# Qatar Islamic Bank

Flash Note 15 April 2010

## Downgrade to Hold; Valuation Less Attractive

- **Earnings lower than expected on investment income due to real estate exposure**
- **Valuation looks less attractive after the recent rally in the stock; trading at a 12% premium to its implied FY10e PB**
- **Downgrade to Hold and reduce our TP by 1% to QAR89.2/share**

**Results highlight:** Earnings were 16% below our estimates and 20% below street estimates due to lower investment income stemming from the bank's real estate exposure in terms of direct property investments and investment in real estate associates. Net interest income was also affected by margin compression as the bank accumulated deposits at a significantly higher rate than credit expansion. The net interest margin fell 50 bps to 3.5% QoQ in the first quarter of 2010. A better-than-expected cost-to-income ratio offset this decline to some extent. Fee income was strong at QAR74 million, up 25% YoY.

**What we think:** On the core front, earnings continue to be strong although the real estate tilt in QIB's business profile weighs on its earnings generation – more than our earlier expectations. Since we upgraded it to Buy on 31 January, the stock went up 10%. Without any near-term company-specific catalysts, the valuation currently looks less attractive. Although we believe QIB's franchise in Islamic banking and the favourable macro environment in Qatar are positive for the stock, there is little further upside potential (11%) based on the current price. As such, we find the stock fairly priced in.

**Action:** We downgrade our rating to Hold from Buy and slightly reduce our TP to QAR89.2/share from QAR89.7/share. We also lower our investment income assumptions for FY10f. We believe real estate market conditions will continue to put pressure on the bank's earnings growth in the medium term. We do not see any stock specific catalyst in the near term to support a re-rating and believe the Qatari macro story is already factored in.

**Valuation and catalyst:** The stock is trading at a FY10f PB multiple of 1.8x, a 12% premium to its implied PB. Even on earnings multiple, the stock is trading at a FY10e PE of 11.1x vs. Doha Bank's 9.3x and QNB's 10.1x. Upside risks to our rating include a significant and sudden improvement in the real estate market and a higher loan growth and fee income supported by the macro-environment.

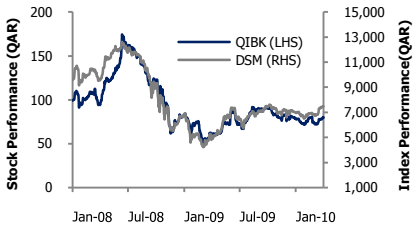
## Hold

| | |
|---|---|
| Target Price (QAR) | 89.2 |
| Market Price (QAR) | 80.3 |
| Upside | 11.1% |
| Listed On | DSM |
| Bloomberg | QIBK QD |
| RIC | QISB.QA |
| Market Cap. (QAR mn) | 16,561 |
| Market Cap. (USD mn) | 4,550 |
| No of Shares (mn) | 207 |
| Foreign Ownership Limit | 25.0% |
| Foreign Ownership Level | 5.0% |

### Shareholder Structure

| | |
|---|---|
| Gulf Finance House | 10.0% |
| QIA | 5.0% |
| Khaleeji Commercial Bank | 4.2% |
| Free Float | 80.8% |

### Price Performance Chart




| KPIs (QAR mn) | New | | Old | | Consensus | |
|---|---|---|---|---|---|---|
| | FY10f | FY11f | FY10f | FY11f | FY10c | FY11c |
| Net Interest Income | 1,505.7 | 1,709.7 | 1,505.7 | 1,709.7 | - | - |
| Total Income | 2,207.0 | 2,554.2 | 2,242.3 | 2,559.4 | - | - |
| Net Income | 1,491.5 | 1,772.6 | 1,527.9 | 1,779.7 | 1,807.0 | 2,106.0 |
| Net Interest Margin | 4.01% | 3.99% | 4.01% | 3.99% | - | - |
| Gross Loans (bn) | 30.4 | 34.9 | 30.4 | 34.9 | - | - |
| Cost/Income | 24.6% | 24.4% | 24.0% | 24.1% | - | - |
| Gross LD | 120.0% | 110.0% | 120.0% | 110.0% | - | - |
| EPS | 7.21 | 8.57 | 7.45 | 8.69 | - | - |
| DPS | 1.44 | 1.71 | 1.49 | 1.74 | - | - |
| Dividend Yield | 1.80% | 2.14% | 1.77% | 2.06% | - | - |
| P/E (x) | 11.1 | 9.4 | 11.3 | 9.7 | - | - |
| P/B (x) | 1.8 | 1.5 | 1.9 | 1.6 | - | - |
| ROAE | 16.3% | 17.6% | 16.8% | 17.7% | - | - |
| ROAA | 3.5% | 3.7% | 3.6% | 3.8% | - | - |

