Qatar Islamic Bank (QIB)

An Attractive Banking Model in an Expanding Economy

Buy

- **Being the market leader in providing Shariah compliant financial services yields better growth opportunities coupled with the highest profitability.**
- **Momentum in the Qatari economy, with a less vulnerable real estate sector than elsewhere, would further support growth.**
- **We initiate coverage on QIB with a 'Buy' recommendation and a target price (TP) of QAR102.69, implying a 39% upside.**

Taking approximately half the market share in terms of deposits and loans in the Qatari Islamic banking system, QIB is well positioned to benefit from the growth potential offered by the expanding Islamic banking sector. As the oldest and biggest Islamic bank in Qatar, it has an edge over its Islamic and conventional peers at a time when even conventional banks are striving to mark a share in this lucrative market segment. More interestingly, the bank's business model exhibits the highest profitability in our coverage in terms of return on equity (ROE), return on assets (ROA) and net interest margin (NIM). QIB's ROE of 27.9%, compared to Qatar National Bank's (QNB) 24.0%, Doha Bank's (DHB) 22.2% and Commercial Bank of Qatar's (CBQ) 21.0% in FY08, is a testament to its profitability.

QIB is a geared play on the Qatari economy with 56% of its financing portfolio in trade and real estate. The IMF forecasts the Qatari economy to grow by 18% in FY09; this would support QIB's business model which is leveraged to spending on infrastructure/real estate and trading. Jones Lang Salle estimates Qatar's major projects at USD55 billion, with Lusail and The Pearl accounting for 56% of the total value. QIB, with its strong track record in financing major real estate projects and strong connections with the government, will benefit from the economic environment. The recent signing of a QAR206 million tower financing project at the Pearl demonstrates the growth potential in the economy and the sector. Not only that, the bank's financing portfolio, which has a balanced exposure to retail, real estate, SME and corporate provides a diversified source of income.

Real estate generally introduces asset quality concerns and uncertainty, especially with the global property market slowing down. In the case of Qatar, however, the downside risk is limited due to the concrete support provided by the government. The timing of purchase of real estate loans and investments by the government could not be any better, removing concerns regarding asset quality and growth limitations. Notably, private real estate and infrastructure projects stem from government spending and as such are backed by the government. This again removes fear of bad loans in the corporate segment to a greater extent.

We initiate coverage on QIB with a Buy recommendation, based on our TP of QAR102.69. We follow a dual approach to arrive at our TP using DCF and comparable PB multiple weighting 80/20, respectively. Our cost of equity is 11.0% and we have a perpetual growth rate of 5%. We added a market risk premium of 6% to the risk free rate of 5%, in arriving at our COE. A severe deterioration in the property market and significant write-downs in its investments are the downside risks to our target.

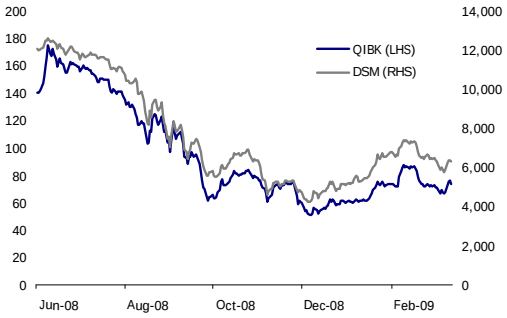
Target Price (QAR)	**102.69**
Market Price (QAR)	73.70
Upside	39.3%
Listed On	DSM
Bloomberg Code	QIBK QD
RIC	QISB.QA
Market Cap. (QARm)	15,238.0
Market Cap. (USDm)	4,186.3
Number of Shares (m)	207
Foreign Ownership Limit	25.0%
Foreign Ownership Level	4.7%
Daily Turnover (QARm)	34.9
Daily Turnover (USDm)	9.6

Ownership Structure*

Qatar Investment Authority	5.0%
Khaleeji Commercial Bank	4.2%
Free Float	90.8%

*Source: Zawya Dow Jones

Price Performance Chart



Key Performance Indicators

Fiscal Year	08A	09E	09C	10E	10C
Net Interest Income (QARm)	897.8	1,276.7	-	1,420.3	-
Total Income (QARm)	1,926.4	1,847.4	-	2,184.7	-
Net Income (QARm)	1,642.5	1,456.0	-	1,770.9	-
Net Interest Margin	3.77%	4.11%	-	4.12%	-
Gross loans (QARb)	21.2	23.4	-	26.2	-
Cost/Income	23.0%	24.4%	-	21.7%	-
Gross Loan to Deposits	128%	104%	-	100%	-
EPS	7.94	7.04	-	8.57	-
DPS	6.67	1.41	-	1.71	-
Dividend Yield	9.05%	1.91%	-	2.32%	-
P/E (x)	9.3	8.5	-	8.6	-
P/B (x)	2.1	2.0	-	1.7	-
ROAE	27.9%	21.3%	-	24.2%	-
ROAA	6.0%	4.1%	-	4.6%	-

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Financial Statements and Ratios

QAR Million	08A	09E	10E	11E	12E	13E
Income Statement						
Interest Income	1,286.4	1,737.8	1,929.3	2,146.7	2,418.8	2,719.8
Interest Expense	388.7	461.1	508.9	552.6	610.7	672.9
Net Interest Income	**897.8**	**1,276.7**	**1,420.3**	**1,594.0**	**1,808.1**	**2,046.9**
Fees & Commissions	223.2	245.5	282.3	324.7	357.1	392.8
FX Income	(80.7)	4.0	4.1	4.3	4.5	4.7
Investment Income	309.0	187.1	244.9	321.1	392.1	441.0
Income from investment property	564.5	120.1	217.7	321.1	392.1	441.0
Other income	12.7	14.0	15.4	16.9	18.7	20.5
Non-Interest Income	**1,028.6**	**570.8**	**764.4**	**988.0**	**1,164.5**	**1,300.1**
Total Income	**1,926.4**	**1,847.4**	**2,184.7**	**2,582.1**	**2,972.7**	**3,347.1**
Total Operating Expenses	**443.9**	**450.8**	**474.2**	**553.1**	**627.4**	**711.9**
Pre-Provisions Income	**1,482.4**	**1,396.7**	**1,710.6**	**2,028.9**	**2,345.3**	**2,635.2**
NPL Provisions	17.3	117.4	67.5	54.2	59.9	66.1
Associate and other income	239.6	162.3	182.6	306.8	385.3	431.5
Pre-Tax Income	**1,704.7**	**1,441.6**	**1,825.7**	**2,281.6**	**2,670.6**	**3,000.5**
Income Taxes	-	-	-	-	-	-
Net Income After Tax	**1,704.7**	**1,441.6**	**1,825.7**	**2,281.6**	**2,670.6**	**2,910.5**
Minority Interest	**62.2**	**(14.4)**	**54.8**	**68.4**	**80.1**	**90.0**
Net Income	**1,642.5**	**1,456.0**	**1,770.9**	**2,213.1**	**2,590.5**	**2,910.5**
Balance Sheet						
Assets						
Cash & Due from Central Bank	1,023.2	2,844.2	3,483.7	3,691.2	4,580.3	5,292.4
Due from Banks	6,367.7	6,641.5	6,088.1	6,818.7	7,705.1	8,629.7
Investments	2,947.2	2,398.3	3,044.0	4,091.2	4,623.0	5,177.8
Gross Loans	**21,234.7**	**23,358.2**	**26,161.2**	**29,300.5**	**32,230.6**	**35,453.7**
NPL Provisions	234.0	327.4	379.7	423.7	472.0	525.2
Unearned Profit	2,134.9	2,055.5	2,354.5	2,856.8	2,900.8	2,659.0
Net Loans and Overdrafts	**18,865.9**	**20,975.3**	**23,427.0**	**26,020.1**	**28,857.8**	**32,269.4**
Other Assets	4,078.9	3,761.5	4,256.6	4,536.5	5,287.3	5,833.4
Net Fixed Assets	260.3	276.6	287.8	300.1	313.6	328.5
Total Assets	**33,543.2**	**36,897.5**	**40,587.2**	**45,457.7**	**51,367.2**	**57,531.2**
Liabilities						
Total Deposits	**16,591.8**	**22,459.8**	**26,161.2**	**30,842.7**	**34,656.6**	**38,122.2**
Due to Banks	8,696.7	6,499.2	4,751.9	3,252.5	3,095.4	3,284.9
Borrowings	-	-	-	-	-	-
Dividends Payable						
Other Liabilities	885.8	535.0	695.1	433.7	457.6	482.9
Total Liabilities	**26,174.4**	**29,494.0**	**31,608.3**	**34,528.9**	**38,209.6**	**41,890.0**
Shareholders' Equity	**7,368.8**	**7,403.5**	**8,979.0**	**10,928.8**	**13,157.6**	**15,641.3**

Investment case

- **QIB, the first and biggest Islamic bank in Qatar, is well positioned to benefit from the expanding Islamic banking sector and the growing Qatari economy. Additionally, the bank exhibits the highest profitability in our coverage.**
- **We believe the bank's real estate exposure is exaggerated by the market as it should not materially weigh on its asset quality or growth. Given government support and a committed pipeline of real estate projects, we do not see stress on either bad loans or growth.**
- **We initiate coverage on QIB with a 'Buy' recommendation and a target price (TP) of QAR102.69, implying a 39% upside.**

Islamic banking sector is expected to continue to expand globally

With Islamic banking activities estimated to grow despite the current financial crisis, QIB is well positioned to benefit from the expanding market segment. Moody's forecasts the global Islamic finance industry to reach USD1 trillion next year from the current USD840 billion. Consequently, Qatar, with a huge high net worth individual base and a GDP per capita of USD58,600, would experience significant growth in the Islamic banking segment. QIB holds approximately half the market share among the Qatari Islamic banks, and is therefore well positioned to benefit from this expected growth. As such, the bank will continue to realize a double-digit growth this year as well, though not at the historical high rates. This year, we expect QIB to increase its loan book and deposit base by 11% and 35%, respectively. It is worth highlighting that these are the highest growth rates we have for banks under our coverage. During our forecast period FY09-13, we expect the bank's loan book to grow by an average of 11%, while our average for the sector stands at 9.75%, thus reflecting QIB's growth potential. Although competition is likely to dampen QIB's growth as a result of conventional banks intensifying their expansion plans in this segment, we still believe QIB, with its strong franchise, is well equipped to face competition from both its Islamic and conventional peers.

