Commercial Bank of Qatar/Commercialbank (CBQK)

Recommendation	**OUTPERFORM**	**Risk Rating**	**R-3**
Share Price	**QR70.70**	**Target Price**	**QR87.59**
Implied Upside	**23.90%**		

Compelling Long-Term Value

We are initiating research coverage on The Commercial Bank of Qatar (CBQK) with a target price of QR87.59 and an Outperform Rating. Commercialbank is Qatar's 2nd largest lender with a focus on the corporate sector. As of 9M2013, CBQK had a ~12% and ~10% market share of loans and deposits (among listed banks), respectively. Focused on regional expansion, CBQK acquired 74.24% of Alternatifbank (ABank) & set forth a 5-year strategy that would improve ABank's efficiency and raise its market share.

Highlights

- **ABank presents avenues for diversification & growth.** Expanding its footprint, CBQK acquired Turkish ABank in 2H2013. Management has set up a 5-year plan that would help the bank operate efficiently boosting its profitability. We assume ABank will contribute ~7.1% (2014e-17e) to CBQK's bottom-line.
- **Resurgence of asset quality issues not a major concern, in our view.** The impairment of a domestic real estate account caused the NPL ratio to skyrocket in 9M2013 while dampening the coverage ratio. However, we are of the view that a significant portion of this loan is recoverable by 2015.
- **Capital raising to improve Tier-1 ratio & propel loan book.** CBQK will issue QR2bn in Tier-1 perpetual notes to improve its Tier-1 capital ratio to 13.0%.
- **Compelling dividend yield & attractive multiples.** CBQK offers an attractive yield of 7.8% based on our 2014 estimates, which is among the highest in the GCC banking sector. Stock trades at a 2014 P/E of 8.2x vs. peer mean of 12.1.

Catalysts

- **Improvement in asset quality & visible progress in the realization of management's 5-year strategy for ABank.** The following developments could be perceived positively by the market: 1) clarity on asset quality (NPL ratio spiked to 3.31% in 9M2013 due to an impairment of a domestic real estate account while the coverage ratio dropped to 53.4%); 2) resurgence of robust profitability due to an expansion in net interest income coupled with a softening in provisions and 3) announcements/newsflow on infrastructure projects (QNB Group estimates an annual spend of ~$30bn during the next three years).

Recommendation, Valuation and Risks

- **Recommendation and valuation: *We rate CBQK an Outperform with a price target of QR87.59.*** Our target price implies an upside of 23.90%.
- **Risks: 1) A potential dividend cut for 2013; we expect QR5.50 in 2013/14 DPS vs. QR6.00 in 2012**; 2) CBQK's objectives for ABank do not materialize; 3) asset quality worsens; 4) concentration risk and general risks rising from regional socio-political issues and 5) currency risk due to a volatile TL/USD.

Key Financial Data and Estimates

	FY2011	FY2012	FY2013e	FY2014e	FY2015e
EPS (QR)	7.61	8.13	6.97	8.65	10.06
EPS Growth (%)	5.16	6.81	(14.32)	24.15	16.35
P/E (x)	9.3	8.7	10.1	8.2	7.0
TBVPS (QR)	57.51	60.37	53.63	56.77	61.30
P/TB (x)	1.2	1.2	1.3	1.2	1.2
DPS (QR)	6.00	6.00	5.50	5.50	6.00
Dividend Yield (%)	8.5	8.5	7.8	7.8	8.5

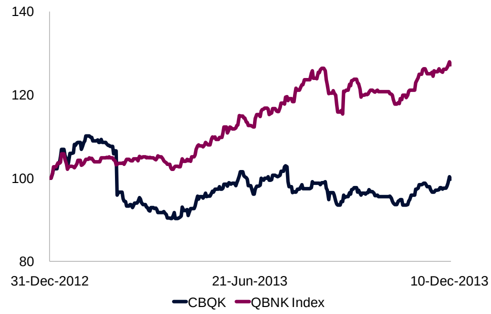
Source: Company data, QNBFS estimates; Note: All data based on current number of shares

Key Data:

Bloomberg Ticker	CBQK QD
ADR/GDR Ticker	GBB39RMD9.L
Reuters Ticker	COMB.QA
ISIN	QA0007227752
Sector	Banks & Financial Services
52wk High/52wk Low (QR)	78.50/63.70
3-m Average Volume	216,318
Mkt. Cap. ($ bn/QR bn)	4.8/17.5
Shares Outstanding (mn)	247.4
FO Limit* (%)	25.0
Current FO* (%)	13.5
1-Year Total Return (%)	7.6
Fiscal Year End	December 2012

Source: Bloomberg (as of December 11, 2013), *Qatar Exchange (as of December 11, 2013); Note: FO is foreign ownership

Relative Price Performance vs. Market Indices



Source: Bloomberg; Note: CBQK is The Commercial Bank of Qatar and QBNK Index is QE All Share Banks & Financial Services Index

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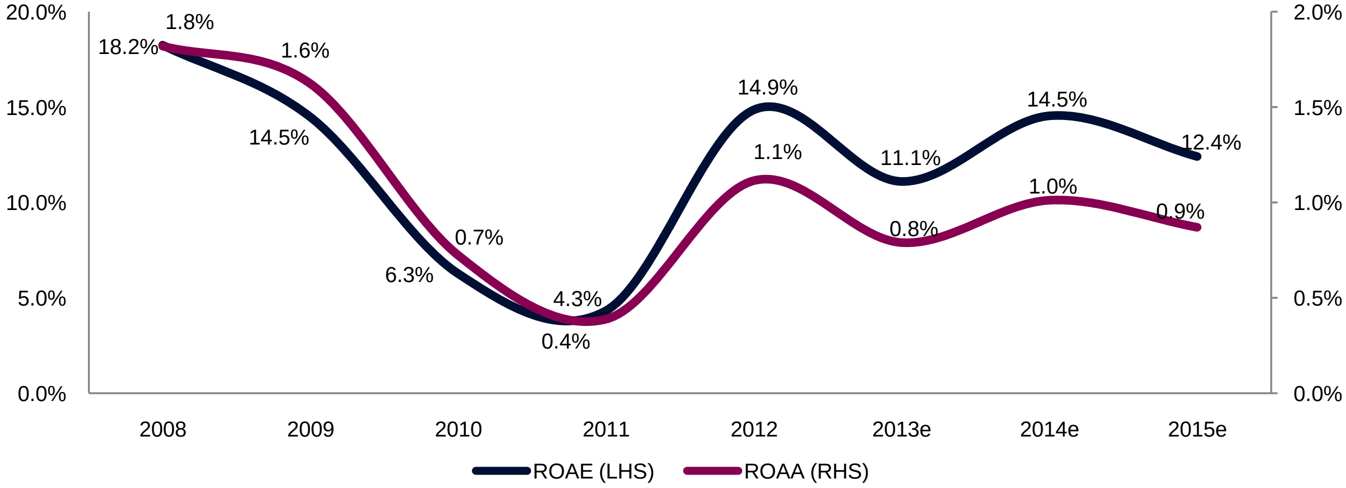
Executive Summary

ABank Presents Opportunities for Growth and Diversification

ABank is expected to contribute ~7.1% (2014e-17e) to Commercialbank's bottom-line. CBQK expanded its regional footprint by acquiring 70.84% of ABank's shares for QR1.8bn (~$500mn) (~2x book value). Following this, the bank acquired an additional 3.40% stake on September 27, 2013, bringing its total ownership to 74.24%. This transaction seems pricey as Russia-based Sberbank acquired Denizbank for 1.3x book value and Kuwait's Burgan Bank acquired Euro Tekfenbank for 1.0x book value (both transactions were conducted in 2012). We recall Commercialbank acquired minority stakes in the National Bank of Oman or NBO (34.9%) during 2005 and in United Arab Bank or UAB (40.0%) during 2007 in order to expand within the GCC. Management's objective was to extract synergies, while at the same time provide technical support to the banks' management. So far, CBQK's investment in these two banks has proven to be successful, yielding positive results with income from associates contributing 12.8% and 18.5% to the bottom-line in 2012 and 9M2013, respectively. Repeating its success with NBO and UAB, management has devised a 5-year strategic plan to make ABank operate efficiently, be more profitable and bolster its position within Turkey.

