Qatar Islamic Bank (QIB)

Downgrade to Hold

- **QIB reported 3Q09 net income of QAR189 million, 58% and 42% lower than our expectations and consensus, respectively, owing to worse than expected investment income and loan loss provisioning.**
- **We revise our net income estimates for FY09e-FY13e and lower our target price to QAR98.59 from QAR102.69.**
- **We downgrade the stock to "Hold" from "Buy" due to rich valuation and disappointing 3Q earnings.**

QIB's 3Q09 net income was QAR188.5 million vs. our expectation of QAR443.9 million and QAR397 million in 3Q08. Decline in profits was due to a sharp drop in investment income and an increase in loan loss provisioning charges. Investment income declined by 70% to QAR49 million from the previous quarter and was 55% lower than our estimates. We believe this is due to the performance of the bank's associates and direct property investments. Loan loss provisioning, another surprise, significantly increased to QAR86 million, the highest seen since 1Q05. This compares with our expectation of charges of QAR17 million and recoveries of QAR17 million and QAR138 million seen in 2Q09 and 3Q08, respectively. We estimate non-performing loans to total loans (NPL ratio) to have increased to 1.63% from 1.38% at the end of last year. Assuming the same coverage ratio (loan loss provision/NPL) of 75% as in last year and a loan loss provision balance of QAR304 million in 3Q09, we arrive at the estimated NPL ratio. Note that the bank does not disclose NPL ratio on a quarterly basis. However, the bank's core operating performance (net interest income and fee income) remained strong, with net interest income rising by 5% to QAR307 million from the previous quarter, in line with our expectations. Gross loan book saw a healthy QoQ growth of 13% to QAR24.9 billion, surprising to the upside. Deposits, however, remained unchanged at QAR202.2 billion during the quarter after growing by a 6% in 2Q09 and 15% QoQ in 1Q09. Net interest margin slightly shrank to 3.84% in 3Q09 from 3.88% in the previous quarter.

We raise our loan growth assumption for 2009 to 20% from 12% on the back of the robust growth seen in the third quarter. QIB should further benefit from the expected increase in infrastructure spending in Qatar. Also, given its size and track record, we believe the bank will benefit from big-ticket deals, adding to its fee income. We already saw the bank arrange a syndicated loan facility of QAR4 billion for Qatar Diar. However, we reduce our net income estimates by 26% in 2009 and 13% in 2010 to account for weaker than previously expected investment income and deteriorating asset quality. We believe investment portfolio and asset quality deterioration will continue to impact the bank's profitability and earnings growth, more than offsetting the resilient core operating performance.

We lower our TP to QAR98.59 from QAR102.69. Our new TP gives little further upside potential of 16%. The stock is currently trading at a FY10e PB multiple of 2.1x, a 18% and 42% premium to the Qatari and MENA sector averages, respectively. Even on PE multiples, the stock appears expensive trading at a FY10e PE multiple of 11.0x, a premium of 26% to the Qatari sector average. We find it hard to justify the valuation premium. Hence, we downgrade the stock to "Hold" from "Buy".

Key Performance Indicators

	New		Old		Consensus	
	FY09e	FY10e	FY09e	FY10e	FY09e	FY10e
NII (QAR Mil.)	1,278.0	1,417.5	1,278.7	1,423.9	-	-
Total income (QAR	1,855.1	2,128.6	2,066.3	2,245.4	-	-
Net income (QAR	1,232.5	1,591.7	1,664.6	1,829.7	-	-
Net interest margin	4.10%	4.11%	4.12%	4.13%	-	-
Gross loans (QAR	26.1	30.0	23.4	26.2	-	-
Cost/Income	24.4%	22.4%	21.8%	21.1%	-	-
Gross LD	122%	120%	110%	105%	-	-
EPS	5.96	7.70	8.05	8.85	-	-
DPS	1.19	1.54	1.61	1.77	-	-
Dividend Yield	1.40%	1.81%	1.89%	2.08%	-	-
P/E (x)	14.26	11.04	10.56	9.61	-	-
P/B (x)	2.50	2.09	2.37	1.96	-	-
ROAE	17.4%	20.6%	22.9%	22.3%	-	-
ROAA	3.5%	4.1%	4.7%	4.7%	-	-