A very attractive business model translating to higher returns

The Islamic banking concept yields a very attractive business model, especially in the midst of the current global financial crisis. A salient feature of Islamic banking, sharing of profit and losses, helps the bank outperform during good times as well as difficult ones. This translates to higher returns and margins, not to mention its exposure to the retail and real estate segments. More interestingly, QIB stands out among its GCC Islamic peers with a ROA of 6.5% during 9M08a and 6.9% in FY07a compared to the average of commercial GCC Islamic banks (rated by S&P) of 3.1% and 3.7% during the same periods. The bank tops the list in terms of ROA, ROE and NIM in our coverage universe as well. QIB's average ROE during the six year period FY03-08 was 28.7%, while the sector average was 23.9%.

Presently, banks in Qatar as well as the UAE are seeing increasing funding costs as they compete for deposits to bridge the gap between deposits and loans. Not only that, wholesale markets continue to remain switched off. On the contrary, QIB does not have any wholesale funding in place and continues to have a solid deposit base with an impressive quarterly growth rate of 14.9% in 1Q09a and 6.0% in 2Q09a. Additionally, margin erosion is not likely to hurt QIB the same way it does conventional banks due to the concept of sharing of profit and losses. Furthermore, the profit equalization reserve helps move some of the funding costs to the equity statement without directly feeding through the income statement. Moreover, the bank exhibits a diversified business model with approximately a quarter of its total financing and investing income coming from international operations.

The local ever-expanding economy supports growth

While the global economy is estimated to contract by 1.6% this year, the IMF expects the Qatari economy to grow by 18%. With significant government spending, notably on infrastructure and real estate, QIB will benefit from its real estate and project financing portfolio. Real estate financing represented 35% of the total financing portfolio. With strong ties with the Qatari government and its solid track record in the private sector, the

bank will continue to see growth in this segment. Although the bank had only 4.4% of its real estate financing portfolio in government related projects, this should rise in the coming quarters given their strong connections with the government. Another interesting point to note is that government spending on real estate and infrastructure would have its cascading effect on the private real estate sector, thus helping QIB's books. The bank already has a backlog of QAR3 billion of committed financing facility under its commitments and contingencies at the end of FY08, which would be financed during the course of this year. This alone translates to an 11% growth in its financing portfolio this year, meaning the bank would see a sizeable growth even on pessimistic grounds. Furthermore, real estate is intertwined with the Qatari economy as it strives to meet its economic goals as per the "National Vision 2030". The biggest project in Qatar, The Pearl, offers plenty of opportunities for QIB, which recently announced financing the QAR206 million Jumana Tower at The Pearl. It is interesting to note that in 1Q09, real estate loans in the entire Qatari banking system grew by 11% despite the slowdown seen in real estate lending elsewhere. Additionally, the real estate loan portfolio ranks second in magnitude in the entire Qatari loan system, with retail topping the list.

In our view, real estate risk is amplified by the market

However, we acknowledge that QIB has substantial exposure to real estate as it represents 35% of the total financing portfolio. Although this is the highest in our coverage, we believe the risks are mitigated due to the following:

1) The Qatari government's initiative to buy real estate financing and investment portfolios. This removed bad loans and declining property investments from the books.

2) The real estate loans in the Qatari banking system grew by 11% in 1Q09, despite the general slowdown in the property market and the 6% contraction seen in the overall Qatari loan system.

3) The bank already has a pipeline of real estate projects for this year which would help increase its financing portfolio without disruption.

4) Real estate will continue to play a vital role in the Qatari economy which has not been as acutely affected by the global economic slowdown as some of the other countries. Qatar actually has the lowest number of project cancellations and delays in the region. However, we admit the bank will see growth slowing down and non-performing loans increasing this year as the entire banking sector enters the transition period after enjoying high growth rates and benign credit experience. We do not consider this to place a severe strain on the bank's profitability or capital base and view it as manageable.

Table 1: KPIs of Qatari banks in Our Coverage

	QNB				CBQ				DHB				QIB			
	2008A	2009E	2010E	2011E	2008A	2009E	2010E	2011E	2008A	2009E	2010E	2011E	2008A	2009E	2010E	2011E
Asset quality																
NPL/Total loans	0.72%	1.25%	1.75%	2.00%	0.85%	1.50%	1.50%	1.50%	2.92%	3.50%	3.50%	2.50%	1.38%	2.20%	2.00%	1.50%
Coverage ratio (Loan loss reserve to NPL)	85%	53%	54%	61%	99%	96%	120%	143%	78%	74%	80%	118%	80%	64%	73%	96%
Coverage ratio adjusted for risk reserve	171%	106%	108%	121%	319%	194%	218%	240%	127%	116%	121%	176%	180%	125%	140%	185%
Liquidity																
Loan/Deposit	98%	96%	94%	91%	106%	115%	109%	105%	107%	116%	112%	110%	128%	104%	100%	95%
Deposit/Funding	70%	69%	70%	73%	54%	49%	52%	53%	62%	53%	54%	54%	51%	62%	66%	69%
Franchise Value (Mkt Cap/Deposits)	34%	32%	28%	24%	51%	52%	45%	39%	31%	32%	29%	26%	92%	68%	58%	50%
Real estate exposure																
% of loans	12%	na	na	na	17%	na	na	na	18%	na	na	na	35%	na	na	na
Efficiency & operations																
Net interest margin	2.24%	2.50%	2.63%	2.69%	2.67%	2.67%	2.72%	2.78%	3.30%	3.25%	3.29%	3.35%	3.77%	4.11%	4.12%	4.16%
Cost/Income	22.6%	22.1%	20.3%	18.2%	27.1%	26.2%	25.1%	23.4%	32.2%	31.00%	31.2%	29.5%	23.0%	24.4%	21.7%	21.4%
ROAA	2.7%	2.4%	2.5%	2.9%	3.2%	2.9%	3.0%	3.1%	2.7%	2.5%	2.7%	3.0%	6.0%	4.1%	4.6%	5.1%
ROAE	24.0%	21.8%	21.7%	22.8%	21.0%	18.0%	18.6%	18.3%	22.2%	21.0%	23.0%	23.1%	27.9%	21.3%	22.2%	22.9%
Market Risk																
Investment securities/Total assets	8%	13%	13%	13%	8%	8%	9%	9%	9%	9%	9%	9%	9%	7%	8%	9%
Investment gains(losses)/Oper inc	15%	2%	9%	16%	14%	0%	3%	3%	9%	7%	7%	8%	21%	13%	14%	16%

Source: HC Brokerage and Company reports

Valuation

We initiate coverage on Qatar Islamic Bank with a "Buy" recommendation

We initiate coverage on QIB with a Buy recommendation, based on our TP of QAR102.69. We follow a dual approach to arrive at our TP using DCF and comparable PB multiple weighting 80/20, respectively. Our COE is 11.0% and we have a perpetual growth rate of 5%. We arrived at our COE by adding a 6% market risk premium to a risk free rate of 5%. The stock is trading at FY09 PB of 2.0x. Due to its higher ROE the stock deserves to trade at a premium, in our view. A severe deterioration in the property market and significant write-downs in its investments are the downside risks to our target.

