reflect the possibility that individuals are indifferent to the difference between a zero interest deposit at a conventional bank and a savings or time deposit at a conventional bank, now that interest rates have fallen so low.

Chart 6 : Deposit structure



Source: Company reports

We see little in the way of balance sheet constraint for QIB in the near future. Indeed, we think liquidity is so good that the more difficult issue is explaining why a US\$750m sukuk needed to be issued now. This may simply be the bankers' maxim that a corporate should issue a bond before it is needed. However, it may also be an attempt to increase the maturity profile of the bank's liabilities to enable it to bid for any long-duration business arising.

Revenue growth driven by loans

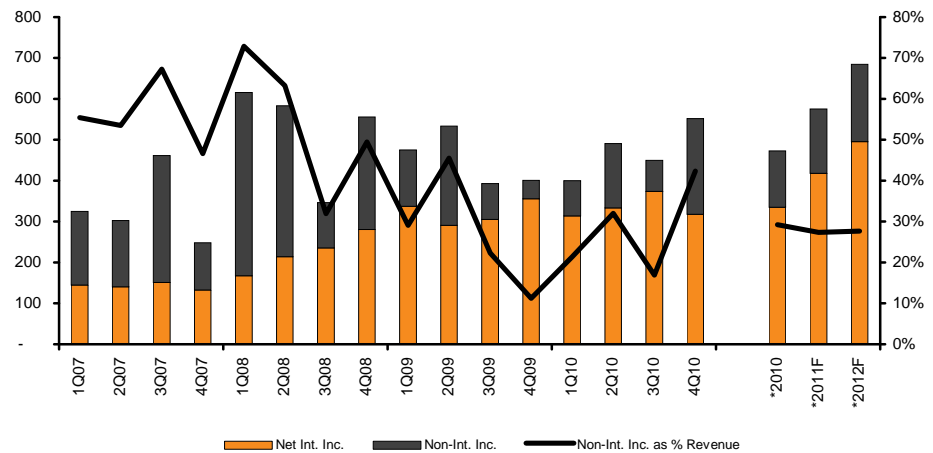
We expect 2011 yoy revenue growth of 22%, driven by an above-market loan growth rate of 20%, affecting both net interest income and fee income. Beyond 2011, we again see loan growth as the driver, though better fee and property-related income may also assist.

Property gains gone for now

As an Islamic bank, with less regulatory oversight of its property exposure, QIB has benefited significantly over the past five years from the real estate boom. Total non-core property revenues amounted to QR862m over 2005-09, although this dwindled to a net figure of just QR10m in 2009, with property leasing revenues exceeding impairments of QR17m. With the party now over, we think it is time for QIB to look at more enduring sources of revenue.

Cyclical sources of revenue have yet to recover

Chart 7 : Revenue split, QRm



*Annual data at quarterly rate.
Source: Company reports, Rasmala forecasts

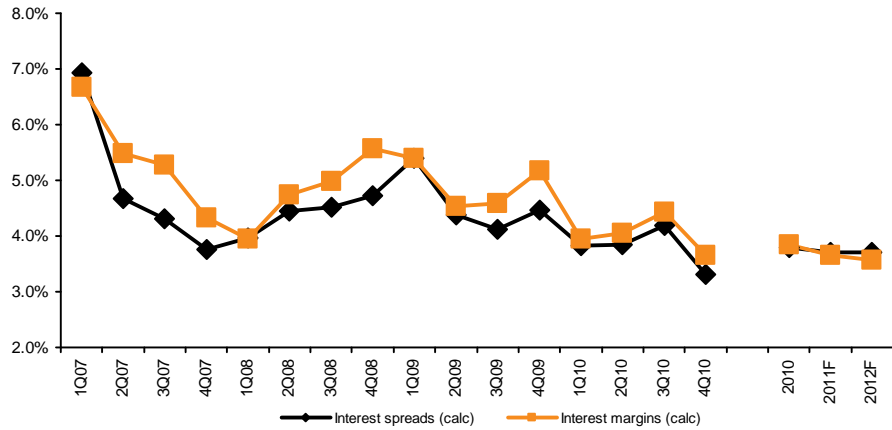
(Interest equivalent) spreads and margins boost already partly reversed

Spreads diminished throughout 2010

At the start of the financial crisis, spreads and margins rose sharply due to the repricing of risk. In addition, as liquidity came back into the system, this helped reduce liability costs, while the longer-duration assets repriced downward less quickly. However, unlike at the conventional banks, this reversed for QIB in 2010. We believe QIB, with its already low cost of deposit funding, has not really benefited from the recent decline in interbank rates. Indeed, the main impact appears to be a shift from liability spreads to asset spreads, although we do not separately forecast these.

With QIB now more reliant on asset spreads, we expect competition to take its toll, and we also expect to see some further weakness from the mix effect as QIB expands its public sector/GRE lending capability, with more limited growth in retail. Overall, we forecast a 19bp decline from 2010 to 2011, although we assume broad stability thereafter.

Chart 8 : Net interest spreads, calculated basis



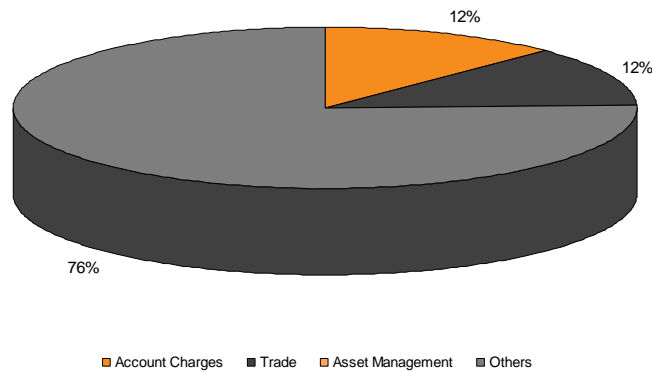
Source: Company reports, Rasmala forecasts

Fees and commissions unusually volatile

Fees and commissions dependent on still solid loan volumes

On a quarterly basis, fees and commissions at QIB have been unusually volatile by Qatari standards, although that is by no means unusual for an Islamic bank. Most fees (88%) are account charges and loan-arrangement fees. We believe the latter is one component of loan pricing, which has no clear dividing line with spreads, partly accounting for the high degree of fee and commission volatility.

Chart 9 : Fees and commissions breakdown, 2010



Source: Company reports

Although QIB gains as much revenue from fees and commissions as any of its competitors, so far its penetration of value-added services is limited. Two product suites that QIB has developed in this area are private banking (PB) and capital markets (QIB Capital).

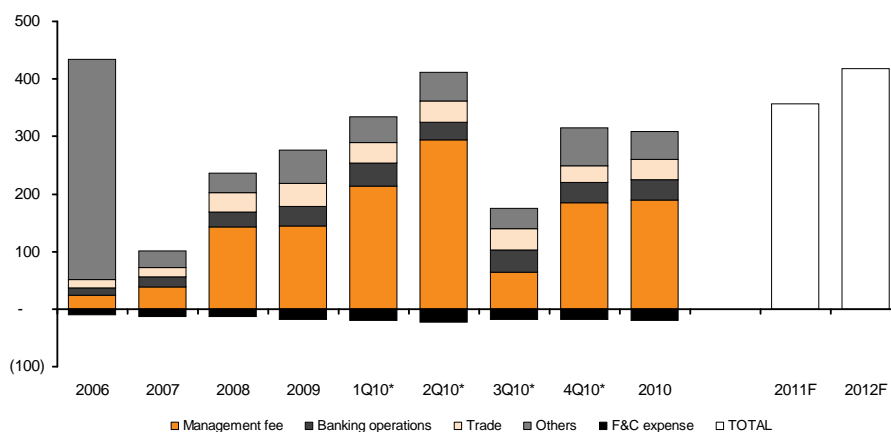
Private banking opportunity

QIB is looking to private banking as a fee driver, but this seems mostly a defensive strategy

QIB's PB department has been relatively successful, gathering QR3.2bn under management, and using its Islamic branding to help differentiate itself from QNB and CBQ's offerings in this area. The strategy involves attracting the high-net-worth (HNW) local population by offering a range of Shariah-compliant customised financial and investment solutions, apart from the well-established property, investment funds and commodities. QIB also opened its first dedicated private-banking customer service centre in 2010.

Although QIB is adding to its cost base, we do not expect it to aim to compete with QNB's more comprehensive offering on a product basis. Rather, we expect QIB to offer an HNW service to those looking for Islamic banking, and that this will primarily be a defensive strategy for deposits.

Chart 10 : Fees and commissions (QRm)



*Quarterly data at annual rate.
Source: Company reports, Rasmala forecasts

QIB Capital may also tap capital markets revenues

QIB Capital necessary, but yet to make its mark

With substantial long-maturity financing facilities to be arranged over the next couple of years, it will be necessary for all banks to address how they intend to get a slice of the pie. A certain amount can be delivered with bank lending, but the reality is that disintermediated financing will sometimes be more appropriate. To address this market, QIB has formed QIB Capital. QNB Capital is the dominant player in the domestic issuance and underwriting business. Nevertheless, if QIB Capital can take a smaller portion, perhaps again leaning on its purer Islamic credentials, then that would still make an incremental difference to revenues, in our view.

Other revenue comes primarily from two sources, property and investments

Limited contribution from other sources of revenue

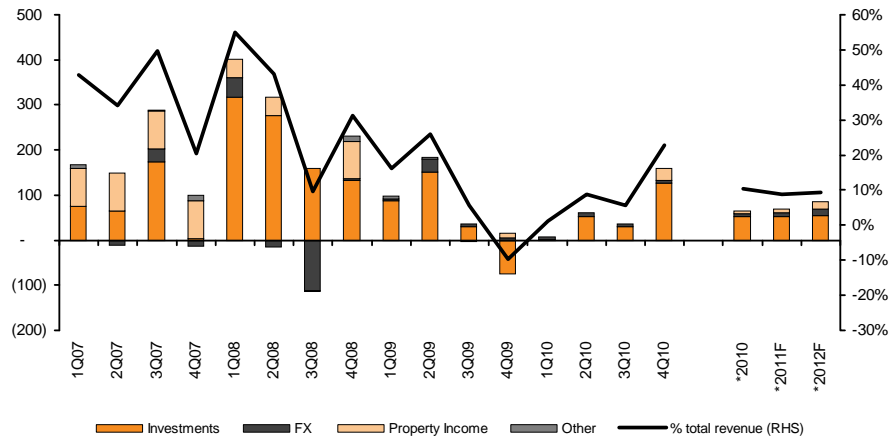
Property returns still muted

Although some property is rental, the total revenue generation from this amounted to an annual rate of only QR27m in 2009-10, and this was offset by impairment losses in 2009. However, by 2011, we expect rental gains to inch back into positive territory. Nevertheless, the amounts are insignificant, in our view.

Bawabat al Shamal an uncertain prospect

Of greater significance from our perspective is the development of Bawabat Al Shamal (North Gate). QIB has formed a joint venture with Al Futtaim, associate Aqar Real Estate and a fourth unnamed partner for a QR6bn entertainment and retail park, and it intends to use much of its QR1.2bn land bank for that purpose. We have insufficient information to provide forecasts for this, but we assume a 6% return on property assets from 2011, bringing the transaction closer to being value-neutral. This may provide significant upside at some point, although the risk we see in the short term is for a marking to market of the property asset.

Chart 11 : Other revenue (QRm)

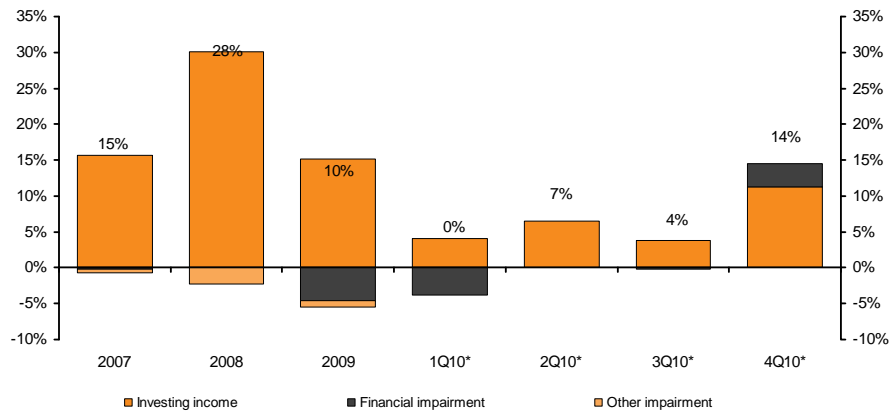


*Annual data presented on a quarterly basis.
Source: Company reports, Rasmala forecasts

Returns on financial investments falling

After a number of years during which QIB achieved impressive returns on its investment portfolio, returns have been low recently, all the more notable as this includes receipts from associates. However, this bounced back in 4Q10, partly due to the writeback of historical impairments, but also, we believe, due to booking gains on the available-for-sale portfolio.

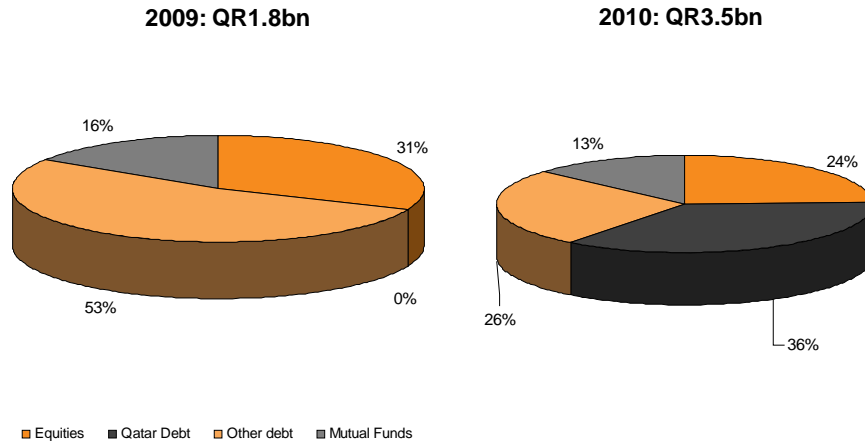
Chart 12 : Non-interest returns on financial investments, net, annualised



*Quarterly data at annual rate.
Source: Company reports

The more structural issue we see for decreased returns is increased conservatism and the reduced size of QIB's investment book. From a peak of 11% of total assets as of 3Q08, the book has now declined to 7% of total assets. The portion of the investment portfolio allocated to shares has also been decreasing, falling to 24% in 2010 from 31% in 2009. More recently the size of the investment portfolio rose sharply to QR3.2bn with the addition of substantial sukuk investments in 2Q10. We think this trend is likely to continue, with the government issuing fixed-income instruments as a way of absorbing liquidity.

Chart 13 : Investment portfolio, 2010



Source: Company reports

Some revenue rebound forecast for 2011

We forecast revenue growth of 22% (2011) and 21% (2012)

Overall, we forecast a 22% yoy increase in total revenue in 2011. We expect the principle drivers of this to be above-market loan growth of 20%, on our estimates, driving both net interest income and fee income, despite pricing pressure in both areas. In addition, we expect fee income to recover from its 2010 drop. Investment income is a substantial area of uncertainty given its uncertain relationship with the liquidity position. Nevertheless, we do not expect to see a repeat of the 1Q10 losses seen this year. We also expect property-related income to benefit from the lack of impairments.

Beyond 2011, the main issues we see are evolutionary rather than revolutionary. Underlying growth will likely be the main driver, although we also include some minor benefit from QIB Capital and Private Banking, raising the contribution from fee income. From 2012, we also assume for modelling purposes a benefit from property returns, although our best guess is that these will be longer dated and in any case not consolidated at that time.

For 2012F, this amounts to a 21% increase in revenue, followed by a 16% increase in revenue in 2013F.

Net income margins stable

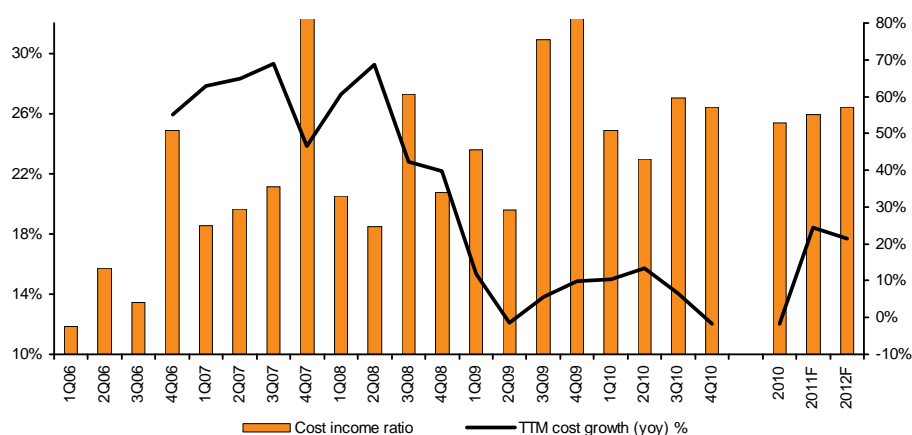
Cost-income ratio driven higher

Cost growth has matched recurring revenues, but, with volatile revenues dissipating, the CIR has been rising

Despite operating expenses rising at a 37% CAGR over the past five years, large corporate deals and real estate revaluation/sale gains pushed revenue significantly higher, thus masking cost growth and lowering the cost-income ratio. With real estate and investment income declining during 2009, total revenues declined 14% and the cost-income ratio jumped an annual 591bp to 27%. The 10% annual increase in operating expenses in 2009 was primarily led by the opening of two new branches, 74 new employees and a 30% Qatarisation rate (employment rate for higher cost National employees).

