Investment Update

Qatar National Bank

Vision, Prudence, Action!

Qatar

Reuters Code:
QNBK.QA

Listing:
Doha Stock Exchange

CMP:
QR213.5 (27.03.2005)

April, 2006

BUY

Investment Summary

- Subsequent to our last report on Qatar National Bank covered under the GCC Banking Sector report in May 2005, where we recommended a buy on the stock with a price target of QR363 (pre-bonus) at the then market price of QR305.7 (pre-bonus), the stock underwent a sharp bull run and reached our target price with a steep rally in Doha Securities Market (DSM).

- During FY2005, the bank performed more or less inline with our estimates with regard to assets, deposits and gross loans & advances, with a variations (actual v/s projection) of 1.65%, -3.9% and -4.3% respectively. Sharp increase in non-interest revenues and net reversal of provision for loans & advances for FY2005 substantially boosted QNB's earnings and therefore beat our earning projections for the year.

- QNB was the first commercial bank in Qatar to start Islamic Banking services. `QNB Al Islami', the first ever Islamic branch in Qatar operated by a commercial bank, was launched in April 2005.

- QNB was the first Qatari bank to issue equity funds earmarked for local market called `Al Watani Funds' during third quarter of 2005.

- During 2005, QNB acquired a 30% stake in Qatar based "Investment House", a QCB approved Islamic Investment Company.

- As part of QNB's regional growth strategy, in March 2005, it took a 25% stake in Mansour Bank, a newly formed commercial bank in Iraq, launched by London-based merchant banker MerchantBridge & Company Limited, which is due to start its operations during the current year.

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- In terms of growth in total assets, deposits and credit facilities granted, QNB lagged behind the commercial banking sector in FY2005. The sector achieved a growth rate of 41.6% in total assets, 40.5% in deposit base and 40.9% in credit facilities granted vis-à-vis these QNB's growth rate for all the respective parameters were at 27.1%, 23.9% and 18.1%.

- NPLs as a percentage of gross loans declined to 2.2% in FY2005 from 2.5% in FY2004.

- In FY2005, QNB's total interest income grew by 53.7% to QR2,172.3mn while its interest cost grew by 75.8% to QR887.5mn. Therefore, despite the higher growth in interest expense as compared to interest income, the bank reported an increase of 41.3% in its net interest income to QR1,284.8mn.

- Non-interest revenue registered a sharp y-o-y growth of 219% in FY2005 to QR904mn. Gain on sale of investments and fees & commission income were the two major contributors to the non-interest income.

- QNB registered a y-o-y growth of 85.7% in its bottomline to reach QR1.54bn. This growth in the bottomline led to an increased earnings per share of QR18.4 in FY 2005 from QR7.9 achieved in the preceding year. The increased earnings translated into higher RoAE and RoAA of 22.2% (15.1% FY2004) and 3.4% (2.2% FY2004) respectively.

- We maintain our earlier Buy recommendation and value the bank's stock at an intrinsic value of QR254.82 based on the Discounted Dividend Model (DDM) and peer group valuation method. The intrinsic value arrived by us is at 19.4% premium to the current market price.

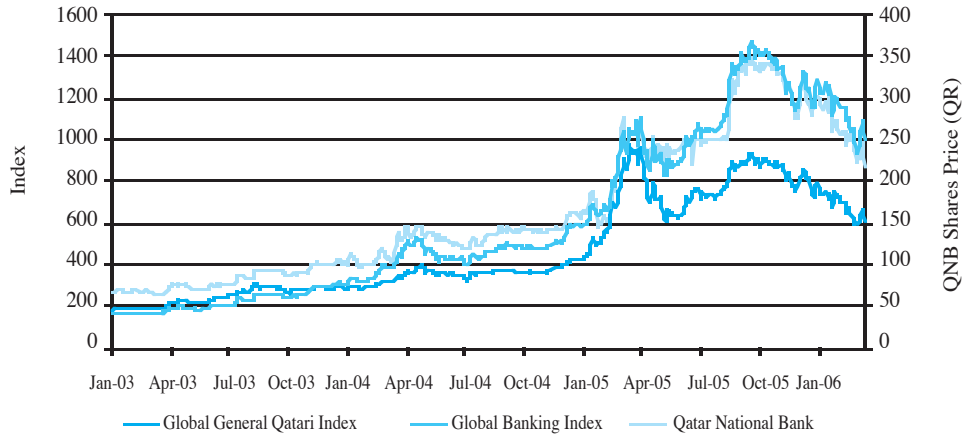
Table 1: QNB at a Glance

Price (as on March 27, 2006)		Shares in issue		Market Cap (QR)		52-week price range (QR)	
QR213.50		129.78mn		27.7bn		349.36 / 217.1	
Year	**Operating Income (QR ' 000)**	**Net Profit (QR ' 000)**	**EPS (QR)**	**BVPS (QR)**	**ROAE (%)**	**P/E* (x)**	**P/BV* (x)**
2007 F	3,121,959	2,244,347	17.3	68.3	26.1%	12.3	3.1
2006 F	2,670,795	1,867,789	14.4	64.3	23.0%	14.8	3.3
2005 A	2,275,992	1,536,812	14.8	76.4	22.2%	20.4	3.9
2004 A	1,172,986	827,497	8.0	56.9	15.1%	25.1	3.5

** Historical P/E & P/BV multiples pertain to respective year-end prices, while those for future years are based on market price in the Doha Securities Market as on March 27, 2006.*

*Source: QNBK and **Global** Research estimates*

Exhibit 1: Share Price Performance Chart



*Source : DSM & **Global** Research*

Strategic Initiatives During 2005

QNB, first commercial bank to venture into Islamic operations

Leading bank... led the move to venture into Islamic banking

QNB was the first commercial bank in Qatar to start Islamic Banking services. `QNB Al Islami', the first ever Islamic branch in Qatar operated by a commercial bank, was launched in April 2005. This branch offers fully compliant Islamic services approved by the Sharia Committee. The Islamic banking services include Current Account, Call Investment Account, Savings Investment Account, Fixed Investment Deposit, Domestic Murabaha Finance for vehicles and goods. A ladies section was also opened during 2005. In 2006, the bank will open one more Islamic banking branch, for which it has already submitted an application to the Qatar Central Bank. To further expand into Islamic segment, in April 2005, QNB acquired a 30% stake in Qatar based "Investment House", a QCB approved Islamic Investment Company. The company also has plans to launch an Islamic fund during 2006.