Table 2: Workings of the Excess Return Calculation

QAR ('000)	2009E	2010E	2011E	2012E	2013E	Terminal Value (TE)
Net income	1,456,006	1,770,883	2,213,132	2,590,519	2,910,521	2,727,388
Cost of equity	785,718	794,087	960,897	1,169,661	1,410,611	1,666,737
Excess equity return	670,288	976,796	1,252,235	1,420,858	1,499,910	1,060,651
TV of excess equity return						17,677,517
PV	**636,209**	**835,256**	**964,669**	**986,098**	**937,803**	**11,052,686**
Div. payout ratio	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%
Return on Equity	21.34%	22.20%	22.85%	22.09%	20.72%	18.00%
Equity invested	7,142,892					
PV of equity excess return	4,360,036					
PV of TV	11,052,686					
Value of Equity	22,555,614					
Number of shares	206,757					
Value Per Share	**109.09**					

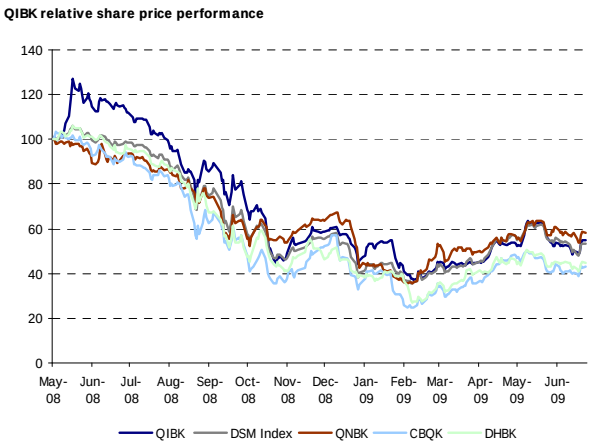
Source: HC Brokerage

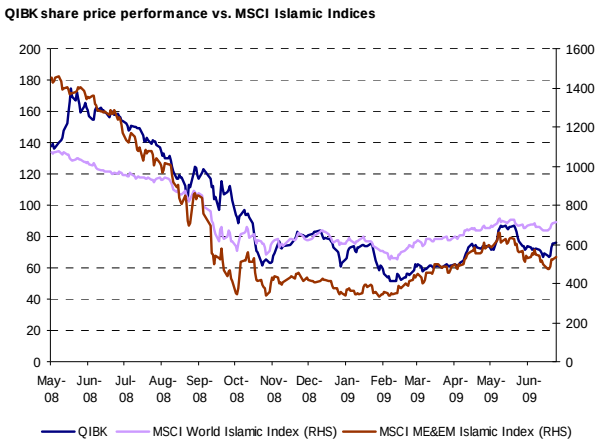
Table 3: Sensitivity Analysis of Value per Share to COE and Perpetual Growth Rate

Perpetual Growth Rate (%)	COE (%) 10.0	11.0	12.0
4.0	121.52	101.46	86.49
5.0	134.25	**109.09**	91.20
6.0	153.34	119.78	97.49

Source: HC Brokerage

Chart 1: Stock price performance





Source: Bloomberg

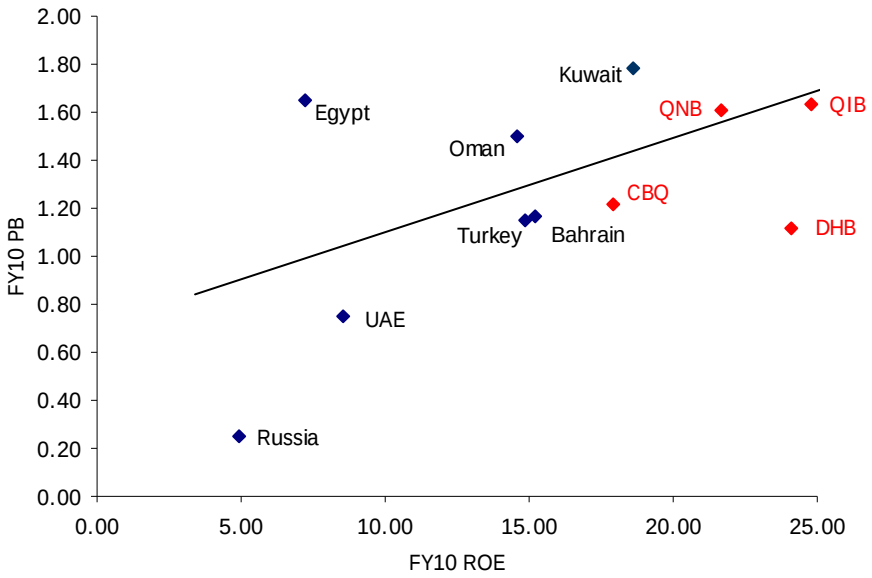
The stock is down almost 60% since its high of QAR174.50 on June 11th 2008. The stock jumped from its low of QAR51.40 in the beginning of March following the announcement of the purchase of banks' DSM listed equity securities by the Qatari government. A broader sell-off seen in the DSM in mid-June, however, dragged the stock downwards from QAR86.80 on June 14.

On relative grounds, the stock had been outperforming the market and other banks until mid-November last year. Later, it started to under-perform the market and QNB when investments and real estate started to show signs of trouble in the region. Yet, the stock has been performing better than Doha and CBQ throughout. Although the stock is catching up with the market, its performance is still lower than QNB. Since we do not see asset quality and real estate to really weigh in on the stock, we see upside potential.

We believe the stock deserves to trade at a higher multiple given its growth potential and profitability

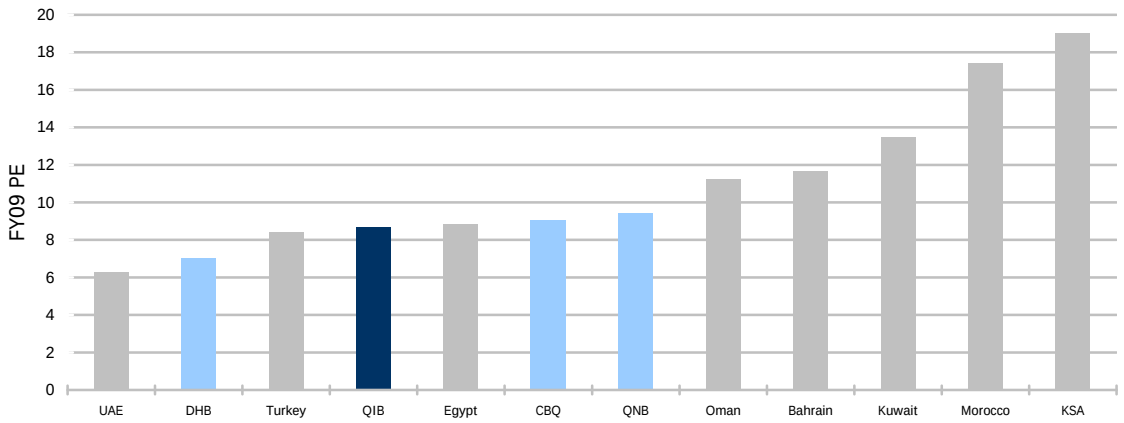
QIB is trading at a FY10 PB of 1.7x. Despite the stock trading at a higher multiple than DHB and CBQ and in line with QNB, we feel it deserves a valuation premium as it offers better growth and return over our forecast period of FY09-12. During our forecast period, QIB is expected to grow its loan book by 11.5% vs. the sector average of 9.5%. We expect FY10 earnings to increase by 21% compared to 19% for the sector. Additionally, the bank would continue to yield higher returns as seen in the past and we forecast ROA of 4.8% during our forecast period, which is 1.4% above the sector. As such, we argue that the stock deserves to trade at a higher multiple than the rest and consider the downside risk regarding asset quality not to be materially different from the rest of the sector, given sovereign support.

Chart 2: QIB's growth potential and higher returns deserve a higher multiple



Source: Bloomberg and HC Brokerage

Chart 3: Attractive on earnings multiple



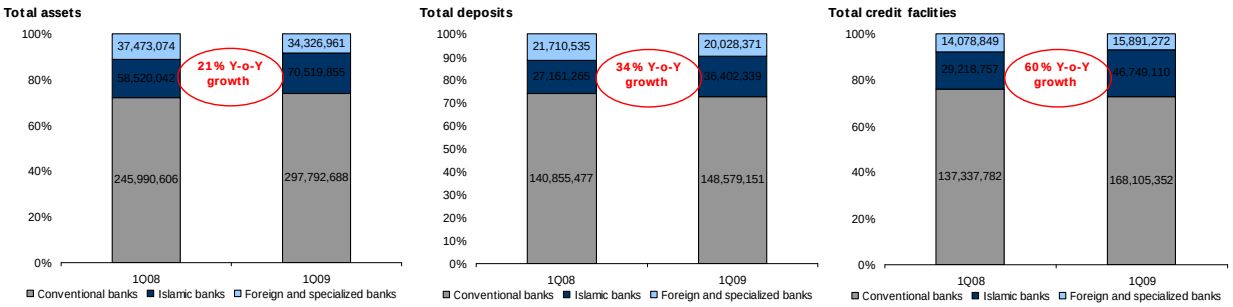
Source: Bloomberg and HC Brokerage

Islamic banking segment is expanding in Qatar…

Despite the current global crisis and the general slowdown seen across the financial sector, Islamic banking is likely to continue to expand, especially in the GCC. Moody's expects the global Islamic finance sector to reach USD1 trillion next year from the current USD840 billion. According to the Institute of Islamic Banking & Insurance, two thirds of global Islamic banking is represented by the GCC. As such, the growth should be mainly driven by the GCC which is reflected in S&P's recent positive outlook on Islamic finance in the GCC. The rating agency finds the region's Islamic banks to weather the economic slowdown and expects them to get back on track with rapid growth soon.

Taking into account Qatar's economic growth and the recent expansion in Islamic banking activities, we believe the Qatari Islamic banking segment will enjoy growth as the global industry expands. This is reflected in the recent expansion activities of conventional banks whereby they are seeking to get a share in this expanding banking segment. As illustrated below, total credit facilities of the Islamic banks in Qatar grew by 60% during the one year period from March 2008 to March 2009, compared to the conventional banks' growth of 22%. Increase in Islamic banking credit facilities was more than the average credit growth of 28% seen in Qatar during the same period. Deposits further support our view, with Islamic banking deposit base increasing by 34% compared to a tiny 5% for traditional banking.