However, with QIB suggesting five new branches per year, increased service-related fee income and a higher Qatarisation rate, we believe the cost-income ratio is unlikely to decline. We forecast a 50bp increase in the cost-income ratio going forward, with it reaching 27.0% in 2013, still well short of the 30% target set by QIB. We believe the discrepancy comes primarily from concerns about pricing with QIB, rather than expectations of sharply higher cost inflation.

Chart 14 : Cost-income ratio, cost growth



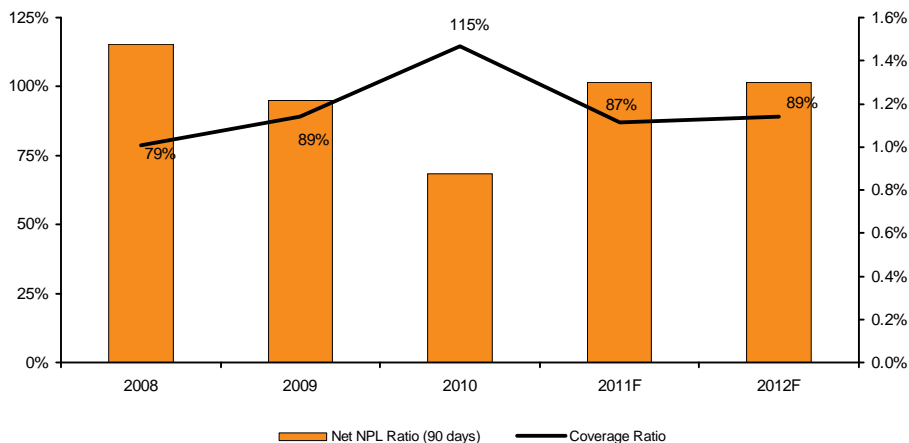
Source: Company reports, Rasmala forecasts

Provisioning anchored by a negligible level of write-offs

Provisioning and NPLs

Surprisingly, NPLs at QIB have not risen at all during the crisis. However, this has been the result of a gradual process of asset quality improvement since 2004. NPLs promptly peaked in 2005 at 6.9% and have been drifting downwards ever since. Although the coverage ratio was only 52% in 2006, the strong recovery of NPLs ever since, and the minimal level of write-offs, have meant that net provisioning for the three years of 2007-09 was actually negative. Provisions have risen since, but the year-end provisioning reversal and lack of actual write-offs suggest this is not a problem.

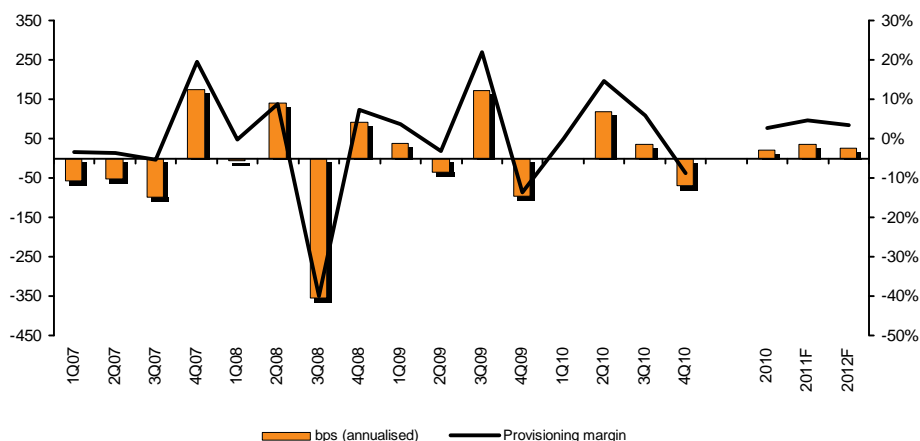
Chart 15 : NPL and coverage ratio



Source: Company reports, Rasmala forecasts

Overall, NPLs as of year-end 2010 stand at just 0.88% of customer loans, down sharply on 2009 levels, primarily due to loan growth rather than falling NPLs. Although we cautiously see some increase in NPLs in 2011F (to 1% of customer assets), we do not expect significant writedowns, and once NPLs begin to fall again in 2012, we might even expect to see some of the existing provisions beginning to be written back.

Chart 16 : Net provisioning, annualised, bp



Source: Company reports, Rasmala forecasts

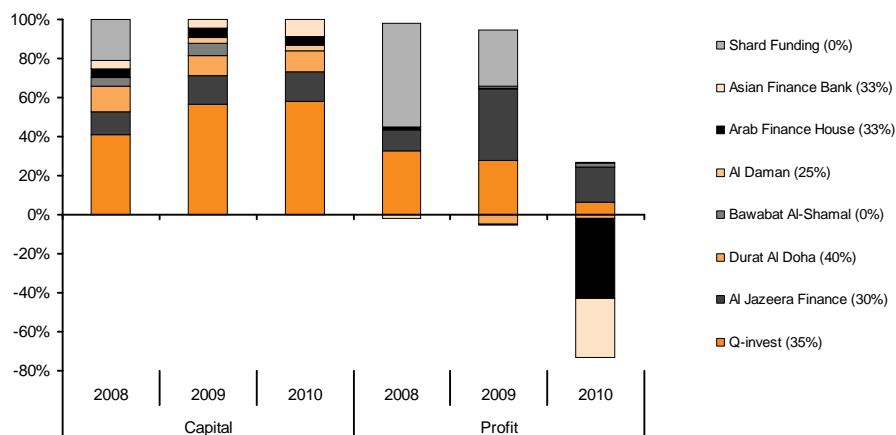
Overall, we might have expected that QIB's disproportionate exposure to the housing sector would result in higher NPLs and ultimately higher provisioning, but we find that this is not the case. As with many Islamic banks catering primarily to national populations in the GCC, even when they suffer from high NPL ratios, they still have surprisingly strong (low) provisioning numbers, with few loans ultimately going bad.

Associate returns dominated by Al Jazeera Finance and QInvest

Associate cash flows shrink, amid reorganisations

Average returns from the associates have been strong, showing a return on book value of 20% in 2008. This halved in 2009 to 10%, mostly as a result of the disposal of Shard Funding, the investment vehicle for the London skyscraper ('The Shard'). Following this disposal, the main contributors to both capital and profitability have been QInvest, the leading Qatari investment bank, and Al Jazeera Islamic, the leading Qatari consumer finance company.

Chart 17 : QR1.5bn associate portfolio as of 2010



Source: Company reports

We believe that Al Jazeera Finance is the dominant player in the relatively well-penetrated personal financing segment. Most earnings in 2009 and a large proportion of earnings of 2008 were driven by property disposals, amounting to QR110m in 2009 and QR42m in 2008. Net of these, net income rose approximately 30% in 2009, to QR71m. In 2010, we believe provisioning and impairments likely remained an issue, potentially deferring a mooted IPO, once scheduled for June 2011.

QInvest is developing into a full-service investment bank, with corporate finance, brokerage and asset management arms being put in place, and with cross-border links with Panmure Gordon in the UK, and with Ambit of India. QIB is disclosing that it has significantly increased its level of ownership, with further details to be provided after the contract is finalised.

In 2011, we may see Bawabat Al-Shamal (North Gate) gain in prominence, but not within associate income. QIB has formed a joint venture with Al Futtaim and Aqar Real Estate for a QR6bn entertainment and retail park, and intends to utilise much of its QR1.2bn land bank for that purpose. To date, no information has been provided, beyond the fact that half of QIB's shareholding was diluted away, resulting in the holding being transferred to investments.

International expansion by minority stake acquisition and establishing new JVs

With its strategy of acquiring minority stakes and establishing finance houses, involving strategic partners, QIB is now looking towards France and Germany. Within Asia, QIB plans to open representative offices in Indonesia, Singapore and Brunei. Further, the bank is also undertaking feasibility studies with the intention of expanding into Turkey and Egypt.

Joint venture cost benefit

One of the main issues with associates is that they are no longer included within regulatory capital and therefore negative-impact RoTCEs and capital allocation decisions. As a result, we believe that there is some pressure for QIB to reassess its approach to associates, particularly given its upcoming rights issue. Although in principle a decision to focus its substantial associate portfolio has little impact on valuations, we believe the increased visibility associated with consolidated accounting and strategic control would have a positive impact on valuations beyond the effect on regulatory capital.

Any new market entry likely to be low risk

Regulatory changes make JVs more difficult to fund

Valuation and recommendation

QIB is not expensive by Qatari standards, but we remain concerned about the weak rate of return, and the extent to which QIB can grow into its capital base. In addition, we reflect an assumption of greater uncertainty in the discount rate cutting any upside.

With above-peer-average loan growth, strong asset quality and adequate capitalisation, it is no surprise to us that QIB trades at a premium valuation. The 2011F PE multiple of 12.2x and the 2010 PB multiple of 2.5x represent a premium of 7% and a discount of 9% to the sector average, respectively, although QNB is the only stock that trades more expensively.

Our DDM valuation takes more account of the lack of a premium ROTCE, largely as a result of its structurally underleveraged nature. In addition, we believe we have less visibility on the stock given the high volatility of individual line items, leading us to ascribe a higher discount rate of 12.1%. On this basis, we ascribe a target price of QR87.97, suggesting 5% potential upside to the current share price of QR84.0, and we ascribe a Hold rating on the stock.

Versus consensus

Our net profit forecasts for 2011-13 are 14%, 15% and 16% below Bloomberg consensus. We believe that this is primarily due to a thin and dated consensus sample for QIB. We note in particular that the 2010 consensus EPS estimate was 6% above the actual number, and we would therefore expect consensus to come down.

Figure 3 : Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|--|--------|---------------------|--------|---------------|--------|
| Explicit Dividends | Net CF to shareholders | | 1,083 | 1,115 | 1,103 | 1,353 |
| | NPV Stage 1 | 3,956 | 3,956 | 3,198 | 2,319 | 1,353 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 3,152 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 1,085 | 20% | 19% | 8,777 | 61,349 |
| | NPV Stage 2 | 3,072 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 55,449 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 13,771 | 12% | 5% | 49,984 | |
| Total NPV | | | COE | | | |
| | Stage 1 (2010-2013) | 3,956 | US RFR | | | 2.56% |
| | Stage 2 (2014-23) | 3,072 | Country Risk Spread | | | 4.00% |
| | Stage 3 (2024+) | 13,771 | Sector Risk Spread | | | 2.50% |
| | NPV | 20,799 | Stock Spread | | | 2.25% |
| | Shares | 236 | Discount Rate | | | 11.31% |
| | * after adjusting for QIA capital subscription | | | | | |
| | Price Target | 88.02 | | | | |
| | Price | 84.00 | | | | |
| | Upside/(Downside) | 5% | | | | |

Source: Company data, Rasmala forecasts

Primary risks

We split our concerns into two categories, balance sheet risks – the risk of an impairment, or a liquidity constraint – and business risks. We believe the risk of an impairment is small, and have no reason to expect outsized business risks. Overall exposure to property is a concern, though.

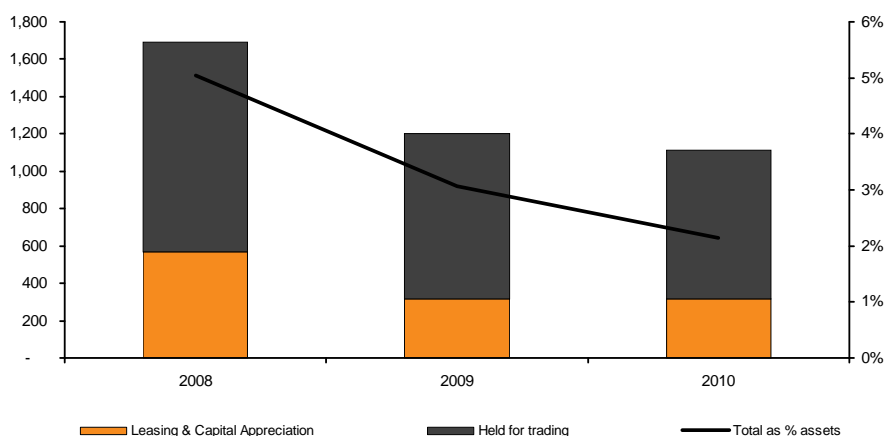
Balance sheet risks limited

Impairment risk on property exposure limited: North Gate properties

As an Islamic bank, with fewer constraints on property-ownership, QIB has the largest direct exposure to property of the four Qatari banks we cover. However, total exposure is limited, amounting to 13% of shareholders' funds and 3% of the balance sheet. From an accounting point of view, it is not possible to assess the value of the land. However, most of it will be rolled into the Bawabat Al-Shamal project on unknown contract terms. While the risk of an impairment continues, we believe there is sufficient upside risk to compensate.

Update on Bawabat al Shamal should provide clarity

Chart 18 : Property portfolio evolution, QR m, % of total assets



Source: Company reports, Rasmala estimates

Impairment risk for financial assets minimal due to low equity exposure

We exclude most financial investments from interest income, but this is for modelling/disclosure limitations rather than due to high equity exposure. In fact, of the QR3.5bn book, just QR1.3bn consists of shares or mutual funds.

Associates amount to a further QR1.5bn, but with QInvest and the Asia Finance Bank still in expansion mode, we do not believe there is much chance of an impairment. Therefore, the at-risk areas, in our view, are only Al Jazeera, and Durat al Doha, which combined with smaller investments amount to QR0.5bn as of 4Q10.

Liquidity risk minimal

Finally, for balance sheet risk, we see little sign of running into a regulatory constraint or facing liquidity risk. QIB raised a US\$750m bond in 4Q10, with maturity in five years. In addition, the forthcoming capital raising in favour of QIA will provide ample liquidity for the foreseeable future.

Business risks less quantifiable

The main short-term risk, in our view, is the exposure to the property market through loans to the housing market. We believe these include both corporate and residential customers, and with the value of the underlying property continuing to fall, loan impairments are certainly a question. Nevertheless, the resilient cash flow in the sector and guidance from management on the issue suggest that this risk is controlled.

As with all Islamic banks, there is an additional regulatory risk over the appropriateness of Islamic banking in general. In particular, there is significant debate among Shariah scholars if Islamic banks should forego business that is not in line with the spirit of risk-sharing; this could become a concern. Nonetheless, Islamic banks have a privileged position in the GCC and Qatar specifically, with more lenient regulatory constraints and arguably a less price-discriminative customer base.

In terms of management, we believe investors will see the loss of the well-respected CEO Salah Jaidah as a disappointment and that this will be an area of uncertainty until a replacement is found. For now the strategic vision is in place, provided by the senior board, and there is no change in tactical implementation. However, until a new CEO is in place, a change of direction remains a distinct possibility.

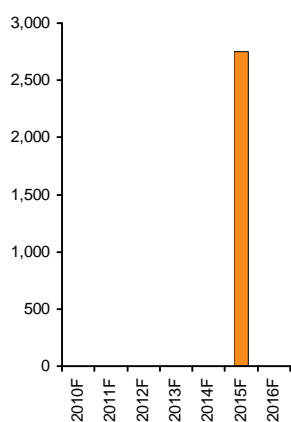
The major risk we see is that there are still a number of areas of uncertainty over the business: 1) the inclusion of interbank revenues within investment income is a reporting weakness on a quarterly basis; 2) fee income is significantly less stable than its conventional peers; and 3) property valuations and the coming reorganisation of Bawabat al Shamal and other associates bring uncertainty.

Dividend and capital

QIB has generally maintained a high payout ratio, averaging 85% over the past three years. We believe that the reality is that payout ratios are determined largely by investor preferences, which vary over time. For the next few years, we believe that investors will be looking for a relatively high payout ratio. Nevertheless, that also depends on the capital requirement of QIB.