We forecast ABank's net profit to grow at a CAGR of 10.0% (2012-17e). Growth could be higher if ABank operates efficiently and ceases to incur investment and FX losses. However, we do not model such assumptions until we start seeing signs of Commercialbank's influence on the Turkish bank. Due to the above mentioned factors, RoAE has been volatile.

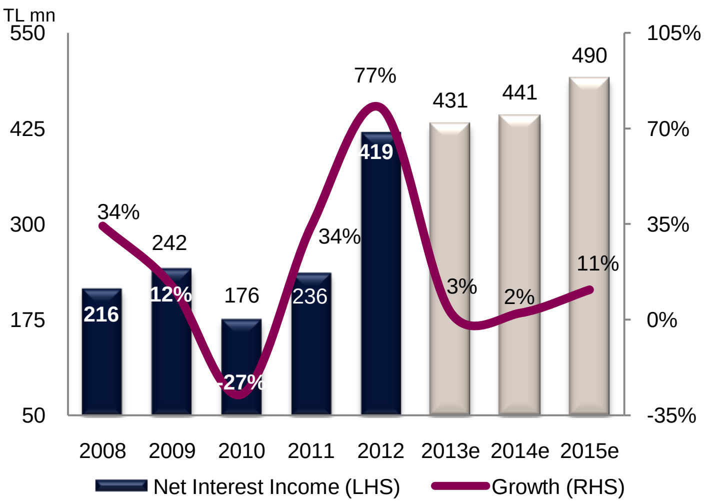
ABank's Volatile RoAE and RoAA



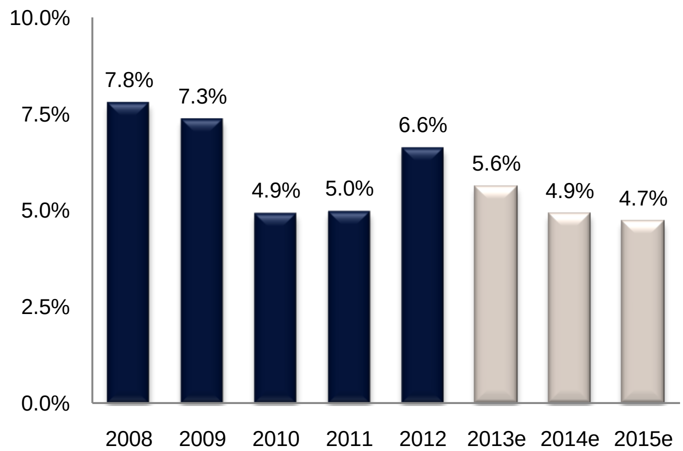
Source: Company data, QNBFS estimates

Net Interest Income and NIMs at ABank have proven to be robust. Net interest income grew at a CAGR of 21.2% (2007-2012) albeit a small base effect. ABank's superior NIMs are a result of its loan book's ~50% exposure to the SME segment. However, we pencil in a CAGR of 6.3% (2012-2017e) as NIMs are expected to come under pressure due to the Central Bank of Turkey's regulatory actions. Based on our forecasts, we believe ABank will contribute an average of ~27% to CBQK's net interest income (2014e-17e).

ABank's Net Interest Income to Gradually Climb



ABank's NIMs Expected to Tread Lower

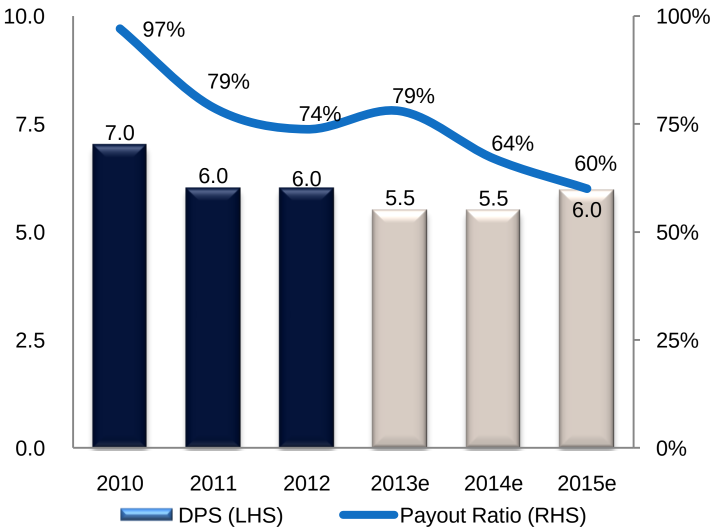


Source: Company data, QNBFS estimates

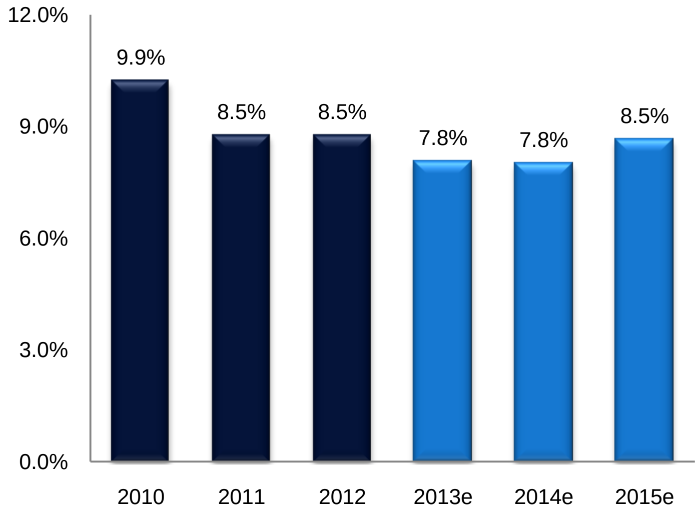
Attractive Dividend Yield

CBQK offers an exceptional dividend yield. CBQK is a lucrative dividend play as it offers one of the highest yields among its domestic and GCC peers. In fact, the bank has consistently delivered robust dividends since 2008. During this period, CBQK averaged a dividend payout ratio of 84%. However, a dip in dividends for 2013 is in the offing, as management has to build its capital position following the ABank acquisition. Nevertheless, we do not envision a drastic cut as that would be detrimental for the stock. Going forward, we pencil in an average payout of 68% (2013e-15e) while dropping the ratio to an average of 50.0% from 2016 and onward. Our estimates are based on our view that in order for the bank to seek expansion opportunities in the future, it should retain some of its cash. There is also a possibility that the company declares bonus shares in the future to retain more of its cash.