Ansbacher widening its presence in Qatar

In September 2005, Ansbacher & Co Ltd, a wholly owned subsidiary of Qatar National Bank (QNB), was granted the first ever licence to conduct business in the newly established Qatar Financial Centre in Doha. The licence enables Ansbacher to establish a permanent presence in Qatar and provide advice on and access to the wide range of the Ansbacher Group's products and services to individuals and organisations in Qatar. These include private and specialist banking services, wealth management, investment advice, yacht finance, fiduciary and fund administration services.

Launch of first local market fund

QNB was the first Qatari bank to issue equity funds earmarked for local market called `Al Watani Funds'. The fund has two schemes, Al Watani Fund and Al Watani Fund II, the first one was designed for Qatari nationals and companies, while Fund II has been tailored for residents, expatriates and non-resident foreign nationals. Both Al Watani Funds are managed by the London-based Ansbacher & Co, a subsidiary of QNB.

QNB participated in almost all the major project financing deals in Qatari as well as regional markets

Corporate Banking and Project Financing deals

In 2005, QNB participated in almost all the major corporate as well as project financing deals not only in Qatar but also in the region. Listed below are some of the major deals undertaken by QNB in Qatar.

Table 2: Few of the major deals by QNB

Company Name	Value	Role of QNB
Ras Laffan Power Company	US$53mn	Granted Credit facilities
Nawras Telecom	US$220mn	Acted as a financial adviser and facility agent
Qatar Vinyl Company	US$483.5mn	Mandated lead arranger for refinancing syndicated loan
Gulf Drilling Company	US$130mn	Participated in loan syndication
Qasco	US$483.5mn	One of the mandated lead arrangers
Qasco	US$75mn	Stand by facility for expansion
Dolphin Energy	US$3.45bn	Mandated lead arranger for project financing facility
QAFAC	US$212mn	Loan agreement
Qatar National Hotels Company	US$97mn	Refinancing agreement
Qatar Real Estate Investment Company	US$375mn	Mandated to lead arrange an Islamic financing package

Source: Zawya

QNB also grew its business regionally by taking a lead role in project finance and syndication deals in countries such as Oman, UAE, Kuwait, Saudi Arabia, etc.

In Qatar, QNB was associated with all the three IPOs which tapped the primary market during 2005. Among those were Qatar Gas Transport Company's QR1.4bn IPO in the month of January, Dlala's QR146mn IPO in May and Barwa Real Estate's QR1.1bn IPO in December 2005. In January 2006, QNB acted as the lead manager for GCC's biggest IPO of QR4.1bn of Al Rayan Bank. This was QNB's tenth IPO management mandate.

Regional Expansion Plans

QNB took a 25% stake in Iraq-based Mansour Bank

As part of QNB's regional growth program, in March 2005, it took a 25% stake in Mansour Bank, a newly formed commercial bank in Iraq. London-based merchant banker MerchantBridge & Company Limited has launched Mansour Bank, which is due to start its operations during the current year. The bank has been initially capitalised at US$38.5mn. QNB also plans to enter Syria through a new private bank Syria & Gulf Bank. In 2006, the bank also plans to open representative offices in Singapore, Iran, and Libya.

Future Strategies

In the domestic market, wholesale and retail banking, investment and wealth management comprise core elements of QNB's future expansion strategies. In 2006, the bank will augment its focus on retail segment, which will be supported by a comprehensive range of products and services delivered via multiple delivery channels. Towards this, during 2006, the bank will establish 5 more branches which will take its branch network to 37. It also plans to expand its network of ATMs to 140 from the current 90. The bank has also tied up with Qatar Fuel Company (Woqod), under which QNB will have Point of Sales (PoS) wherever Woqod will have its petrol station. Apart from this, the bank has also tied up with Q-Post and major shopping centers in Qatar to have its PoS outlets. In all, the bank has plans to increase its total PoS network by 67% from the current 1,400. The bank is also recruiting more people to strengthen its manpower under retail segment. All these measures are targeted to augment the bank's retail presence in Qatar, improving customer service standards and defend the growing competition in the sector. To increase its product offerings in investments and funds management, the bank is in the midst of launching a real estate fund under Ansbacher, which will invest in Qatar's real estate market.

As part of its offshore expansion plans the bank will continue to explore opportunities in regional as well as other countries. Towards this it has plans to open representative (rep) offices in Singapore and Libya. In 2006, the bank set up a new international division which is looking after the entire international operations of the bank under one division. This include operations of Ansbacher, QNB's holdings in offshore banks and its rep offices in other countries. The new division is also responsible for the bank's international expansions.

In 2005, the bank made successful diversification into Islamic banking. To further expand its operations, the bank is planning to set up another branch offering Islamic banking products and services, for which it has already submitted an application to the Qatar Central Bank.

The bank has strong presence in the institutional banking business where it will continue to explore overseas business opportunities apart from the domestic market. Its overall future strategies are aimed at strengthening its position in the retail segment as well as wholesale banking business which will help it to retain its leading position in the domestic market and also to become one of the leading financial institutions in the region.

Financial Performance – FY2005

High quality of assets and substantial growth in non-interest revenue have acted as key earning drivers in FY2005

In FY2005, QNB lagged behind the commercial banking sector in terms of growth in total assets, deposits and credit facilities granted. The sector achieved a growth rate of 41.6% in total assets, 40.5% in deposit base and 40.9% in credit facilities granted vis-à-vis these QNB's growth rate for all the respective parameters were at 27.1%, 23.9% and 18.1%. However, high quality of loan portfolio, substantial improvement in non-interest revenues, good performance of investments portfolio and net reversal of NPL provisions were some of the key earning drivers for FY2005.

Operating Income

In 2005, QNB's total interest income grew by 53.7% to QR2,172.3mn. Among the major components of gross interest income, interest from loans & advances grew by 68.4% to QR1,753.2mn and interest on funds due from banks & other FIs increased by 158.5% to QR152.9mn, while interest income from investments in bonds declined by 22.4% to QR242.4mn. The bank's interest cost grew by 75.8% to QR887.5mn and among the major constituents, interest expense on customer deposits grew by 89.9% to QR750.5mn while that on funds due to banks & FIs increased by 42.2% to QR113.2mn. Thus, despite the higher increase in interest expense as compared to interest income, the bank reported an increase of 41.3% in its net interest income to QR1,284.8mn.

Gain on investments...gaining non-interest revenue

As part of QNB's efforts to diversify its revenue base, non-interest revenue registered a sharp y-o-y growth of 219% in FY2005 to QR904mn. Gain on sale of investments and fees & commission income were the two major contributors to the non-interest income of the bank and accounted for 37.8% and 42.9% respectively of the total non-interest revenue. Among all the non-interest revenue components, income from investments registered the highest growth in FY2005 and it stood at QR340.9mn as compared to QR19.1mn in FY2004. The bank's fees & commission income grew by 135.7% to QR388mn. The increase in fees and commission income was mainly on account of the bank's increased focus on acting as a lead manager for loan syndications and also due to investment activities to customers. The bank's dividend income grew by 30.5% to QR68.7mn.