Risk of a writedown of associates unlikely

Chart 19 : Debt maturity profile

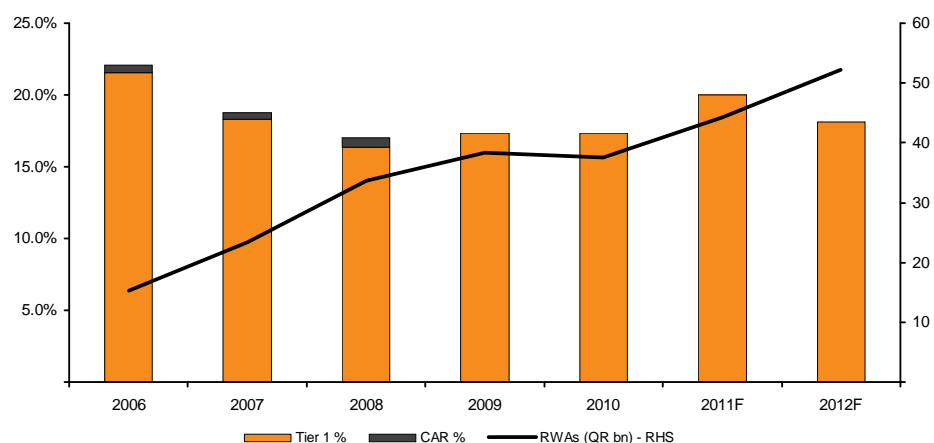


Source: Company reports

CEO departure brings uncertainty, and reporting visibility does not match the sector average

Capital is abundant following the year-end review of risk weightings

Chart 20 : Capital adequacy, boosted by 2011 private placing



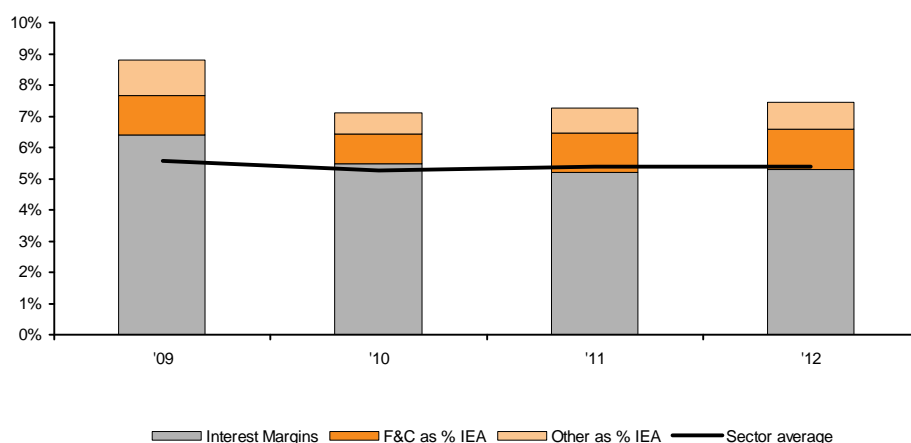
Source: Company reports, Rasmala forecasts

We were surprised by the high year-end capital adequacy ratio for 2010 of 17.4%. We had been expecting that year-end results would suggest that capital was getting thin. However, declines in capital deductions and sharply reduced risk weighting for credit have meant that the capital adequacy ratio has increased despite loans growing far faster than equity. In addition, the announcement of the Qatar Investment Authority (QIA) capital increase means QIB is more likely to be suffering from an excess of capital over the next few years than a shortage. This may well be the largest impediment to a high ROTCE.

Long-term drivers

We expect QIB to have one of the highest loan growth rates over 2010-12, at a CAGR of 19%. In addition, we expect the current mid-teens level of returns to climb back up towards 20%. In particular, we note superior revenue margins, not just on a calculated basis, but also on a reported basis providing superior returns on average assets of 2.89% in 2010 (average: 2.68%).

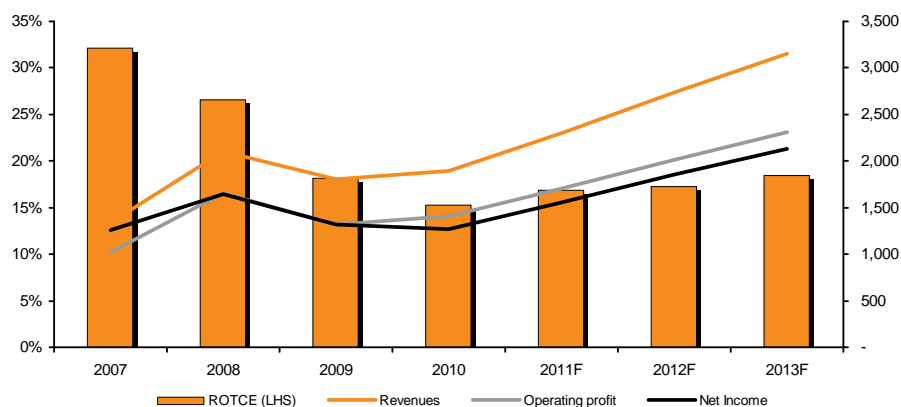
Chart 21 : Revenue margin (net interest margin + non-interest margin)



Source: Company reports, Rasmala forecasts

However, we set against this a structurally lower level of gearing. Tier-1 capital is just 79% of the equity base, due to a high level of associates, and this ratio is likely to decline as QIB moves to a more efficient capital structure. Gearing of 6.5x in 2010 is likely to be the most stretched QIB's balance sheet will be in the near future, but, even in the long term, there may be limits on the extent of QIB's gearing. In addition, an aversion to Tier-2 debt from Islamic banks means generally higher Tier-1 capital. As a result of superior returns on assets, but we believe structurally lower leverage, we model a long-term level of returns of 20%, towards the lower end of the range for Qatari banks.

Chart 22 : Income statement, RoTCEs



Source: Company reports, Rasmala forecasts

For growth, on the other hand, we are fairly positive, estimating a long-term growth rate of 18%, at the top of the range for the Qatari banks. QIB is primarily the leading Islamic bank in all areas of financing except the public sector and elements of GRE business. Nevertheless, in the short to medium term, we expect it to take an increased share of public sector business, and in the longer term it appears well-placed to take advantage of resurgent private sector business.

With the longer-term nature of the business, however, and the more uncertain competitive position in Islamic banking, we assign QIB the highest discount rate in the sector, with a stock spread of 2.5% (the component of the discount rate which reflects stock specific risk). CBQ and Doha Bank both have the penetration of Islamic banking as a core target. In addition, QIB is looking to rebalance its franchise away from property and the uncertain impact of this on, for example, spreads, is enough to justify the 50bp premium to CBQ and Doha Bank.

Key sensitivities

Table 1 : Sensitivity to key input variables, based on +/- 1 percentage point

| | +1 pp | -1 pp |
|---------------|--------|-------|
| Phase 2 | | |
| ROTCE1 | 4.6% | -4.6% |
| Growth | 1.5% | -1.4% |
| Discount rate | -15.2% | 20.8% |
| Phase 3 | | |
| ROTCE2 | 8.7% | -8.7% |
| Growth | 0.1% | -0.1% |

Source: Company data, Rasmala forecasts

Income statement

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Net interest income | 1289 | 1339 | 1671 | 1980 | 2303 |
| Non-interest income | 513.7 | 552.1 | 628.7 | 757.9 | 852.5 |
| Total income | 1802 | 1891 | 2300 | 2738 | 3156 |
| Operating costs | -487.4 | -479.3 | -596.3 | -723.8 | -849.9 |
| 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 |
| <u>Pre-prov operating profit</u> | 1315 | 1412 | 1703 | 2015 | 2306 |
| Provisions charges | -31.1 | -50.0 | -103.8 | -87.8 | -92.1 |
| <u>Post-prov op prof</u> | 1284 | 1362 | 1599 | 1927 | 2214 |
| 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 | 1599 | 1927 | 2214 |
| Taxation | 10.9 | -66.4 | -40.0 | -48.2 | -55.3 |
| Minority interests | 27.4 | -27.4 | -16.7 | -21.6 | -24.9 |
| Preference dividends | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other post-tax items | 0.00 | 66.4 | 40.0 | 48.2 | 55.3 |
| Reported net profit | 1322 | 1335 | 1583 | 1905 | 2189 |
| Tot normalised items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Normalised PTP | 1284 | 1362 | 1599 | 1927 | 2214 |
| Normalised net profit | 1322 | 1335 | 1583 | 1905 | 2189 |

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Net loans to customers | 22663 | 29352 | 34711 | 41357 | 48924 |
| Other int earn assets | 8903 | 12431 | 15097 | 16853 | 18958 |
| Goodwill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Oth non-int earn assets | 5165 | 7068 | 7589 | 8302 | 8935 |
| Total assets | 39273 | 51840 | 60657 | 70273 | 81390 |
| Total customer deposits | 20361 | 30258 | 35058 | 41770 | 49413 |
| Oth int-bearing liabs | 8691 | 11125 | 12530 | 14409 | 16549 |
| Non int-bearing liab | 2203 | 2207 | 2403 | 2655 | 3189 |
| Total liabilities | 31255 | 43590 | 49991 | 58834 | 69151 |
| 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 | 270.5 | 290.1 | 310.4 |
| Total liab & sh equity | 39273 | 51840 | 60657 | 70273 | 81390 |
| Risk weighted assets | 38314 | 37523 | 44221 | 52274 | 61349 |
| Est non-perf loans | n/a | n/a | n/a | n/a | n/a |
| Specific provisions | -248.2 | -297.8 | -401.1 | -488.2 | -579.5 |
| 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 | 44221 | 52274 | 61349 |
| Reported net profit | 1322 | 1335 | 1583 | 1905 | 2189 |
| Opening risk assets | 33591 | 38314 | 37523 | 44221 | 52274 |
| Closing risk assets | 38314 | 37523 | 44221 | 61349 | 0.00 |
| Change in risk assets | 4723 | -790.8 | 6698 | 17128 | -52274 |
| Capital required | 472.3 | -79.1 | 0.00 | 0.00 | 0.00 |
| Free capital flow | 849.8 | 1414 | 1583 | 1905 | 2189 |
| Ordinary dividend paid | -1181 | -1083 | -1100 | -1103 | -1353 |
| 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 | 811.6 | -1103 | -1353 |
| Net capital flow | 1580 | 330.6 | 2394 | 801.8 | 835.8 |
| Tier 1 capital | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Company data, Rasmala forecasts

year to Dec

| Standard ratios | QIB | | | | | Comm Bank of Qatar | | | QNB | | |
|---------------------------|-------|-------|-------|-------------|-------|--------------------------|-------------|-------|-------|-------------|-------|
| Performance | FY09A | FY10A | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F |
| Non-int inc/gr op inc (%) | 28.5 | 29.2 | 27.3 | 27.7 | 27.0 | 30.6 | 30.4 | 31.2 | 23.9 | 24.3 | 24.9 |
| Cost/income (%) | 27.0 | 25.3 | 25.9 | 26.4 | 26.9 | 32.0 | 33.0 | 33.0 | 18.6 | 19.6 | 20.6 |
| Costs/average assets (%) | 1.34 | 1.05 | 1.06 | 1.02 | 1.21 | 1.34 | 1.35 | 1.53 | 0.63 | 0.65 | 0.80 |
| Net income growth (%) | -24.1 | 0.06 | 20.4 | 20.5 | 14.9 | 19.6 | 16.1 | 12.0 | 18.2 | 25.4 | 14.9 |
| Net cust loan growth (%) | 20.1 | 29.5 | 18.3 | 19.1 | 18.3 | 16.2 | 15.2 | 15.8 | 19.5 | 19.9 | 20.2 |
| Cust deposit growth (%) | 22.7 | 48.6 | 15.9 | 19.1 | 18.3 | 15.2 | 15.4 | 16.1 | 17.9 | 19.0 | 18.3 |
| Net interest margin (%) | 4.50 | 3.62 | 3.62 | 3.35 | 3.92 | 3.67 | 3.50 | 3.89 | 3.00 | 2.78 | 3.25 |
| Return on avg assets (%) | 3.56 | 2.99 | 2.84 | 2.72 | 3.15 | 2.95 | 2.87 | 3.24 | 2.74 | 2.65 | 3.07 |
| Return on avg equity (%) | 19.5 | 16.8 | 17.2 | 17.1 | 19.6 | 16.4 | 16.6 | 18.7 | 21.8 | 18.2 | 21.1 |
| RORWA (%) | 3.68 | 3.52 | 3.87 | 3.62 | 4.19 | 3.64 | 3.38 | 3.82 | 5.49 | 5.20 | 6.20 |
| | | | | year to Dec | | | year to Dec | | | year to Dec | |
| Valuation | | | | | | | | | | | |
| Normalised EPS growth (%) | -27.2 | -4.08 | 16.4 | 15.4 | 14.9 | 14.4 | 11.2 | 12.0 | 18.2 | 25.4 | 14.9 |
| Reported PE (x) | 13.8 | 14.3 | 12.3 | 10.7 | 9.30 | 11.2 | 10.0 | 8.96 | 11.9 | 9.46 | 8.23 |
| Normalised PE (x) | 13.8 | 14.3 | 12.3 | 10.7 | 9.30 | 11.2 | 10.0 | 8.96 | 11.9 | 9.46 | 8.23 |
| Price/book value (x) | 2.33 | 2.26 | 1.91 | 1.78 | 1.66 | 1.72 | 1.63 | 1.55 | 1.98 | 1.70 | 1.47 |
| 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 (%) | 6.49 | 5.95 | 5.54 | 5.56 | 6.82 | 6.80 | 7.21 | 8.13 | 2.49 | 2.47 | 2.75 |
| | | | | year to Dec | | | year to Dec | | | year to Dec | |
| Per share data | FY09A | FY10A | FY11F | FY12F | FY13F | Solvency | FY09A | FY10A | FY11F | FY12F | FY13F |
| Tot adj dil sh, ave (m) | 216.6 | 216.6 | 226.4 | 236.3 | 236.3 | Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Pre-prov prof/share (QAR) | 6.07 | 6.52 | 7.52 | 8.53 | 9.76 | Total CAR (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported EPS (QAR) | 6.10 | 5.85 | 6.81 | 7.86 | 9.03 | Equity/assets (%) | 19.9 | 15.5 | 17.1 | 15.9 | 14.7 |
| Normalised EPS (QAR) | 6.10 | 5.85 | 6.81 | 7.86 | 9.03 | Net cust loans/dep (%) | 111.3 | 97.0 | 99.0 | 99.0 | 99.0 |
| Book value per sh (QAR) | 36.1 | 37.1 | 44.0 | 47.2 | 50.5 | Rep NPL/gr cus adv (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend per share (QAR) | 5.45 | 5.00 | 4.66 | 4.67 | 5.73 | Tot prov/rep NPLs (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend cover (x) | 1.12 | 1.23 | 1.44 | 1.73 | 1.62 | Bad debts/advances (%) | 0.14 | 0.17 | 0.30 | 0.21 | 0.19 |
| | | | | year to Dec | | | | | | year to Dec | |

Priced as follows: QISB.QA - QR84.00; FGB.AD - Dh17.80
Source: Company data, Rasmala forecasts

Valuation methodology

| Stage 1 (2010-2013) | | 2010 | 2011 | 2012 | 2013 |
|--------------------------|--|----------------------|--------|---------------|---------------|
| Explicit Dividends | Net CF to shareholders | 1,083 | 1,100 | 1,103 | 1,353 |
| NPV Stage 1 | 3,943 | 3,943 | 3,184 | 2,319 | 1,353 |
| Stage 2 (2014-23) | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 20% | 19% | 8,777 | 61,349 |
| NPV Stage 2 | 3,072 | | | | |
| Stage 3 (2024+) | | Model Numbers | | | |
| Terminal Value | 2023 | ROTCE2 | Growth | Capital Req'd | |
| | | 12% | 5% | 49,984 | |
| NPV Stage 3 | 13,771 | | | | |
| Total NPV | | COE | | | |
| Stage 1 (2010-2013) | 3,943 | US RFR | | | 2.56% |
| Stage 2 (2014-23) | 3,072 | Country Risk Spread | | | 4.00% |
| Stage 3 (2024+) | 13,771 | Sector Risk Spread | | | 2.50% |
| NPV | 20,786 | Stock Spread | | | 2.25% |
| Shares (m) | 236 | Discount Rate | | | 11.31% |
| | * after adjusting for QIA capital subscription | | | | |
| Price Target | 87.97 | | | | |
| Price | 84.00 | | | | |
| Upside/(Downside) | 5% | | | | |

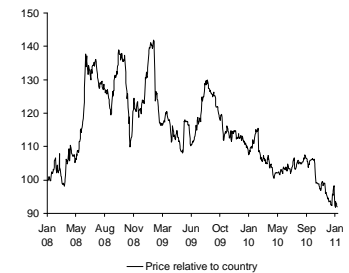
Source: Company data, Rasmala forecasts

Company description

Hold

Price relative to country

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.



Strategic analysis

Average SWOT company score: 3

Revenue split 9M10

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

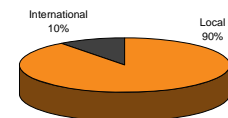
Corporate and private banking expansion, Islamic product innovation and international expansion are the primary opportunities for QIB. However, it also aims to have success in public sector lending and through QIB Capital.

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)



Source: Company

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%)

Competitive position

Average competitive score: 4+

Broker recommendations

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+

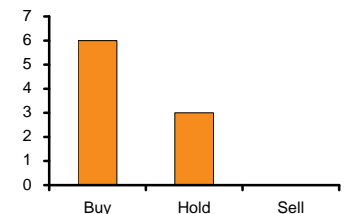
We believe the availability of substitute products (capital markets and wholesale lending) is rising, but it is currently unclear to what extent Qatar will favour its own banking system.

