QATAR NATIONAL BANK (QNB) RATING BUY

05 October 2010

Upgrading to Buy; 2011e Multiples Attractive

FAIR VALUE CHANGE | BANKS | QATAR

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Raise Fair Value to QAR187.9 Per Share, Upgrade to Buy

We raise our fair value (FV) for QNB to QAR187.9 from QAR152 to reflect our new, higher earnings forecasts. On our new numbers, the stock trades at a P/E of 9.0x and P/B of 2.3x in 2011e, multiples that are not demanding in our view considering the bank's very safe business model, high profitability (ROE of 28% in 2011e) and strong visibility on medium-term growth. We upgrade our rating to Buy as our FV now implies 22% upside potential.

QNB Continues to Benefit from Qatar Short-Term Growth Dynamics

Top-down, Government spending continues to be a key theme in Qatar. QNB is a major beneficiary of public-sector credit demand given its strong relationships with the Qatari government. Private sector credit growth remains weak, both at the retail and corporate levels and we do not expect any significant pick up in the short-term.

Upgrade Forecasts on 1H2010 Strong Asset Growth and Spreads

We now forecast EPS to grow by a strong 33% in 2010 and 19% in 2011. Our estimates factor in a slowdown in loan growth rates from 2H2010 and a slight narrowing in net interest spreads from the high level reported in 1H2010. Pricing competition will be a driver of spreads compression in the short-term, in our view, as other Qatari banks - even those with primarily a private-sector focus - aim to grab a share of the public sector business. We nevertheless expect QNB to report double-digit loan growth in both 2010 (17%) and 2011 (16%).

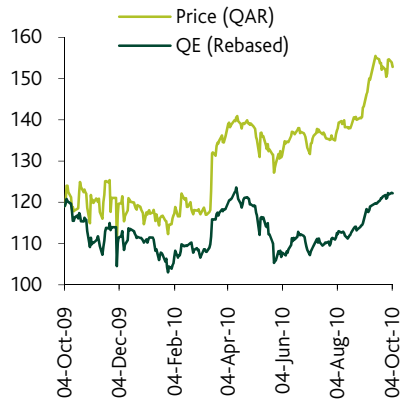
3Q2010 Preview: Estimate Earnings to Grow by 31% Y-o-Y

QNB will report 3Q2010 results tomorrow 6 October 2010. We forecast a net profit of QAR1,391 million, an increase of 31% Y-o-Y (-3% Q-o-Q), with revenue growth expected to be the main earnings driver.

STOCK DATA

Price*	**QAR152.9***
Fair Value	**QAR187.9**
Last Div. / Ex Date	QAR4 on 09 Feb 2010
Mkt. Cap / Shares (mn)	QAR59,838 / 391.5
Av. Mthly Liqdty (mn)	394.8
52-Week High / Low	QAR155.5 / 110.1
Bloomberg / Reuters	QNBK QD / QNBK.QA
Est. Free Float	50%

SHARE PRICE PERFORMANCE RELATIVE TO QE REBASED



KEY FINANCIAL HIGHLIGHTS

December Year End (QAR mn)	2009a	2010e	2011e	2012e
Banking Income	5,657	7,248	8,222	9,191
Operating Income (Pre-provisions)	4,550	6,048	6,926	7,793
Net Attributable Income	4,202	5,571	6,613	7,527
EPS (QAR)	13.95	14.23	16.89	19.23
P/E* (x)	11.0	10.7	9.0	8.0
P/BV*(x)	2.5	2.7	2.3	2.0
Dividend Yield	2.6%	3.7%	4.4%	5.0%
ROAE	25.2%	27.5%	27.7%	26.7%
Capital Adequacy Ratio	13.2%	16.0%	16.6%	17.2%
NPL Coverage	85%	120%	117%	116%