Generous Dividend Payout



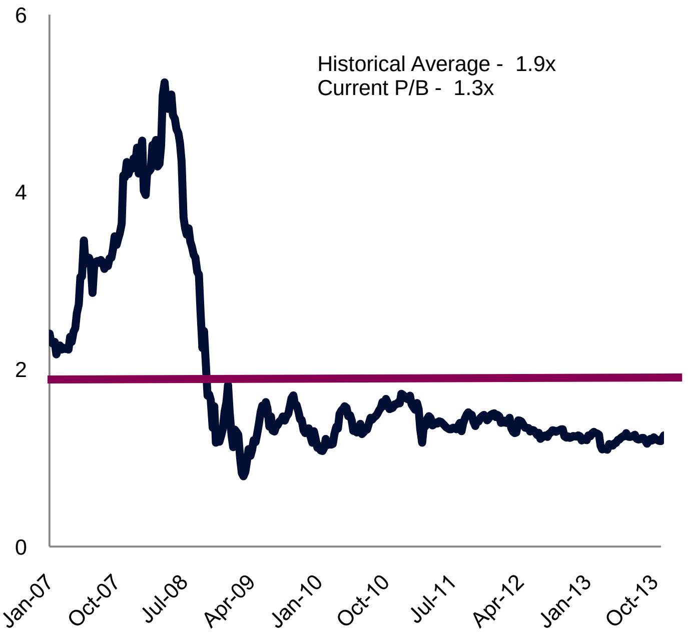
Compelling Dividend Yield



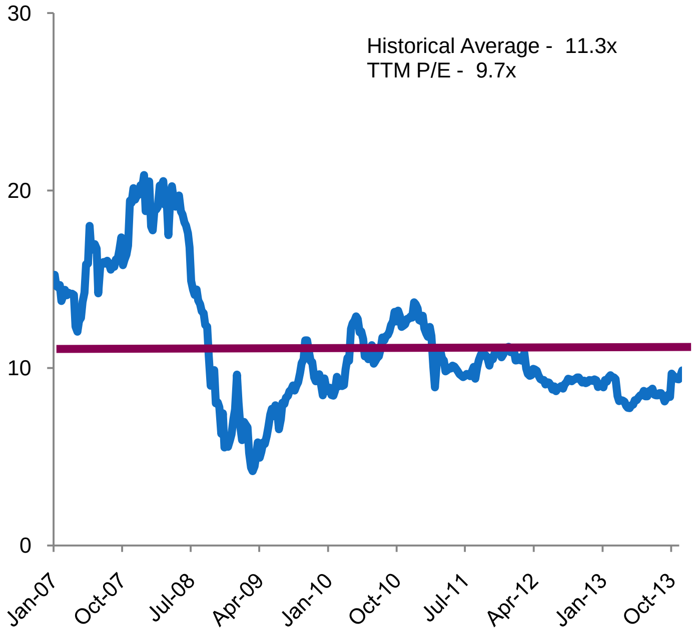
Source: Company data, QNBFS estimates

CBQK's valuation is undemanding. The stock trades at a steep discount to its 5-year average P/B and P/E ratios. Moreover, the stock is also trading at an unjustifiable discount to its GCC peers.

Trading at a 32% Discount to Historical Average………….



And a 14% Discount to Historical P/E

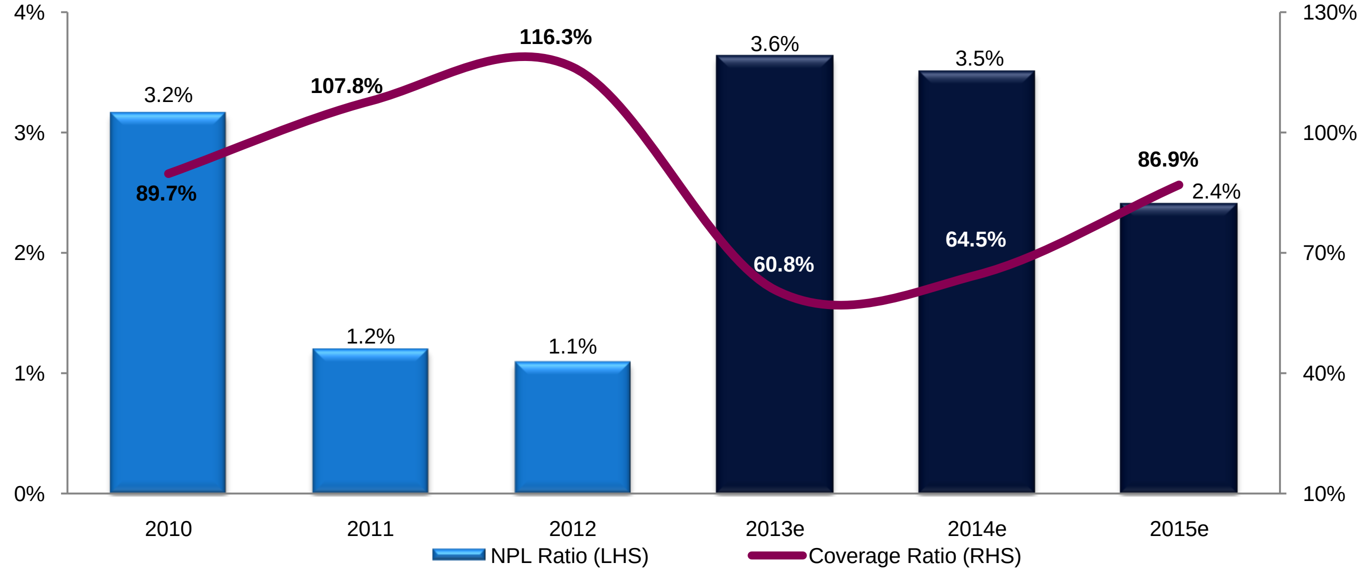


Source: Bloomberg, QNBFS estimates

Asset Quality – The Worst is Over

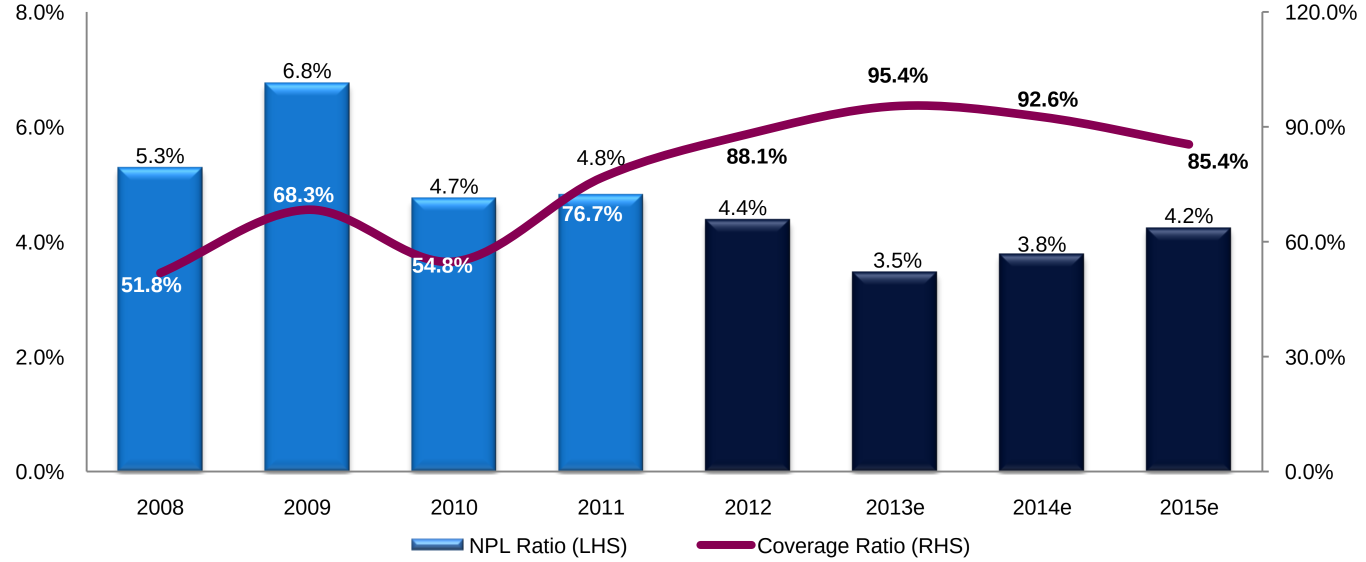
Recent asset quality issues should not be a drag on the stock going forward. Asset quality issues resurfaced this year mainly from the impairment of a domestic real estate loan (QR1.1bn) in 2Q2013. Consequently, the NPL ratio spiked to 3.28% (3.31% including ABank) and the coverage ratio dropped to 48.0% (53.4% including ABank) as of 9M2013. Currently the bank's management is in remedial negotiations with the real estate company. Hence, management is confident that they will be able to recover the majority of the loan. We are also of the same view. As such, we carry the NPL in 2014 but we forecast a drop in 2015 to 2.4% (NPL ratio) as the bank recovers a significant chunk of the loan. On the other hand we expect ABank's NPL ratio to remain on the high side as the bank's loan book is tilted towards SMEs and small business loans. As a general rule of thumb, impairments arising from SMEs and small business loans tend to be much higher than corporate loans.