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



Source: Bloomberg

28 January 2011

Initiation of coverage

Hold

Target price
QR215.89

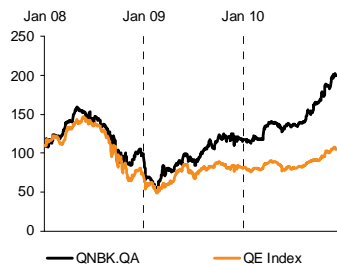
Price
QR200.10

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

| | (1M) | (3M) | (12M) |
|----------------|-------|-------|-------|
| Price (QR) | 182.8 | 163.6 | 115.5 |
| Absolute (%) | 9.5 | 22.3 | 73.2 |
| Rel market (%) | 6.4 | 6.3 | 25.5 |
| Rel sector (%) | 4.7 | 3.8 | 15.6 |



Market capitalisation
QR78.33bn (€15.81bn)

Average (12M) daily turnover
QR16.13m

Sector: QE Bank Index
RIC: QNBK.QA, QNBK QD
Priced QR200.10 at close 24 Jan 2011.
Source: Bloomberg

Analyst

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Qatar National Bank

Quality no secret

QNB trades at a premium to peers in Qatar and the UAE, reflecting what we see as its strong, liquid and low-risk balance sheet with consistent growth and strong ties to the government. But, with premium returns in perpetuity apparently priced in, and given non-negligible acquisition risk, we see QNB as fully valued.

Key forecasts

| | FY09A | FY10A | FY11F | FY12F | FY13F |
|---------------------------|-------|-------|-------|-------|-------|
| Reported PTP (QRm) | 4,191 | 5,718 | 6,759 | 8,474 | 9,737 |
| Reported net profit (QRm) | 4,202 | 5,704 | 6,743 | 8,454 | 9,714 |
| Reported EPS (QR) | 10.50 | 14.30 | 16.90 | 21.20 | 24.30 |
| Normalised EPS (QR) | 10.50 | 14.30 | 16.90 | 21.20 | 24.30 |
| Dividend per share (QR) | 3.08 | 5.00 | 4.98 | 4.94 | 5.50 |
| Normalised PE (x) | 19.10 | 14.00 | 11.90 | 9.46 | 8.23 |
| Price/book value (x) | 4.24 | 3.52 | 1.98 | 1.70 | 1.47 |
| Dividend yield (%) | 1.54 | 2.50 | 2.49 | 2.47 | 2.75 |
| Return on avg equity (%) | 25.10 | 28.00 | 21.80 | 18.20 | 21.10 |

Accounting standard: IFRS
Source: Company data, Rasmala forecasts
year to Dec, fully diluted

Public sector growth the key to the day

We believe QNB stands to gain from its substantial public sector exposure over the next two to three years. In addition, although energy investments are reaching maturity, infrastructure and World Cup investments may extend public sector lending growth by another two to three years. This, combined with sector-beating ROTCEs approaching the mid-20s, makes a strong case for investors to view QNB as the high-quality franchise in Qatar. Nevertheless, we believe its strengths and opportunities are already well appreciated.

Revenue diversification likely to mean higher costs

As well as high growth, public sector exposure brings low cost-income ratios (2010A: 17.6%), low provisioning margins (2010A: 7.3%), low cyclicality and the possibility of high gearing (2010A: 10.0x) due to low risk weightings, all of which contribute to sustainably high ROTCEs (2010A: 26.6%). However, as public sector growth slows, we believe QNB is likely to diversify its sources of growth via the private sector and international expansion. Although spreads and non-interest income contributions should improve, the main impact is likely to be lower sustainable returns.

Positive metrics abound, with some upside risk

A key area of uncertainty for us is whether we have been too cautious or not cautious enough on the expected benefit from public-sector spending. We believe the economics favour a bond-market or self-financing solution, but conversely recent developments suggest the government is expecting to utilise the banking sector. For now, we give limited credit for international expansion, although this could provide upside potential.

Valuation and recommendation

QNB is the most expensive bank in our Qatar coverage universe, trading at a 2011F PE of 11.9x and a 2010 PB of 3.5x. We assume a discount rate of 10.2% and an exit ROTCE of 23%. On this basis, we ascribe a target price of QR215.9, suggesting 8% potential upside to the current share price of QR200.1. On this basis, we initiate coverage with a Hold recommendation: a further re-rating would push it to an unjustified premium, in our view.

Important disclosures can be found in the Disclosures Appendix.

Distributed outside MENA by The Royal Bank of Scotland N.V. and its affiliates under a strategic alliance with Rasmala Investment Bank Ltd.

The basics

Versus consensus

| EPS (QR) | Ours | Cons | % diff |
|----------|-------|--------|--------|
| 2011F | 16.87 | 16.41 | 2.80 |
| 2012F | 21.15 | 18.102 | 16.83 |
| 2013F | 24.30 | 19.8 | 22.72 |

Source: Bloomberg, Rasmala forecasts

Forced ranking*

| Company | Rec | Upside / Downside |
|-----------|------|----------------------|
| Doha Bank | Hold | 1% |
| CBQ | Buy | 22% |
| QIB | Hold | 8% |

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: Rasmala forecasts

Key events

| Date | Event |
|--------------|------------|
| 6 April 2011 | 1Q results |

Source: Company

Catalysts for share price performance

For a positive re-rating, we see only one key potential catalyst: the prospect of much stronger loan volume growth than the 20.0% we forecast for the next three years. However, another key uncertainty relates to the bank's use of its recent sudden liquidity influx and whether this will continue and in what form. About QR10bn of this relates to corporate time deposits of over one year arriving in 4Q10. However, QNB is also raising QR12.7bn in a rights issue (equivalent to 57% of 2010 year-end book value), and how the bank uses these proceeds will be a key determinant of future share price performance.

Earnings momentum

We expect loan volume growth (of 20%) to be the main determinant of earnings growth going forward. On the back of this, we forecast 18% headline earnings growth in 2011 (with the liquidity boost being offset by margin pressure), followed by 25% in 2012 (with the full year of higher liquidity no longer being offset by margin pressure) and 15% in 2013.

In addition to superior loan growth, the main positive features in 2011 are likely to be solid fee and commission growth of 24%, partly driven by historic balance sheet volume growth and a recovery from a weak 4Q10, but also by self-help measures such as the expansion of QNB's financial services. Provisioning should also decline sharply from its 4Q10 peak.

On the negative side, sideways movement in interest rates is likely to clip spreads for interest-sensitive banks, of which QNB appears to be one. In addition, we believe increasing diversification is likely to lead to rising costs.

Valuation and target price

Given its high level of returns, it is little surprise that QNB trades at premium multiples. On a 2010A P/TB basis, QNB trades at 3.5x, or at a 41% premium to our coverage universe average, although on an earnings multiple basis this sinks to just a 3% premium based on a PE of 11.9x for 2011F. We believe the superior level of returns and better growth prospects suggest the tangible book multiple is justified, but with an expectation of declining revenue spreads and a rising cost-to-income ratio based on diversification, we hesitate to ascribe a high target value.

We calculate our target price of QR215.9 using 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. We assume a discount rate of 10.2% and an exit ROTCE of 23%.

How we differ from consensus

Our forecasts for 2011-13 exceed the Bloomberg consensus by 3%, 17% and 23%. However, we believe that the main difference is that we have modelled the pending rights issue already, and higher capital is driving higher earnings. We also believe we are more cautious than the market on both spreads and costs.

Risks to central scenario

In principle, QNB is a low-risk entity, but, with so much of its value based on future growth, we see this as misleading. In terms of growth, QNB is widely expected to benefit more than the rest of the sector from government spending, in both absolute and relative (to its size) terms. Nevertheless, with a only a portion of funding likely to be provided by domestic banks, it is highly uncertain what the growth rate may be, and we see both upside and downside risk here. In addition, we have some concerns about the level of liquidity flowing into QNB, and whether this will be utilised effectively. Small acquisitions are likely in the cards, but whether the bank can successfully utilise the recent strong deposit inflow and the very substantial upcoming rights issue is a matter for debate.

From an earnings point of view, the main concerns are the sustainability of ROTCE. As a result of the capital raising, we assume that ROTCE will fall from 26.6% to 21.3% in 2011 and to 19.3% in 2012, in spite of increasing ROATAs. This, however, is equivalent to 30% ROTCE on a fully leveraged basis. Whether or not QNB can deploy that excess capital usefully, so as to hold on to those superior levels of return, and what will happen to public sector lending in the ultra-long term are likely to be key questions over the next 10 years.

Key assumptions and sensitivities

Putting further liquidity and capital to work

Currently, it appears the government plans to ensure adequate liquidity and capital in the banking system to prevent anything going amiss with its infrastructure investments. In most cases, the incremental capital and liquidity should be easily absorbed in banks' existing growth and payments to shareholders. But, the numbers for QNB are substantially larger than elsewhere, with QR10bn of corporate time deposits arriving in 4Q10 and an additional QR12.7bn of rights issue capital expected to arrive in 2Q11 – a total liquidity influx larger than QNB's current total equity.

For now, we assume the deposits can be absorbed in the operations of the business, temporarily raising liquidity before being drawn down into lending. In addition, the central bank has announced the 1Q11 issuance of QR50bn of debt to soak up liquidity. We also assume QNB can give up some of its short-term deposits, although it is doubtful whether this would have a positive impact on spreads. For now, we park the proceeds of the rights issue in interest earning assets. However, if the proceeds are used for substantially higher organic growth than we currently forecast, then we are clearly being too conservative with our forecasts.

On the other hand, if the rights issue funds were used for a substantial acquisition (which we deem unlikely), we would be concerned about the overpayment issue. We believe the most likely possibility is for the funds to be used for domestic funding and aggressive international expansion, both organic and inorganic. If QNB can generate 2x book value of the rights issue, that would provide an extra QR12.7bn, equivalent to an additional 16% upside potential.

High growth drives discount rate sensitivity

As for all the Qatari banks in our coverage, the sensitivity to the discount rate is significant. However, QNB's superior growth rate makes this even more of an issue. Our baseline discount rate for Qatari banks is 9.06%, and we add a 110bp stock spread to that for QNB, based on some of the issues we raised in our risks discussion on the preceding page. This still gives QNB the lowest discount rate in the sector, 50bp below Commercial Bank of Qatar (CBQ), 90bp below Doha Bank and 110bp below Qatar Islamic Bank (QIB). We calculate that each percentage point increase in the discount rate would have a -17% impact on the target price, while each percentage point decrease would have a +24% impact.

In terms of forecast sensitivity, the main issues are growth, capital and ROTCEs

- **Growth forecasts the strongest in our coverage:** We forecast growth rates of 20% for each year in 2011-13, followed by stage 2 growth of 17% for 2014-23. The sensitivity to growth is relatively small, with each percentage point of stage 2 growth being worth around 3% of the target price. Consequently, the higher growth rate across the period is worth around 10% of the target price compared with a benchmark growth rate of 15% throughout Stage 1 and Stage 2.
- **Capital:** We base our forecasts on a post-rights issue scenario, although, even on a 2010 basis, QNB was already adequately capitalised, in our view, at 15.3%. Given the lower payout ratio and higher level of returns, we would have expected this to be sufficient to cater to its current disclosed growth plans, but 2010 saw a bump in the payout ratio, and there has been more talk of inorganic and international growth. Longer term, we assume a 12% equity ex associates to RWA ratio, but the sensitivity to this will depend upon other assumptions.
- **ROTCE:** In the short term, we expect the capital injection to bring down returns from 26.6% in 2010 to 21.3% 2011, and then 19.3% 2012. Despite pressure on spreads and the cost-to-income ratio, we believe this can be maintained by gradually rebuilding leverage. Our 23% long-term forecast is at premiums of 1% to Doha Bank, 3% to QIB and 5% to CBQ, with each percentage point correlating to a 3% impact on the target price. Given the very high net profit margin of 76.2% in 2010, rising to a forecast 78.9% in 2012, changes in costs or provisions have a relatively small impact on earnings.

Terminal value assumptions

We set a standard 12% ROTCE and 5% growth rate across the sector in the very long term (2024+), effectively reducing the exit book value multiple to a little over 1x. A 1ppt change has a 5% impact on the target price, but we do not pretend to differentiate between the banks over this period.

Executive summary

QNB is the highest quality bank by any measure of financial performance, in our view. However, the challenge will be for it to deploy the capital from an upcoming rights issue to take advantage of substantial public-sector financing requirements.

We believe QNB is undoubtedly a high-quality bank, well positioned for future growth. In terms of operations, it has the highest net profit margin by far among the banks we cover (2010A: 76.2%), as a result of having the lowest cost-to-income ratio (2010A: 17.6%), and a generally low provisioning margin (although in 2010A it was above average at 7.3%). In addition, its substantial public-sector business implies a low risk weighting for assets, and, consequently, very high gearing (2010A: 10.0x), despite having a very defensive tier-1 and total capital ratio (2010A: 15.3%). Bearing this in mind and taking into account its strong positioning for future public sector growth, the lower revenue margins (interest margin + non-interest margin of 3.8% in 2010A) can be forgiven. However, all of this is widely recognised by the market, and, consequently, QNB trades at a 2010A P/TB of 3.5x and a 2011F P/CE of 11.9x (not adjusted for the rights issue), premiums of 41% and 3%, respectively, to the Qatari banking sector averages.

Well positioned for domestic growth

Currently, the main growth opportunity seems to be in public-sector lending. The government has been clear about its spending objectives. A portion of this is likely to be cash-funded or funded directly by the capital markets. Of the rest, much is expected to be financed by international banks. But, it is also clear that local banks expect to be given a slice of the pie, and we believe this is nowhere more the case than at QNB, given its government connections. We thus expect strong public-sector loan growth to be the core driver of 20% average loan growth in the next three years.

Beyond that horizon, there is a risk that public-sector loan growth will atrophy, although we still expect it to be a significant driver of total loan growth, and QNB's efforts at diversification are increasingly likely to be important. In addition, public-sector growth could be more front-end loaded, although QNB's robust liquidity position (amounting to 371% of equity, excluding the 57% injection from the expected rights issue) should be able to deal with that.

International strategy also crystallising

With QNB's estimated market share of 40.8% (as of 4Q10) growing faster than the average of the overall market, the local market is beginning to seem small for a bank this size. Consequently, management is beginning to emphasise international growth opportunities. In particular, QNB is acquiring a foothold in nearly all countries in the three main Arab groupings – the Maghreb, the Levant and the Arabian Peninsula – with Egypt and Morocco and Saudi being the only gaps. However, its ambitions also extend to Europe (mostly private banking) and Asia, where it is currently adding an 80% stake in Indonesia's Bank Kesawan.

These acquisitions and extensions have generally been small, limiting the scale of risk, with the exception of the acquired stakes in the UAE's Commercial Bank International (CBI) and Jordan's Housing Bank for Trade & Finance (HBTF) and the rapidly expanding Syrian joint venture, QNB Syria. In total, the operations outside Qatar, Europe and North America amount to just 11% of assets or 22% of liabilities. Nevertheless, although, in principle, these frontier-market expansions seem sensible, further development brings both acquisition and dilution risk, and may make the current high leverage more difficult to maintain.

Maintaining profitability

Critical to the current high level of returns is the public sector business, which allows high leverage, low costs and low provisioning to drive a very impressive ROTCE. We believe this business could become more competitive with other sources of growth being relatively dormant and CBQ and other banks looking to take their share. In addition, as QNB gradually becomes more diversified, some ROTCE attrition should be expected.

Critical assumption: will future investments dilute returns?

We believe that we have made one core assumption that essentially drives our valuation, and that is over the core ROTCE in stage 2. We calculate a core ROTCE (on a fully leveraged basis) of 30% in 2013. However for the 2014-23 year time horizon, we assume this drops to an average of 23%. The key assumptions on which this is based are that:

- the public sector lending space becomes significantly more competitive; and
- capital deployment alternatives, such as its international expansion strategy, will not be able to attain the same level of profitability as the current business.

Although we are comfortable with both these assumptions, if QNB maintains the current level of profitability until 2023, then that would take the upside to 32%. If it maintains that level of profitability indefinitely, the upside would swell to approximately 100%.

Overall, current valuation is justified, in our view

Overall, we believe QNB is well placed to take advantage of its current opportunities and is likely to maintain a high core profitability, justifying the current premium valuations. In addition, provided QNB can justify the scale of the capital raising, the imminent rights issue should go far towards making the current high multiples more palatable. Our target price of QR215.89 represents 8% potential upside to the current share price. Hold.