*Price as at 04 October 2010
Source: Qatar National Bank, EFG Hermes estimates

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I. UPGRADING FORECASTS

ESTIMATE EPS GROWTH AT 33% IN 2010, 19% IN 2011 ON REVENUE GROWTH

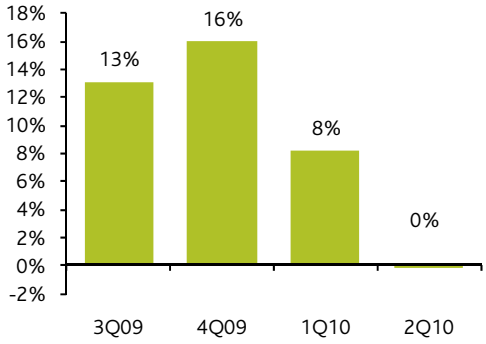
We upgrade our earnings forecasts for Qatar National Bank (QNB) to QAR5,571 million in 2010 (20% upgrade) and QAR6,613 million in 2011 (35% upgrade). The uplift to our short-term earnings expectations largely reflects stronger-than-expected asset growth and net interest spreads during 1H2010. We now estimate QNB's EPS to grow by a strong 33% Y-o-Y in 2010 and 19% Y-o-Y in 2011. Our estimates factor in a deceleration in loan growth rates in 2H2010 following a very strong expansion in previous quarters (particularly 4Q2009 and 1Q2010), although we still forecast Y-o-Y loan growth to remain in double-digits in 2010 (+17%) and 2011 (+16%). We expect net interest spreads to soften from the high level reported in 1H2010 as we account for some downward pressure on lending pricing.

DOMESTIC LOAN GROWTH DYNAMICS CONTINUE TO FAVOUR QNB SHORT-TERM

Loan growth in Qatar continues to be driven by borrowing demand from the government and from semi-government agencies. QNB has been a major beneficiary due to its strong relationships with the public sector- around 50% of QNB's loans and deposits are sourced from public and semi-public sector entities, and the Qatar Investment Authority holds a 50% stake in the bank. QNB has a dominant position in public sector lending in Qatar with an estimated 70% market share. Public sector spending will continue to be the major theme in Qatar as the government continues with its development programme, which includes projects to expand gas-export capacity, and other projects associated with the gas value chain (transportation and gas-intensive industries like aluminium), infrastructure, education and healthcare.

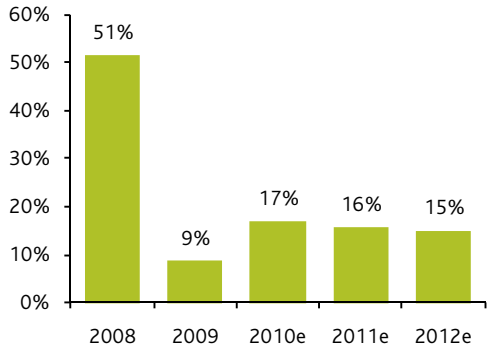
Private sector credit demand in Qatar remains weak, both at the consumer and corporate level. According to QCB's statistics, loan growth to the private sector was positive but a meagre 5% Y-o-Y in August 2010. In the short term, most banks, even those with a traditionally private sector focus (Commercial Bank of Qatar), will aim to grab public sector business, in our view. We understand that the Qatari government is also looking to distribute public sector credit amongst different Qatari banks rather than the QNB meeting most of the public sector credit demand. For QNB in particular, we expect loan growth rates to soften, but remain in double digits at an estimated 17% in 2010 and 16% in 2011.