CBQK's NPL Ratio and Coverage to Improve Over Time



Source: Company data, QNBFS estimates

ABank's NPL Ratio to Remain on the High side while Coverage to Improve Over Time

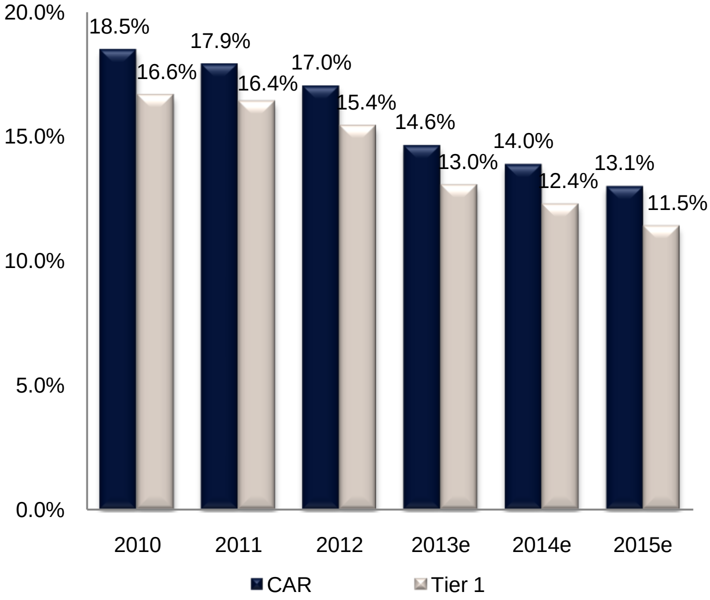


Source: Company data, QNBFS estimates

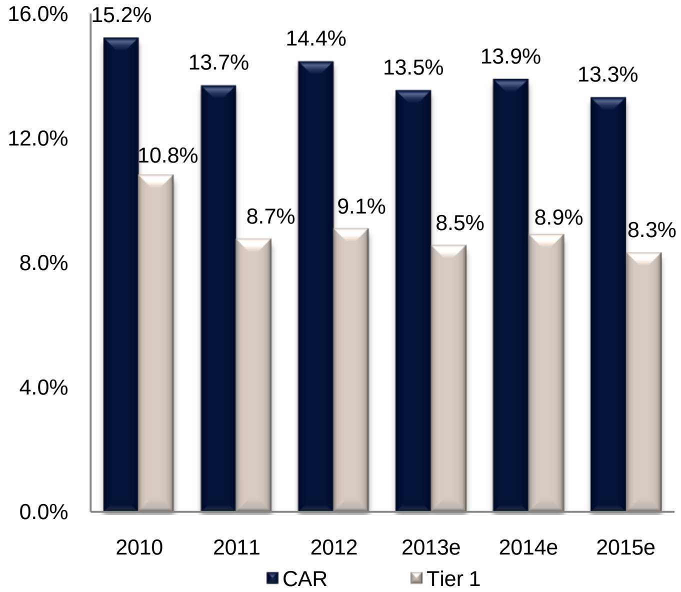
Capital Raising is in the Pipeline

Capital raising to enhance Tier-1 position and propel loan growth. Commercialbank's has announced that it will raise capital by issuing Tier-1 perpetual capital notes worth ~QR2bn in order to boost its Tier-1 capital. This transaction will be a private placement in the domestic market and is expected to conclude by December 2013 (deadline is March 2014). We have factored this into our assumptions and based on our calculation the notes should increase 2013's Tier-1 and CAR by ~215bps and ~238bps, respectively. Without this injection, Tier-1 ratio and CAR would be 10.9% and 12.2%, respectively. Moreover, we are of the view that Commercialbank needs to raise further capital. If we assume another QR2bn in capital raising during 2014, CBQK's Tier-1 ratio and CAR would improve to 14.3% and 15.7%, respectively. But, we do not factor a second tranche of financing in our model currently.

Capitalization at the Low End but Expected to Rise



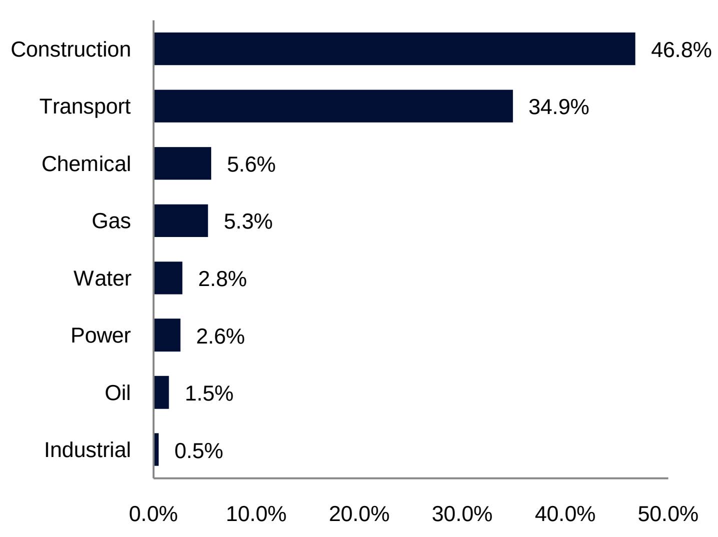
ABank Requires Capitalization



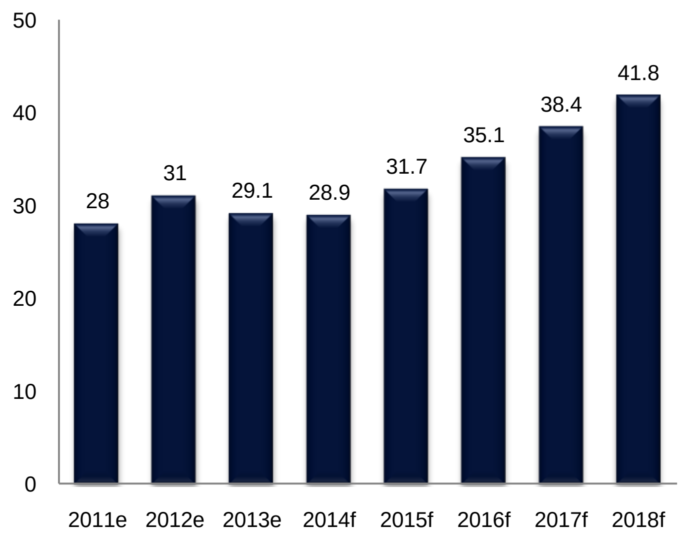
Source: Company data, QNBFS estimates

CBQK should also benefit from the infrastructure/construction boom. The NDS 2011-16 (National Development Strategy) estimates ~$225bn in investments will be made during 2011-16 (QNB Group estimates $183bn of this plan is yet to be spent) with significant capital being deployed in infrastructure and construction. This is in line with the estimated total budgets (~$248bn) of all projects currently underway in Qatar, including all those that have been initiated, plus those that are under study, being designed or in the tendering process, and also including medium-to-long-term spending plans. QNB Group expects project activity to gain momentum during 2013-2018. This includes Phase 1 of the Doha Metro Project (valued at ~$8.2bn), which is part of the Qatar Rail Development Project. It is noteworthy that Commercialbank is involved in a consortium financing a significant portion of the tenders. We are still of the view that the banking sector will be one of the primary beneficiaries and a major driver of Qatar's infrastructure and construction boom, as current and future projects need to be financed. Given that CBQK is Qatar's 2nd largest bank, and focused on the private corporate sector, we are of the view that the bank would continue to be involved in the financing of future projects.

