المجموعة المالية - هيرميس
EFG HERMES

QATAR NATIONAL BANK

2Q2009 Preview - Still Good Value

07 JULY 2009

QATAR | BANKING

Short-Term Rec.: Buy	Current Price*: QAR 113.9
Long-Term Rec. : Buy	LT Fair Value : QAR 167.8

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- **Reducing LTFV to QAR165.4 from QAR208.6:** We are updating our numbers for recent developments, as well as raising the cost of capital to bring it in line with the rest of the banking sector. The impact of this on our estimated LTFV is to bring it down to QAR167.8 from a previous figure of QAR208.6. This represents a 20% downward revaluation, of which 16% relates to the 1% increase in discount rate. Our discount rate for Qatari banks remains 1% below that for the UAE banks. Nevertheless, we leave our recommendations unchanged at ST/LT Buy, in spite of the 60% rally from its low.

- **Reducing Estimates:** The main revisions we have made to forecasts relate to a reduction in balance sheet growth, as well as fee & commission growth. This is offset by stronger spreads in the short-term, strong foreign currency-related revenue and much improved cost control. Provisioning, as elsewhere, is a significant source of uncertainty, but it is clear that rates will be rising this year and next, putting further pressure on earnings growth. The net result is that our 2009e bottom line forecast remains largely unchanged, however in 2010e-11e, we adjust our net income forecast downwards by 6% and 15% respectively.

- **More Conservative on Balance Sheet Growth Rates:** The key forecast adjustment is clearly to balance sheet growth rates. We continue to believe that the engine of growth will be the public sector, which drove over half of QNB's loan book growth of 52% Y-o-Y in 2008. While we believe this growth rate will be substantially trimmed in 2009, we also expect that the two other main sources of growth – real estate and personal lending – may well see a sharp decline. Consequently, we reduce our growth expectations for 2009e-10e from 30% and 25% respectively to 15% for each year.

- **Weaker Loan Growth Will Also Overspill to Other Areas:** Since fees on loans & advances account for 48% of total fees and commissions, weaker loan growth will automatically feed through to weaker non-interest income. In addition, weaker fees from customer investments - amounting to15% of fee income in 2008 - will also play its part. Trading & investments, meanwhile, continue to benefit from strong income from dealing in foreign currencies, which has so far been largely unaffected by the downturn.

- **Cost-Income Ratio Improving:** One positive is that, QNB has managed to bring its cost-income ratio down from 27% in 2007 to 24% in 2008, and has started 2009 with a 21% cost income ratio. While these lower levels are unlikely to prove sustainable, our previous forecast of an increase to 30% in the short term was clearly too negative. Also, given high public sector exposure, provisioning rates have been only marginally increased.

COMPANY NOTE

December year end	*2008a*	*2009e*	*2010e*	*2011e*
Total Banking Income	*4,770*	*5,114*	*5,775*	*6,368*
Cost / Income	*24%*	*21%*	*23%*	*25%*
Provisions / Avg. Loans (bps)	*29*	*42*	*35*	*35*
Net Attributable Income	*3,653*	*3,725*	*4,223*	*4,514*
ROAE	*22.7%*	*21.6%*	*22.4%*	*21.2%*
ROAA	*2.60%*	*2.52%*	*2.51%*	*2.32%*
EPS	*12.50*	*12.56*	*14.24*	*15.22*
P/E	*9.2*	*9.2*	*8.1*	*7.6*
Dividend Yield	*5.3%*	*4.5%*	*6.1%*	*5.0%*
P/BV	*2.3*	*1.9*	*1.7*	*1.5*
Capital Adequacy	*13.9%*	*18.0%*	*17.7%*	*17.7%*
Loan Growth	*51%*	*-6%*	*15%*	*15%*
Loans / Deposits	*96.0%*	*88.4%*	*86.0%*	*84.1%*
Provisions / NPLs	*85%*	*92%*	*81%*	*79%*

Figures in QAR million unless otherwise stated



Estimate Changes

	2008a	*2009e*		*2010e*	
(QAR mn)		*Old*	*New*	*Old*	*New*
Net Interest Income (mn)	*2,856*	*3,302*	*3,463*	*4,115*	*3,756*
Total Banking Income	*4,770*	*5,395*	*5,114*	*6,830*	*5,776*
IBP	*3,644*	*3,777*	*4,052*	*4,782*	*4,461*
Net Attributable Income	*3,653*	*3,681*	*3,725*	*4,515*	*4,223*

Stock Data

Last Ex-Div Date	*QAR6.0 on 9 Feb 2009*
Mkt Cap / Shares (mn)	*QAR34,282 / 297*
Av. Mthly Liqdty (mn)	*QAR 328.5*
52-Week High / Low	*QAR191.12 / 72.2*
Bloomberg / Reuters	*QNBK QD / QNBK.QA*
Est. Free Float	*50%*