FIGURE 1: QNB LOAN GROWTH Q-O-Q



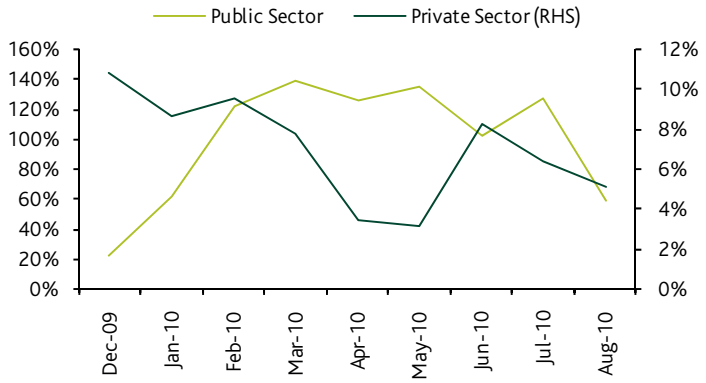
Source: QNB, EFG Hermes estimates

FIGURE 2: QNB LOAN GROWTH FORECASTS



Source: QNB, EFG Hermes estimates

FIGURE 3: Y-O-Y LOAN GROWTH SECTOR LEVEL: PRIVATE SECTOR GROWTH REMAINS SLOW



Source: Central Bank, EFG Hermes

STRICTER RULES ON CONVENTIONAL BANKS' ISLAMIC BANKING ACTIVITIES

The QCB has introduced new regulations for the Islamic banking operations of conventional banks. The deadline for banks to be compliant is end-December 2011. The new regulations include the following key points: i) a 15% limit on the share of Islamic banking assets to total assets; ii) a maximum ratio of loans to deposits of 90% for the Islamic banking operation; we understand from banks' management that this in reality a looser "loans to stable resources ratio", in line with the ratio already applicable to all Qatari banks; iii) banks will not be allowed to open new branches for the time being, but this rule will not affect existing approvals for branch openings..

Impact on QNB: Expect a Softening in Growth Rates for QNB Al Islami

QNB and other conventional banks in Qatar launched Islamic banking services through Islamic windows in 2005. QNB has been by far the most successful of the Qatari conventional banks, with its market share of Islamic banking assets now standing at c20% compared to a c35% share held by QIB, Qatar largest Islamic Bank, and the small shares held by CBQ (3%) and Doha Bank (2%). QNB's loan growth since end-2009 has been primarily driven by Islamic assets, mainly focused on the corporate sector and to GREs, according to our understanding.

For QNB specifically, loans to stable resources (including shareholders' equity as stable resources) was according to our calculations 73% in December 2009, below the new ceiling. Total Islamic banking assets to total assets accounted for 16.5% as at June 2010. If we only include domestic Islamic banking assets (QNB Al Islami) and exclude the bank's Sudanese Islamic subsidiary, the share of Islamic banking assets to total assets falls to 13.5%. We believe the effect of the new law will be nevertheless a softening in growth rates for QNB Islamic banking operations. Ultimately, the very fast rate of expansion was not expected to be maintained into 2011, even if the new law was never introduced, in our and management's view.

SPREADS TO TREND DOWN FROM HIGH 1H2010 LEVEL

QNB's net interest spread improved strongly in 1H2010 to 298 bps compared to 212bps in FY 2009, driven mainly by a marked fall in funding costs. Liquidity for QNB and for the Qatari banking sector improved during 1H2010 owing to strong growth in private sector deposits. This resulted in a reduction in deposit rates. We nevertheless expect net interest spreads to fall in 2H2010 as a result of downward pressure in loan pricing due to competition and the recent 50bps cut in lending rates by the QCB. QNB's balance sheet liquidity is high, with the current loan to deposit ratio at 85%. Therefore in the short term we do not expect funding costs to pressure the bank's net interest spread.

NPLS/GROSS LOANS TO REMAIN BELOW 1%

QNB's credit quality deteriorated slightly in 1H2010, but the bank's NPL ratio remained low at 0.75% in June 2010 compared to 0.70% in March 2010. Provisioning charges have increased Y-o-Y, but remain contained at 7% of operating profits during 1H2010. Credit quality is not an area of concern for QNB, in our view, given the quality of its loan book and the high concentration of loans to the Qatari Government.

II. VALUATION

A. RAISE FAIR VALUE TO QAR187.9 PER SHARE; UPGRADE RATING TO BUY

We revisit our Discounted Equity Cash Flow (DECF) valuation model for QNB to incorporate our higher earnings growth forecasts and lower cost of equity (CoE) assumption. We now use a CoE of 10.4% compared to our previous assumption of 11%, which was last revised in October 2009 and which reflected higher levels of risk aversion. The CoE assumption we use for QNB is 100 bps lower than the ones used for Commercial Bank of Qatar (primarily private sector focused) and Qatar International Bank (Qatar's largest Islamic bank).