Estimated Current Projects Spending Budgets (%)



Projects Spend from 2011 to 2018 ($bn)

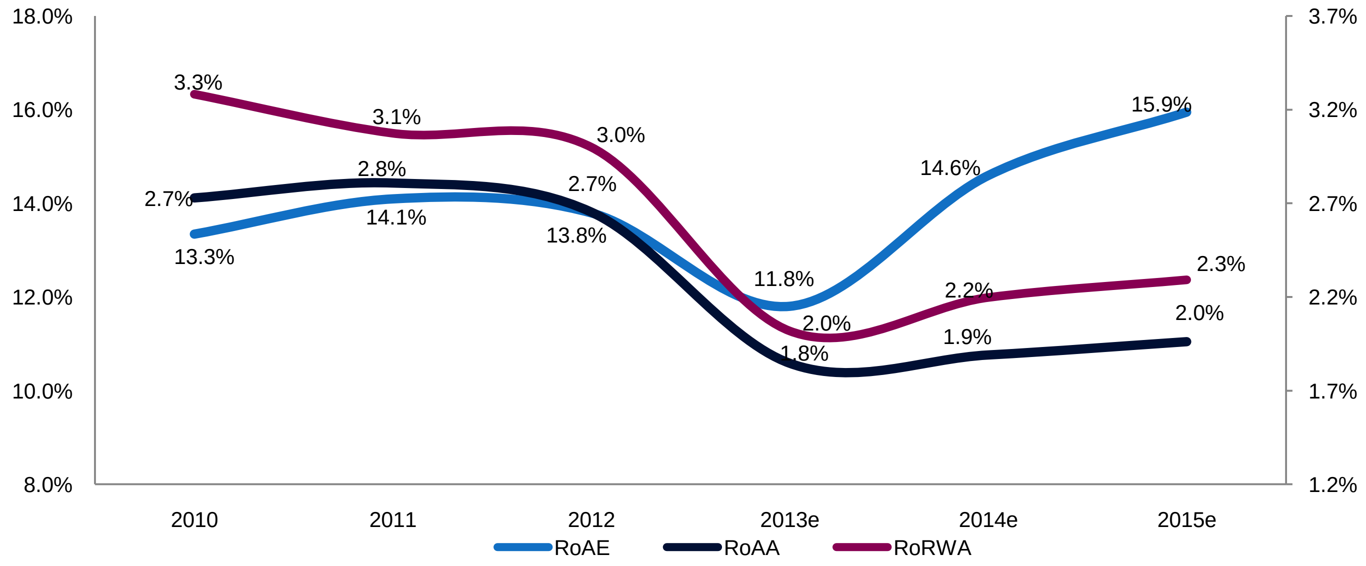


Source: QNB Group, MEED Projects

Solid Growth on the Horizon

We estimate CBQK to register a CAGR of 15.3% in net profit for 2013e-17e (8.7% over 2012-17e). We estimate net interest income to grow at a CAGR of 15.6% over 2012-17e. We see Commercialbank growing its net operating income by deploying its funds in the corporate segment and infrastructure projects (as mentioned previously, CBQK is involved in a consortium financing a significant portion of Phase 1 of the railway project). On the other hand, we do not expect the bank to aggressively expand its real estate portfolio as this segment is at 155% of Tier-1 capital as of the end of December (QCB's real estate exposure ceiling policy is for a maximum of 150% of Tier-1 capital). However, with the inclusion of the QR2bn Tier-1 notes and based on our estimates, the ratio drops to ~130 in 2013. Moreover, we assume, Commercialbank will not increase its exposure to real estate beyond 136% of Tier-1 capital (by 2016). Further, ABank's healthy NIMs are expected to bolster CBQK's margins due to ABank's heavy focus on SMEs. Management announced that the bank will embark on an aggressive strategy (5-year plan) to help ABank operate efficiently and increase its domestic market share in Turkey. In the past, Commercialbank was successful in improving the operations of its GCC associates (NBO and UAB). Based on this, management is confident in making a similar positive impact on ABank's operations. Furthermore, management will issue Tier-1 capital notes worth QR2bn, which will help the bank grow its balance sheet and improve its Tier-1 ratio. Hence, if management's ambitious plans materialize, the bank's RoAE and RoAA can markedly improve.

RoAE and RoAA to Improve Significantly



Source: Company data, QNBFS estimates

9M2013 Results

CBQK witnessed its 9M2013 net profit drop 16.6% YoY on the back of significant provisions. CBQK posted a net profit of QR1.3bn in 9M2013 vs. QR1.6bn in the same period last year, resulting in a decline of 16.6% YoY. The drop in net profit was driven by provisions coupled with impairments on investments. CBQK has endured two major defaults so far this year involving a domestic real estate loan and an account outside Qatar. As such the bank's NPL ratio rose to 3.31% vs. 1.09% at the end of 2012. Consequently, management had to provision for these loans. Thus, provisions increased to QR368.1mn vs. QR66.4mn in 9M2012. Moreover, CBQK's coverage ratio dropped to 53% vs. 116% at the end of 2012. Net interest income increased 10.9% YoY. The YoY increase was due to the consolidation of ABank in 3Q2013. Moreover, fees and commissions gained by 14.2%. CBQK's operating expenses increased by 28.4% YoY causing the headline cost-to-income ratio to climb to 34.2% vs. 29.8% in 9M2012. Furthermore, core cost-to-income ratio (excludes gains from investment securities, dividends & income from associates) also deteriorated, rising to 40.4% vs. 35.9% in 9M2012. The increase in costs was attributed mainly to one-time expenses arising from the ABank acquisition, ABank consolidation and an increase in headcount. CBQK's trailing twelve months RoAE slipped to 12.4% vs. 13.8% at the end of 2012. Net loans and deposits soared by 33.5% YTD (QR64.9bn) and 39.4% YTD (QR57.7bn), respectively. Thus, the LDR fell to reach 112% from 2012's 117%.

Catalysts

Visible Progress in the Realization of Management's Target for ABank

Commercialbank needs to enhance ABank. CBQK acquired ABank for ~$500mn (2x book value) in the second half of 2013 in order to expand its regional footprint. The transaction received mixed reviews among the investor community as some felt that the asking price was relatively rich compared to similar transactions that took place in Turkey during 2012. ABank does not operate efficiently and consistently generates investment and FX losses, which has dampened the bank's strong net interest income (ABank enjoys handsome NIMs due to its asset mix). Nevertheless, CBQK's management has put together a 5-year plan for ABank that could substantially improve the bank's operations. When CBQK starts disclosing positive progress on the implementation of its strategy for ABank and extracting value, we believe investors could demonstrate more appetite for CBQK stock.

Clarity on asset quality. Commercialbank's NPL ratio skyrocketed this year mainly due to an impairment of a domestic real estate account. We are of the view that this was one of the factors, which did not sit well with investors. We believe that when this loan becomes performing, the NPL ratio would significantly improve, resulting in a more acceptable coverage ratio.

Resurgence of robust profitability. CBQK's 2013 profitability is expected to be weak mainly due to a surge in provisions. As mentioned previously, the increase would be mainly due to a domestic real estate account. We believe a softening of provisions in the next couple of years should help drive the bank's profitability in a robust manner.

Announcements/newsflow on infrastructure projects. QNB Group estimates an annual spend of approximately $30bn during the next three years on projects that are currently underway or announced (owing to project completion). Thus, as the projects (worth ~200bn) are implemented and the private sector becomes more involved, we expect CBQK to expand its loan book by a CAGR of 17.5% (2012-17e). The increase in loans would lead to a 24.1% and 16.3% YoY net profit growth for 2014 & 2015, respectively.

Valuation

Our target price of QR87.59/share implies an upside of 23.9% over the current price. As such, we rate CBQK an Outperform.