Hold

Target Price (QAR)	98.59
Market Price (QAR)	85.00
Upside	15.99%

Listed on	Bloomberg
Bloomberg Code	QIBK QD
RIC	QISB.QA

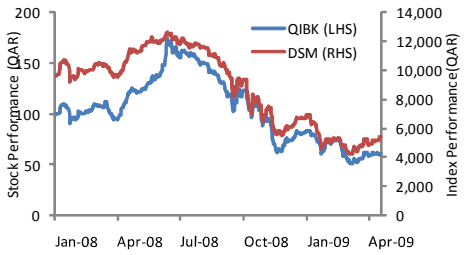
Market Cap. (QARm)	17,553.6
Market Cap. (USDm)	4,822.4

No of shares (m)	207
Foreign Ownership Limit	25.00%
Foreign Ownership Level	4.96%

Shareholder Structure

Qatar Investment Authority	5.00 %
Free Float	90.8%

Price Performance Chart



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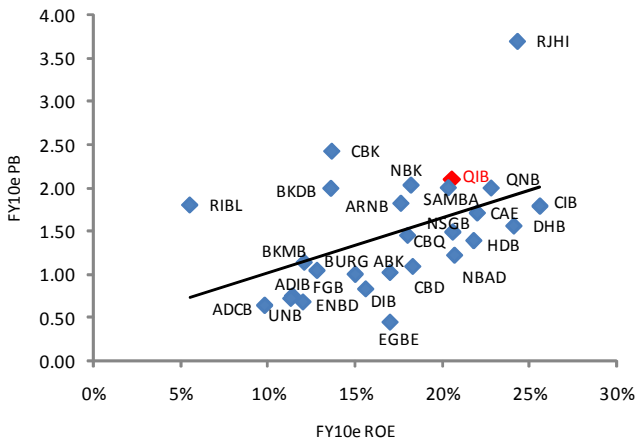
Table1: Comparison of Actual vs. Estimates

QAR'000	3Q09a	3Q08a	YoY change	2Q09a	QoQ change	3Q09e	Surprise
Net interest income	306,980	246,237	25%	293,586	5%	305,684	0%
Non-interest income	106,657	99,962	7%	256,851	-58%	259,818	-59%
Total income	413,637	346,199	19%	550,437	-25%	565,502	-27%
Operating expenses	121,424	94,421	29%	104,337	16%	99,169	22%
Operating profit	292,213	251,778	16%	446,100	-34%	466,333	-37%
Provisions	106,743	(138,258)	na	(489)	na	29,007	268%
- Loan loss	86,075	(138,258)	na	(17,498)	na	16,998	406%
- Other	20,668	0	na	17,009	22%	12,009	72%
Net income	188,510	397,075	-53%	462,418	-59%	443,918	-58%
Cost/Income	29%	27%		19%		18%	
Net loans	22,414,761	17,926,055	25%	19,710,768	14%	20,095,510	12%
Deposit	20,196,228	16,412,423	23%	20,202,131	0%	21,212,238	-5%
Shareholders' equity	7,755,699	6,926,258	12%	7,523,619	3%	7,967,537	-3%

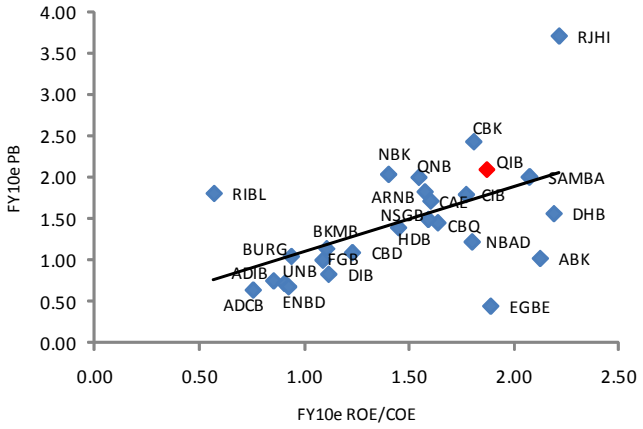
Source: Company financials, HC Brokerage