The contribution of non-interest income to total operating income increased substantially in 2004 to 41.3% from 23.8% during the preceding year. Total operating income (net of provisions) of the bank grew by 94% in FY2005 to QR2,276mn as compared to QR1,173mn reported during the preceding year.

Non-interest revenue is likely to go down in FY2006

Going forward, we believe that the bank's profit from sale of investments will not grow at the same pace as in FY2005. The Doha Securities Market witnessed an exponential growth of 83.4% in 2005, which is unlikely to continue in 2006. Therefore, overall growth rate of non-interest revenue is likely to go down in FY2006.

Table 3: QNB's Operating Income

(QR '000)	FY2004	FY2005	Growth (%)
Interest Income	1,413,793	2,172,318	53.7%
Interest Expense	(504,730)	(887,507)	75.8%
Net interest income	**909,063**	**1,284,811**	**41.3%**
Fees and commission	164,597	387,993	135.7%
Net Gains from Dealing in Foreign Currencies	38,555	64,646	67.7%
Gain from Investments	19,092	340,940	1685.8%
Gain / (Loss) from Investments in Associates	-	3,750	-
Dividend Income	52,658	68,709	30.5%
Income from financing and investing activities	-	14,304	-
Other Operating Income	8,461	23,698	180.1%
Total Non-Interest Income	**283,363**	**904,040**	**219.0%**
Less: Provisions	(27,189)	78,070	-387.1%
Investment Revaluation Gains/ (Losses)	7,749	9,071	17.1%
Operating Income (net of provisions)	**1,172,986**	**2,275,992**	**94.0%**

Source: QNB's Annual Report

Spreads and Net Interest Margin

Mainly backed by the increase in the effective interest rates on loans & advances and also on funds due from banks, QNB's net spread and net interest margin increased to 3.1% and 3.3% from 2.5% and 2.7% respectively in 2004. Going forward, we believe that interest rates on customer deposits are not likely to increase at the same pace at which they will increase on loans & advances. Therefore, margins will continue to expand. After staying on a declining trend for the last few years, the bank's interest expense to interest income ratio increased to 40.6% in FY2005 from 35.7% in FY2004.

Operating Expenses

The year 2005 witnessed significant increase in staff and other costs, the major reason behind that was the consolidation of accounts of Ansbacher with QNB. Among the major cost components, staff expenses of the bank witnessed an increase of 101.5% in FY2005 to stand at QR384.6mn. Other operating expenses grew by 113.3% to QR250.3mn whereas depreciation increased by 106.5% to QR56.1mn.

Profitability

Net profit in FY2005 grew at a higher rate of 85.7% as compared to 29.1% in FY2004

On the back of substantial boost in both non-interest revenues and net interest income, QNB registered an impressive y-o-y growth of 85.7% in its bottomline to QR1.54bn. During the year 2005, the bank also realized some of its bad debts which led to net reversal of provisions for loans and advances to the extent of QR76.5mn whereas last year the provision amount was at QR30.3mn.

The bank's earnings per share stood at QR14.8 in FY2005 which was at QR8 in FY2004. The increased earnings translated into higher return on average equity (RoAE) and return on average assets (RoAA) of 22.2% and 3.4% for FY2005 which were at 15.1% and 2.2% respectively in FY2004. This achievement highlights the prudent asset diversification across the sectors without compromising on the quality of the loan portfolio.

Table 4: Profitability Indicators

Profitability	2004	2005
EPS (QR)	8.0	14.8
ROAE (%)	15.1%	22.2%
ROAA (%)	2.2%	3.4%

*Source: **Global** Research*

Composition of Assets – diversifying asset base to non-government sectors

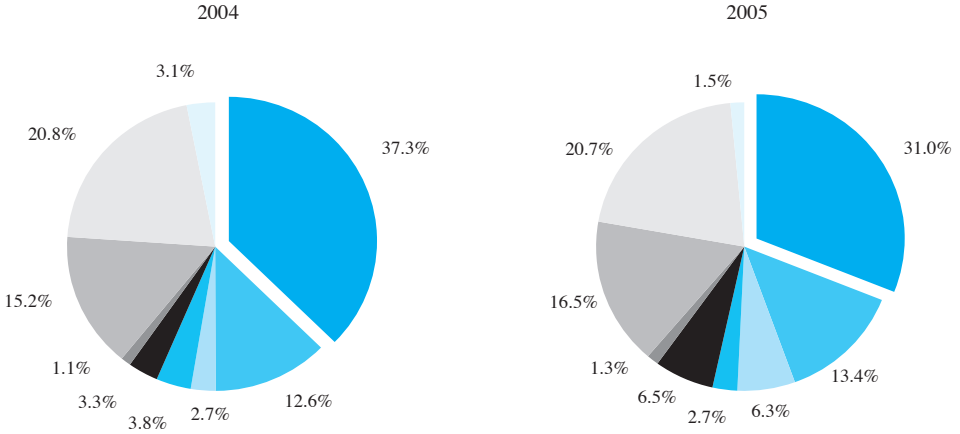
QNB is extending its exposure in favour of Industrial and Services sectors

The total assets of the bank grew by 26.6% in FY2005 to QR50bn. Among the major asset components, gross loans & advances grew by 18.1% to QR32.1bn and it accounted for 64% of the total assets. Out of the total loan portfolio of QR32.1bn, QR418.8mn accounted by Islamic financing. Investments stood at QR7.59bn which were at QR7.62bn in FY2004, funds with banks & FIs increased significantly during the year by more than 200% to QR7.5bn.

During FY2005 also the bank continued its focus to diversify its loan portfolio in favor of other sectors and reduced its exposure to the government sector. In FY2005, exposure to the government sector declined, though marginally by 2.4%, to QR9.97bn from QR10.2bn in FY2004. Its share in the total loan portfolio declined to 31% from 37.3% in FY2004, which has been happening since last few years as the bank is tilting its loan portfolio in favor of high yield assets in other sectors as compared to the government sector where yields are low. The bank's exposure to Industrial and Services sectors grew significantly by 168.8% and 129.9% to QR2bn and QR2.1bn respectively. In FY2005, the share of both these sectors, Industrial and Services, in the total loan portfolio witnessed robust jump to 6.3% and 6.5% from 2.7% and 3.3% respectively in FY2004. We expect that Industrial, Services and Real Estate sectors would turn out to be the biggest beneficiaries of the scale of projects Qatar has in the pipeline. Therefore, QNB, being the largest bank in Qatar, will continue to achieve significant growth in terms of exposures to these sectors.