We value CBQK using a blended valuation methodology, which assigns a 50%:50% weighting to a) Warranted Equity Valuation (WEV) and b) Residual Income Model (RI).

a) We utilize a WEV technique derived from the Gordon Growth Model: P/B = (RoAE-g)/(Ke-g).

This model uses sustainable return on average equity (RoAE) based on the mean forecast over the next seven years, cost of equity (Ke), expected long-term growth in earnings (g) and present value of interim dividends to arrive at a fair value for this stock. We consider this method best suited to arriving at an intrinsic valuation through the economic cycle.

b) We also derive CBQK's fair value by employing the RI valuation technique, which is calculated based on the sum of its beginning book value, present value of interim residuals (net income minus equity charge) and the present value of the terminal value (we apply a fundamental P/B multiple based on the Gordon Growth Model to the ending book value at the end of our forecast horizon).

The RI model is suitable for the following reasons: 1) when the company does not pay dividends or the pattern of dividend payments is unpredictable; 2) the company is expected to generate negative free cash flows for the foreseeable future and 3) as the traditional free cash flow to equity (FCFE) formula does not apply to banks. A major advantage of RI in equity valuation is a greater portion of the company's intrinsic value is recognized from the beginning BVPS as opposed to the terminal value (common in traditional FCFE methodology). In Commercialbank's case, 67% of the fair value is derived from the bank's beginning BVPS vs. 22% from the terminal value.

Both valuation methodologies rest on a common Cost of Equity (CoE) assumption of 12.1%.

We calculate a risk free rate of 4.4% by adding the 10-year US treasury bond yield (2.7%) to the inflation differential between Qatar (3.7%) and the US (2.0%). We factor in an adjusted beta of 0.96 vs. 0.94 (actual). Finally, we add a local equity risk premium of 8.0% to arrive at a CoE of 12.1%.

Valuation Matrix

WEV	
Sustainable RoAE (%)	15.5%
Book Value of 2019e (QR)	91.22
Estimated Cost of Equity (%)	12.1%
Terminal Growth Rate (%)	4.0%
Intrinsic Value (QR)	85.59
Current Market Price (QR)	70.70
Upside/(Downside) Potential (%)	21.1%
Equity Value (QR mn)	21,179

RI	
Beginning BVPS (2013) (QR)	60.37
Present Value of Interim Residuals (QR)	12.38
Present Value of Terminal Value (QR)	19.35
Terminal Growth Rate (%)	4.0%
Intrinsic Value (QR)	89.59
Current Market Price (QR)	70.70
Upside/(Downside) Potential (%)	26.7%
Equity Value (QR mn)	22,169

Source: Bloomberg, *QNBFS estimates

Price Target Calculation

Methodology	Equity Value (QR mn)	Weight (%)	Fair Value (QR mn)
WEV	21,179	50	10,589
Residual Income	22,169	50	11,085
Blended Equity Value			21,674
Shares Outstanding (mn)			247.446
Target Price (QR)			87.59
Upside/(Downside)			**23.9%**

Source: Bloomberg, *QNBFS estimates

Relative Valuation

Valuation appears to be undemanding. We believe the bank is trading at a discount relative to its Qatari peers primarily due to short-term weak profitability and asset quality issues. We suspect Commercialbank will trade in-line with its peers once the bank shows encouraging signs that its objectives related to its recent acquisition are being totally or even partially met, asset quality issues subside and the bank returns to generating robust profitability. The bank trades on a P/E and P/B multiple of 8.2x and 1.2x on our 2014 estimates. On a P/TB basis, CBQK trades at a significant discount to the overall average of the Qatari banking sector. CBQK offers an attractive dividend yield (DY) of 7.8% for 2014, besting its domestic peers.

Peer Group Valuation

Name	Price (QR)	P/E LTM	P/E 2014	Current P/B	Current ROE	Dividend Yield 2014
Commercial Bank of Qatar*	70.70	9.7	8.2	1.3	12.4%	7.8%
Qatar National Bank	173.40	12.7	11.2	2.4	19.3%	3.5%
Al Khalij Commercial Bank*	19.99	12.4	13.9	1.3	9.7%	5.0%
Doha Bank*	57.30	9.4	9.6	1.7	16.1%	6.5%
Al Ahli Bank	56.40	13.7	12.8	2.1	16.2%	5.3%
Qatar Islamic Bank*	70.00	15.0	11.6	1.4	9.5%	6.1%
Masraf Al Rayan*	33.50	12.9	13.6	2.5	17.3%	3.6%
Qatar International Islamic Bank*	61.00	11.8	11.8	1.8	14.5%	5.7%
Average		12.6	12.1	1.9	14.6%	5.1%

Source: Bloomberg, *QNBFS estimates

Risks to Our Thesis

- **A potential dividend cut for 2013 could impact the stock in the very near term.** We expect QR5.50 in DPS for 2013 and 2014 vs. QR6.00 in 2012. There is also a possibility that the company declares bonus shares in 2013 to retain more of its cash.
- **Management's plans to enhance ABank's operations do not materialize.** ABank is the smallest bank out of the 12-listed banks in Turkey and has to compete heavily with long-running rivals. Moreover, the bank has not been operating efficiently due to a high cost-to-income ratio, investment losses and FX losses dampening robust net interest income, fees and commissions. Thus, Commercialbank's management has put forth a 5-year plan to turn the bank around, gain additional market share and enhance its profitability. However, there is always the possibility that CBQK may fall short of its intended target.
- **Asset quality further worsens.** The bank experienced a large impairment on a domestic real estate loan this year. Hence, management is working on rectifying the issue with minimal damage. Nevertheless, recovery may fall short of expectations. We, on the other hand, assume that a significant portion of the loan will become performing. We further assume that major improvements in the NPL ratio will be witnessed in the coming three-to-five years.
- **CBQK faces concentration risk.** Since the majority of its operations and assets are within Qatar and to a small extent in Turkey, any downturn in the local economy, downward changes in oil and gas prices or deterioration in the regional socio-political status quo could pose a risk to the bank.
- **Commercialbank faces currency risk.** Given the volatility of the Turkish Lira vs. the US Dollar, profitability and growth in ABank may be subject to downward adjustments at the consolidation level.

Qatar Banking Sector

In October 2013, as reported by the QCB, the sector loan book grew by 2.7% MoM (12.0% YTD) vs. flattish performance in September. Total domestic public sector loans expanded by 6.7% MoM (+9.9% YTD) after a flattish performance in September. The government segment rebounded, expanding by 21.7% MoM (+15.1% YTD). On the other hand, the government institutions' segment (represents ~65% of public sector loans) grew by only 2.3% MoM (+11.2% YTD). We believe public sector loan growth will be the primary driver of the overall loan book in the fourth quarter of 2013 and 2014. Our assumption is based on the expected uptick in project mobilizations in the coming months. Private sector loans inched up 1.0% MoM (+11.3% YTD). The Contractors segment posted the biggest growth, up 9.8% MoM (+34.1% YTD), while the Real Estate (contributes ~29% to private sector loans) loan book grew by 1.6% MoM (down 1.9% YTD). Consumption and others (contributes ~31% to private sector loans) registered a growth of 2.7% MoM (+15.3% YTD). Generally the public sector has been the thrust of loan growth; however, loans to the private sector (+10.1% YTD) outpaced the public sector (+3.0% YTD) so far this year. For the full year 2013, we forecast loans to increase by 15% but also expect NIMs to show signs of stabilization. Going forward in 2014, we expect better visibility on project executions to lead to robust loan book growth.