Chart 1: Valuation

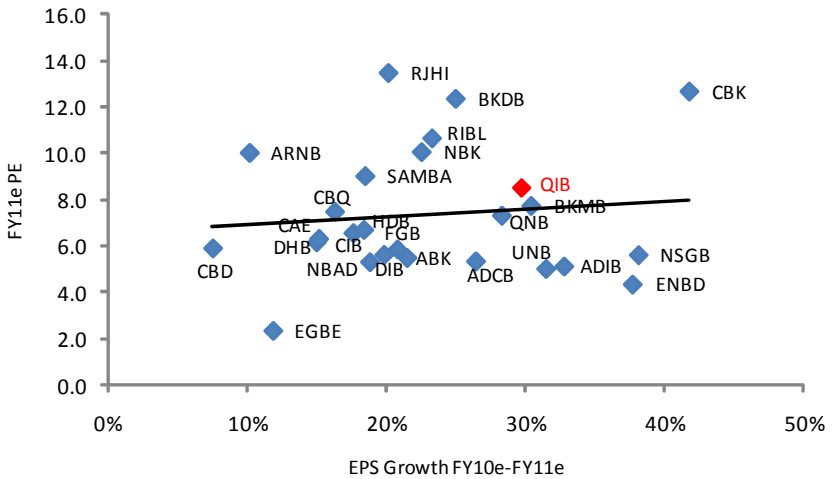
FY10e PB vs. FY10e ROE



FY10e PB vs. ROE/COE



FY11e PE vs. EPS Growth (FY10e – FY11e)



Source: Company financials, Bloomberg, HC Brokerage

Financial Statements

QAR Million	2008	2009e	2010e	2011e	2012e	2013e
Income Statement						
Interest income	1,286.4	1,738.1	1,930.5	2,149.0	2,422.7	2,725.2
Interest expense	388.7	460.1	512.9	563.9	625.0	690.2
Net interest income	**897.8**	**1,278.0**	**1,417.5**	**1,585.1**	**1,797.7**	**2,035.1**
Fees & Commissions	223.2	227.6	261.8	301.1	331.2	364.3
FX Income	(80.7)	60.6	61.2	64.2	67.4	70.8
Investment income	309.0	170.8	197.4	254.6	307.2	345.5
Other income	577.2	118.1	190.8	271.5	325.8	366.0
Non-interest income	**1,028.6**	**577.1**	**711.1**	**891.4**	**1,031.6**	**1,146.6**
Total income	**1,926.4**	**1,855.1**	**2,128.6**	**2,476.5**	**2,829.3**	**3,181.7**
Total operating expenses	443.9	451.8	477.0	556.2	630.8	715.6
Pre-provision income	1,482.4	1,403.3	1,651.6	1,920.3	2,198.5	2,466.0
Provisions	17.3	257.3	194.6	100.1	92.1	81.3
Associate and other income	239.6	74.3	184.0	309.1	388.1	434.6
Pre-tax income	**1,704.7**	**1,220.3**	**1,641.0**	**2,129.2**	**2,494.5**	**2,819.3**
Income taxes	-	-	-	-	-	-
Net income after tax	**1,704.7**	**1,220.3**	**1,641.0**	**2,129.2**	**2,494.5**	**2,819.3**
Minority interest	62.2	(12.2)	49.2	63.9	74.8	84.6
Net income	**1,642.5**	**1,232.5**	**1,591.7**	**2,065.3**	**2,419.6**	**2,734.7**
Balance Sheet						
Assets						
Cash & due from central bank	1,023.2	1,184.2	1,439.7	2,027.3	2,667.2	2,924.8
Due from banks	6,367.7	6,689.8	6,132.4	6,868.2	7,761.1	8,692.4
Investments	2,947.2	1,932.6	2,452.9	3,205.2	3,621.9	4,056.5
Gross loans	**21,234.7**	**26,118.7**	**30,036.5**	**33,640.9**	**37,005.0**	**40,705.5**
NPL provisions	234.0	442.9	608.1	692.2	766.2	827.3
Unearned profit	2,134.9	2,611.9	3,379.1	4,373.3	4,440.6	4,070.6
Net loans	**18,865.9**	**23,063.9**	**26,049.3**	**28,575.4**	**31,798.2**	**35,807.7**
Other assets	4,078.9	3,981.3	4,482.0	4,772.7	5,538.0	6,097.7
Net fixed assets	260.3	313.9	326.1	339.6	354.3	370.6
Total assets	**33,543.2**	**37,165.8**	**40,882.4**	**45,788.3**	**51,740.8**	**57,949.7**
Liabilities						
Total deposits	**16,591.8**	**21,408.8**	**25,030.4**	**30,582.7**	**36,279.4**	**40,705.5**
Due to banks	8,696.7	7,429.7	6,473.6	4,258.7	2,406.0	1,806.8
Borrowings	-	-	-	-	-	-
Other liabilities	885.8	1,114.6	716.2	447.6	462.3	493.1
Total liabilities	**26,174.4**	**29,953.1**	**32,220.2**	**35,288.9**	**39,147.8**	**43,005.4**
Shareholders' equity	**7,368.8**	**7,212.7**	**8,662.2**	**10,499.3**	**12,593.0**	**14,944.2**

Rating Scale

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

Disclaimer

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