Figure 1 : Dupont analysis

| STAGE ONE | STAGE TWO | STAGE THREE | STAGE FOUR | STAGE FIVE | ADDITIONAL COMMENTS |
|-------------------------|-------------------------|-------------------------------|------------------------------|-----------------------------------|-------------------------|
| ROTCE | Gearing | Tier 1 ratio | TCR | | |
| 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | | |
| 23.5% 26.6% 21.3% 19.3% | 9.70 10.03 6.78 6.87 | 13.2% 15.3% 22.8% 22.6% | 13.2% 15.3% 22.8% 22.6% | | |
| 18.9% 18.5% 18.7% 18.7% | 7.36 7.87 6.49 6.49 | 14.8% 15.1% 18.0% 16.9% | 15.9% 16.2% 18.8% 17.6% | | |
| | ROAA | IEA / TA | Loans / IEAs | | |
| | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | | |
| | 2.71% 2.92% 2.68% 2.83% | 90.5% 80.8% 88.3% 88.4% | 67.0% 73.0% 66.2% 67.6% | | |
| | 2.79% 2.68% 2.69% 2.69% | 81.9% 78.2% 83.3% 84.2% | 70.5% 72.1% 69.4% 70.4% | | |
| | | Revenue / average IEAs | Interest Margins | Spreads | |
| | | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | |
| | | 3.4% 3.8% 3.8% 4.0% | 2.75% 3.45% 3.03% 3.07% | 2.64% 3.45% 3.00% 2.90% | |
| | | 4.9% 4.6% 4.8% 5.0% | 3.57% 3.86% 3.69% 3.69% | 3.52% 3.88% 3.70% 3.70% | |
| | | | Non II / average IEAs | F&C to ave IEAs | |
| | | | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | |
| | | | 1.01% 0.86% 0.90% 0.98% | 0.62% 0.58% 0.63% 0.66% | |
| | | | 1.46% 1.21% 1.30% 1.30% | 1.03% 0.84% 0.87% 0.90% | |
| | | | | Other revenues to ave IEAs | |
| | | | | 2009 2010 2011F 2012F | |
| | | | | 0.38% 0.28% 0.27% 0.32% | |
| | | | | 0.44% 0.37% 0.43% 0.45% | |
| | | Net Profit Margin | Op. Margin | Cost-Income Ratio | |
| | | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | |
| | | 77.6% 76.2% 79.4% 78.9% | 79.1% 82.4% 81.4% 80.4% | 20.9% 17.6% 18.6% 19.6% | |
| | | 66.5% 64.3% 67.0% 67.0% | 70.8% 72.3% 72.0% 71.5% | 29.2% 27.7% 28.0% 28.0% | |
| | | | Provn Margin | Net Provisioning | NPL ratio |
| | | | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F | 2009 2010 2011F 2012F |
| | | | -5.3% -7.3% -3.2% -2.3% | 0.28% 0.49% 0.20% 0.15% | 0.59% 0.77% 0.80% 0.75% |
| | | | -8.3% -8.0% -5.6% -4.5% | 0.58% 0.60% 0.44% 0.44% | 1.78% 1.76% 1.75% 1.75% |
| | | | XYZ Margin | | |
| | | | 2009 2010 2011F 2012F | | |
| | | | 3.8% 1.2% 1.2% 0.8% | | |
| | | | 4.0% -0.1% 0.7% 0.5% | | |

Source: Company reports, Rasmala estimates

Not just a public sector bank

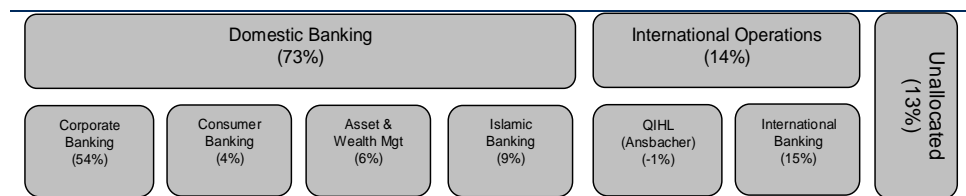
QNB's fortunes inevitably reflect changes in the public sector, but there is certainly more to the bank than that. Private-sector growth is still an important feature and international expansion is a key target.

QNB is the dominant public sector bank in Qatar, but much besides

QNB is the largest bank in Qatar, with a domestic branch network of 40 branches, excluding the 12 Al Islami branches and three mobile branches. It is also the most geographically diverse of the Qatari banks, with a presence in most Arab countries across the main three Middle Eastern areas: the Maghreb, the Levant and the Arabian Peninsula. Of particular note are QNB's franchises in Syria (through QNB Syria), Jordan and Palestine (through HBTF), and the UAE (through CBI).

QNB's domestic operations are dominated by its relationships with the public sector, which, as of year-end 2010, provided 50% of its capital, 44% of its conventional deposit base and 52% of its loan book. In the credit market as a whole, with the public sector accounting for 39.4% of all bank credit in 3Q10 (up from 30.7% in 3Q08), this has certainly been a boon for QNB. Nevertheless, QNB has also been developing its domestic product density and recently made efforts to extend its footprint, particularly into Syria and Tunisia.

Figure 2 : QNB organisational chart, split by net profit %, 4Q10



Source: Company reports

Domestic operations dominated by corporate banking

Corporate Banking, including Public Banking, dominates domestic banking

Domestically, QNB operates through four main divisions: Corporate Banking, Consumer Banking, Asset & Wealth Management, and Islamic Banking. This, however, was a new breakdown as of 4Q09, preventing us from discussing any meaningful trends. Nevertheless, by far the most important of these is the Corporate Banking operation, which includes public-sector lending.

Besides balance-sheet-led banking, QNB obtains significant fee-driven business from the asset management operation, and also from QNB Capital, the in-house investment bank.

International banking raising its contribution

International Banking expanding across MENA and beyond

Internationally, QNB has two divisions: QNB International Holdings Limited (QIHL) and International Banking. QIHL is the holding company for the newly trimmed Ansbacher operation, which experienced a revenue drop of 69% in 2009, with earnings turning into losses. We do not expect Ansbacher to make a significant contribution to QNB's results going forward.

Declines at QIHL were more than offset by the solid growth of the International Banking division, where revenues rose 58% and net profits 68% yoy in 2009. This took the division's net profit contribution to 15% of group total in 2009, from 11% a year earlier. International Banking includes a branch network across seven MENA (Middle East and North Africa) countries, a European high-net-worth operation and the recently launched standalone bank QNB Syria.

Associate income now contributing 4.1% of net profit (9M10)

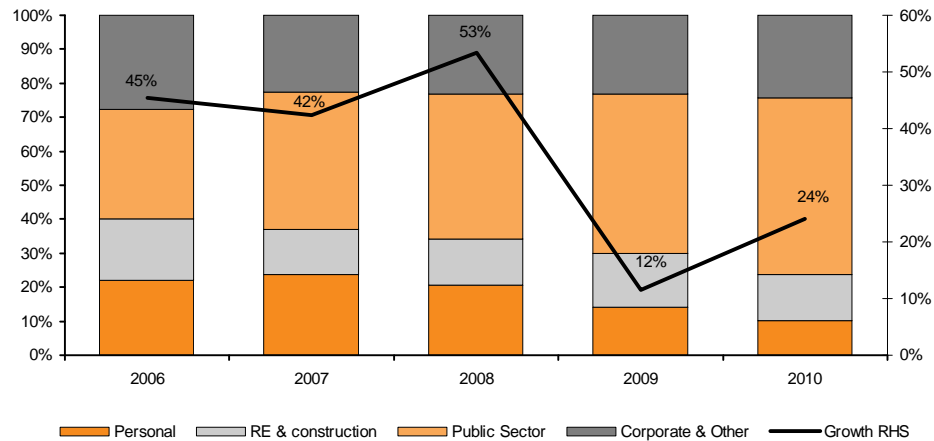
QNB also has four main international associates, across Jordan (Housing Bank for Trade & Finance, HBTF, 34%), the UAE (Commercial Bank International, 23%), Iraq (Mansour Bank, 23%) and, most recently, Tunisia (Tunisian-Qatari Bank, 50%). In addition, QNB has a 20% stake in Al Jazeera Finance Company – a dominant player in the domestic consumer finance market. These investments have all been acquired since 3Q07. The most significant of these is HBTF, although CBI is also a significant component.

Structurally, public sector likely to lead growth

Public sector lending growth the main opportunity

With 54% of net profit coming from the corporate banking division, and within that, the bulk coming from the public sector, it is clear to us that the public sector remains the engine of profits for QNB. This is also reflected in the breakdown of the loan portfolio. After two years where public sector lending accounted for 47% and then 85% of all growth, public-sector lending now accounts for over half of QNB's loan book.

Chart 1 : Gross loan book split, loan growth %



Source: Company reports

In the 11 months to November 2010, total credit across the Qatari financial system grew 14%, with the public sector accounting for 71% of that. We believe QNB's strong position in getting public-sector business has been a key driver of the bank's 24% yoy loan growth. Public-sector growth accounted for 73% of QNB's loan book increase in 2010, with lending to the service sector the only other significant area of volume growth.

Public sector lending relatively secure, with downside risk

If public sector lending is at the heart of QNB's growth story, it is only fair to ask how secure that is. QNB maintains that bidding for public sector business is done on an open-market basis – a view disputed by some of its competitors. In addition, QNB has advantages in being the largest bank in the region, with close connections to the government. The bank's absolute size makes managing the substantial liquidity issues that much easier. In addition, where a loan is syndicated in an international consortium, QNB is likely to be the default bank for an international consortium to approach for a local partner.

Nevertheless, with public sector growth accounting for 51% of 2009 and 71% of 2010 (year to November) loan growth for the sector as a whole, it is little surprise to us that many other banks are seeking, with varying degrees of success, to get a slice of the pie. The two main approaches are developing relationships and lobbying government for a more equitable distribution, although a price-led strategy is likely employed where effective.

Domestic competitors and wholesale market competitors

To date, only Masraf al Rayan (NR) has made significant inroads into the sector, and that mostly while it was filling out its franchise in 2007-08. With the exception of Commercial Bank of Qatar (CBQ), we believe the other banks will make limited progress in this area, unless there is a re-evaluation of the government's approach to distributing government business. Consequently, any loss of market share in this area should be manageable. Of greater concern is the likelihood of increased competition from syndicated borrowers and capital markets, which are arguably better structured for providing these facilities. To this end, QNB Capital will aim to gain a slice of any issuance fees.

Corporate lending falling behind the curve

Although QNB is not known specifically as a corporate bank, it is still the largest corporate bank in Qatar. Corporate lending increased 11% in 2009, significantly below the 21% growth rate for the sector as a whole. QNB continues to be closely linked to the service sector, and this contributed to the 37.4% growth rate in 2010, although we suspect this may be narrowly focused. On an underlying basis, we believe QNB continues to expand its product offering to the corporate sector, gaining market share to make up for modest losses in market share in public sector businesses.

Real estate and contracting exposure

Property and construction exposure falls mainly into two categories: public sector infrastructure/industrial exposure and private sector residential/commercial building. Of these, the assumption is that public sector exposure is healthy, with building projects ultimately backed by government funding and driven by government strategy. In addition, the economics of it are often driven by the infrastructure or energy industries.

For residential lending, although construction is frequently ultimately backed by the government, the deflating regional property bubble has obviously put a hole in the business. Although this business is opaque, it seems likely that the large developers have slowed delivery, but are still being encouraged to maintain some cash flow to ensure the health of suppliers.

Between 2007 and 2009, QNB raised its exposure to contracting by 245% and to real estate lending by 94% for a combined increase in property loans of 105%. However, this trend turned in 2010, with property lending increasing by 4.5%. Contracting exposure for the sector as a whole continued to grow, with total banking sector credit rising 35% in the year to November 2010 on the back of infrastructure expansion, while real estate exposure, with its links to the residential market, was flat.

Consumer lending declining

Consumer loans in National Accounts declined sharply in 2009, and QNB's lending to the sector was even more exaggerated, slipping 24%, with this decline continuing into 2010. The vast majority of consumer lending is to the Qatari National segment, whose leverage constraints are linked to government wages. Consequently, with little in the way of salary increases over the past two years, growth in lending to the segment has remained rather directionless.

As of 2009, QNB remained somewhat under-represented in the sector, but with a domestic branch network no greater than that of its main competitors, there is no clear reason why we would expect QNB to have greater penetration of lending. We expect this to be the slowest lending segment to recover, and forecast a growth rate of just 10% for QNB lending to the sector.

QNB AI Islami successful, but some cannibalisation clear

Not only has AI Islami accumulated 26.0% market share in Islamic banking over the past six years, but, as of 4Q10, Islamic lending accounted for 21% of QNB's loan book, up from 13% at the start of the year. Although this increase may be due to the addition of a few public sector loans, QNB has been busy in the corporate and retail segments, rapidly expanding its product density.

AI Islami is the only Islamic arm of a conventional bank that has captured significant market share. Part of this is the larger branch network (AI Islami operates through 12 branches), and potentially QNB's determination to build enough product density to adequately service relevant customers. However, a big part is likely also to be cannibalisation of the existing franchise, and diversion of public sector lending towards Islamic lending. By implication, AI Islami is at least partially a defensive operation.

Lending forecast at a 20% CAGR for 2011-13

For 2010, net loans grew at 24% yoy to QR131bn, with QNB benefitting from its continued focus on state lending. We believe growth from the sector will begin to be more constrained as certain projects reach completion and as the government increasingly accesses bond financing over bank financing. Nevertheless, given the tremendous growth opportunities, we still believe that QNB can maintain a public sector growth rate of 25%. Over the longer term, we expect QNB to shift towards the corporate and retail segments. With this in mind, we forecast a three-year CAGR of 20% for 2010A-13F+.

Internationalisation – from Mauritania to Indonesia

Although structural factors are likely to largely determine QNB's medium-term outperformance, we believe several near-term factors could also aid growth. The most important is international expansion, which now accounts for 31% of assets and 14% of net profit. QNB's presence now includes 23 countries worldwide, with concentration primarily on the MENA region.

QNB AI Islami is the only Islamic arm of a conventional bank to get significant traction

QNB has a well-structured plan for expanding internationally

Recent development

Recent developments include the launch of QNB-Syria and QNB-Switzerland in 2009, followed in July 2010 with the group's first branch in Mauritania and obtaining a full branch licence in Lebanon (for launch in 1H11). Broadly speaking, international banking falls into two or three camps: a regional MENA banking network, and a European high net worth franchise, with trade finance also being a feature, of course.

The latest US\$82m agreement for the acquisition of an 80% stake in Indonesia's Bank Kesawan in 1Q11 does not quite fit that mould. The likelihood is that QNB has stretched from providing MENA coverage to considering opportunities within the Islamic arena as fair game.

The MENA branch network – building a regional base

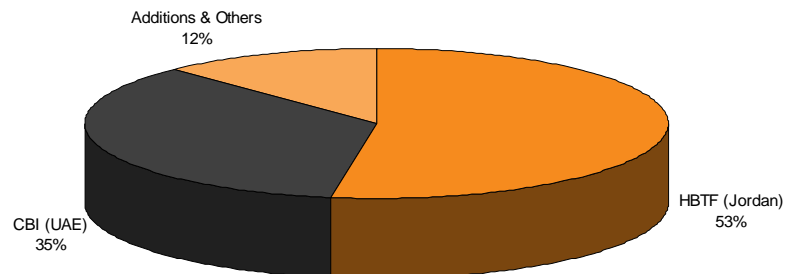
QNB's new branch openings in Lebanon and Mauritania supplement Gulf Cooperation Council (GCC) branch operations in Yemen, Oman and Kuwait and also up to five Al Islami branches in Sudan, making its network one of the broadest across the MENA region. In addition, progress has been made in terms of deepening these relationships, with the Omani and Sudanese operations having expanded significantly in 2010, jumping from one each to four and five respectively, although this has not been definitively confirmed.

QNB Syria began life in November 2009, but after its first anniversary, it is expanding rapidly. The branch network is now targeted to reach 15 by the end of 2011, potentially making it already more than a quarter the size of the Qatari operation.

Associates – building an option

In addition to its international operations and subsidiaries, QNB has a number of associate investments, with a book value totalling QR4.6bn, contributing 2.5% and 4.6% of QNB's assets and net profits, respectively. Of the five main investments, only two are really significant: the 34%-owned HBTF in Jordan, and the 23.8%-owned CBI in Dubai.

Chart 2 : Associates, breakdown by investment cost (QR4.6bn)



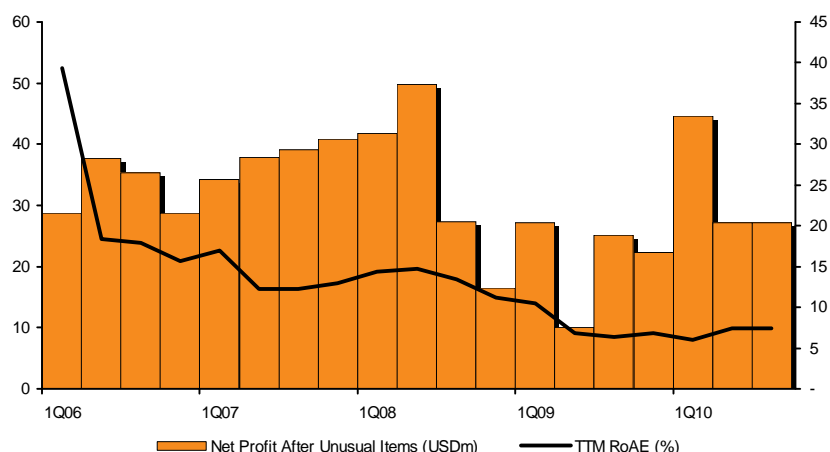
Source: Company reports, Rasmala estimates

HBTF is the second-largest bank in Jordan, with total assets of US\$8.6bn as of 3Q10 and 96 branches in Jordan, 12 branches in Palestine and one each in Bahrain and Syria. The average RoAE has been unimpressive, delivering no better than single-digit returns since the beginning of the economic crisis. Part of this is structural, with HBTF suffering from high taxation. Over the past two years, however, it has also suffered from a high provisioning margin, which has kept the return on equity solidly below 10%.