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Prices as of 7 July 2009

I. SUMMARY OF CHANGES

Lower loan forecast partially technical

QNB has long been the bank for the public sector, and this has not changed recently. Indeed from 2006 to 2008 loans to government agencies expanded from QAR6 billion to QAR38 billion, accounting for 59% of all loan growth. Unsurprisingly therefore QNB continues to see public sector spending as a continued driver of growth. In the meantime though, this has been a strongly negative influence on the loan book, with 1Q2009 results indicating a substantial drop due to a QAR7 billion agency loans being transferred to bonds, as well as a low-margin QAR10 billion agency loan which was netted against deposits from the same borrower. In addition, the second largest source of growth – personal loans – is unlikely to see the same expansion in 2009 we have seen in recent years.

Stronger spreads in the short term

The netting of low-margin agency loans and the repricing of the entire loan book, is likely to have an overall positive impact on the income statement. We expect spreads to strengthen throughout the year, before falling back to more normalised levels in 2010e and beyond. Given our lower forecast loan volumes, the result is that we raise our forecast for 2009 net interest income to QAR3.5 billion, but lower our forecasts in later years.

Fees & commissions also weak

Weak loan growth has also filtered through to weak fee and commission growth, which has actually been negative for the last two quarters Y-o-Y. Surprisingly, 1Q2009 did however reflect a degree of bounce-back, rising from QAR196 million to QAR240 million, although we expect this to be partially due to timing effects. Going forward, we expect weak loan growth to be the dominant effect, and so see further Y-o-Y weakness until 4Q2009e. Fees from "investment activities of customers" – amounting to 15% of fee income - is also likely to be a drag on Y-o-Y growth numbers during 2009e, although the actual trough will probably have been in 1Q2009. Further recovery will be in loan with forecast loan growth rates.

Trading & investment partial recovery

Trading & investment income managed somewhat of a recovery in 1Q2009, although this really reflected a much smaller provision for impairment of financial investments. Going forward, we assume that further impairments are minimal, as well as assuming that foreign exchange gains are maintained and that net gains from financial investments rises to 63% of the average for 2008. Given the sell down of the DSM listed part of the investment portfolio, and hence reduced equity proportion, this does not seem like an unreasonable presumption.

Finally on revenue, dividend income continued to rise Y-o-Y. However, this number exhibits strong seasonality, with normally 65% of dividend receipts arriving in the first quarter and the remainder in the second quarter. The result is that the annual total will be significantly less than the first quarter figure annualised.

Costs impressive, provisioning negligible but rising

In terms of deductions, the figure for total expenses in 1Q2009 represented the best quarter since 4Q2007. Whilst this cost control is impressive. Further improvements seem impossible, given the cost-income ratio of just over 20%. We believe that a reversion towards 25% and beyond is inevitable, given that the cost environment for QNB should not be wholly different from other banks. In the short term, lower rents may provide some benefit. Meanwhile provisions fell to a negligible level in 1Q2009. This, however, was more due to a reversal of cautious provisioning in 4Q2008 than any strength in loan quality. We continue to expect an increase in the latter quarters this year, but do not forecast net provisioning rising over 40 bps at any point in the near future, given the high public sector exposure.

Overall, still good value

Overall, while the current market environment is clearly tough, we have not had to adjust our forecasts as much as might have been expected. The main reason for that is that we had not assumed the previous positive outlook was sustainable. Consequently, the adjustment to fair value is predominantly driven by the change in discount rate, rather than shifts in forecasts. While QNB is expensive relative to the rest of the banking sector in both Qatar and the UAE, we believe the much more conservative loan book, as well as the greater visibility the stock provides makes this a good defensive investment.

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Figure 1: 2Q2009 Preview
AED million, unless otherwise stated

	2Q2008a	1Q2009a	2Q2009e	Y-o-Y	Q-o-Q
Balance Sheet					
Loans & Islamic Financing	84,285	81,596	86,218	2%	6%
Financial Instruments	15,304	17,184	17,121	12%	0%
Total Assets	**152,640**	**140,618**	**145,819**	**-4%**	**4%**
Customer Deposits & Islamic Funding	98,524	91,898	97,737	-1%	6%
Capital Market Liabilities	-	-	-		
Total Liabilities	**133,658**	**123,992**	**128,242**	**-4%**	**3%**
Net Liquid Assets	16,819	6,293	6,783		
Shareholders' Equity	**18,982**	**16,627**	**17,577**	**-7%**	**6%**
Income Statement					
Net Interest & Islamic Returns	655	833	850	30%	2%
Total Non-Interest Income	515	429	436	-15%	2%
Total Banking Income	**1,170**	**1,263**	**1,286**	**10%**	**2%**
Total Operating Expenses	(264)	(260)	(263)	0%	1%
Provisions for Loans Losses	(14)	(14)	(95)	562%	594%
Pretax Income	**944**	**1,019**	**957**	**1%**	**-6%**
Net Attributable Income	**940**	**1,011**	**951**	**1%**	**-6%**
Headline Attributable Income	**940**	**1,011**	**951**	**1%**	**-6%**