Personal loans segment continued to maintain its share in total loans and advances at the same level of 2004 of 20.8%, however, y-o-y growth rate came down to 17% from 34% in 2004. In future this will prove to be another major growth area for the bank's loan portfolio with its renewed focus on retail sector.

Exhibit 2: Sectoral Distribution of QNB's Loan Portfolio



Source: QNB's Annual Report

Non-Performing Loans

Despite the growing loan book and declining exposure to the government sector, the bank's NPLs grew marginally by 3.6% to QR690.7mn in FY2005 from QR666.6mn in FY2004. NPLs as a percentage of gross loans declined to 2.2% in FY2005 from 2.5% in FY2004. This shows that the reduced exposure to the government sector, lending to which are de facto performing credit, have not affected the strong quality of the bank's loan portfolio. The bank has sufficient coverage to its NPLs at 92% in FY2005, which reduced from 113% in FY2004.

Table 5: Quality of Loan Portfolio

	2004	2005
NPL's to Gross Loans	2.5%	2.2%
NPL Coverage (%)	113%	92%

*Source: **Global** Research*

Investments – rising equity exposure

Investments of QNB remained almost at the same level at QR7.59bn in FY2005. Out of this, around 52.8% was accounted for by debt securities and the rest by equities. However the share of debt securities came down from 68.4% in the previous year. The bank also has investments in Mutual Funds but that accounts for only 1.54% of total investments. Over the last few years, the bank's investments saw reduced exposure to debt which came down to 52.8% in FY2005 from 68.4% and 79.3% in FY2004 and FY2003 respectively while the share of equity investments witnessed corresponding rise in its share.

Composition of Liabilities

In FY2005 customer deposits of the bank grew by 23.9%

Among the components of liabilities, the share of customer deposits (including unrestricted investment accounts) in total liabilities declined marginally in FY2005 to 73.3% from 75.2% in the preceding year and it registered a y-o-y growth of 23.9% to QR36.7bn. Within conventional banking deposits, current & call accounts recorded the highest growth of 68% to stood at QR17.4bn, saving accounts witnessed a growth of 32.9% to QR652.9mn and time deposits declined by 11.7% to QR16.5bn. Islamic banking current accounts was at QR1.9bn and unrestricted investment accounts stood at QR249.2mn. The amount due to banks & other FIs increased by 20.7% to QR2.6bn. The contribution of shareholders' equity in total liabilities grew marginally to 17.4% from 16.9% in FY2004.

Capital Adequacy Ratio – declining, but well above the required level

Though the bank remained strongly capitalized its CAR has been declining since last two years. Its CAR has declined to 21% in FY2005 from 22% and 30% in FY2004 and FY2003 respectively. However it is well above the 10% requirement of Qatar Central Bank and 8% under Basle requirements. With regard to Basel-II requirements, the bank is already meeting this under standardized approach.

Pay-out Ratio

In FY2005, the bank's pay-out ratio stood at 50.7% (cash) which was at 75.3% (cash) in FY2004. The bank has also issued 25% stock dividend along with the cash dividend for FY2005. With this the bank's equity capital increased to QR1.30bn from QR1.04bn due to issuance of 25% bonus shares. The year-end 2005 stock price of the bank witnessed a sharp y-o-y increase of 51%, due to which its cash dividend yield declined to 2.5% at 2005 year end prices which was at 3% at 2004 year end prices.

Outlook

Qatari banking sector is in the midst of change and becoming more challenging

Qatari banking sector is witnessing the entry of new banks in 2006 – one each in conventional banking and Islamic banking segments. In the conventional banking segment, Gulf Commercial Bank is coming out with an IPO in April 2006. In the Islamic Banking segment, Al Rayan Bank has already raised the funds from the primary market.

To tap the growing importance of Islamic finance, especially in the GCC region, many Qatari banks have ventured into Islamic banking as a window within the conventional bank. In 2005, all the three major banks, namely Qatar National Bank, Doha Bank and Commercial Bank of Qatar entered into Islamic banking. Recently, Ahli Bank of Qatar has also got the approval from the Qatar Central Bank for Islamic banking and soon it will start its operations. So effectively all the six leading banks in Qatar are now providing Islamic banking products. However, we believe that old Islamic banks will continue to hold their positions in the sector and new conventional banks will see tough competition among themselves to have a pie of the Islamic banking sector. At the same time, the advent of new Islamic bank, Al Rayan Bank, will definitely pose stiff competition to the Islamic banks, as this is the largest Islamic bank in the world with a capital of QR7.5bn (US$2.06bn).

With regard to scale of big ticket projects, Qatar has several billion dollar projects in the pipeline, from both hydrocarbon to non-hydrocarbon sectors. At the same time GCC region also has multi billion dollar projects from diverse sectors which provide tremendous opportunities for banking sector in the region to expand. However, Qatari banks on a standalone basis do not have the necessary funds to finance mega projects which are being implemented in the country and GCC region at large. Therefore, there is an utmost need on the part of Qatari banking system to focus on evaluating different options to raise necessary funds to expand the size of their balance sheets. In this regard, we believe that the conventional banks recent diversification into Islamic banking is in right direction as Islamic banking has large untapped potential not only in the region but all over the world.

With regard to providing new financial products, Qatari banks have started providing investment funds for local markets, which was at opportune time when the DSM was doing extremely well and interest rates on deposits were not attractive for investors at about 2%. In this segment QNB led the move with Ansbacher.

In FY2005, all the banks in Qatar had reported significant growth in their profit from sale of investments. We believe that going forward it is unlikely to continue as DSM has witnessed a significant correction since the beginning of 2006 and in the first quarter of 2006 it lost about 21.7% over 2005 year end level. Therefore, share of profit on sale of investments in total non-interest revenue for all the banks are likely to come down in 2006.

To face this changing industry dynamics, all the major banks have renewed their focus on retail banking, especially the leading banks, with innovative products and customized services. Also, over the last few years, local Qatari banks are focusing on expanding their capital base which is expected to continue in the near future. This will help the banks to shore-up their capital adequacy ratio and to leverage their balance sheet and increase profitable lending opportunities.

Considering the sector specific developments discussed above, we believe that QNB's future strategies are in right direction to develop non-state related businesses by diversifying its asset base across various sectors. We believe that the bank's successful expansion into wealth management business will further help it to expand fees and commission income and diversify its revenue stream. The economy of Qatar offers lot of opportunities for the banking sector to expand further in institutional as well as retail segments and though QNB is in an advantageous position as compared to peer banks, it has to compete aggressively in all the facets of banking to stay ahead in the sector.