We believe that provisioning recovery should take returns back into double digits, over 2011-13. However, low levels of leverage, weak loan growth, high costs and low non-interest income all present areas for potential improvement.

Either through subsidiaries, joint ventures or associates, QNB has a presence across MENA

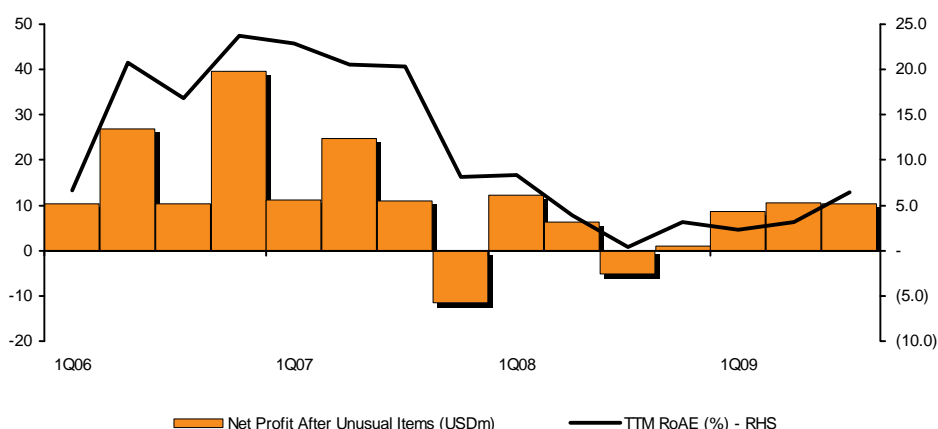
Chart 3 : HBTF, net profit after unusual items, TTM RoAE % (US\$m)



Source: Zawya

CBI's headquarters is in UAE, where it operates out of 16 branches, with most spread across the smaller emirates. As of 3Q10, CBI had total assets of US\$3.2bn. Like HBTF, CBI's operations have provided inadequate returns in past two years. CBI has been running with a high cost-income ratio (exceeding 50%) and a high provisioning margin, which has made an adequate RoAE difficult to achieve, although the provisioning margin was down to 21% as of 9M10. In addition, the declining net interest margin has limited the visible benefit of modest growth (5% net loan growth yoy).

Chart 4 : CBI, net profit after unusual items, TTM RoAE % (US\$m)



Source: Zawya

Building a Pan-MENA franchise

Across the Maghreb, QNB still does not have a presence in Morocco or Egypt, with only a rep office in Libya and an indirect presence in Algeria. In the Arabian Peninsula, the main missing piece of the puzzle is Saudi Arabia. In Arab Levant, QNB has the full set, although its presence in Palestine is only through HBTF, and stretching the definition to the non-littoral countries, Iran is only addressed with a rep office so far.

A presence across the Maghreb, Levant and Arabian Peninsula

Although QNB's current international expansion may include expansion into some or all of these areas, as we can see from the recent Indonesian announcement, QNB has intentions beyond the region, expanding perhaps to some of the major Islamic countries. Surprisingly, given its liking for Indonesia, QNB does not see Malaysia as a major long-term growth area. Instead, the main identified possibilities are India, and, to a lesser extent, Turkey and Vietnam (see next).

So far, QNB has shown an aptitude for going into new countries with a minimum of fuss, setting up greenfield sites or making small acquisitions or minority investments. This will take a lot of stitching together to make it work effectively, and will take up a lot of management's time. Nevertheless, from a financial point of view, this is likely to minimise the risk associated with out-of-market acquisitions, and plausibly maximise the benefit of government links.

European intentions are aiming to build Swiss style Private Banking operation

Home markets, network countries and extended network countries

QNB, in its bond issuance documentation for 4Q10, categorised international opportunities into three buckets according to their potential contribution to earnings of the international division: home markets that could potentially each contribute 20% or more; network countries each targeting 5-20% contribution; and extended network countries with smaller contributions.

Within the home markets are listed Jordan, where QNB already has a sizable presence through associate HBTF; the UAE, where it has associate CBI; and Indonesia, where it may soon have Bank Kesawan. Also listed is the EU, where it has significant private banking operations and the rump of the Ansbacher group; and, more surprisingly, India. We regard the last as an area of acquisition risk, due to difficulties in building branch networks from scratch.

QNB's intention is to provide universal banking services in home markets; wholesale, trade and limited retail services in network countries; and purely complementary services in extended network countries, such as trade finance, probably out of a local rep office. Overall, these categorisations suggest significant room for growth over the coming years.

The other international opportunity – building a HNW operation

For now, the international HNW operations are split into three segments: QNB Private, headquartered in Doha but with branches in London and Paris; QNB Banque Privée (Suisse) based in Geneva; and QIHL's Ansbacher group, now only in London following the disposal/closure of its Bahamas, Channel Islands and Zurich offices.

We believe that ultimately these will operate substantially under the same umbrella. QNB Private still seems to have only a limited amount of Swiss-style private banking products. Banque Privée is still rolling out its IT network, outsourcing/migrating its back-office operations to B-Source, a back-office solution provider for small private banks. Ansbacher has been stripping down its operations from a global yacht/mortgage financing company to its bare bones. What should arrive at the other end is a dedicated Swiss-style private bank for Qatari clients.

Although private banking in the region is mainly defensive in nature, with banks aiming to retain the bottom end of the private banking market with vanity products and a service focus, we believe that QNB Private Banking is looking to go some way beyond that. Although the very top clients are still likely to need the services of the top private banks, we believe QNB may be successful in retaining the middle tier.

Growth likely to remain elevated in the short term

Although credit growth has slowed dramatically, we believe the core of QNB's business will grow slightly below the rate for the public-sector business. In addition, we believe market share gains in corporate banking and international growth will both mean QNB has the highest growth rate of the Qatari banks beyond the short term.

Although public sector lending is the prime driver of credit growth at the moment, we believe this will decline as large public sector projects reach completion and as competition builds from disintermediated financing at the top end and from the smaller banks at the bottom end. Consequently, in the medium term, we expect public-sector growth to decline and that for QNB to decline below the growth rate for private-sector lending. Nevertheless, as international operations continue to grow in importance, we do not expect an actual reversal of the growth differential.

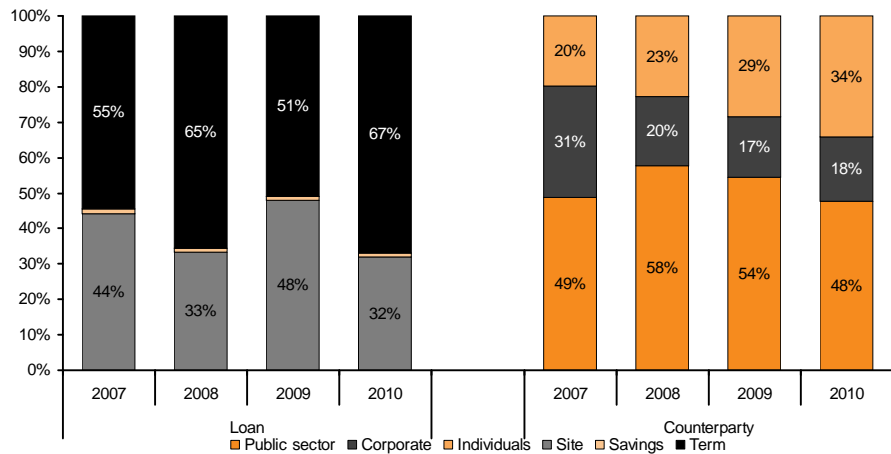
In conclusion, we believe QNB will grow significantly above market rates in the medium term. Initially, this will be driven by high exposure to the public sector, but increasingly it will be driven by international lending. The principle risks to this are that the public sector will actually deleverage after the current period of increasing leverage, or that QNB will lose its market-leading position. In addition, although international development seems to be going well at the moment, it is not yet clear to what extent the QNB proposition is applicable in the new markets.

Public-sector funding continues to be the mainstay

In terms of funding, QNB is fairly close to its optimal structure. In 2010, QNB used its excess asset liquidity to pay down its interbank liabilities, and this has meant funding growth has been driven primarily by customer deposits. In addition, however, customer deposits have been rising more quickly than loans and the balance sheet as a whole, allowing the loan-to-deposit ratio (LDR) to decline from 96% in 4Q08 to 80% in 4Q10. As a result, the balance sheet has become increasingly liquid, and net liquid assets now amount to 34% of the total loan book. In addition, this has generally been without significant capital market funding, which remains low for QNB, despite the recent US\$1.5bn capital raising. Instead, a high level of deposit and equity funding

has taken up the slack. Of conventional deposits, 48% came from the public sector as of 4Q10, providing a stable but high-cost deposit base.

Chart 5 : Deposits, split by customer, type %



Source: Company reports

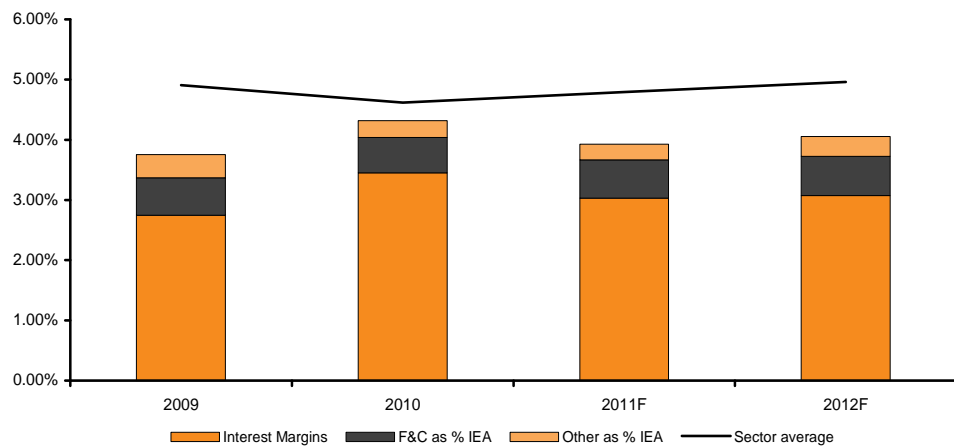
We believe there is room to raise the loan-deposit ratio while at the same time reducing liquidity. These higher levels of liquidity were necessary in pre-crisis times for managing extraordinary high levels of growth, and then were important during the economic crisis for managing liquidity volatility, but are less relevant now. In addition, the proportion of equity funding seems high, suggesting there is room for an increase in capital leverage. However, given a reluctance to use tier-2 capital, the last published CAR of 13.2% may become restrictive.

In the short term, we assume that QNB warehouses a substantial portion of this liquidity in government bonds, reducing the net liquid position from 34% to 14% of loans.

Non-interest income of growing importance

Given the high proportion of public sector business, it is little surprise to us to see revenue margins significantly below the sector average. Asset and liability interest spreads on public sector business, while better than they were before the economic crisis, are undoubtedly still lower than corporate or retail spreads. In addition, we believe most public-sector business drives little in the way of fees and commissions. Consequently, it is easy to see why QNB's revenue margins are structurally weaker than the Qatari sector average.

Chart 6 : Revenue margin, as % IEA vs sector average



Source: Company data, Rasmala forecasts

Interest margins low compared to the sector, but still above long term trends: we expect a decline

Interest margins unsustainably high

Although interest margins are lower than the sector average, and although we believe the shift to risk-based pricing and stricter asset liability management has had a positive impact, we also believe spreads and margins exceed their long-term trends. Increased liquidity has meant falling interest rates overall, but these have affected shorter-duration liability rates more quickly than asset rates, and this has had a positive effect on spreads, at least in the short term.

In 2011, we expect to see some reversal of 'crisis pricing'. At the start of the economic crisis, spreads on lending rose significantly. This was partly a reflection of a more disciplined approach to lending. However, it was also a temporary measure to reflect high short-term provisioning and increased difficulties with liquidity management. As a result, QNB's spreads rose from 2.27% in 2008 to 3.245% in 2010, and we expect some of this to be returned over the coming quarters.

Other drivers have been more prosaic. QNB substantially reduced its low-spread interbank balances in 2010, removing some of the padding in spreads, but this has had little impact on net interest income. Over 2011, with substantial swings in net liquid assets on a quarterly basis, we expect volatile spreads, but likely in a downward direction on both a measured and actual basis.

F&C to be boosted by QNB Capital, Private Banking and trade

Penetration of F&C has been low at QNB. That has largely been due to the fact that QNB's loan arrangement fees are less than half those for its nearest competitors. In addition, fees from trade finance as a proportion of trade letters amount to just 60bp, compared with 94bp for CBQ. In both cases, this relates to the fact that QNB's main counterparty is the government, requiring relatively unsophisticated products and generally large ticket lending facilities. However, CBQ also has a credit card operation and Doha an outsized trade services operation.

QNB Capital to boost fee income

QNB Capital, QNB's corporate finance and project advisory arm, achieved several milestones in debt and equity advisory over the past two years, and has been involved in M&A and project finance. QNB Capital typically is involved in deals where the Qatari state or investment authority has a leading stake.

QNB Capital has a strong competitive position for Qatari deals

In particular, on the equity side, QNB Capital acted as a lead manager for the US\$952m IPO of Vodafone Qatar in 3Q09, and the US\$475m IPO of Nawras in 4Q10. On the debt side, QNB Capital was the lead on the US\$2.75bn Qtel debt issuance in 4Q10, and the US\$7bn Qatar sovereign bond issue. On the advisory side, QNB Capital was mandated to advise on the QR8.4bn merger between Qatar Navigation and Qatar Shipping.

Current capital market activity levels in Qatar do not appear to be significantly depressed, with the debt and equity markets picking up much more effectively than in other GCC countries. An additional reason for developing QNB Capital, however, is that capital market financing may prove to be a significant competitor to bank financing going forward, and it certainly therefore makes sense for QNB to have a stake in both camps. Although we expect QNB Capital to be a significant success, we do not expect the incremental impact to be substantial.

Wealth Management still resolving structural issues

Wealth management downsizing Ansbacher and creating anew QNB Suisse

Private Banking, taken as whole, was still going backwards for QNB, as of 2009, although in 2010 it began to find traction. The restructuring of Ansbacher has seen its assets fall by 80% over 2008-10, with no immediate suggestion of a turnaround. In addition, QNB Banque Privée has yet to reach internal maturity, in our opinion, with infrastructure announcements still the order of the day. Nevertheless, 2010 was a strong year for the asset and wealth management operation with assets rising 40% yoy and earnings following suit. Consequently from 2011, we believe Private Banking as whole will be back on a growth path.

For now, we believe the strategy of the international private banking operation will be on retaining existing clients. However, the next step will be to bring back 'in-house' some of the HNW Qatari mandates that have gone to Swiss banks. More speculatively, QNB Asset & Wealth Management also hopes to be able to provide a service to a niche of international clients.

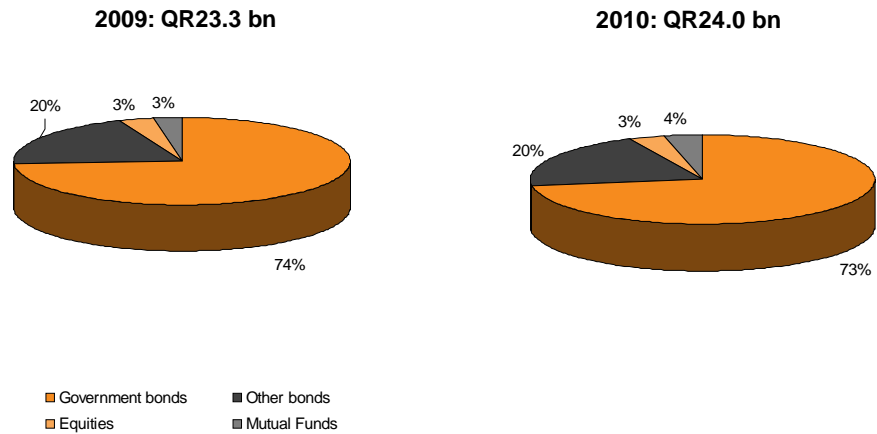
From a growth point of view, we believe this operation will grow steadily, more than matching the rate of growth of the rest of the business in the short term. Longer-term growth will be driven by penetration of the UHNW (ultra high net worth) Qatari market, the broader MENA HNW market or the European market, although for now we assume little contribution from these areas. With a cost-income ratio of 5% and a net margin of 87%, the profitability of this business is assured.

Government and other bonds dominate the investment portfolio, and this is set to increase

Majority financial investments in bonds

Not surprisingly, within our universe, QNB maintains the highest-quality financial investment book, with 93% held in bonds and the remaining 7% split between equity and mutual funds. In 2009, the bank exchanged QR4bn worth of AFS equity investments for cash and bonds, with the latter providing a steady yield of 5.5%. Returns from these investments are, however, overwhelmingly reported as investment income, resulting in little impact from market volatility and very weak trading and investment gains by historical standards.