WE ASSIGN QNB A PREMIUM FOR SAFETY, VISIBILITY ON MEDIUM-TERM GROWTH AND HIGH ROE

Our new FV of QAR187.9 per share implies an estimated P/BV of 2.8x and an estimated P/E of 10.8x in 2011, multiples which are not aggressive in our view. The bank currently trades at 9.0x P/E and 2.2x P/BV in 2011e. We assign a premium to QNB to reflect the bank's strong franchise, its safe business model and the strong visibility on medium-term earnings growth and profitability. We upgrade our rating on the stock to Buy as our new FV implies 22% upside potential.

B. QNB'S VALUATION DRIVERS

POSITIVE VALUATION DRIVERS

i) **A very safe business**: From a top-down perspective, QNB presents one of the least risky balance sheets in the GCC given its predominant exposure to the Qatari government, in our view. GRE loans account for 50% of its loan book. Additionally, real estate and construction (primarily in Qatar) account for just 13% of total loans (data as at December 2009) compared to 18% for CBQ and 20% for the entire Qatari banking sector.

ii) **Expanding overseas operations**: QNB is still a domestic bank, with around 70% of its assets in Qatar, but it has been expanding into other MENA countries given its dominance in the local market and the expected slowdown in credit demand from GREs beyond 2012. This includes greenfields launched in Syria, Sudan, Yemen, Kuwait, Oman and minority stakes bought in Jordan, Tunisia and the UAE. The greatest potential lies in Syria and Sudan, given low penetration levels and the countries' favourable demographic dynamics, in our view. QNB's strategy is to replicate the success of its franchise abroad, i.e., to focus on government lending.

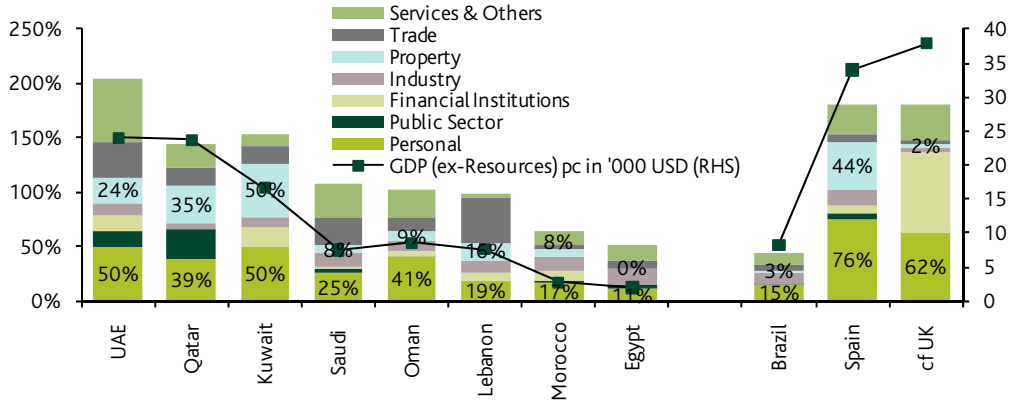
iii) **High ROE sustainable in medium term**: Due to QNB's public sector lending focus, its ROE of 28% (in 2011e) is above-sector average due to the bank's high costs efficiency and its more leveraged balance sheet. We expect ROE to trend down in the medium term due primarily to margin pressure and a slight decline in cost efficiency in light of competition. We nevertheless expect QNB's ROE to be maintained at c20% in the medium term.

NEGATIVE VALUATION DRIVERS

iv) **Uncertain long-term growth dynamics**: We believe that government spending will continue to drive GDP in Qatar into the medium term in spite of a significant slowdown in public sector lending demand forecasted beyond 2012, when some of the announced Government projects will be completed. In the long term, we believe that credit penetration and demographics are key long-term credit growth drivers for an economy. Credit penetration in Qatar is already high, with loans to GDP ex-natural resource accounting for c150%. We believe there are some opportunities for growth in the corporate sector, excluding real estate.

The assumption for the retail market in Qatar is that the governments investments in building a "knowledge economy" will lead to immigration and this will lead to the creation of an internal market. There is, however, some degree of uncertainty as to whether the "Qatari model" will be successful in the long run or not.