We believe that QNB has to compete aggressively to stay ahead in the sector

VALUATION

For arriving at the fair value of QNB we have used the following methods:
(a) Dividend Discounting Method (DDM); and
(b) The Relative Valuation Method

Dividend Discounted Method (DDM)

Using the DDM model , we estimate the intrinsic value of QNB shares at QR235.56

While valuing banks, we have consistently been using the dividend discounting method, as we believe it is the most suitable method to value banks owing to the nature of banking business. In case of DDM, the cash flows for the investor includes potential dividends. Therefore, our valuation of QNB is based on discounting the present and future stream of dividends.

The DDM model constructed by us is based on a four year forecast of dividends (2006-09) for QNB. The dividend for the forecast period and the terminal value is then discounted back at the discount rate generated, to provide the total net present value (NPV) of the bank. In our calculations, we have made the following assumptions in order to arrive at the equity value of QNB.

- Risk free rate: We have assumed a risk free rate of 5.7%. To arrive at risk free rate we have taken the discount rate of Kuwait, which is at 6%. As Kuwait has a lower country risk rating than Qatar, we have subtracted the difference of country risk premiums between Qatar (0.9%) and Kuwait (1.2%) from the discount rate of 6%. Thus, we arrived at a risk free rate of 5.7% for Qatar. Since our last coverage of QNB in May 2005, the discount rate of Kuwait has increased to 6% from 5%, similarly the country risk premiums of Qatar and Kuwait have been changed to 0.9% and 1.2% from 1.43% and 1.35% respectively. The difference in country risk premiums have been taken from the study done by Prof. Damodaran and available on his web site www.pages.stern.nyu.edu.com.
- We have assumed the equity risk premium of 5.5%.
- A beta of 1 is taken for QNB. The actual beta for the bank is low, but to more appropriately reflect the market risk we have taken it as 1.
- Based on the above assumptions and CAPM model, the cost of equity for Qatar National Bank works out to 11.2%.
- We have further assumed a terminal growth rate of 5%, looking at the prospects of the economy and for the bank.

Table 6: DDM valuation

Amount in QR'000	2006F	2007F	2008F	2009F	Terminal Value
Dividends Expected	1,447,537	1,718,048	1,991,335	2,253,270	38,160,225
NPV of Dividends Expected	5,612,990				
NPV of Terminal Value	24,956,965				
Estimated Fair Value of Equity	30,569,955				
No. of Shares Outstanding	129,776,000				
DDM value of QNB (QR)	**235.56**				
Current Share Price (QR)	213.5				
Upside /(Downside) Potential (%)	**10.33%**				

Based on the above method and assumptions, the DDM model gives a value of QR235.56 per share of QNB, which is around 10.33% higher than the current market price of QR213.5 per share.

Sensitivity Analysis

A sensitivity analysis for different estimated long-run future growth rates and cost of equity is provided. The table provides estimated fair values for QNB shares based on a range of varying inputs. The shaded area at the center shows the most probable range of alternatives.

Table 7: Sensitivity Analysis

		Terminal Growth Rate				
		3%	4%	5%	6%	7%
Cost Of Equity	9.20%	248.16	289.52	350.57	449.78	639.18
	10.20%	212.68	241.75	281.99	341.39	437.93
	11.20%	185.89	207.27	235.56	274.73	332.54
	12.20%	164.94	181.23	202.05	229.59	267.72
	13.20%	148.11	160.87	176.73	197.01	223.82

At the current market price of QR213.5 per share, QNB is available at a forward multiple of 14.8x and 12.3x of FY2006F and FY2007 earnings respectively.

Relative Valuation

We believe that the comparative valuation for the banking sector is more appropriately reflected through the Price to Book Value (P/BV) multiple. Therefore, the peer group valuation is done by comparing the P/BV multiples enjoyed by the other banks in the sector. The book value multiples of a stock are a reflection of various factors such as the expected profitability, growth potential as perceived by the market, predictability and sustainability of revenues, quality of earnings and the quality of management among others.

The P/BV of all the six banks are based on their results for the year ended 2005 and closing prices as on March 27, 2006. The P/BV of all the six banks are ranges from 3x to 9.9x with the average multiple being at 5.16x.

We estimate the intrinsic value of QNB's shares at QR254.82 and ....

Table 8: Peer Banks P/BV Multiples

	QNB	Doha Bank	CBQ	QIB	QIIB	ABQ	Total / Average
Equity (QR mn)	7,930	2,401	5,303	1,930	882	1,075	18,743
Shares (mn)	129.8	69.3	93.4	99.5	40.6	40.6	
Book Value (in QR)	61.1	34.6	56.8	19.4	21.7	26.5	
CMP (QR) as on March 27, 2006	213.5	261.9	211	192.3	215.6	80.3	
Market Capitalization (QR mn)	27,707	18,161	19,716	19,121	8,759	3,262	96,725
P/BV (x)	3.5	7.6	3.7	9.9	9.9	3.0	5.16

*Source: Bank's Financial Statements and **Global** Research*

Therefore, on the basis of the average P/BV of 5.16x, QNB's stock valuation comes to QR331.88 based on forecasted book value for FY2006. As the book value multiples vary with time and are dependent on several factors such as market sentiment and other qualitative factors, we have provided 20% weightage to the book value multiple and 80% to the DDM value calculation.

	Fair Value Per Share (QR)	Weightage	Weighted Value Per Share (QR)
As per DDM Method	235.56	80%	188.44
As per Relative Valuation	331.88	20%	66.38
Estimated Fair Value			***254.82***

therefore, we continue to recommend a BUY for the stock.

The combination of both the methods suggests a price of around QR254.82 per share. The stock currently trades at around QR213.5, which implies that the value arrived by using above methods is 19.4% higher than the current market price. Hence, we maintain our earlier rating and recommend a BUY on the stock with a medium term perspective.