The public sector has outpaced the private sector in deposit growth YTD. Public sector deposits expanded by 6.9% MoM (+34.8 YTD) after a strong performance in September, while private sector deposits retreated by 2.6% MoM (+11.0% YTD). Delving into segment details, the government institutions segment (represents ~54% of public sector deposits) contracted by 4.9% MoM (+25.8% YTD). However, the government segment continued its positive momentum, growing by 37.5% MoM (11.2% MoM in September 2013) and is up 72.3% YTD. The semi-government institutions segment increased by 4.4% MoM (+12.0% YTD). On the private sector front, the consumer segment grew by 2.8% MoM (+16.0% YTD), while the companies & institutions segment declined by 7.8% MoM (+6.2% YTD).

3Q2013 earnings for listed Qatari banks were a mixed bag. Overall, the listed banks posted a 1.2% YoY growth in 3Q2013 bottom-line. As is generally the case, QNB Group (QNBK) contributed to the bulk of this bottom-line growth (QR258mn increase in net income vs. a combined loss of QR210mn for the other seven listed banks) followed by Masraf Al Rayan (MARK) and Al Ahli Bank (ABQK). Growth in net profit for the overall banking sector was dented by CBQK's and QIBK's lackluster performance. As mentioned previously, growth drivers varied among the various banks; some banks exhibited growth through positive performance from net interest income and fees, while others witnessed a sharp decline due to muted investment gains and rise in provisions. QNBK (including NSGB) and ABQK exhibited positive results across the board, while MARK's growth stemmed from lack of provisions and a surge in net interest income (+35.3% YoY). This was mainly due to a 22.7% drop in interest expense. CBQK, QIBK and KCBK displayed weak results. CBQK's bottom-line was hindered mainly due to two factors; 1) the bank reported investment losses (QR35.2mn) attributed to ABank (without ABank, CBQK generated gains of ~QR17mn vs. QR127.9mn in 3Q2012) and 2) CBQK posted provisions for loan losses of QR174.2mn vs. QR34.5mn in 3Q2012 and investment impairments of QR56.6mn vs. QR8.1mn during the same period last year. QIBK posted weak figures across the board, most notably fees and commissions plummeted by 31.9% YoY and investment income receded by 7.0% YoY. On the other hand, KCBK's decline in profits was solely due to weak investment income. Nevertheless, NIMs looked like they were stabilizing during the third quarter of 2013.

Net Income for Listed Qatari Banks

In QR mn	3Q2012	3Q2013	Change YoY
Al Ahli Bank	126	143	13.4%
The Commercial Bank of Qatar	548	281	(48.8%)
Doha Bank	321	329	2.5%
Al Khalij Commercial Bank	117	108	(7.6%)
Masraf Al Rayan	358	436	21.7%
Qatar Islamic Bank	394	345	(12.4%)
Qatar International Islamic Bank	191	203	6.4%
QNB Group	2,111	2,368	12.2%
Total Banks	**4,165**	**4,213**	**1.2%**

Source: Company data

Company Description

As of 9M2013, CBQK is Qatar's second largest lender with a ~12% and ~10% market share in loans and deposits (among listed banks), respectively. CBQK is a conventional full service bank offering commercial banking and investment banking services and products to corporate and retail customers. Incorporated in 1975, the bank offers commercial loans, trade and project finance, treasury services, consumer loans, current and savings accounts, time deposits, credit cards, e-cards, internet banking and phone banking services. As of September 2013, the bank had a domestic network of 29 branches and 151 ATMs in operation.

The bank embarked on a regional expansion strategy in 2005. CBQK acquired a 34.9% minority stake in the National Bank of Oman (NBO), Oman's second largest lender. In 2007, it acquired a 40.0% stake in United Arab Bank (UAB) a Sharjah/UAE based financial institution. The rationale behind these acquisitions was to benefit from regional synergies and, at the same time, provide technical support to the banks' management. CBQK's investment in these two banks has yielded positive results with income from associates contributing 12.8% and 18.5% to the bottom-line in 2012 and 9M2013, respectively.

Further expanding its footprint, CBQK acquired ABank recently. CBQK became the majority shareholder of ABank on July 18, 2013 by acquiring 70.84% of the bank's shares for QR1.8bn (~$500mn) (~2x book value). Following this, the bank acquired an additional 3.40% stake on September 27, 2013, bringing its total ownership to 74.24%. This acquisition opened windows of opportunity both regionally and internationally for the bank to capture trade flows between Qatar/Turkey and GCC/Turkey. Established in 1991, ABank is the smallest bank out of the 12-listed banks in turkey. The bank operates 73 branches in 27 cities across Turkey and mainly caters to small and mid-sized enterprises.

Subsidiaries/Associates

Company	Country	Share (%)
National Bank of Oman	Oman	34.9
United Arab Bank	UAE	40.0
Asteco Qatar LLC	Qatar	30.0
Massoun Insurance Services	Qatar	50.0
Alternatifbank	Turkey	74.2
ALease	Turkey	99.9

Source: Company data

Solid shareholder base with clout. CBQK enjoys strong support from the Qatari government much like all banks in Qatar, as is evident from the 16.7% and 12.5% stakes held by Qatar Holding and various GREs.

Major Shareholders

Shareholder	Investor Type	Country	Share (%)
Qatar Holding	Government	Qatar	16.7
Government-Related Entities	Government	Qatar	12.5
CBQK Founding Shareholders	Private	Qatar	10.0
Total			**39.2**

Source: Company data

Management Team

Name	Designation
H.E. Abdullah bin Khalifa Al Attiyah	Chairman
Hussain Ibrahim Alfardan	Managing Director
Andrew Stevens	Group Chief Executive Officer
Abdulla Saleh Al Raisi	Chief Executive Officer
Nicholas Coleman	Group Chief Financial Officer