FIGURE 4: LENDING PENETRATION BY SECTOR, AS A % OF GDP EX-RESOURCES



Source: Central Banks, EFG Hermes

FINANCIAL STATEMENTS

FIGURE 5: INCOME STATEMENT (DECEMBER YEAR END)
In QAR million, unless otherwise stated

	2008a	2009a	2010e	2011e	2012e
Interest Income	6,805	7,296	9,457	10,381	11,784
Interest Expense	(3,969)	(3,569)	(4,032)	(4,366)	(5,142)
Net Interest Income	**2,836**	**3,726**	**5,425**	**6,015**	**6,643**
Fee & Commission Income	917	968	1,074	1,235	1,445
FX Income	328	305	330	315	320
Investment Income	707	347	188	289	372
Other Income	304	311	231	368	411
Non-interest Income	**2,255**	**1,931**	**1,823**	**2,207**	**2,549**
Total Banking Income	**5,091**	**5,657**	**7,248**	**8,222**	**9,191**
Operating Expenses	(1,042)	(1,107)	(1,200)	(1,296)	(1,399)
Operating Profit	**4,049**	**4,550**	**6,048**	**6,926**	**7,793**
Loan Loss Provisions	(248)	(281)	(409)	(217)	(167)
Other Provisions	(130)	(78)	(40)	(35)	(15)
Other Income / Expense	2	14	0	(0)	0
Pre-tax Profit	**3,672**	**4,206**	**5,599**	**6,673**	**7,610**
Taxes	(20)	(17)	(20)	(47)	(68)
Net Profit before Minorities	**3,653**	**4,188**	**5,579**	**6,626**	**7,542**
Minorities & Profit Sharing	0	13	(8)	(13)	(15)
Net Attributable Income	**3,653**	**4,202**	**5,571**	**6,613**	**7,527**

Source: QNB, EFG Hermes estimates

FIGURE 6: BALANCE SHEET (DECEMBER YEAR END)
In QAR million, unless otherwise stated

	2008a	2009a	2010e	2011e	2012e
Cash & Central Bank Deposits	6,270	9,880	21,388	20,497	19,472
Interbank Assets	27,044	30,181	20,794	23,913	29,208
Financial Investments (incl T-Bills)	11,815	23,333	23,566	26,394	30,353
Customer Loans (Net)	100,053	108,783	127,209	147,349	169,524
Goodwill	-	-	-	-	-
Fixed & Other Assets	6,791	7,152	8,837	8,194	8,795
Total Assets	**151,974**	**179,329**	**201,795**	**226,347**	**257,352**
Interbank Liabilities	19,721	20,794	16,144	18,108	18,015
Customer Deposits	104,253	125,872	148,529	170,809	194,722
Borrowings	6,719	6,724	6,824	6,924	7,024
Other Liabilities	4,637	5,967	8,180	4,391	6,955
Total Liabilities	**135,330**	**159,357**	**179,676**	**200,231**	**226,715**
Minority Interests	0	191	200	230	235
Shareholders' Equity	**16,643**	**19,781**	**21,919**	**25,887**	**30,403**
Total Liabilities & Shareholders' Equity	**151,974**	**179,329**	**201,795**	**226,347**	**257,352**

Source: QNB, EFG Hermes estimates

FIGURE 7: DUPONT ANALYSIS
as a % of average assets

	2008a	2009a	2010e	2011e	2012e
Net Interest Income	2.13%	2.25%	2.85%	2.81%	2.75%
Non-interest Income	1.69%	1.17%	0.96%	1.03%	1.05%
Operating Expenses	-0.78%	-0.67%	-0.63%	-0.61%	-0.58%
Other Revenue / (Expenses)	0.00%	0.01%	0.00%	0.00%	0.00%
Total Provisioning	-0.28%	-0.22%	-0.24%	-0.12%	-0.08%
Taxes, Minorities & Profit Sharing	-0.01%	0.00%	-0.01%	-0.03%	-0.03%
ROAA	**2.74%**	**2.54%**	**2.92%**	**3.09%**	**3.11%**
Average Gearing (Assets / Equity)	9.6	9.9	9.4	9.0	8.6
ROAE	**26.3%**	**25.2%**	**27.5%**	**27.7%**	**26.7%**