BALANCE SHEET

	Qatar National Bank							
Amount in Qatari Riyal '000	**2002**	**2003**	**2004**	**2005**	**2006 (F)**	**2007 (F)**	**2008 (F)**	**2009 (F)**
Assets								
Cash & balances with banks	890,958	810,808	1,700,369	2,406,328	2,484,109	2,212,765	2,539,460	2,609,214
Due from Banks and Other FIs	4,840,842	3,315,875	2,345,936	7,499,202	9,149,026	10,246,910	11,374,070	12,625,217
Loans and advances (Gross)	20,628,160	23,897,522	27,194,984	32,113,501	38,215,066	44,902,703	50,964,568	57,589,961
Other assets	173,343	364,019	756,996	571,762	623,221	666,846	720,194	777,809
Less : provisions	(675,051)	(756,187)	(753,423)	(636,001)	(590,448)	(538,707)	(565,433)	(592,530)
Total Current Assets	25,858,252	27,632,037	31,244,862	41,954,792	49,880,974	57,490,517	65,032,858	73,009,672
Investment securities - debt	4,498,470	5,562,885	5,213,275	3,886,981	4,422,338	4,643,455	4,474,602	4,228,499
Investment securities - equity	612,771	1,454,550	2,411,549	3,698,505	3,618,277	3,799,191	4,474,602	5,168,166
Investment in associates	-	-	-	52,460	52,460	52,460	52,460	52,460
Gross fixed assets	277,181	364,033	897,219	855,599	924,047	997,971	1,077,808	1,164,033
less: accumulated depreciation	(190,749)	(224,659)	(368,784)	(388,180)	(448,243)	(513,111)	(580,474)	(653,226)
Net fixed assets	86,432	139,374	528,435	467,419	475,804	484,860	497,334	510,807
Total Assets	**31,055,925**	**34,788,846**	**39,398,121**	**50,060,156**	**58,449,853**	**66,470,482**	**74,531,856**	**82,969,603**
Liabilities								
Due to banks and other FIs	2,020,887	3,644,546	2,153,383	2,598,708	2,962,527	3,258,780	3,454,307	3,661,565
Deposits from customers	23,600,190	24,100,030	29,613,833	36,457,014	43,019,277	49,472,168	55,903,550	62,611,976
Other liabilities	453,935	1,436,554	1,095,555	2,046,368	2,251,005	2,476,105	2,723,716	2,996,087
Proposed dividend	467,193	545,059	622,925	778,656	1,447,537	1,718,048	1,991,335	2,253,270
Total Liabilities	26,542,205	29,726,189	33,485,696	41,880,746	49,680,345	56,925,101	64,072,907	71,522,899
Unrestricted investment accounts	-	-	-	249,151	423,557	677,691	1,050,421	1,470,589
Owner's Equity								
Paid-up equity capital	1,038,208	1,038,208	1,038,208	1,038,208	1,297,760	1,297,760	1,297,760	1,297,760
Statutory reserve	1,038,208	1,038,208	1,038,208	1,038,208	1,297,760	1,297,760	1,297,760	1,297,760
General reserve	1,770,034	1,770,034	1,770,034	1,775,457	1,775,457	1,775,457	1,775,457	1,775,457
Risk reserve	-	-	-	169,422	210,183	260,436	305,787	345,540
Fair value reserve	321,178	777,871	1,439,387	2,549,232	2,549,232	2,549,232	2,549,232	2,549,232
Proposed bonus shares	-	-	-	259,552	-	-	-	-
Proposed transfer to statutory reserve	-	-	-	259,552	-	-	-	-
Retained earnings	346,092	438,335	626,588	840,627	1,215,559	1,687,046	2,182,531	2,710,366
Total Shareholder's Equity	4,513,720	5,062,656	5,912,425	7,930,258	8,345,951	8,867,690	9,408,528	9,976,115
Total Liabilities & Shareholders' Equity	**31,055,925**	**34,788,846**	**39,398,121**	**50,060,156**	**58,449,853**	**66,470,482**	**74,531,856**	**82,969,603**

OPERATING STATEMENT

	Qatar National Bank							
Amount in Qatari Riyal '000	**2002**	**2003**	**2004**	**2005**	**2006 (F)**	**2007 (F)**	**2008 (F)**	**2009 (F)**
Interest Income	1,462,424	1,340,725	1,413,793	2,172,318	2,819,808	3,259,007	3,527,261	3,667,315
Interest Expense	(623,183)	(482,838)	(504,730)	(887,507)	(1,170,220)	(1,393,226)	(1,472,632)	(1,507,266)
Net interest income	**839,241**	**857,887**	**909,063**	**1,284,811**	**1,649,587**	**1,865,782**	**2,054,630**	**2,160,048**
Add : Fees and commission	97,547	140,270	164,597	387,993	543,190	678,988	807,995	961,515
Add : Net Gains from Dealing in Foreign Currencies	19,256	24,448	38,555	64,646	87,272	109,090	128,726	151,897
Add: Gain from Investments	4,170	2,213	19,092	340,940	146,336	155,767	206,845	216,962
Add: Gain / (Loss) from Investments in Associates	(331)	(532)	-	3,750	4,721	5,246	5,771	6,295
Add : Dividend Income	23,376	34,172	52,658	68,709	103,558	101,312	121,574	156,611
Add: Income from financing and investing activities	-	-	-	14,304	55,030	113,155	191,117	259,155
Add : Other Operating Income	2,891	1,117	8,461	23,698	35,547	40,879	45,785	51,279
Total Non-Interest Income	146,909	201,688	283,363	904,040	975,654	1,204,436	1,507,813	1,803,714
Total Operating Income	**986,150**	**1,059,575**	**1,192,426**	**2,188,851**	**2,625,242**	**3,070,218**	**3,562,443**	**3,963,762**
Less: Provision for Impairment of Loans & Advances	(106,255)	(82,708)	(30,339)	76,457	40,126	44,903	(35,675)	(37,433)
Add: Recovery of Provision/(Provision) for Properties Acquired against Settlement of Debts	-	-	6,585	4,020	-	-	-	-
Less: Other Provisions / (Recoveries)	(20,000)	23,803	(3,435)	(2,407)	-	-	-	-
Less: Investment Revaluation Gains/ (Losses)	(18)	(28,988)	7,749	9,071	5,427	6,839	8,949	10,336
Operating Income (net of provisions)	**859,877**	**971,682**	**1,172,986**	**2,275,992**	**2,670,795**	**3,121,959**	**3,535,717**	**3,936,665**
Less : Staff Expenses	(154,300)	(172,585)	(190,864)	(384,622)	(434,004)	(468,294)	(530,357)	(590,500)
Less: Employees' Termination Benefits	(11,800)	-	-	-	-	-	-	-
Less: Provision for Pension Fund	-	(23,938)	-	-	-	-	-	-
Less: Expenditure on Bank's Community Support Programme	(8,000)	(14,943)	(19,394)	(43,457)	(54,751)	(59,317)	(67,179)	(74,797)
Less: Other Expenses	(75,791)	(74,999)	(97,940)	(206,831)	(240,372)	(265,367)	(309,375)	(344,458)
Less: Depreciation	(23,659)	(33,543)	(27,159)	(56,071)	(60,063)	(64,868)	(67,363)	(72,752)
Less: Goodwill Impairment	-	-	-	(40,378)	-	-	-	-
Less: Unrestricted Investment Account Holders' Share of Profit	-	-	-	(798)	(2,541)	(5,083)	(6,828)	(8,824)
Profit Before Taxes	**586,327**	**651,674**	**837,629**	**1,543,835**	**1,879,063**	**2,259,031**	**2,554,615**	**2,845,335**
Less : Taxes	(6,123)	(10,551)	(10,132)	(7,023)	(11,274)	(14,684)	(17,882)	(19,917)
Net Profit	**580,204**	**641,123**	**827,497**	**1,536,812**	**1,867,789**	**2,244,347**	**2,536,732**	**2,825,417**
P&L Appropriation Account:								
Retained Earnings Broght Forward	236,901	346,091	438,335	626,587	840,627	1,215,559	1,687,046	2,182,531
Net Profit for the year	580,204	641,123	827,497	1,536,812	1,867,789	2,244,347	2,536,732	2,825,417
Proposed Dividend	(467,193)	(545,059)	(622,925)	(778,656)	(1,447,537)	(1,718,048)	(1,991,335)	(2,253,270)
Director Fees	(3,820)	(3,820)	(3,820)	(4,560)	(4,560)	(4,560)	(4,560)	(4,560)
Proposed Issue of Bonus Shares	-	-	-	(259,552)	-	-	-	-
Net Movement in Risk Reserve	-	-	(12,500)	(20,452)	(40,761)	(50,253)	(45,352)	(39,752)
Trfr to Statutory Reserve	-	-	-	(259,552)	-	-	-	-
Cl Balance of Retained Earnings	346,091	438,335	626,587	840,627	1,215,559	1,687,046	2,182,531	2,710,366