Chart 7 : Financial investment portfolio



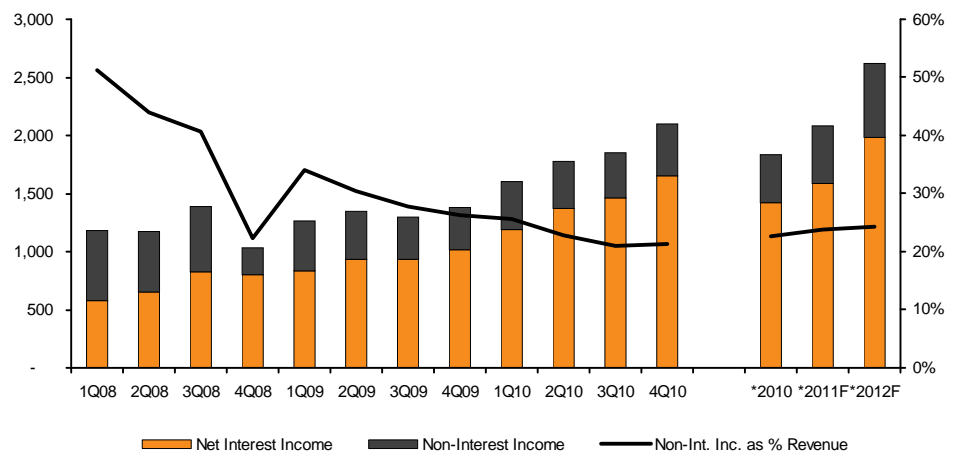
Source: Company reports

Overall revenues

After falling steadily to 76% in 4Q10, we expect the contribution from net interest income to be broadly stable from now. The decline was due primarily to the conversion of the investment portfolio to interest-earning items. Fees and commissions have also contributed to strong revenue growth, but their contribution has fallen from 18% to 16% of total revenue.

We do not expect dramatic change. Spread decreases will have an impact on the contribution of net interest income. Meanwhile, faster public-sector growth is also likely to provide slim pickings for fees and commissions, although we should see some recovery in service-related areas. Beyond 2013, we may see the contribution from fees and commissions rise as private-sector lending begins to outpace public-sector lending, but we do not explicitly forecast those numbers.

Chart 8 : Revenue, split by net interest income and other (QRm)



*annual data at a quarterly rate

Source: Company reports, Rasmala forecasts

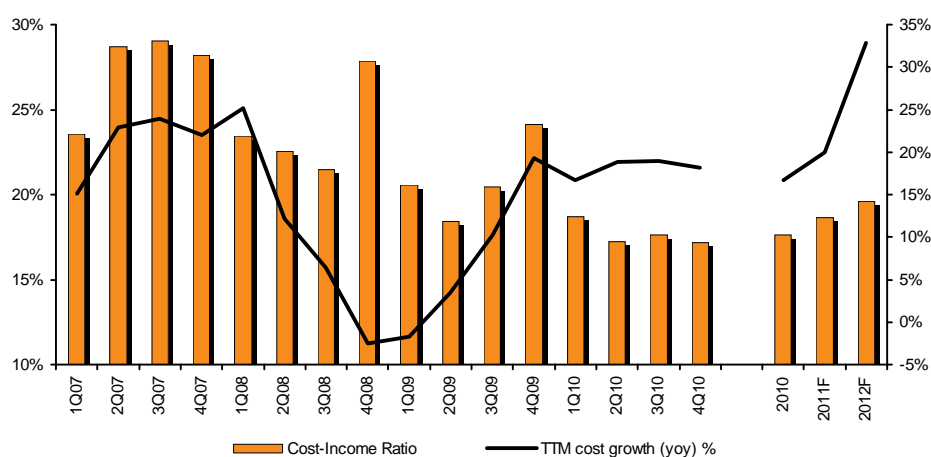
Cost-income ratio expected to remain low

Spread anomaly and large-ticket lending driving the low cost income ratio

A retail bank needs branches and contact points, a corporate bank needs specialist product teams, but a public-sector bank primarily needs an established relationship. Of these, the latter is the cheapest and most defensive, and this directly drives QNB's remarkably good cost income number. A strong revenue stream, lower capex on retail branches and implementation of strong IT systems have enabled QNB to maintain one of the lowest cost-income ratios in the region.

In 2010, with spreads staying buoyant, cost-income fell further to 18%, despite a last published Qatarisation rate of 53% and a 17% yoy increase in costs. Looking ahead, we project the CI ratio will rise 100bp pa over the next three years, but remain well below the internal target of 25%.

Chart 9 : Cost-income ratio, cost growth



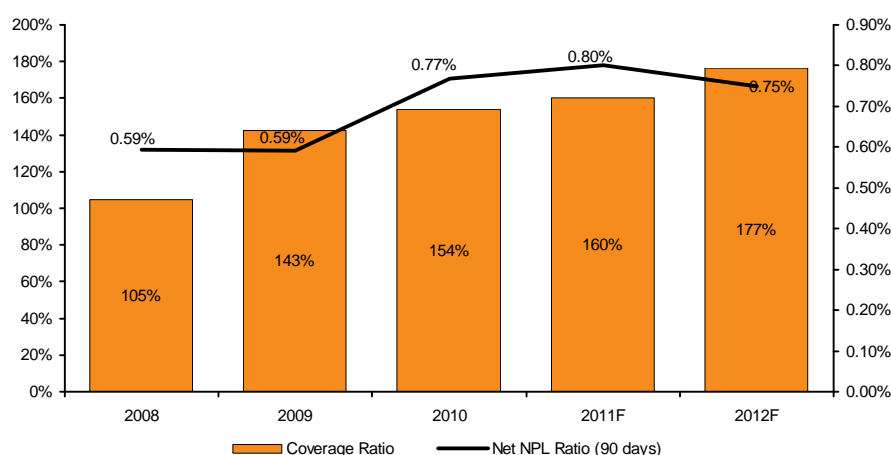
Source: Company reports, Rasmala forecasts

Best-in-class asset quality

Provisioning under control by 2011, but in any case not high

Although QNB has come a long way in terms of revenue diversification, 47% of its loan book is still allocated to the public sector. As a result, there has been really very little to fear in terms of rising NPLs. QNB's net NPL ratio peaked in 2Q09 at just 71bp on a 90-day basis. Although NPLs were again on a rising trend throughout 2010, given rising government spending we expect NPLs to peak in early 2011 at around 100bp.

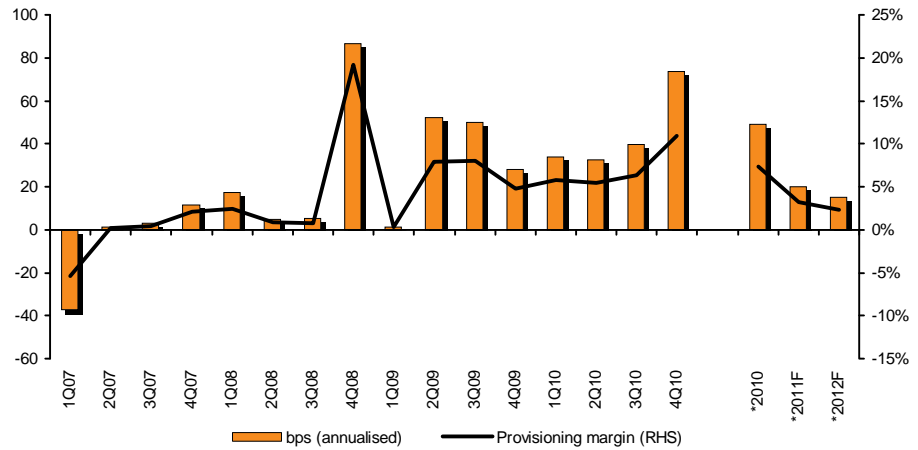
Chart 10 : NPL and coverage ratio



Source: Company reports, Rasmala forecasts

We believe NPLs are moving towards a second peak, but we are even more sanguine about provisioning. The coverage ratio in 4Q08 was 105%, and, following nearly two years of high provisioning (by historical standards), the coverage ratio stands at a steady 154%. There is significant scope for NPLs to continue to rise without worrying about the adequacy of provisions. Provisioning reached an annualised peak of 87bp in 4Q08, with even that figure representing not just asset deterioration, but improvement in the coverage ratio.

Chart 11 : Provisioning, annualised, as percentage of loans and revenues



*annual data at a quarterly rate
Source: Company reports, Rasmala forecasts

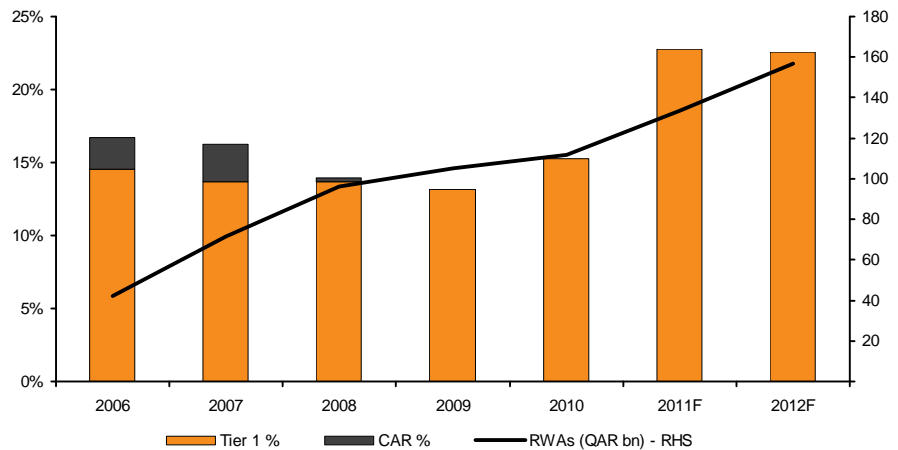
The cyclical trend will be falling provisioning and NPLs. We believe the increased proportion of private sector business will eventually turn this around, but not within our forecast horizon.

Dividend and capital

It's going to take a long time to soak up all this capital

QNB is the only bank not to maintain a payout ratio exceeding 50%, averaging 38% since 2006. In part, this has been the luxury of having a higher level of returns and, therefore, despite a lower payout ratio, having a perfectly satisfactory absolute level of dividend coupon, which is important to some investors. However, it is also the product of a higher growth rate and, therefore, a higher required (and justifiable) level of capital retention.

Chart 12 : Capital and RWA, %, QRbn



Source: Company reports, Rasmala forecasts

For 4Q10, QNB reported a total capital ratio of 15.3%, which we believe is sufficient for the bank's known expectations, including a higher rate of dividend from 2010 and a near 20% level of annual growth. However, if there is significant investment or acquisition abroad, there is the possibility that capital could become constrained.

In response, QNB recently announced a QR12.7bn rights issue, which at first glance seems like overkill, especially compared with the size of the last mooted acquisition, the US\$82m (QR300m) investment in Bank Kesawan. Consequently, either QNB is preparing for much higher growth than we have forecast, or it is anticipating significant capital investment, or it will end up cutting its leverage and raising its capital ratios dramatically, negatively affecting ROTCE. For now, we take a neutral view on the capital raising, pending further clarity, and have yet to include it in our model.

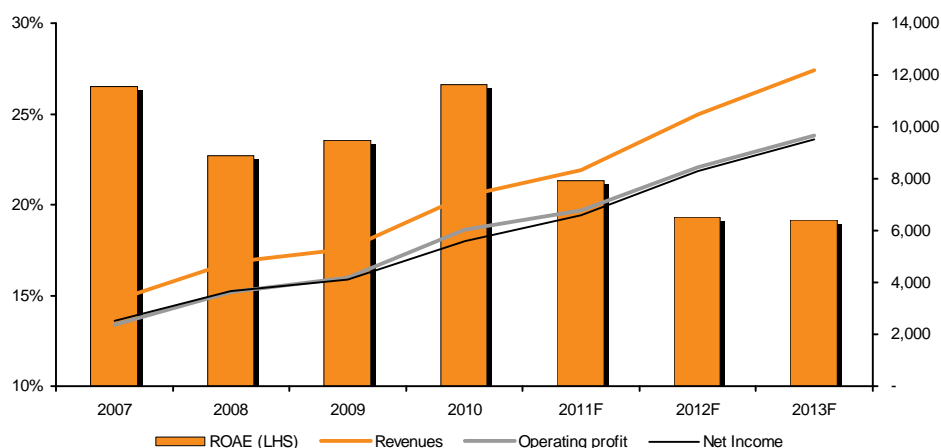
Long-term drivers

Underlying returns are top of the sector, but excess capital is likely to undermine this in the short term

ROTCEs to remain strong

QNB's conservative business model and state-backed asset growth have enabled it to withstand recent volatility and to provide a steady 22%-plus ROTCE. The consistent rise in revenues, as well as the lower cost and provisioning ratios, have ensured top-line growth has made it through to the bottom line. Headline net income for 9M10 totalled QR4.2bn (a 33% yoy increase), setting QNB for up for a full year-end net income figure of QR5.5bn, amounting to a 32% yoy increase.

Chart 13 : Income statement (QR m), ROTCEs, %



Source: Company reports, Rasmala forecasts

Medium-term growth assured

Matching the outlook for returns is the similarly rosy outlook for growth. QNB is likely to remain the lender of choice for the many infrastructure investments that were already due to take place. In addition, we believe it is also likely to be the primary beneficiary of the additional World Cup expenditure, the bulk of which is expected to occur in the next seven years. With this in mind, increasing diversification into the large corporate segment and the additional potential benefit of a broad network of branches across MENA frontier markets, we believe a CAGR of 20% is possible.

Superior longer-term estimates

We expect superior profitability and growth in the medium term

We estimate only two longer-term variables and, in both cases, we make above-market assumptions. We exit the forecast period in 2013 with a forecast capital efficient ROTCE of 23%, based on a target tier-1 ratio of 12%. Consequently, on the assumption of ROTCE fading from a higher level, we assume 23% is a reasonable estimate going forward. This compares with a range for its competitors of 18-22%.

The second key input variable is the growth rate. We believe QNB can maintain a superior growth rate through the coming periods based on its public-sector exposure and international branch network. With this in mind, we allocate a 17% CAGR for lending growth.

Valuation and recommendation

Critical to QNB's premium valuation is whether it can maintain profitability going forward, while deploying its substantial capital resources. We believe that significant dilution is likely (stage 2 ROTCE of 23%) limiting the premium payable for the excess capital.

QNB is the most expensive Qatari bank in our coverage, trading at a 2011F PE of 11.9x and a 2010A PB of 3.5x. The principle reasons for this are its superior ROTCE, its strong growth rate and lower level of risk, although with the capital raising the ROTCE will drop to 21% in 2011F (the PB will also drop). In addition, we believe QNB is the first bank to move towards a Pan-MENA banking operation, and has done so at relatively low cost.

On our DDM calculations, QNB also justifies its price, primarily due to the sustainably high ROTCE, and strong short- to medium-term growth rate. Despite a likely slowdown of government spending within the next five years, we continue to believe QNB will find room to expand. Even if its core market becomes more competitive, we believe it will continue to generate superior returns. On this basis, we ascribe a fair value of QR215.9, indicating 8% potential upside from the current price, and we rate the stock at Hold.

Figure 3 : Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|------------------------|---------|---------------------|----------|---------------|---------|
| Explicit Dividends | Net CF to shareholders | | 1,957 | (10,775) | 1,934 | 2,152 |
| | NPV Stage 1 | (4,620) | (4,620) | (7,245) | 3,888 | 2,152 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 23,499 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 21,653 | 23% | 17% | 29,866 | 197,326 |
| | NPV Stage 2 | 33,775 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 194,753 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 55,357 | 12% | 5% | 143,561 | |
| Total NPV | | | COE | | | |
| | Stage 1 (2010-2013) | (4,620) | US RFR | | | 2.56% |
| | Stage 2 (2014-23) | 33,775 | Country Risk Spread | | | 4.00% |
| | Stage 3 (2024+) | 55,357 | Sector Risk Spread | | | 2.50% |
| | NPV | 84,513 | Stock Spread | | | 1.10% |
| | Shares | 391 | Discount Rate | | | 10.16% |
| | Price Target | 215.89 | | | | |
| | Price | 200.10 | | | | |
| | Upside/(Downside) | 8% | | | | |

Source: Company data, Rasmala forecasts

Upside capital deployment risk

We believe that we have made one core assumption that essentially drives our valuation, and that is over the core ROTCE in stage 2. We calculate a core ROTCE (on a fully leveraged basis) of 30% in 2013. However for the 2014-23 year time horizon, we assume this drops to an average of 23%. The key assumptions on which this is based are that:

- the public sector lending space becomes significantly more competitive; and
- that capital deployment alternatives, such as its international expansion strategy, will not be able to attain the same level of profitability as the current business.

Although we are comfortable with both these assumptions, if QNB maintains the current level of profitability until 2023, then that would take the upside to 32%. If it maintains that level of profitability indefinitely, the upside would swell to approximately 100%.

Primary risks and discount rates

Downside risk continues to be increasing competition from new entrant banks resulting in declines in market share, lower efficiency and lower return to shareholders.

