Qatar National Bank (QNB)

Company Note 9 July 2009

2Q09 Earnings Review – Start of a New NPL Cycle

- **Net income increased to QAR1,057 million in 2Q09, up 12% from 2Q08. Profits were primarily driven by net interest income which offset the sharp increase in loan loss provisions. In the meantime, the loan book shrank 2% YoY, while expanding by 2%, QoQ.**
- **Non-performing loans (NPL) continued their upward trend in the second quarter with NPLs to total loans (NPL ratio) steadily increasing to 0.85% in 2Q09 from 0.7% in 4Q08. This, in turn, translated to higher loan loss provisions in the income statement.**
- **We reiterate our "Hold" recommendation and maintain our Target Price (TP) at QAR135.76, implying a 16% upside potential.**

QNB's 2Q09 net income of QAR1,057 million is up 12% from 2Q08 and 7% above our estimates. The positive surprise to our estimate was mainly due to higher than expected investment and dividend income. We believe the bank will not see write-downs in the coming quarters as it has a positive fair value reserve and no equities in its investment portfolio. Net interest margin improved to 2.48% in 2Q09 from 2.39% in 1Q09. We attribute this to the bank's edge in attracting government deposits. Government contributed 62% of the QAR10.9 billion increase in deposits during the quarter, naturally helping margins.

More importantly, we highlight the loan loss provisions of QAR107 million, which is significantly higher than QAR3 million 1Q09, and slightly higher than our estimate of QAR100 million. Although the current quarter's provisioning is lower than the 4Q08 amount of QAR198 million, we expect asset quality to continue to weigh on the bank's bottom line in the coming quarters. This could be seen in the rise of the bank's NPL ratio which was at 0.7% in 4Q08, 0.8% in 1Q09 and 0.85% in 2Q09. We have already modeled an NPL ratio of 1.25% for FY09.

The loan book slightly increased to QAR82.9 billion in 2Q09 from QAR81.6 billion in 1Q09. Note that the loan book contracted significantly (18% quarterly) during 1Q09 due to a one-off settlement by the government. In 2Q09, government loans grew by QAR6 billion, which should have resulted in a loan book value somewhere closer to our forecast of QAR88 billion. The bank, however, sold off some of its real estate loan portfolio to the government, dragging the loan book down to QAR82.9 billion at the end of 2Q09. We estimate the amount of loans sold off to the government to be in the range of QAR4.6-6.0 billion. We arrived at the lower range based on the difference between the increase in government loans during the quarter and loan book at end 2Q09. The upper range is the increase in QNB's investment portfolio during the quarter, as the government paid in bonds for the real estate loans which it bought.

We reiterate our "Hold" and maintain our TP QAR135.76. Our TP provides an upside of only 16%. We have not changed our earnings estimates and apply the same COE of 11%. We continue to view the stock as fairly valued at FY09 PB of 1.9x vs. sector average of 1.6x.

Key Performance Indicators

Fiscal Year	New		Old		Consensus	
	09E	10E	09E	10E	09C	10C
Net (QARm)	3,762	4,334	3,762	4,334	-	-
Total Income (QARm)	5,388	6,300	5,388	6,300	-	-
Net Income (QARm)	3,813	4,349	3,813	4,349	-	-
NIM	2.50%	2.63%	2.50%	2.63%	-	-
Gross Loans (QARb)	106.0	116.6	106.0	116.6	-	-
Cost/Income	22.1%	20.3%	22.1%	20.3%	-	-
Gross L/D	96.2%	93.7%	96.2%	93.7%	-	-
EPS	12.66	14.44	12.66	14.44	-	-
DPS	3.17	4.33	3.17	4.33	-	-
Dividend Yield	2.74%	3.75%	2.74%	3.75%	-	-
P/E (x)	9.1	8.0	9.1	8.0	-	-
P/B (x)	1.9	1.6	1.9	1.6	-	-
ROAE	21.8%	21.7%	21.8%	21.7%	-	-
ROAA	2.4%	2.5%	2.4%	2.5%		