CASH FLOW STATEMENT

	Qatar National Bank							
Amount in Qatari Riyal '000	**2002**	**2003**	**2004**	**2005**	**2006 (F)**	**2007 (F)**	**2008 (F)**	**2009 (F)**
Operating								
Operating Activities	731,498	793,942	837,567	1,196,343	1,877,739	2,252,914	2,626,261	2,920,707
Profit for the Year (Before Taxes)	586,327	651,674	837,629	1,543,835	1,879,063	2,259,031	2,554,615	2,845,335
Provision for impairment of loans and advances	106,255	82,708	30,339	(76,457)	(40,126)	(44,903)	35,675	37,433
Provision for Legal cases	20,000	-	11,262	12,388	-	-	-	-
Depreciation	23,659	33,543	27,159	56,071	60,063	64,868	67,363	72,752
Directors fees	-	-	-	-	(4,560)	(4,560)	(4,560)	(4,560)
Provision / (release) of provision for impairment of investments	18	28,988	(7,749)	(9,071)	(5,427)	(6,839)	(8,949)	(10,336)
Other provisions	-	37,508	-	-	-	-	-	-
Release of other provisions	-	(31,628)	(18,291)	(5,441)	-	-	-	-
Provision for property acquired against settlement of debts	-	-	(6,585)	(4,020)	-	-	-	-
Profit on sale of investments	-	(981)	(19,092)	(340,940)	-	-	-	-
Goodwill impairment	-	-	-	40,378				
Fair value adjustment of investments	77	-	-	-	-	-	-	-
Amortisation of premium or discount on investments	3,098	2,833	2,960	3,205	-	-	-	-
Loss form associates	331	(703)	-	-	-	-	-	-
(Profit)/loss on sales of fixed assets	(2,144)	(14)	(6,738)	(12,443)	-	-	-	-
Taxes Paid	(6,123)	(9,986)	(13,327)	(7,412)	(11,274)	(14,684)	(17,882)	(19,917)
Gain from investment in associates	-	-	-	(3,750)	-	-	-	-
Net Increase/Decrease in Operating Activities	**(592,080)**	**1,154,023**	**(661,227)**	**(1,309,706)**	**(497,724)**	**(600,767)**	**4,876**	**(325,933)**
Inc./(Dec.) in due to banks	52,177	1,623,659	(1,615,619)	445,325	363,819	296,253	195,527	207,258
Dec/(Inc.) in due from banks	(1,508,509)	1,524,967	917,318	(5,153,266)	(1,649,824)	(1,097,883)	(1,127,160)	(1,251,148)
(Inc) in originated debt securities	(91,316)	-	-	-	-	-	-	-
(Inc.) in available for sale investmenets	(182,915)	-	-	-	-	-	-	-
Inc. in customer deposits	2,210,307	499,840	1,900,865	7,092,332	6,562,263	6,452,891	6,431,382	6,708,426
Inc. in unrestricted investment accounts	-	-	-	-	174,406	254,134	372,730	420,168
Dec./(Inc.) in loans and advances	(1,110,028)	(3,270,934)	(840,096)	(4,810,060)	(6,101,565)	(6,687,637)	(6,061,865)	(6,625,394)
(Inc.) / Dec. in other assets	(12,897)	(186,540)	(229,009)	150,639	(51,459)	(43,625)	(53,348)	(57,615)
Inc./(Dec.) in other liabilities	51,101	963,031	(794,686)	965,324	204,637	225,100	247,611	272,372
Total Operating	**139,418**	**1,947,965**	**176,340**	**(113,363)**	**1,380,015**	**1,652,147**	**2,631,138**	**2,594,774**
Investing								
Purchase of investments	-	(1,491,390)	(993,851)	(1,007,361)	(455,129)	(402,031)	(506,559)	(447,460)
Redemption of held to maturity investments	3,309	-	-	-	-	-	-	-
Sale / Redemption of investments	-	62,000	2,097,743	2,334,829	-	-	-	-
Sale / (Purchase) of Associates	-	8,544	-	(48,710)	-	-	-	-
Acquisition of Subsidiary, Net of cash acquired	-	-	203,744	-	-	-	-	-
Purchase of fixed assets and property	(32,611)	(85,083)	(37,432)	(42,352)	(68,448)	(73,924)	(79,838)	(86,225)
Sale of fixed assets and property	6,116	229	21,639	24,326	-	-	-	-
Total Investing	**(23,186)**	**(1,505,700)**	**1,291,843**	**1,260,732**	**(523,577)**	**(475,955)**	**(586,396)**	**(533,685)**
Financing								
Dividend paid to shareholders	(415,451)	(467,390)	(548,178)	(617,384)	(778,656)	(1,447,537)	(1,718,048)	(1,991,335)
Total Financing	**(415,451)**	**(467,390)**	**(548,178)**	**(617,384)**	**(778,656)**	**(1,447,537)**	**(1,718,048)**	**(1,991,335)**
Net Change in Cash	(299,219)	(25,125)	920,005	529,985	77,782	(271,344)	326,694	69,754
Exchange rate differences	(13,308)	(55,025)	(30,444)	175,973	-	-	-	-
Net Cash at beginning	1,203,485	890,958	810,808	1,700,369	2,406,327	2,484,109	2,212,765	2,539,459
Net Cash at end	890,958	810,808	1,700,369	2,406,327	2,484,109	2,212,765	2,539,459	2,609,213