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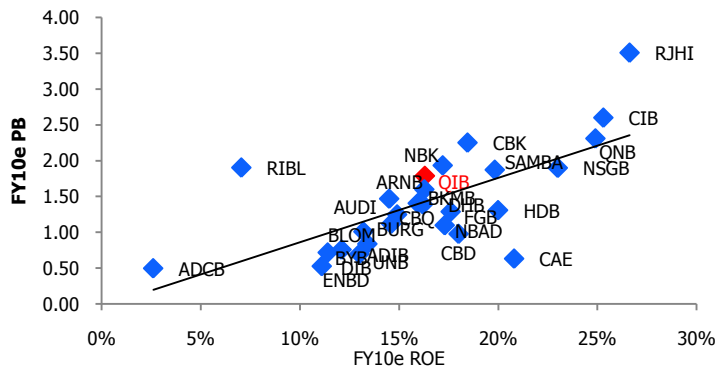
**Table 1:** Comparison of Actual vs. Estimates

| QAR million | 1Q10a | 1Q09a | YoY | 4Q09a | QoQ | 1Q10e | Surprise |
|---|---|---|---|---|---|---|---|
| Net Interest Income | 322.0 | 353.0 | -9% | 335.1 | -4% | 368.4 | -13% |
| Non-interest Income | 94.7 | 122.1 | -22% | 127.7 | -26% | 150.7 | -37% |
| Total Income | 416.7 | 475.1 | -12% | 462.8 | -10% | 519.1 | -20% |
| Operating Expense | 99.4 | 112.2 | -11% | 149.5 | -34% | 135.6 | -27% |
| Operating Profit | 317.3 | 362.9 | -13% | 313.3 | 1% | 383.5 | -17% |
| Provision | 17.0 | 17.5 | -3% | 7.0 | 143% | 22.9 | -26% |
| - Loan loss | 17.0 | 17.5 | -3% | -55.0 | na | 20.5 | -17% |
| - Other | 0.0 | 0.0 | na | 62.0 | na | 2.4 | na |
| Net Income | 300.1 | 350.2 | -14% | 321.0 | -6% | 358.2 | -16% |
| | | | | | | | |
| Cost-to-Income Ratio | 24% | 24% | | 32% | | 26% | |
| | | | | | | | |
| *in billion* | | | | | | | |
| Net Loans | 24.0 | 19.3 | 24% | 22.7 | 6% | 24.2 | -1% |
| Deposit | 25.3 | 19.1 | 32% | 20.4 | 24% | 22.7 | 11% |
| Shareholder Equity | 8.1 | 7.0 | 16% | 9.0 | -10% | 9.4 | -14% |