Balance sheet risks

With 74% of the investment book comprising government bonds, and an additional 20% other bonds, market risk is limited to the 3% that is equities and an additional 3% of mutual funds. Together these amounted to 8% of shareholders' funds as at year-end 2009, and almost certainly less than that figure as of 3Q10. Consequently, an impairment of 10% would be wholly non-material. In addition, given the positive revaluation reserve, small impairments could be absorbed without having an impact on the income statement.

Downside risks can be understated, especially as they are mainly in the long term

The main other source of balance sheet risk comes from valuation of the associate portfolio, which in total amounts to QR4.6bn, or 20% of shareholders' funds. The largest associate was acquired at 1.5x book, while CBI was acquired at 4x book value, generating more than QR2bn of goodwill. Of this, the bulk relates to CBI, which is now trading (in an illiquid market) at less than book value, and has generated a TTM ROE of just 6.4%. This therefore raises the possibility of a writedown of up to QR1.2bn, although we do not expect this to actually occur.

Business risks

Our main concern is that QNB's core franchise will be eroded more rapidly than expected. QNB has a strong relationship with the government of Qatar, which we believe will be difficult for other banks to compete with. Nevertheless, with the smaller banks lobbying for a fair market share and with CBQ providing a product-, rather than a service-driven, approach, some erosion of its position is a possibility.

In addition, we are concerned that although government spending is a key driver of short-term government growth, and although World Cup expenditure improves the scale and longevity of this, public-sector lending growth may come to an abrupt halt. For now, we assume public sector expenditure continues at a low double-digit rate in the medium term, but certainly it will remain an open question as to whether the government will aim to de-lever at some point.

We also believe there is some acquisition risk at QNB. The bank has already indicated the likely acquisition of Bank Kesawan of Indonesia in 1H11. It has also indicated five potential 'home markets' beyond Qatar. In addition to Jordan and the UAE, where it is up-to-scale with its HBTF operation and CBI associate, these include certain countries within the EU, India and the previously mentioned Indonesia. Although QNB has generally entered countries at a reasonable cost, the peak of the market acquisition of the CBI stake indicates that this has not always been the case.

Key sensitivities

Table 1 : Sensitivity to key input variables, based on +/-1 percentage point

| | +1 pp | -1 pp |
|----------------|-------|-------|
| Phase 2 | | |
| ROTCE1 | 3% | -3% |
| Growth | 3% | -3% |
| Discount rate | -18% | 27% |
| Phase 3 | | |
| ROTCE2 | 9% | -9% |
| Growth | 4% | -3% |

Source: Company data, Rasmala forecasts

Income statement

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|----------------------------------|-------------|-------------|-------------|--------------|--------------|
| Net interest income | 3726 | 5675 | 6334 | 7937 | 9157 |
| Non-interest income | 1564 | 1655 | 1985 | 2553 | 3032 |
| Total income | 5291 | 7330 | 8319 | 10490 | 12189 |
| Operating costs | -1107 | -1292 | -1550 | -2059 | -2514 |
| 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 |
| <u>Pre-prov operating profit</u> | 4184 | 6038 | 6769 | 8431 | 9675 |
| Provisions charges | -285.1 | -536.9 | -265.8 | -238.2 | -247.6 |
| <u>Post-prov op prof</u> | 3899 | 5501 | 6504 | 8193 | 9428 |
| Associates (pre-tax) | 292.8 | 216.3 | 255.7 | 281.2 | 309.3 |
| Other pre-tax items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported PTP | 4191 | 5718 | 6759 | 8474 | 9737 |
| Taxation | -113.0 | -133.5 | -157.9 | -197.9 | -227.4 |
| Minority interests | 13.3 | 2.13 | 2.52 | 3.16 | 3.63 |
| Preference dividends | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other post-tax items | 110.0 | 118.0 | 139.5 | 174.9 | 201.0 |
| Reported net profit | 4202 | 5704 | 6743 | 8454 | 9714 |
| Tot normalised items | 14.2 | 0.00 | 0.00 | 0.00 | 0.00 |
| Normalised PTP | 4191 | 5718 | 6759 | 8474 | 9737 |
| Normalised net profit | 4188 | 5704 | 6743 | 8454 | 9714 |

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

| QRm | FY09A | FY10A | FY11F | FY12F | FY13F |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net loans to customers | 108783 | 131696 | 157320 | 188665 | 226811 |
| Other int earn assets | 53514 | 48735 | 80233 | 90559 | 106601 |
| Goodwill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Oth non-int earn assets | 7152 | 9039 | 10921 | 12270 | 14227 |
| Total assets | 179329 | 223382 | 268926 | 316021 | 370321 |
| Total customer deposits | 125872 | 165470 | 195077 | 232058 | 274442 |
| Oth int-bearing liabs | 29603 | 26481 | 25792 | 28380 | 31347 |
| Non int-bearing liab | 5182 | 8596 | 7410 | 8432 | 9837 |
| Total liabilities | 160657 | 200547 | 228279 | 268870 | 315626 |
| Share capital | 18481 | 22280 | 39659 | 46004 | 53365 |
| Reserves | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total equity (excl min) | 18481 | 22280 | 39659 | 46004 | 53365 |
| Minority interests | 190.7 | 555.2 | 988.3 | 1146 | 1330 |
| Total liab & sh equity | 179329 | 223382 | 268926 | 316021 | 370321 |
| Risk weighted assets | 105249 | 112003 | 133796 | 156592 | 197326 |
| Est non-perf loans | n/a | n/a | n/a | n/a | n/a |
| Specific provisions | -923.6 | -1572 | -2031 | -2519 | -3075 |
| 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 | 105249 | 112003 | 133796 | 156592 | 197326 |
| Reported net profit | 4202 | 5704 | 6743 | 8454 | 9714 |
| Opening risk assets | 96056 | 105249 | 112003 | 133796 | 156592 |
| Closing risk assets | 105249 | 112003 | 133796 | 197326 | 0.00 |
| Change in risk assets | 9193 | 6755 | 21793 | 63530 | -156592 |
| Capital required | 919.3 | 675.5 | 0.00 | 0.00 | 0.00 |
| Free capital flow | 3282 | 5029 | 6743 | 8454 | 9714 |
| Ordinary dividend paid | -1204 | -1957 | -1948 | -1934 | -2152 |
| Share buy back/spec div | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Equity / preference issue | 0.00 | 0.00 | 12722 | 0.00 | 0.00 |
| Cash flow from financing | -1204 | -1957 | 10775 | -1934 | -2152 |
| Net capital flow | 2078 | 3072 | 17518 | 6520 | 7562 |
| Tier 1 capital | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Company data, Rasmala forecasts

year to Dec

| Standard ratios | QNB | | | | | Comm Bank of Qatar | | | QIB | | |
|---------------------------|-------|-------|-------|-------------|-------|--------------------------|-------|-------------|-------|-------|-------------|
| Performance | FY09A | FY10A | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F | FY11F | FY12F | FY13F |
| Non-int inc/gr op inc (%) | 29.6 | 22.6 | 23.9 | 24.3 | 24.9 | 30.6 | 30.4 | 31.2 | 27.3 | 27.7 | 27.0 |
| Cost/income (%) | 20.9 | 17.6 | 18.6 | 19.6 | 20.6 | 32.0 | 33.0 | 33.0 | 25.9 | 26.4 | 26.9 |
| Costs/average assets (%) | 0.67 | 0.64 | 0.63 | 0.65 | 0.80 | 1.34 | 1.35 | 1.53 | 1.06 | 1.02 | 1.21 |
| Net income growth (%) | 12.0 | 36.4 | 18.2 | 25.4 | 14.9 | 19.6 | 16.1 | 12.0 | 20.4 | 20.5 | 14.9 |
| Net cust loan growth (%) | 8.73 | 21.1 | 19.5 | 19.9 | 20.2 | 16.2 | 15.2 | 15.8 | 18.3 | 19.1 | 18.3 |
| Cust deposit growth (%) | 20.7 | 31.5 | 17.9 | 19.0 | 18.3 | 15.2 | 15.4 | 16.1 | 15.9 | 19.1 | 18.3 |
| Net interest margin (%) | 2.46 | 3.29 | 3.00 | 2.78 | 3.25 | 3.67 | 3.50 | 3.89 | 3.62 | 3.35 | 3.92 |
| Return on avg assets (%) | 2.52 | 2.83 | 2.74 | 2.65 | 3.07 | 2.95 | 2.87 | 3.24 | 2.84 | 2.72 | 3.15 |
| Return on avg equity (%) | 25.1 | 28.0 | 21.8 | 18.2 | 21.1 | 16.4 | 16.6 | 18.7 | 17.2 | 17.1 | 19.6 |
| RORWA (%) | 4.16 | 5.25 | 5.49 | 5.20 | 6.20 | 3.64 | 3.38 | 3.82 | 3.87 | 3.62 | 4.19 |
| | | | | year to Dec | | | | year to Dec | | | n/a |
| Valuation | | | | | | | | | | | |
| Normalised EPS growth (%) | 12.1 | 36.5 | 18.2 | 25.4 | 14.9 | 14.4 | 11.2 | 12.0 | 16.4 | 15.4 | 14.9 |
| Reported PE (x) | 19.1 | 14.0 | 11.9 | 9.46 | 8.23 | 11.2 | 10.0 | 8.96 | 12.3 | 10.7 | 9.30 |
| Normalised PE (x) | 19.1 | 14.0 | 11.9 | 9.46 | 8.23 | 11.2 | 10.0 | 8.96 | 12.3 | 10.7 | 9.30 |
| Price/book value (x) | 4.24 | 3.52 | 1.98 | 1.70 | 1.47 | 1.72 | 1.63 | 1.55 | 1.91 | 1.78 | 1.66 |
| 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 (%) | 1.54 | 2.50 | 2.49 | 2.47 | 2.75 | 6.80 | 7.21 | 8.13 | 5.54 | 5.56 | 6.82 |
| | | | | year to Dec | | | | year to Dec | | | n/a |
| Per share data | FY09A | FY10A | FY11F | FY12F | FY13F | Solvency | FY09A | FY10A | FY11F | FY12F | FY13F |
| Tot adj dil sh, ave (m) | 391.5 | 391.5 | 391.5 | 391.5 | 391.5 | Tier 1 capital ratio (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Pre-prov prof/share (QAR) | 10.7 | 15.4 | 17.3 | 21.5 | 24.7 | Total CAR (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Reported EPS (QAR) | 10.5 | 14.3 | 16.9 | 21.2 | 24.3 | Equity/assets (%) | 10.3 | 9.97 | 14.7 | 14.6 | 14.4 |
| Normalised EPS (QAR) | 10.5 | 14.3 | 16.9 | 21.2 | 24.3 | Net cust loans/dep (%) | 86.4 | 79.6 | 80.6 | 81.3 | 82.6 |
| Book value per sh (QAR) | 47.2 | 56.9 | 101.3 | 117.5 | 136.3 | Rep NPL/gr cus adv (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend per share (QAR) | 3.08 | 5.00 | 4.98 | 4.94 | 5.50 | Tot prov/rep NPLs (%) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividend cover (x) | 3.48 | 2.91 | 3.46 | 4.37 | 4.51 | Bad debts/advances (%) | 0.26 | 0.40 | 0.17 | 0.13 | 0.11 |
| | | | | year to Dec | | | | | | | year to Dec |

Priced as follows: QNBK.QA - QR200.10
Source: Company data, Rasmala forecasts

Valuation methodology

| Stage 1 (2010-2013) | | | 2010 | 2011 | 2012 | 2013 |
|---------------------|------------------------|---------|---------------------|----------|---------------|---------|
| Explicit Dividends | Net CF to shareholders | | 1,957 | (10,775) | 1,934 | 2,152 |
| | NPV Stage 1 | (4,620) | (4,620) | (7,245) | 3,888 | 2,152 |
| Stage 2 (2014-23) | | | Model Numbers | | | |
| Modelled Dividends | Excess Capital | 23,499 | ROTCE1 | Growth | Capital Req'd | RWA |
| | Modelled Dividends | 21,653 | 23% | 17% | 29,866 | 197,326 |
| | NPV Stage 2 | 33,775 | | | | |
| Stage 3 (2024+) | | | Model Numbers | | | |
| Terminal Value | 2023 | 194,753 | ROTCE2 | Growth | Capital Req'd | |
| | NPV Stage 3 | 55,357 | 12% | 5% | 143,561 | |
| Total NPV | Stage 1 (2010-2013) | (4,620) | COE | | | |
| | Stage 2 (2014-23) | 33,775 | US RFR | 2.56% | | |
| | Stage 3 (2024+) | 55,357 | Country Risk Spread | 4.00% | | |
| | NPV | 84,513 | Sector Risk Spread | 2.50% | | |
| | Shares | 391 | Stock Spread | 1.10% | | |
| | | | Discount Rate | 10.16% | | |
| | Price Target | 215.89 | | | | |
| | Price | 200.10 | | | | |
| | Upside/(Downside) | 8% | | | | |

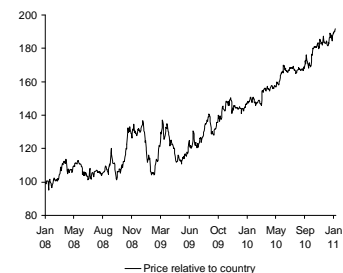
Source: Rasmala forecasts

Company description

Hold

Price relative to country

Qatar National Bank (QNB) was established in 1964 as the country's first bank and is 50% owned by the Government via the QIA. It continues to be the primary banker to the Government and the public sector, in addition to maintaining sector leadership with a lending market share of 41%. Over the past decade, the bank has been relatively successful in diversifying its concentrated revenue base, developing other business segments such as HNW retail, private banking, Islamic banking, fund management, investment banking, brokerage and international banking. The diversification is backed by a physical presence with 55 local branches (41 conventional, 11 Islamic and 3 mobile) and an international network (branches, representative offices and associates) spanning 22 countries.



Strategic analysis

Average SWOT company score: 4

4

Divisional breakdown, FY10

Strengths

5

QNB has an entrenched position in the public sector, allowing it to maintain defensive market share. In addition, QNB has the most developed international franchise, with operations across the Arab World and beyond.

Weaknesses

4

Loan and deposit market share loss apart from a conservative and protective business strategy (even in the boom time) is considered as the biggest weakness of QNB.

Opportunities

3

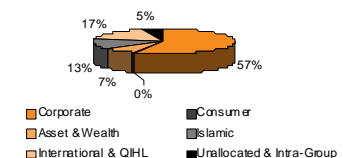
Capitalising on the US\$150bn worth of infrastructure projects being executed by the state. In addition, QNB has become the premier regional frontier market bank - a position it needs to turn into cash flow.

Threats

2

Geopolitical instability is an issue, but only at the margin. A greater concern is the renewed focus from competitors on its core public sector franchise.

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



Source: Company data

Market data

Headquarters

Qatar National Bank Building, Al Corniche Street, P.O. Box 1000, Al Doha, Qatar

Website

<http://www.qnb.com.qa/english/>

Shares in issue

391.5m

Freefloat

50%

Majority shareholders

Qatar Investment Authority (50%)

Competitive position

Average competitive score: 3+

3+

Broker recommendations

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 local government ownership in most banks coupled with branch limits for foreign banks keeps barriers to entry high for this sector.

Customer power

3+

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

Substitute products

2+

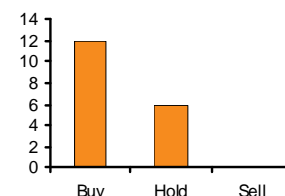
We believe the availability of substitute products (capital markets and wholesale lending) is on the rise, but it is currently unclear to what extent Qatar will favour its own banking system.

Rivalry

4+

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

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



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

Comm Bank of Qatar (RIC: COMB.QA, Rec: Buy, CP: QR90.00, TP: QR109.40): We base our valuation on a 3-stage DDM: a 3-yr stage of explicit forecasts, a ten year stage of trend forecasts and a terminal stage based on a GGM. Downside risks include a significant rise in NPLs as only 15% of lending is to the public sector, with consumer, real estate and construction accounting for 48%, collectively. A rise in competition could spur compression in interest margins. Lastly, deteriorating market conditions could hamper UAE-based UAB's growth, thus lowering CBQ's overall ROE prospects.

Doha Bank (RIC: DOBK.QA, Rec: Hold, CP: QR62.60, TP: QR63.19): 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 GGM. The key downside risk to our target price is that Doha Bank will be shut out of the current public sector lending opportunity, and that it then finds consumer business less profitable. Upside risks are primarily that it manages to carve a niche in public sector lending or that the private sector recovers more aggressively than expected.

Qatar Islamic Bank (RIC: QISB.QA, Rec: Hold, CP: QR84.00, TP: QR87.97): 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.

Qatar National Bank (RIC: QNBK.QA, Rec: Hold, CP: QR200.10, TP: QR215.89): 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 risk remains increasing competition from new entrant banks resulting in a decline in market share, and falling pricing. Upside risks are better-than-expected growth from existing projects and increased contribution from international operations, although the latter is likely to return lower ROEs than the core business.

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