Chart 4: Breakdown of Qatari banking system suggests that Islamic banking has been expanding at a higher rate than conventional segments over the past year



Note: Value stated in QAR'000

Source: Qatar Central Bank

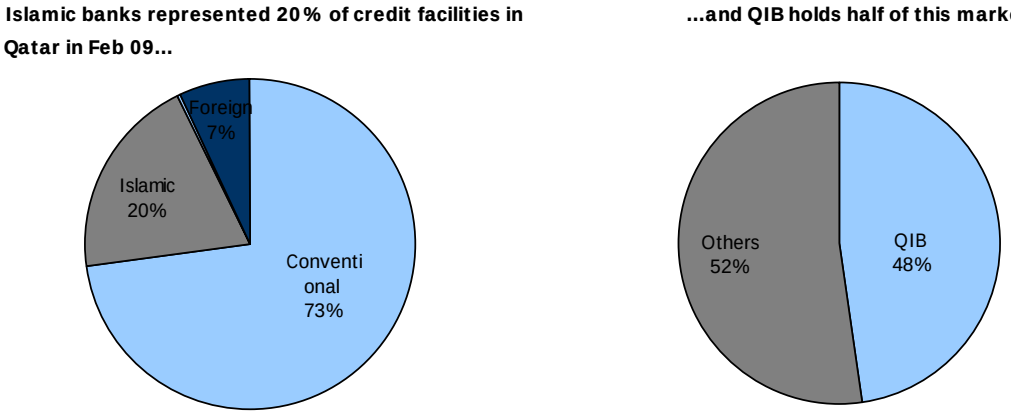
Furthermore, Qatar compares favourably in the international Islamic arena as per the figures shown in the academic research on *"The development of Islamic finance in the GCC"* by Rodney Wilson. In 2007, Qatar saw the highest growth (77.5%) in its Shariah compliant financial assets and was ranked seventh in terms of Shariah compliant financial assets by "The Banker". With the Qatar Vision 2030, we believe the Islamic banking segment in Qatar will continue to grow despite the global financial crisis. This is further supported by the recent slew of initiatives taken by the Qatari government. Real estate, a dominant sector in Islamic banking, continues to play a key role in the Qatari economy and has withstood the crisis better than elsewhere.

… and QIB is the market leader, well placed to benefit from this growth…

QIB represents approximately half the Qatari Islamic banking sector in terms of financing activities

Islamic banks represent 20% of the Qatari banking financing activities and QIB accounts for half of that market. The remaining market share is divided between Qatar International Islamic Bank (QIIB) and Masraf Al Rayyan (MAR) with the latter having a larger share. When we look at the entire banking system in Qatar, QIB has a market share of 9% just after Doha Bank which has a market share of 11%, as of FY08. Being the biggest in terms of Islamic banking and also not far behind the conventional banks places the bank in a better position to grow its financing portfolio.

Chart 5: QIB has a competitive edge over its peers to benefit from the growing Islamic banking sector



Source: Qatar Central Bank, QIB reports

Not only that, the Islamic banking segment in general offers better growth opportunities in the current global economic context. As a result, even conventional banks are increasingly fighting for a share in this pie. In our report *"Banking on an economic boom"* dated 2 June 2009, we discussed the aggressive expansion of Islamic banking activities by conventional banks. Although this would mean increased competition for QIB, we believe this would have minimal impact on the bank. With a solid franchise and strong relationships, it is well equipped to maintain its position as the market leader.

Loan book increase in double digits throughout FY09-13e

Loan book grew at a 5YR CAGR of 40% during the period of FY03-08 compared to the sector average of 38%. As the chart below illustrates, the bank's financing portfolio increased by 2.5% in 1Q09 which we believe was done to bring the loan to deposit ratio back to normal levels from the 128% seen at the end of FY08. The bank did manage to reduce its loan to deposit ratio to 109% in 2Q09. Meanwhile, the credit ratio, limited to 90% by the Qatar central bank, is at a comfortable 77%. Adjusted for the sale of real estate loans to the government, QIB's financing portfolio increased sharply by 11% QoQ in 2Q09. This compares with CBQ's adjusted quarterly growth of less than 2% during the same period. We expect deposit growth to be at 35% this year, providing support to loan growth without inflating the loan to deposit ratio. Our financing portfolio growth expectation for this year is 11%, the highest we have in our coverage. We have a 6% loan growth rate for CBQ this year, which is the highest among the three other banks in our coverage. We have been very prudent in our financing portfolio growth assumption given the real estate and retail bias.

Actually, when we look at the Istisna commitment maturing within a year as of the end of FY08, it amounts to QAR2.4 billion, translating to an 11% growth in the total financing portfolio. Istisna commitment refers to real

estate and financing projects that the bank has already committed to finance; given the maturity of one year, it should materialize this year. Thus, leaving the other sectors and any new projects aside, this alone would bring an 11% growth to the financing portfolio. Yet, being prudent we have assumed only 50% of that growth would be realized this year due to 1) project cancellations/delays and 2) statutory limit in expanding real estate lending activities. We admit that this is very pessimistic but we would prefer to be on the conservative side. As such, our 11% overall growth rate includes the 5.5% from Istisna commitments which were already entered into last year. We have added only 5.5% of growth from new real estate financing deals and other sectors.

Chart 6: QIB's quarterly loan growth in 1Q09 was relatively encouraging, slightly lower than CBQ



**QNB's loan book shrank due to a one-off event in 1Q09*

Source: Company reports

Real estate and retail will continue to help loan book expansion

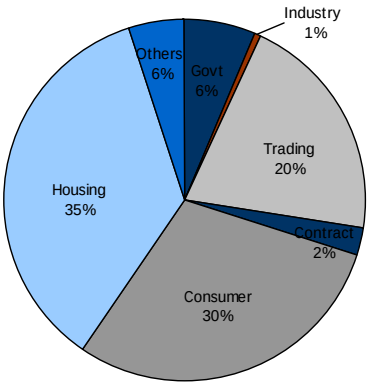
Being an Islamic bank with limited sectors to invest in, it is not surprising that real estate represents a big chunk of QIB's financing portfolio. Retail follows real estate, taking 30% of the total financing portfolio as of the end of last year, which is typical for Islamic banks. Moody's estimates the retail market share of Islamic banks in the GCC region at 25% and expects further growth in this segment. It is interesting to note that the retail loan segment continues to top the list of the entire Qatari banks' loan system from 2005 until 1Q09. The other prominent sector in QIB's financing portfolio is trade, which represented one fifth of QIB's overall portfolio during the same period. With the local economy expected to grow in double digits, the bank will also benefit from increased trading activities. Additionally, as the chart below indicates, real estate sector loans in the Qatari system grew by 11% in 1Q09 while merchandising grew by 18%. This bodes well for the bank as its portfolio is geared to these two sectors.

More importantly, the government purchased part of the real estate financing portfolio during the second quarter, leaving the bank ample room to grow its real estate portfolio. The bank sold real estate loans in the region of QAR2 billion to the government. The central bank limits the real estate financing portfolio of Islamic banks to an average of 15% of deposits and 150% of equity. When we calculate this limit based on FY08 figures, it amounts to QAR6.7 billion compared to the actual real estate financing portfolio exposure of QAR7.5 billion. The bank's sale of real estate financing portfolio along with growth in its deposit and equity base should allow it to increase real estate lending activities without imposing any limit on its growth potential.

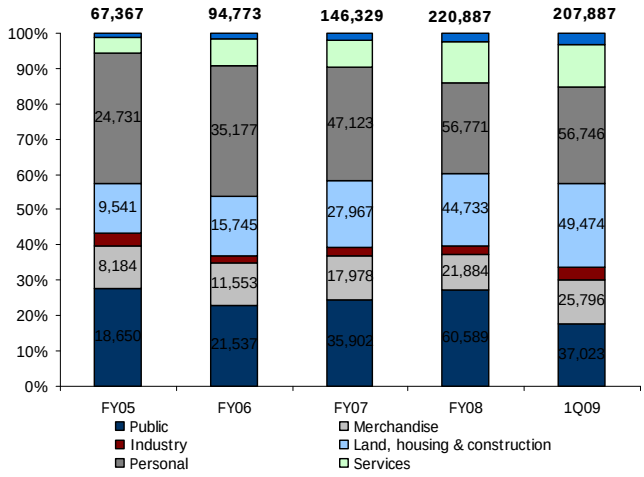
The bank's growth potential translates into an average annual growth of 11% during the period of FY09-12, higher than the sector average of 9.5%. Given the size of the bank and its market share in the Islamic banking segment, we find it well positioned to benefit from the growth potential offered by the segment it serves in.