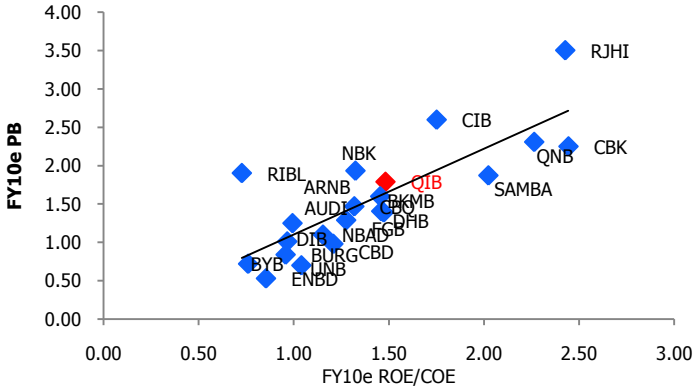
Source: Company reports, HC Research

**Chart 1:** Valuation

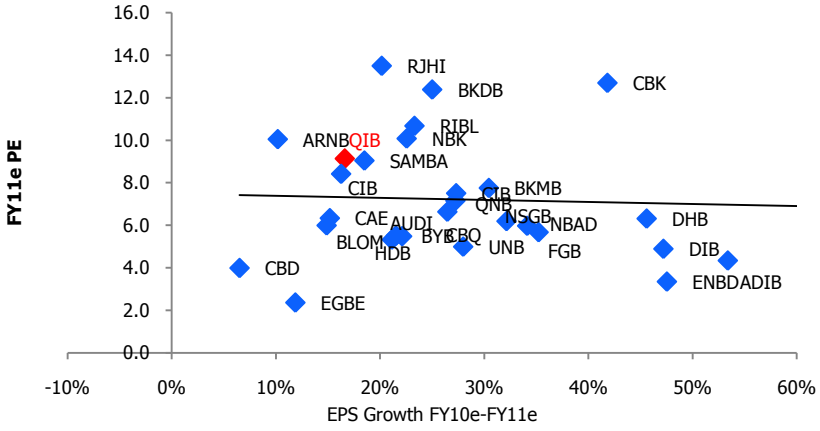
FY10e PB vs. ROE




FY10e PB vs. ROE/COE




FY11e PE vs. EPS growth




Source: Bloomberg, HC Research

# Financial Statements

| QAR million | 2009a | 2010f | 2011f | 2012f | 2013f | 2014f |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Interest Income | 1,799.0 | 2,101.7 | 2,402.4 | 2,702.1 | 3,033.3 | 3,404.2 |
| Interest Expense | 510.4 | 595.9 | 692.7 | 731.9 | 811.9 | 901.6 |
| **Net Interest Income** | **1,288.7** | **1,505.7** | **1,709.7** | **1,970.2** | **2,221.4** | **2,502.6** |
| Fees and Commissions | 258.7 | 297.5 | 342.1 | 376.4 | 414.0 | 455.4 |
| FX Income | 45.1 | 45.6 | 47.9 | 50.3 | 52.8 | 55.4 |
| Investment Income | 253.9 | 197.4 | 253.3 | 283.7 | 317.7 | 355.8 |
| Other Income | 55.6 | 160.7 | 201.2 | 225.2 | 252.1 | 282.2 |
| **Non-interest Income** | **613.4** | **701.3** | **844.5** | **935.5** | **1,036.6** | **1,148.8** |
| **Total Income** | **1,902.0** | **2,207.0** | **2,554.2** | **2,905.7** | **3,258.0** | **3,651.5** |
| Total Operating Expenses | 487.4 | 542.5 | 623.6 | 705.2 | 791.6 | 896.2 |
| Pre-provision Income | 1,414.6 | 1,664.5 | 1,930.6 | 2,200.5 | 2,466.4 | 2,755.3 |
| Provisions | 130.8 | 126.8 | 103.2 | 70.2 | 78.2 | 87.2 |
| Associate and Other Income | - | - | - | - | - | - |
| **Pre-tax Income** | **1,283.8** | **1,537.7** | **1,827.4** | **2,130.3** | **2,388.2** | **2,668.1** |
| Income Taxes | (10.9) | - | - | - | - | - |
| **Net Income After Tax** | **1,294.7** | **1,537.7** | **1,827.4** | **2,130.3** | **2,388.2** | **2,668.1** |
| Minority Interest | (27.4) | 46.1 | 54.8 | 63.9 | 71.6 | 80.0 |
| **Net Income** | **1,322.1** | **1,491.5** | **1,772.6** | **2,066.4** | **2,316.5** | **2,588.1** |
| | | | | | | |
| **Balance Sheet** | | | | | | |
| **Assets** | | | | | | |
| Cash Due from Central Bank | 1,338.2 | 1,921.3 | 3,292.3 | 4,982.5 | 5,655.6 | 7,147.0 |
| Due from Banks | 8,902.6 | 9,032.7 | 8,093.3 | 8,498.0 | 9,517.7 | 10,659.9 |
| Investments | 1,818.6 | 2,032.4 | 2,276.2 | 2,549.4 | 2,855.3 | 3,198.0 |
| **Gross Loans** | **25,734.3** | **30,366.5** | **34,921.5** | **38,413.6** | **42,255.0** | **46,480.5** |
| NPL Provisions | 264.2 | 169.9 | 64.8 | (55.9) | (174.7) | (291.4) |
| Unearned Profit | 2,806.6 | 2,846.9 | 3,055.6 | 3,457.2 | 3,169.1 | 3,486.0 |
| **Net Loans** | **22,663.5** | **27,349.8** | **31,801.0** | **35,012.3** | **39,260.5** | **43,285.8** |
| Other Assets | 4,250.7 | 4,526.0 | 4,811.0 | 5,293.0 | 5,828.7 | 6,424.1 |
| Net Fixed Assets | 299.1 | 301.5 | 309.4 | 318.0 | 333.8 | 351.1 |
| **Total Assets** | **39,272.7** | **45,163.6** | **50,583.2** | **56,653.2** | **63,451.6** | **71,065.8** |
| | | | | | | |
| **Liabilities** | | | | | | |
| **Total Deposits** | **20,361.0** | **25,305.4** | **31,746.8** | **36,584.4** | **42,255.0** | **46,480.5** |
| Due to Banks | 8,691.0 | 9,037.7 | 6,825.2 | 6,170.1 | 5,199.7 | 6,241.9 |
| Borrowings | - | - | - | - | - | - |
| Other Liabilities | 1,021.9 | 1,252.6 | 844.5 | 932.5 | 1,019.5 | 1,131.4 |
| **Total Liabilities** | **30,073.9** | **35,595.7** | **39,416.5** | **43,686.9** | **48,474.2** | **53,853.8** |
| **Shareholder Equity** | **9,198.8** | **9,567.9** | **11,166.7** | **12,966.3** | **14,977.4** | **17,212.0** |

## Rating Scale

| Recommendation | Upside |
|---|---|
| Buy | Greater than 20% |
| Hold | -5% to 20% |
| Sell | Less than -5% |

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