Source: QNB Quarterly Reports, EFG-Hermes

Coming Quarters to be Defined by Provisioning

In terms of specific forecasts for 2Q2009, we believe that revenues will be mildly weak Q-o-Q as improved trading income compensates for lower dividend income. We believe the cost income will be broadly stable after recent improvements, but expect a sharp pick up in provisioning after a very benevolent figure in 1Q2009. The result, we believe, will be a 6% decrease in net income Q-o-Q. While QNB will be relatively protected, the increase in provisioning is likely to remain the dominant trend over coming quarters. We will update for the buyout of the property loan portfolio (amounting perhaps to c.QAR3 billion) following 2Q2009 results. This adjustment would not affect our 2Q2009 income statement forecasts.

II. FINANCIAL FORECASTS

Balance Sheet (December Year End)

QAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Cash & CB Deposits	6,270	8,981	10,035	11,257	12,189
Interbank Assets	27,044	25,310	26,455	28,654	32,910
Loans & Islamic Financing	100,053	94,549	108,646	124,983	150,199
Financial Instruments	11,815	20,085	27,115	35,250	44,062
Other Investments & Associates	4,597	5,056	5,562	6,118	6,730
Other Assets	1,576	1,834	2,096	1,879	2,521
Fixed Assets	618	630	718	819	958
Total Assets	**151,974**	**156,446**	**180,627**	**208,959**	**249,569**
Customer Deposits & Islamic Funding	104,253	106,927	126,307	148,635	179,828
Interbank Liabilities	21,989	21,654	22,827	25,058	29,353
Other Financial Liabilities	6,719	6,719	7,391	8,426	9,858
Other Operating Items	2,370	1,804	2,075	2,386	2,864
Proposed Dividend	1,807	1,537	2,087	1,722	4,479
Total Liabilities	**137,137**	**138,642**	**160,687**	**186,228**	**226,382**
Shareholders' Equity	14,837	17,804	19,940	22,732	23,187
Total Liabilities and Equity	**151,974**	**156,446**	**180,627**	**208,959**	**249,569**

Source: QNB, EFG-Hermes estimates

Income Statement (December Year End)

QAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Net Interest & Islamic Returns	2,856	3,463	3,756	4,165	4,677
Dividend Income	138	156	172	189	208
Fees & Commissions	976	885	1,018	1,171	1,381
Trading & Investments	769	587	803	813	705
Other Operating Income	32	23	26	30	36
Total Non-Interest Income	1,915	1,651	2,019	2,203	2,331
Total Banking Income	**4,770**	**5,114**	**5,775**	**6,368**	**7,007**
Salaries & Employee Related Costs	(641)	(580)	(712)	(849)	(1,004)
Other General & Adm. Expenses	(486)	(482)	(602)	(728)	(871)
Total Operating Expenses	(1,126)	(1,062)	(1,315)	(1,577)	(1,875)
Income before Provisions	3,644	4,052	4,461	4,791	5,132
Provisions for Loans Losses	(248)	(378)	(359)	(413)	(348)
Provision for Investment Losses	(0)	(40)	(44)	(47)	(51)
Pretax Income	3,396	3,633	4,058	4,331	4,733
Net Attributable Income	**3,653**	**3,725**	**4,223**	**4,514**	**4,934**

Source: QNB, EFG-Hermes estimates

Ratios

In %, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Capital Adequacy Ratio	13.9%	18.0%	17.7%	17.7%	15.1%
Loans / Deposits	96.0%	88.4%	86.0%	84.1%	83.5%
NPL Coverage Ratio	85.4%	91.7%	81.5%	79.3%	80.6%
Net Interest Spread	1.80%	2.23%	2.10%	2.00%	1.90%
Cost / Income	23.6%	20.8%	22.8%	24.8%	26.8%
Provisioning (bps)	0.29%	0.42%	0.35%	0.35%	0.25%
RoAE	22.7%	21.6%	22.4%	21.2%	21.5%
RoAA	2.60%	2.52%	2.51%	2.32%	2.15%
EPS	12.50	12.56	14.24	15.22	16.64
BVPS	50.03	60.03	67.24	76.65	78.19
DPS	6.09	5.18	7.04	5.81	15.10

Source: QNB, EFG Hermes estimates

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Accumulate	10 to 25%
Neutral	(10%) to 10%
Reduce	(10%) to (25%)
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