Chart 7: Retail and real estate, both of significance to the Qatari economy, make up more than half of QIB's financing portfolio

As an Islamic bank QIB has substantial exposure to Qatari real estate market and retail market



Personal and real estate sectors continue to play a critical role in Qatari lending activities even in 1Q09



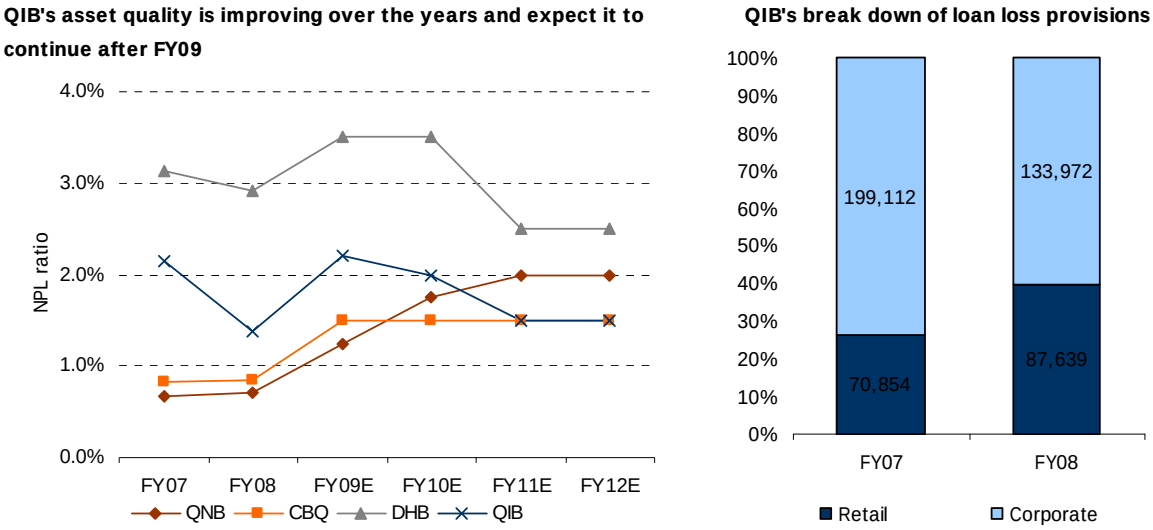
** Values given in QAR'000*

Source: QIB reports and QNB Economic Review

Solid asset quality

For a bank with retail exposure of 30% and real estate exposure of 35%, we find its non-performing loans to total loans (NPL) ratio of 1.38%in FY08 comfortable. This is reflected in the second quarter results, with a recovery of QAR17 million for loan loss charges. Meanwhile, the sector is seeing increasing loan loss charges on retail portfolio on the back of global economic conditions. To illustrate, QNB had provision charges of QAR107 million while CBQ had QAR145 million during 2Q09. Management expects non-performing loans to decline to QAR100-150 million by end of this year from QAR294 million last year. On prudent terms, however, we estimate the FY09 NPL ratio at 2.20% which translates to NPLs of QAR514 million. Government purchase of real estate financing portfolio would immensely help asset quality along with the current high recovery rates experienced by the bank. Despite this, we have forecast non-performing loans to double this year due to the retail tilt. Among the banks in our coverage, QIB's NPL ratio is slightly higher than QNB and CBQ, but lower than DHB.

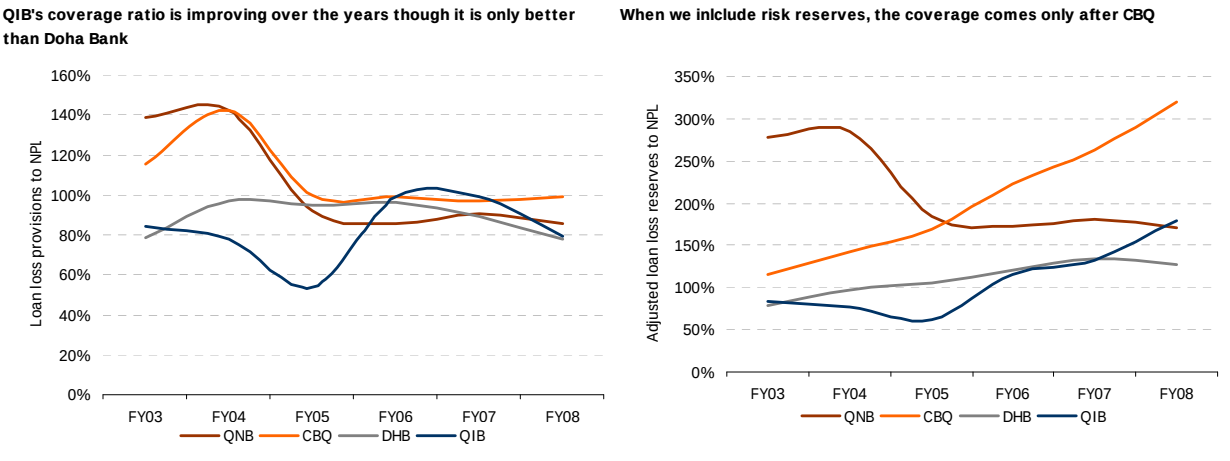
Chart 8: QIB's asset quality is improving and the bank does not have any bad loan provisions on real estate – a healthy sign



Source: Company reports

When we look at the coverage ratio (loan loss reserves to NPL), the bank ranks third in our Qatari coverage universe, coming before Doha Bank in FY08. Coverage ratio averaged 82% during the period FY03-08, while the sector average was 96%. When we take into account the risk reserve as well, the coverage ratio has steadily increased over time and is 180% in FY08. This is only lower than CBQ which relatively has a very high coverage ratio of 319% during the same period.

Chart 9: The bank has adequately provided for its bad loans when the risk reserve is added on



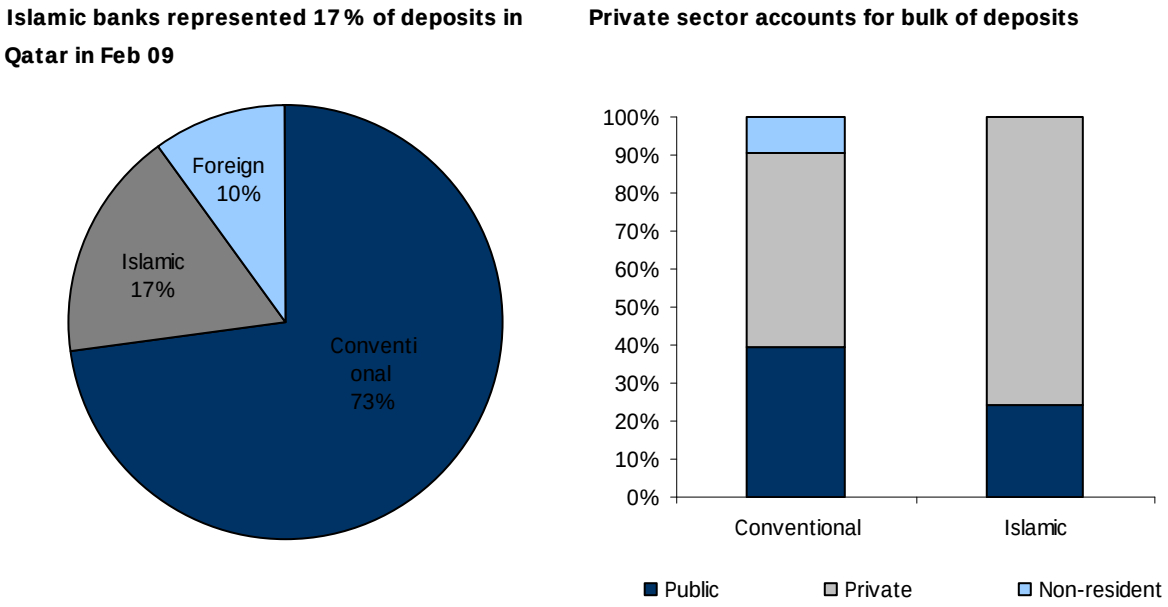
** We have removed the QAR65 million owing to depositors from risk reserves in FY08*

Source: Company reports

Market leader in deposits as well

Similar to financing activities, QIB holds approximately 50% of the market share in terms of deposits in the Islamic banking segment. As is typical of any Islamic bank, QIB also derives bulk of its deposits from the private sector (retail and corporate) as opposed to the public sector, which represented only 10% of QIB's deposit base in FY08.

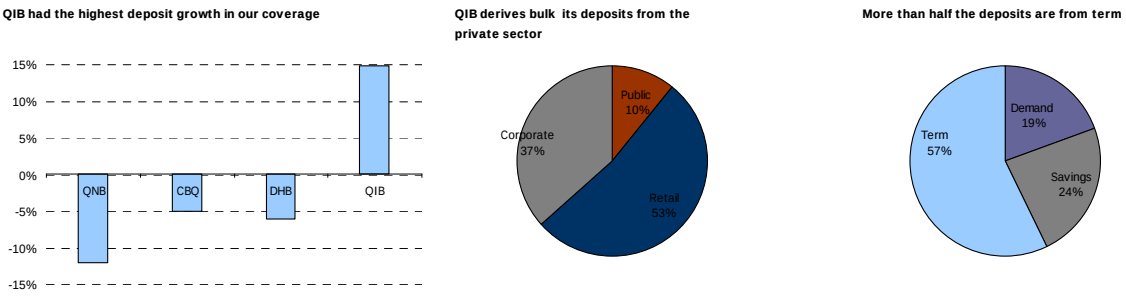
Chart 10: Islamic banks represent one fifth of total Qatari deposit base and tend to depend more on the private sector



Source: Qatar Central Bank

It is worth highlighting that QIB was the only bank in our coverage that saw its deposit base rise in 1Q09, despite the intense competition for deposits in the banking system. This proves the growth potential offered in this segment, as the bank grew its deposit base by 14.9% in 1Q09 and 6.0% in 2Q09. We believe the bank will be able to achieve a 35% growth in its deposit base this year as the sector continues to grow. The 35% growth in deposits vs. the 11% growth in net loans this year will also help the bank get its utilization rates back on track.