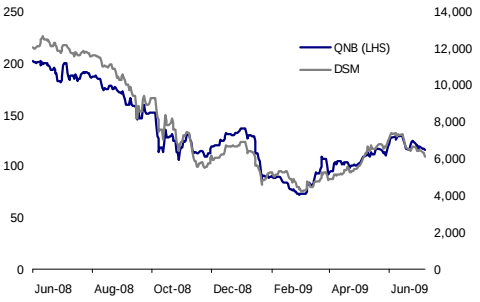
Hold

Target Price (QAR)	**135.76**
Market Price (QAR)	116.90
Upside	16.1%
Listed On	DSM
Bloomberg Code	QNBK QD
RIC	QNBK.QA
Market Cap. (QARm)	34,809
Market Cap. (USDm.)	9,563
Number of Shares (m)	301
Foreign Ownership Limit	25.0%
Foreign Ownership Level	3.9%
Daily Turnover (QARm)	13.9
Daily Turnover (USDm)	3.8

Ownership Structure

Free Float	50.0%
Qatar Investment Authority	50.0%

Price Performance Chart



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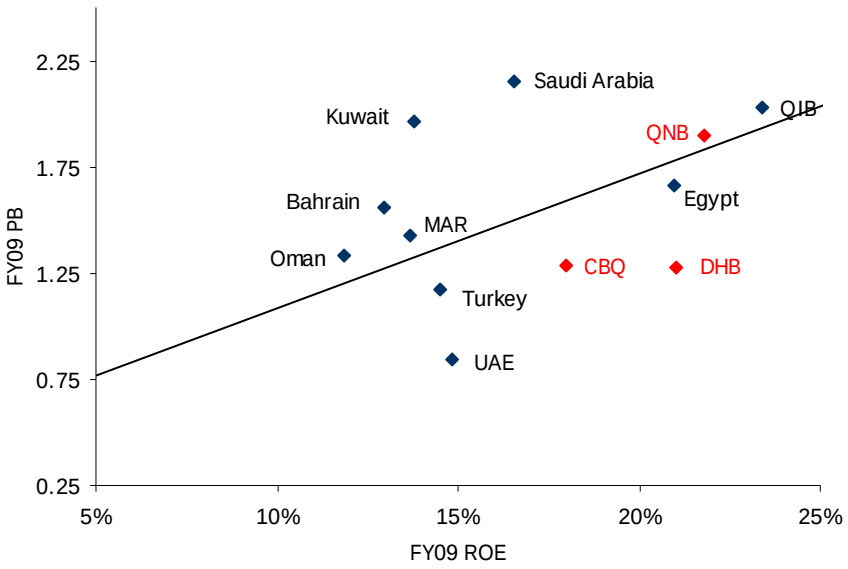
Table 1: QNB – 2Q09 earnings vs. our estimates

QAR million	2Q09	2Q08	Y-o-Y	1Q09	Q-o-Q	2Q09E*	Surprise
Net interest income	**937,344**	**654,577**	**43%**	**833,419**	**12%**	**917,283**	**2%**
Non interest income	426,636	493,916	-14%	452,600	-6%	389,488	10%
Total income	**1,363,980**	**1,148,493**	**19%**	**1,286,019**	**6%**	**1,306,771**	**4%**
Operating Expenses	248,446	263,868	-6%	259,674	-4%	261,664	-5%
Operating Profit	**1,115,534**	**884,625**	**26%**	**1,026,345**	**9%**	**1,045,106**	**7%**
Provisions	117,767	-7,022	NM	38,525	206%	103,829	13%
Net Income	**1,056,823**	**939,741**	**12%**	**1,010,611**	**5%**	**983,415**	**7%**
Net loans	82,898,186	84,284,995	-2%	81,596,352	2%	88,728,172	-7%
Deposits	102,822,776	98,524,141	4%	91,898,331	12%	98,235,304	5%
Shareholders' equity	17,725,350	18,981,661	-7%	16,626,546	7%	17,609,961	1%