Source: QNB, EFG Hermes estimates

FIGURE 8: VALUATION MULTIPLES

	2008a	2009a	2010e	2011e	2012e
Per Share Data (QAR)					
EPS	13.95	14.23	16.89	19.23	20.65
DPS	4.00	5.69	6.76	7.69	8.26
Payout Ratio	29%	40%	40%	40%	40%
BVPS	61.69	55.99	66.13	77.67	90.06
BVPS (ex-goodwill)	61.69	55.99	66.13	77.67	90.06
Valuation (x)					
P/E	10.1	11.0	10.7	9.0	8.0
Dividend Yield	4.9%	2.6%	3.7%	4.4%	5.0%
P/B	2.5	2.5	2.7	2.3	2.0

Source: EFG Hermes estimates

FIGURE 9: PROFITABILITY

	2008a	2009a	2010e	2011e	2012e
Yield on Earning Assets	5.34%	4.60%	5.18%	5.05%	5.05%
Cost of Funds	-3.43%	-2.48%	-2.45%	-2.35%	-2.45%
Net Interest Spread	**1.91%**	**2.12%**	**2.73%**	**2.70%**	**2.60%**
Net Interest Margin	**2.23%**	**2.35%**	**2.97%**	**2.93%**	**2.85%**
Non-interest Income / Total Banking Income	44.3%	34.1%	25.2%	26.8%	27.7%
Costs to Income	20.5%	19.6%	16.6%	15.8%	15.2%
Tax Rate	0.5%	0.4%	0.4%	0.7%	0.9%
ROAA	**2.74%**	**2.54%**	**2.92%**	**3.09%**	**3.11%**
ROAE	**26.29%**	**25.15%**	**27.51%**	**27.67%**	**26.74%**

Source: QNB, EFG Hermes estimates



FIGURE 10: ASSET QUALITY AND CAPITAL

Asset Quality	2008a	2009a	2010e	2011e	2012e
NPL Ratio	0.72%	0.75%	0.82%	0.84%	0.81%
Provisions / NPLs	67%	85%	120%	117%	116%
Provisioning to Average Gross Loans (bps)	0.00	28.42	33.00	15.00	10.00
(NPLs-Provisions) / Equity	1.4%	0.6%	-1.0%	-0.9%	-0.8%
Provisioning charges / Pre-provisions Profit	9%	8%	7%	4%	2%
Capital					
Tier-1	13.2%	16.0%	16.6%	17.2%	17.6%
CAR	13.2%	16.0%	16.6%	17.2%	17.6%
Risk-weighted Assets (RWAs) / Total Assets	59%	63%	64%	64%	65%

Source: QNB, EFG Hermes estimates

FIGURE 11: GROWTH RATIOS

	2008a	2009a	2010e	2011e	2012e
Loans (Net)	51%	9%	17%	16%	15%
Deposits	31%	21%	18%	15%	14%
Assets	33%	18%	13%	12%	14%
Risk-weighted Assets (RWAs)	34%	10%	20%	15%	14%
Net Interest Income	47%	31%	46%	11%	10%
Fee Income	26%	6%	11%	15%	17%
Non Interest Income	47%	-14%	-6%	21%	15%
Total Banking Income	47%	11%	28%	13%	12%
Operating Profit (Pre-provisions)	58%	12%	33%	15%	13%
Pre-provision Profits	45%	15%	33%	19%	14%
Net Attributable Income	46%	15%	33%	19%	14%

Source: QNB, EFG Hermes estimates

FIGURE 12: BALANCE SHEET STRUCTURE AND OTHER RATIOS

	2008a	2009a	2010e	2011e	2012e
Loans / Deposits (Net)	96%	86%	86%	86%	87%
Loans / Assets (Net)	66%	61%	63%	0%	0%
Net Interbank / Assets	5%	5%	2%	3%	4%
Financial Investments / Assets	8%	13%	12%	12%	12%
Deposits / Assets	69%	70%	74%	75%	76%
LT & MT Borrowings / Liabilities	5%	4%	4%	3%	3%

Source: QNB, EFG Hermes estimates

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Rating	Potential Upside (Downside) %
Buy	Above 15%
Neutral	(10%) and 15%
Sell	Below (10%)

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