Chart 11: QIB has access to a large Islamic deposit base, as seen in its 1Q09 quarterly growth



Source: Company Reports

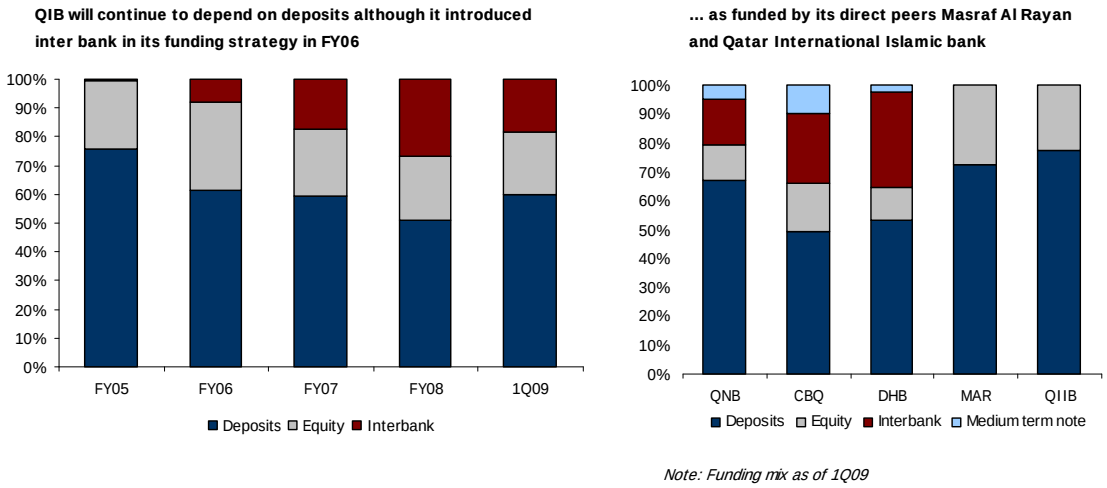
The bank depends on deposits for its funding

Historically, the bank has depended on deposits for funding although it slightly deviated in the past two years. Management, however, remains committed to continue to rely on deposits. Slowdown in growth of financing activities coupled with solid growth in deposit base this year will help the bank get back on track in terms of its funding strategy. In our view, QIB's funding strategy of reliance on deposits will work well for the bank as the profit rate is based on the actual profit or loss incurred by the bank. As such, the bank's margins should be shielded from

the ongoing pricing war in the Qatari deposit market.

The bank started interbank borrowing only in FY06 and this funding source has slightly increased since then. Interestingly, interbank borrowing declined to QAR6.7 billion in 2Q09 from QAR8.7 billion in FY08. Based on our assumption of 35% deposit growth in FY09, we expect deposits' contribution to funding to increase to 62% this year from 51% last year. We forecast this to increase to 69% in FY11e. Increasing dependence on steadier source of income saves the bank from any sort of uncertainty in the interbank markets.

Chart 12: The bank depends more on deposits though it has introduced interbank in the recent past



Note: Funding mix as of 1Q09

Source: Company reports

Similar to conventional banks (as discussed on our report "Banking on an economic boom" dated 2 June 2009), QIB also has a maturity mismatch whereby it funds the majority of its long term financing activities with shorter term investment accounts.

The highest capital adequacy ratio with ample liquidity

As the table shows, QIB has the highest total capital adequacy (17.04%) and Tier I capital ratio (16.35%) in our coverage, well above the central bank's minimum requirement of 10%. Shares issued to QIA amounting to QAR956 million would further boost capital base along with helping liquidity. With no refinancing needs stemming from its funding structure, we do not see any liquidity strains in the bank. Additionally, sale of real estate portfolio to the government has brought in fresh liquidity and this would be followed by another 5% of capital injection by the QIA by end of this year. The solid capital base acts a cushion for the bank against any write-offs related to investments and bad loans given the current global economic environment. We would be comfortable even if the bank sees its NPLs rise to relatively higher levels as it has an adequate capital base to absorb these losses.

Table 4: Capital adequacy ratio of banks in our coverage as of FY08

Banks	Tier I (%)	Tier II (%)	Total (%)
QNB	13.7	0.2	13.9
CBQ	15.2	0.5	15.7
DHB	11.1	2.4	13.5
QIB	16.35	0.7	17.04

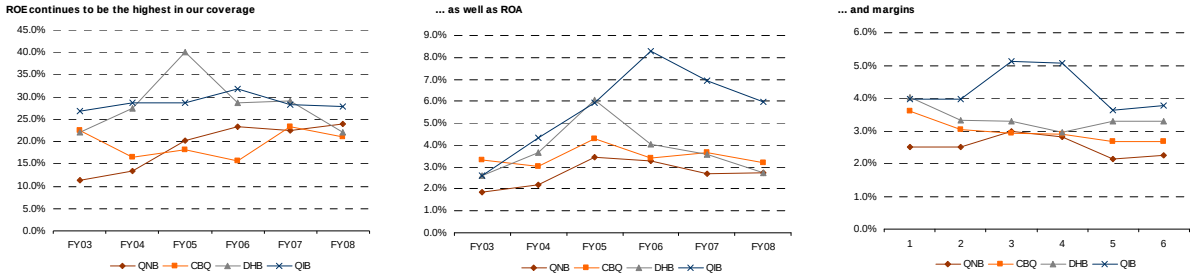
Source: Company reports

...with its profitable business model.

The most profitable in our coverage

As an Islamic bank, QIB has the most profitable business model in our coverage. This arises mainly from its ability to pay profit rates based on actual expenses and refrain from paying any if it incurs losses, unless otherwise instructed by the central bank. It is noteworthy that QIB compares favourably with its Islamic peers in the GCC as well. According to S&P, the average ROA generated by the commercial GCC Islamic banks rated by the agency was 3.1% during 9M08 and 3.7% in FY07. Meanwhile, QIB's figures were 6.5% and 6.9%, respectively, during the same period. We present below a comparison of ROE, ROA and NIM of banks in our coverage in Qatar.

Chart 13: QIB yields the highest profitability in our coverage



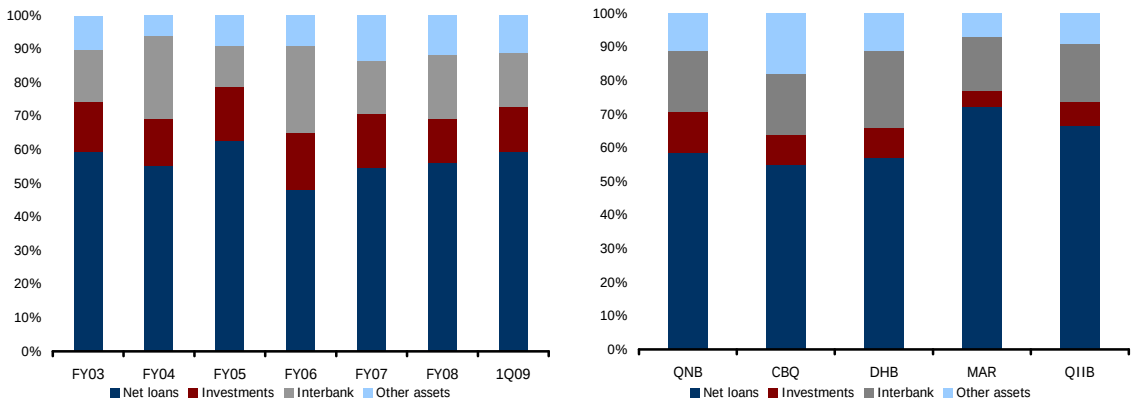
Source: Company reports

During the period FY03-08, QIB's average ROE stood at 28.7% while the sector's was 23.9%. Even on ROA basis, QIB has the highest average of 5.7% during FY03-08 compared to the sector average of 3.9%. During our forecast period of FY09-12, QIB generates ROA of 4.8% while the sector 3.4%. It also has the highest net interest margin at 3.8% in FY08 compared to Doha Bank's 3.3%, the highest amongst other banks in our coverage. We believe this is due to the bank's Islamic background and its tilt towards retail segment. We expect the NIM to further expand in FY09 to 4.12%.

Asset deployment more in line with its conventional peers rather than its direct competitors

QIB has about 50-55% of its total assets in its financing portfolio, leaning towards the business model of conventional banks. Islamic banks generally have more of their assets in the financing portfolio as illustrated by Masraf Al Rayyan (MAR) and Qatar International Islamic Bank (QIIB). We believe this helps the bank diversify its revenue stream.

Chart 14: Comparison of asset allocation of Qatari banks



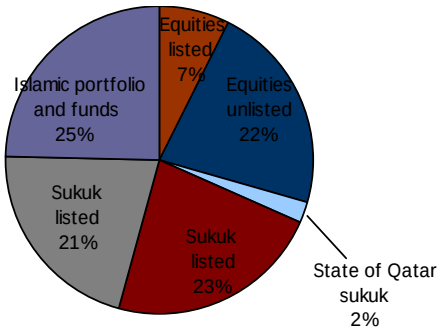
Source: Company reports

Investments are a concern in the short term

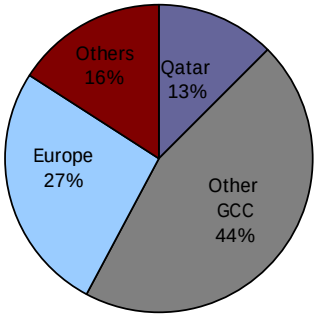
Investments are made up of only available for sale (AFS) securities, with no held to maturity or fair value securities held through income statement in its portfolio. Since change in fair value of AFS securities are taken to the equity statement, it will not hurt the bottom line. Permanent impairments, however, would have an impact on the income statement. Even after selling the DSM listed equity securities to the government in 1Q09, which we estimate to be worth QAR221 million, the portfolio will be left with unlisted equities. As of FY08, this represents 22% of the portfolio. Additionally, the bank has 25% of its investments in Islamic portfolio and funds that we believe would bring in some volatility. Thus, we have forecast a 39% drop in investment income this year from last year's QAR309 million. However, we expect investment income to pick up in FY10, increasing to QAR245 million. Overall, we expect investment income to represent approximately 12% of total income during our forecast period of FY10-13. This has resulted in our earnings forecast for this year to drop 11% YoY. Earnings, however, increase by 20% on average during the forecast period FY10-13. Moreover, the investment portfolio represents only 37% of total equity and 8% of total assets, giving comfort. Above all, with markets showing signs of improvement, we do not expect the bank to face any significant risk from its investment portfolio.