*HC forecasts

Source: Company reports and HC Brokerage

Chart 1: The multiple suggests the stock is fairly valued



Source: Bloomberg and HC Brokerage

Financial Statements and Ratios

QAR Million	07A	08A	09E	10E	11E	12E
Income Statement						
Interest Income	5,040.3	6,853.0	8,484.8	9,213.5	10,341.5	11,534.9
Interest Expense	3,108.2	3,997.5	4,723.1	4,879.2	5,389.5	5,447.3
Net Interest Income	**1,932.1**	**2,855.5**	**3,761.7**	**4,334.3**	**4,952.0**	**6,087.6**
Fees & Commissions	726.3	975.9	946.6	1,041.3	1,145.4	1,260.0
FX Income	175.2	330.4	337.0	370.7	407.7	448.5
Investment Income	374.5	569.3	82.4	446.0	994.9	1,114.3
Other Income	138.3	245.6	260.8	107.8	113.1	118.8
Non-Interest Income	**1,414.2**	**2,121.1**	**1,626.8**	**1,965.8**	**2,661.2**	**2,941.6**
Total Income	**3,346.4**	**4,976.6**	**5,388.4**	**6,300.0**	**7,613.2**	**9,029.2**
Total Operating Expenses	**901.4**	**1,126.4**	**1,189.4**	**1,278.9**	**1,386.9**	**1,644.2**
Pre-Provisions Income	**2,444.9**	**3,850.3**	**4,199.0**	**5,021.1**	**6,226.4**	**7,385.0**
NPL Provisions	42.3	378.2	529.4	876.0	981.1	1,098.9
Associate and other income	122.9	200.3	162.6	225.6	252.7	283.0
Pre-Tax Income	**2,525.5**	**3,672.3**	**3,832.2**	**4,370.8**	**5,497.9**	**6,569.1**
Income Taxes	19.3	19.8	19.2	21.9	27.5	32.8
Net Income After Tax	**2,506.1**	**3,652.5**	**3,813.1**	**4,348.9**	**5,470.4**	**6,536.3**
Minority Interest	**(1.4)**	**-**	**-**	**-**	**-**	**-**
Net Income	**2,507.5**	**3,652.5**	**3,813.1**	**4,348.9**	**5,470.4**	**6,536.3**
Appropriations	-	-	-	-	-	-
Net Income	**2,507.5**	**3,652.5**	**3,813.1**	**4,348.9**	**5,470.4**	**6,536.3**
Balance Sheet						
Assets						
Cash & Due from Central Bank	10,948.6	6,269.6	8,645.8	7,364.8	8,663.4	10,147.2
Due from Banks	21,302.6	27,044.5	21,139.5	27,074.9	30,323.8	33,962.7
Investments	11,308.9	11,814.9	21,139.5	23,464.9	26,280.7	29,434.3
Gross Loans	**67,168.7**	**101,931.7**	**106,009.0**	**116,609.9**	**130,603.0**	**146,275.4**
NPL Provisions	408.3	625.0	703.1	1,104.6	1,583.0	2,147.7
Net Loans and Overdrafts	**66,064.1**	**100,053.5**	**105,305.9**	**115,505.3**	**129,020.0**	**144,127.8**
Other Assets	4,084.9	6,172.9	5,691.4	6,317.5	7,075.6	7,924.6
Net Fixed Assets	651.5	618.2	689.7	771.8	795.4	821.4
Total Assets	**114,360.7**	**151,973.6**	**162,611.8**	**180,499.1**	**202,159.0**	**226,418.0**
Liabilities						
Total Deposits	**79,363.9**	**104,252.6**	**110,208.9**	**124,419.1**	**144,076.7**	**164,068.6**
Due to Banks	12,423.5	21,988.7	23,884.1	23,696.7	20,943.1	20,563.5
Borrowings	6,714.8	6,719.1	6,750.0	6,750.0	6,750.0	6,750.0
Dividends Payable			953.3	1,304.7	1,641.1	1,634.1
Other Liabilities	2,000.1	2,369.9	2,522.9	2,538.3	2,656.9	2,264.5
Total Liabilities	**100,502.3**	**135,330.4**	**144,319.1**	**158,708.8**	**176,067.8**	**195,280.6**
Shareholders' Equity	**13,858.4**	**16,643.2**	**18,292.6**	**21,790.3**	**26,091.2**	**31,137.4**

Rating Scale	
Recommendation	**Upside**
Buy	Greater than 25%
Hold	0-25%
Sell	Less than 0%

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