RATIOS

Profitability	Qatar National Bank 2002	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
- Return on Average Assets	2.0%	1.9%	2.2%	3.4%	3.4%	3.6%	3.6%	3.6%
- Return on Average Equity	13.5%	13.4%	15.1%	22.2%	23.0%	26.1%	27.8%	29.2%
- Net interest income/ Op. Income (net of provisions)	85%	80%	75%	60%	63%	61%	57%	54%
- Non-interest income/ Op. Income (net of provisions)	15%	20%	25%	40%	37%	39%	43%	46%
Margins								
- Interest Expense to Interest Income	42.6%	36.0%	35.7%	40.6%	40.8%	41.5%	39.8%	38.6%
- Interest Income to Interest Earning Assets	5.13%	4.27%	4.19%	5.59%	6.03%	6.04%	5.87%	5.56%
- Interest Expense to Interest Bearing Liabilities	2.54%	1.81%	1.70%	2.50%	2.74%	2.80%	2.60%	2.37%
- Net Spread	2.58%	2.46%	2.49%	3.09%	3.30%	3.24%	3.27%	3.19%
- Net Interest Margin	2.94%	2.73%	2.69%	3.32%	3.58%	3.55%	3.55%	3.43%
Efficiency								
- Cost to Total Op Income	32%	33%	29%	30%	30%	27%	28%	27%
- Staff Expense to Total Op Income	18%	18%	16%	17%	16%	15%	15%	15%
Liquidity								
- Loans to Interest Earning Assets	59%	73%	78%	74%	74%	75%	76%	77%
- Loans to Customer Deposits	87%	99.2%	91.8%	87.5%	88.0%	89.5%	89.5%	89.9%
- Customer Deposits to Equity	523%	476%	501%	460%	515%	558%	594%	628%
- Due from Banks to Due to Banks	240%	91%	109%	289%	309%	314%	329%	345%
Credit Quality								
- Non Performing Loans (QR'000)	609,742	679,900	666,600	690,700	764,301	898,054	1,070,256	1,266,979
- Loan Loss Reserve (QR'000)	675,051	756,187	753,423	636,001	590,448	538,707	565,433	592,530
- NPL's to Gross Loans	3.0%	2.8%	2.5%	2.2%	2.0%	2.0%	2.1%	2.2%
- NPL's to (Equity+Loan loss reserve)	16%	16%	13%	9%	10%	11%	12%	14%
- Loan Loss Reserve to Gross Loans	3.3%	3.2%	2.8%	2.0%	1.5%	1.2%	1.1%	1.0%
- NPL Coverage (incl. Interest in suspense)	111%	111%	113%	92%	77%	60.0%	52.8%	46.8%
- NPL Coverage (excl. Interest in suspense)	152%	154%	159%	122%	103%	80.0%	71.6%	66.4%
Capital Adequacy								
- Equity to Total Assets	15%	15%	15%	16%	14%	13%	13%	12%
- Equity to Gross Loans	22%	21%	22%	25%	22%	20%	18%	17%
Constitution of Total Income								
- Interest Income to Total Op Income	85.2%	79.8%	75.5%	60.6%	65.3%	64.8%	62.5%	60.5%
- Fees & Comm. to Total Op. Income	11.3%	14.4%	14.0%	17.0%	20.3%	21.7%	22.9%	24.4%
- Investment Income to Total Op Income	0.8%	3.2%	6.5%	18.5%	9.7%	8.6%	9.7%	9.9%
- FX Income to Total Op. Income	2.2%	2.5%	3.3%	2.8%	3.3%	3.5%	3.6%	3.9%
- Other Income to Total Op. Income	0.3%	0.1%	0.7%	1.0%	1.3%	1.3%	1.3%	1.3%
Operating Performance								
- Change in Interest Income	17%	6%	14%	56%	26%	16%	9%	8%
- Change in Fees and Commission	12%	44%	17%	136%	40%	25%	19%	19%
- Change in Investment Income	-20%	32%	97%	471%	-39%	3%	28%	14%
- Change in Fx Income	2%	27%	58%	68%	35%	25%	18%	18%
- Change in Other Income	32%	-61%	657%	180%	50%	15%	12%	12%
RATIO'S USED FOR VALUATION								
- Shares in Issue	103,820,772	103,820,772	103,820,772	103,820,772	129,776,000	129,776,000	129,776,000	129,776,000
- EPS (QR)	5.6	6.2	8.0	14.8	14.4	17.3	19.5	21.8
- Book Value Per Share (QR)	43.5	48.8	56.9	76.4	64.3	68.3	72.5	76.9
- Market Price Year End (QR)	83	128	199.7	301.7	213.5	213.5	213.5	213.5
- P/E	14.8	20.6	25.1	20.4	14.8	12.3	10.9	9.8
- P/BV	1.9	2.6	3.5	3.9	3.3	3.1	2.9	2.8

** Market price for 2005 and subsequent years are as per closing prices on DSM on March 27, 2006.*

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The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist				
Company	Recommendation	Ticker	Price	Disclosure
Qatar National Bank	BUY	QNBK.QA	QR213.5	1, 10

1. Global Investment House did not receive and will not receive any compensation from the company or anyone else for the preparation of this report.
2. The company being researched holds more than 5% stake in Global Investment House.
3. Global Investment House makes a market in securities issued by this company.
4. Global Investment House acts as a corporate broker or sponsor to this company.
5. The author of or an individual who assisted in the preparation of this report (or a member of his/her household) has a direct ownership position in securities issued by this company.
6. An employee of Global Investment House serves on the board of directors of this company.
7. Within the past year , Global Investment House has managed or co-managed a public offering for this company, for which it received fees.
8. Global Investment House has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
9. Global Investment House expects to receive or intends to seek compensation for investment banking services from this company in the next three month.
10. Please see special footnote below for other relevant disclosures.

Global Research: Equity Ratings Definitions	
Global rating	Definition
Buy	Fair value of the stock is >10% from the current market price
Hold	Fair value of the stock is between +10% and -10% from the current market price
Reduce	Fair value of the stock is between -10% and -20% from the current market price
Sell	Fair value of the stock is < -20% from the current market price

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