Chart 15: QIB should have sold off only the 7% listed equities to the government leaving it with a 22% exposure to equities (unlisted)

Total investments were QAR2.9 billion in FY08



Foreign exposure of the portfolio is significant

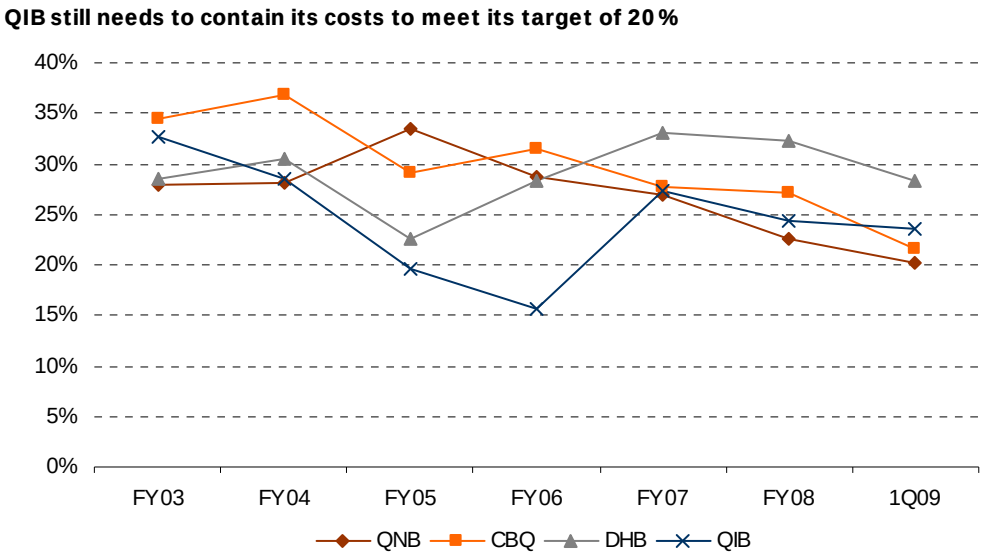


Source: QIB reports

Room for improvement in cost to income ratio

Management strives to keep the cost to income ratio below 20%. Cost to income ratio fell to 23.0% in FY08 from 24.0% in FY07 and we forecast the cost to income ratio to be 24.4% this year. One of the primary reasons for the increase in the cost to income ratio would be lower income base, making the ratio look high. However, we expect it to improve to 21% during FY10-13.

Chart 16: Comparison of cost to income ratio



Source: Company reports

Real Estate Impact Less Pronounced than Perception, in Our View

Substantial real estate exposure stemming from its business model, but limited risks

As discussed above, QIB has significant exposure to real estate due to its Islamic background. The biggest exposure arises from its financing portfolio and the remaining exposure is not material in the context of QIB. Al Aqar, a real estate development company, is a subsidiary of QIB and is thus fully consolidated in its books. We estimate subsidiaries to have contributed approximately 7% of the bottom line last year. As such, we believe that it should not hurt its earnings materially. Hence, it is the financing portfolio that introduces some risk into the business model although it is to a great extent mitigated by government involvement.

The Qatari economic structure which is intertwined with the real estate sector and the banking system credit facility growth so far suggest that real estate sector should not hurt QIB's growth. Qatar's property market is performing better than the rest of the region, and government spending on real estate and infrastructure projects continues to be robust. As discussed in the first section of the report, even when we subtract 50% of the project financing commitments, the real estate segment alone will yield the bank a 5.5% annual growth this year. On the asset quality front too, the government initiative has removed the fear of bad loans as well as providing room for growth. Again, real estate, even if it is corporate or SME, is always backed by the government as most of the projects in Qatar are subcontracted by the government. As such, we do not expect the real estate exposure of the bank to hurt its growth or asset quality materially apart from a general slowdown experienced by all banks across the industry.

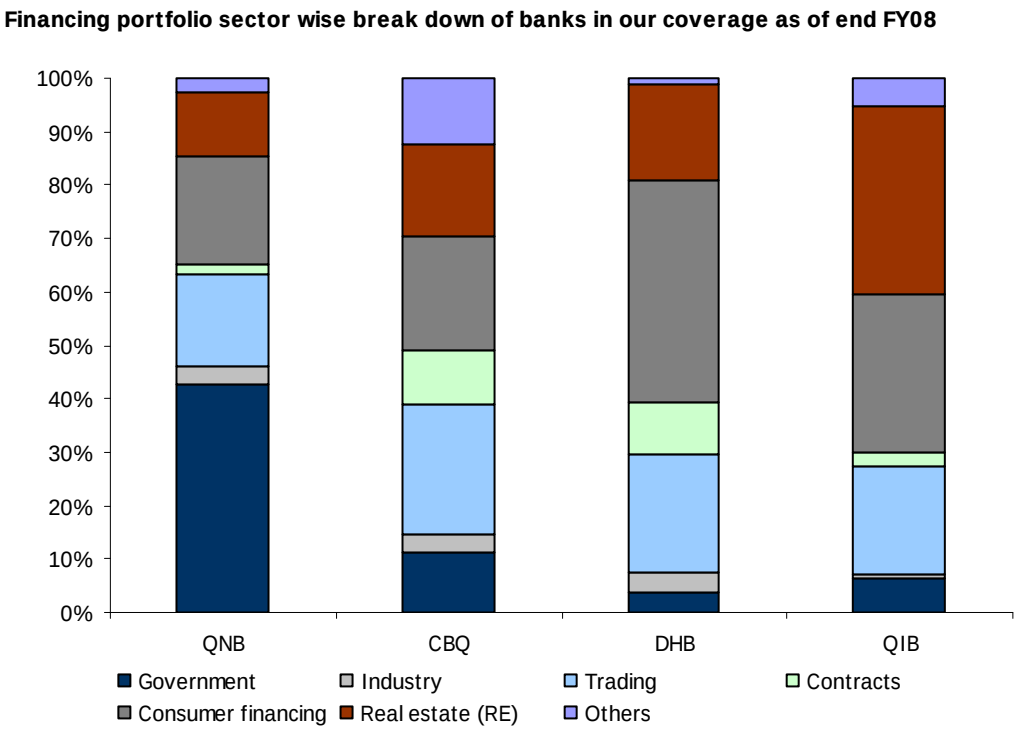
Table 5: QIB's Real Estate Exposure

As of FY08	in QAR '000	% of equity	% of total assets
In financing portfolio	7,836,027	102%	22%
In direct investment	1,334,972	18%	4%
In associates	820,476	11%	2%
Al Jazeera Islamic Co	192,056	3%	1%
Durat Al Doha	212,853	3%	1%
Shard Funding	343,592	5%	1%
Bawabat Al-Shamal	71,975	1%	0%
In Subsidiaries			
Al Aqar Real Estate	n/a	n/a	n/a
European Finance House	n/a	n/a	n/a
Total	9,691,475	132%	29%

Source: QIB reports

Chart 17 provides a comparison of real estate exposure of banks under our coverage, which indicates QIB having the highest amongst them. Additionally, it is the only bank in our coverage with direct property investments. QIB has QAR1.3 billion in direct property investments in FY08, only 18% of equity. As such, the magnitude is not large and, more importantly, the government purchase of real estate portfolio shields the bank from any decline in fair value. It would, of course, reduce its income from the investments. QIB generated QAR564 million of income from direct property investments, the highest since FY03. We estimate this to significantly fall to QAR120 million this year due to the sale of some property investments to the government. However, we expect it to pick up next year and forecast income of QAR218 million, which is still lower than the FY08 levels.

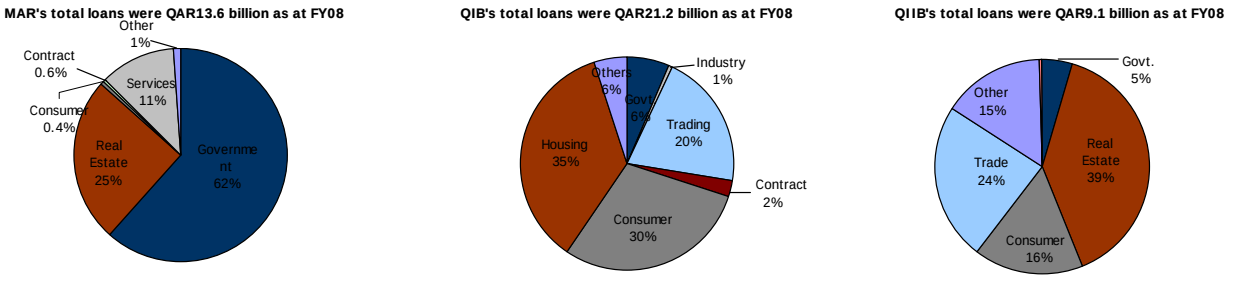
Chart 17: Loan composition of banks in our coverage as of FY08



Source: Company reports

We find it more appropriate to compare QIB's financing portfolio with its direct peers MAR and QIIB as a result of their shared Islamic background. As illustrated below, all three banks have relatively higher exposure to real estate than conventional banks, though nothing exceptional. Although MAR is leveraged to the government sector with lower exposure to real estate, QIB's portfolio mix is more balanced with significant exposure to retail, trade and real estate. This offers the bank greater diversification, which is essential at this point in time.

Chart 18: QIB has a balanced financing portfolio mix relative its direct peers, offering a diversified business model



Source: Company reports

That said, we do expect the global property market along with the current economic atmosphere to slightly hurt the performance of the bank's associates this year. Since most of its associates are directly or indirectly engaged in real estate related activities across the globe, we expect this to impact earnings. Associate income contributed 15% to QIB's bottom line in FY08 and we estimate this to fall to 11% this year on the back of the general slowdown seen across the globe.

Table 6 : Working of the Contribution of Subsidiaries to QIB's Earnings

In QAR'000	FY07	FY08
Consolidated net profit before minority interest	1,322,716	1,704,711
Parent company's net income	1,201,342	1,588,905
Net income from subsidiaries	121,374	115,806
% contribution to bottom line	9.7%	7.1%

Source: QIB reports

Non-financing income likely to be lower this year, but improve in FY10

As with any Islamic bank, QIB derives a large chunk of its income from non-financing income (non-interest income for conventional banks). When we examine the history, non-financing income represented more than 50% of total income (an average of 47.7% during FY03-08). This, however, declined in 2Q09 to 37%, due to a fall in investment income. As such, we expect lower contribution from non-financing income in the range of 30% this year, but our forecast for the period FY10-13 yields an average of 38%. Again, we have taken a cautious approach in forecasting non-financing income; our forecast is more in line with the pre-2004 level. Despite this, earnings show an average growth of 20% during our forecasted period FY10-13, as stated above.

We expect earnings to be slightly impacted by investment income, but loan book growth and asset quality risks to remain limited

In sum, although we expect a dip in investment and other non-financing income this year due to current global economic conditions, we remain positive on the bank's prospects. In 2Q09, QIB reported net income of QAR462 million, resulting in a 32% quarterly growth and 16% yearly growth. These numbers compare favourably with banks which have reported so far in our coverage. Notably, loan book adjusted for sale of real estate portfolio has grown an impressive 11% QoQ, and loan loss charges are positive (i.e. recovery) during the quarter. As such, we are comfortable with the asset quality and the level of growth seen in the bank's financing portfolio.

Background

- Founded in 1982 as the first Shariah compliant bank in Qatar, QIB provides commercial and investment banking services to its retail and corporate clients in Qatar and internationally. Qatar Investment Authority holds a 5% stake in the bank, following the government initiative to strengthen the Qatari banks' capital base. Khaleeji Commercial Bank holds a 4.2% and the remaining is widely held by the public. As of May 2009, the bank has a branch network of 25 and has 708 employees.
- QIB has come a long way in its international expansion agenda since its inception via organic and acquisition growth. QIB's strategy has been to enter international markets via associates or subsidiaries. As such, associates and subsidiaries play a key role in the bank's expansion agenda.

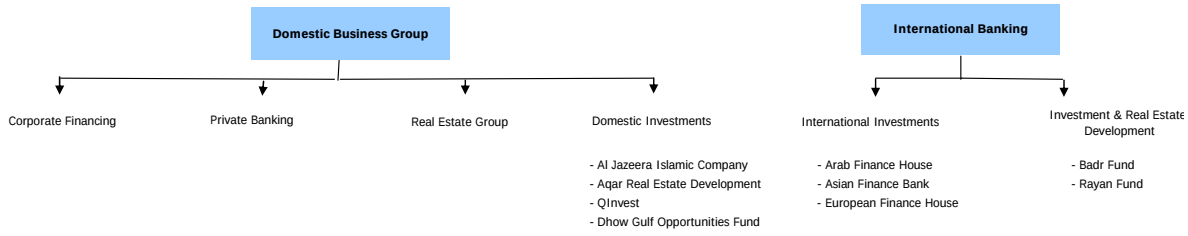
Table 7: Details of Associates

Company	Business Activities	Country	Stake
Arab Finance House	Islamic banking	Lebanon	32.51%
Asian Finance Bank	Investment banking	Malaysia	21.00%
QInvest	Investment banking	Qatar	25.00%
Al Jazeera Islamic Co	Islamic banking	Qatar	30.17%
Durat Al Doha	Real estate development	Qatar	39.90%
Shard Funding Ltd	Real estate development	UK	25.00%
Babawat Al-Shamal	Rea estate	Qatar	37.25%

Source: Company reports

- The bank fully consolidates its two subsidiaries Aqar Real Estate Development and European Finance House. Aqar Real Estate Development is located in Qatar and QIB holds a 49% stake in the developer. European Finance House is based in the UK and serves the European market.
- The bank divides its banking operations geographically with two major business segments: Domestic Business Group and International Banking. The local operations contributed three quarters of the total financing and investing income in 1Q09, with the remaining coming from international operations.

Chart 19: Business segments of QIB

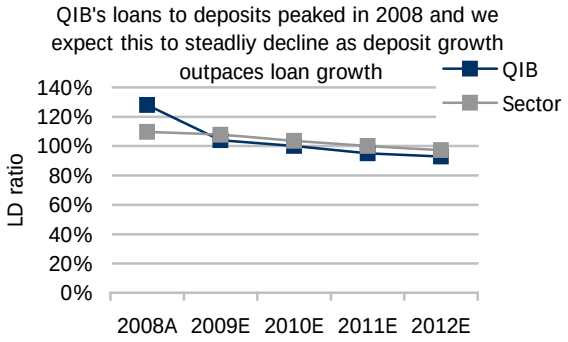


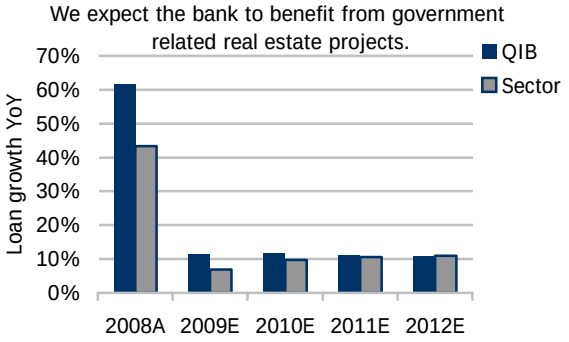
Source: Company reports

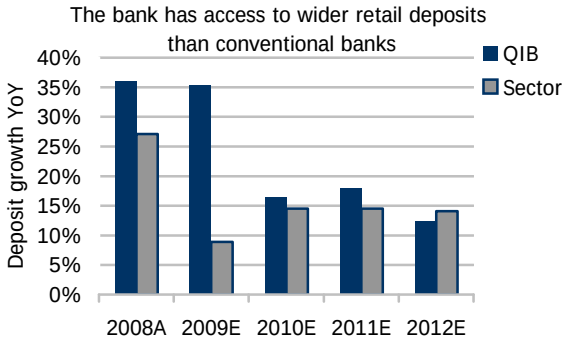
SWOT Analysis of QIB

Strengths	***Weakness***
i. Strong margins ii. Market leader in the Islamic banking arena iii. Good asset quality iv. Significant growth in the deposit base v. Solid capital base vi. Strong franchise in the Islamic banking market segment	i. Substantial exposure to real estate ii. Maturity mis-match between financing activities and deposits iii. Approximately 40% of the investment portfolio invested outside the region
Opportunities	***Threats***
i. Access to the regional and international market through its associates and subsidiaries ii. Islamic banking activities expected to continue to expand in the region and the globe	i. A severe slow down in the property market

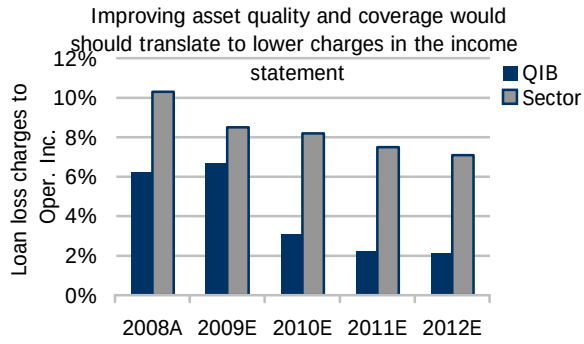
Performance snapshot: QIB vs. Sector

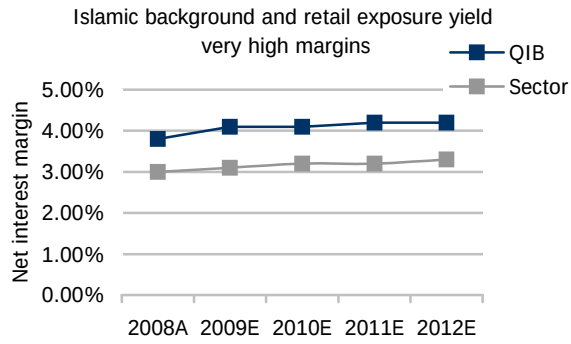












Source: HC Brokerage and company reports

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

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