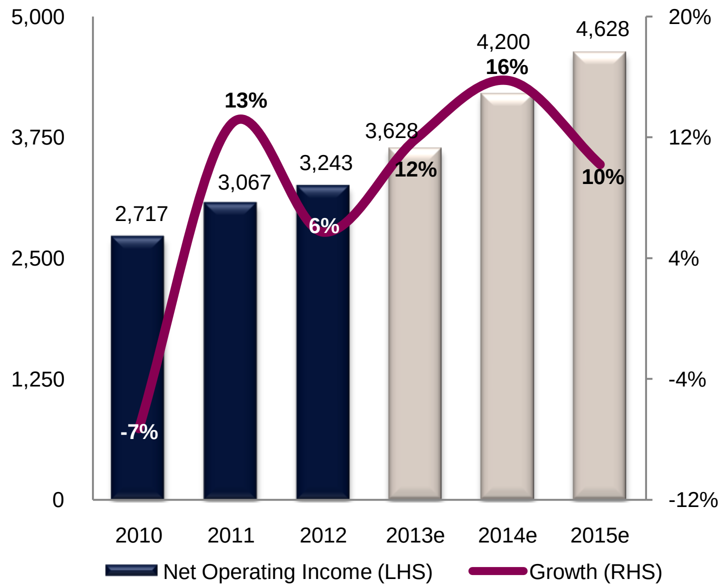
Source: Company data

Key Forecasts

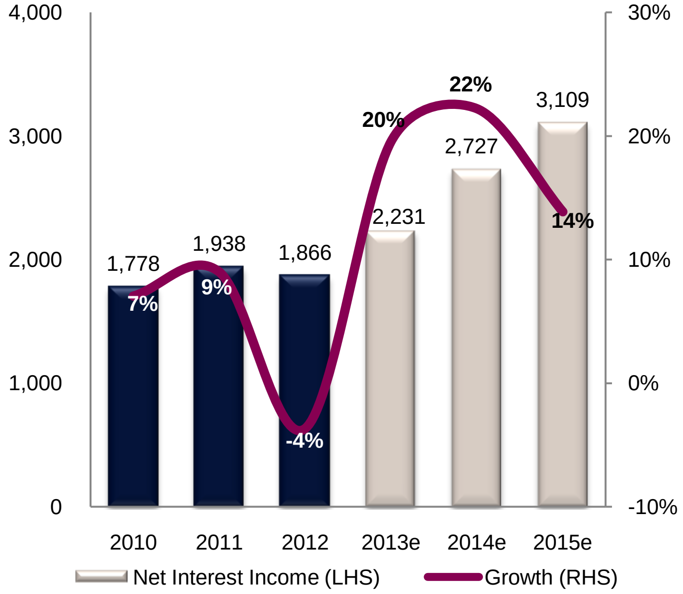
Revenue

We estimate net operating income to grow at a CAGR of 11.2% (2012-17e). We expect growth to come from net interest income, growing at a CAGR of 15.6% (2012-17e). The ensuing growth is based on our assumption of an expansion in the loan book by a CAGR of 17.5% (2012-17e). Moreover, we assume fees and commissions and share of profit from associates will contribute, growing at a CAGR (2012-17e) of 10.5% and 10.2%, respectively. Further, we factor in a CAGR of 5.7% for FX income during the same period vs. 13.2% growth during 2007-12 due to ABank's consistent FX losses. It is noteworthy here that we take a conservative approach when dealing with investment gains mainly due to the unpredictable nature of this activity. We forecast CBQK's gains from investments to represent 2.5% of operating income (2013-17) vs. 5.6% (2008-12). We note investment gains are muted because of ABank's consistent investment losses. As such, CBQK could register a higher growth in operating income if it delivers superior/robust investment gains. This scenario of generating growth through investment gains was a common theme among the majority of local banks. Competition within the banking industry was strong as most banks saw the yields on their assets and NIMs take a drop while the cost of funding remained rigid. Thus, CBQK's NIMs contracted by ~71 bps in 2012 reaching 2.87%, the lowest in the bank's operating history over 2001-12. Furthermore, NIMs remained under some pressure in 1Q2013 (~2.55%) and 2Q2013 (~2.51%). However, in 3Q2013, NIMs recouped ~8 bps to 2.59%. Presently, NIMs are beginning to stabilize. NIMs have also come under pressure at ABank, although it remains higher than that of CBQK due to the nature of its exposure. We estimate CBQK's standalone NIM for 2013 at 2.57%. However, when we include ABank, the NIM is expected to be ~2.80%.

Net Operating Income (QR mn)

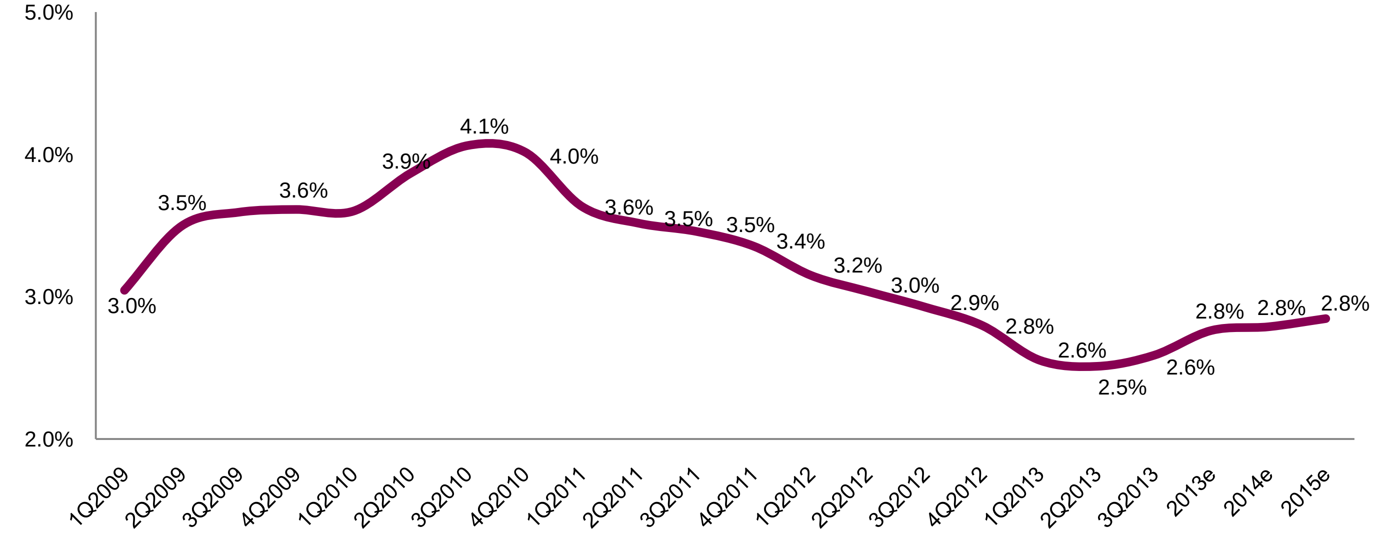


Net Interest Income (QR mn)



Source: Company data, QNBFS estimates

NIMs have Bottomed Out and Should Stabilize

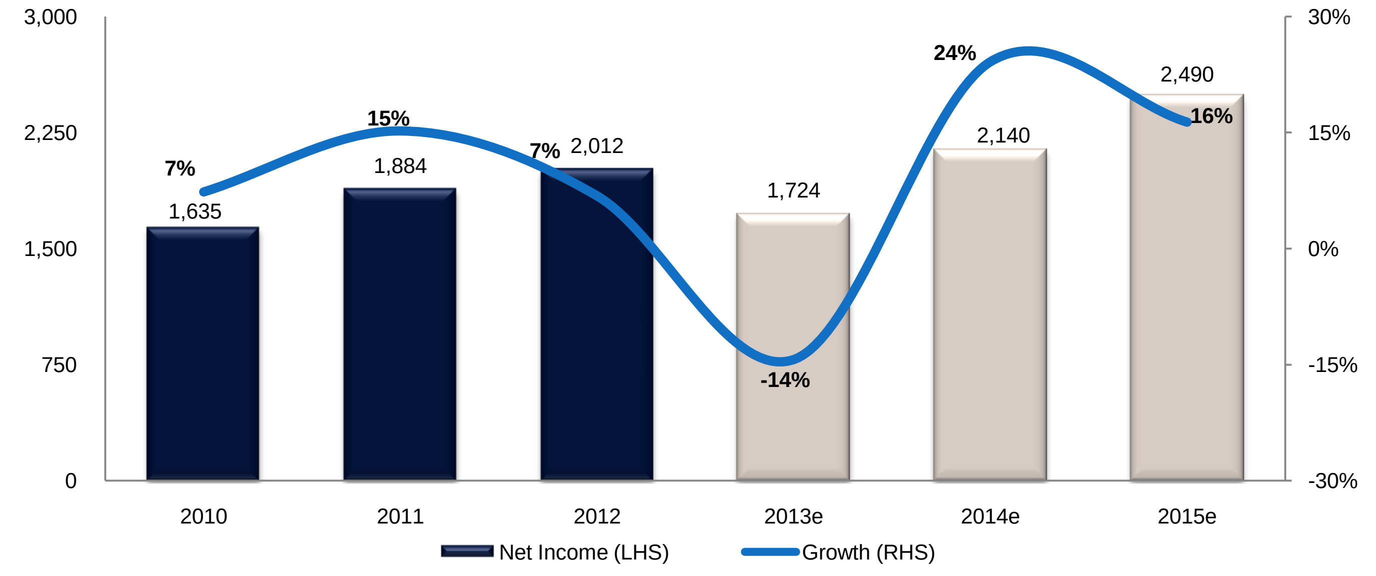


Source: Company data, QNBFS estimates

Earnings

CBQK is expected to conclude 2013 with an EPS of QR6.97 (QR8.13 in 2012) on the back of a spike in provisions coupled with higher operating expenses (one-time costs related to ABank acquisition and consolidation of ABank's operating expenses) and lower investment gains. We believe CBQK will register a CAGR of 8.7% in 2012-2017e (15.3% over 2013e-17e) as core banking income strengthens along with a softening in provisions.

Net Profit Estimates (QR mn)

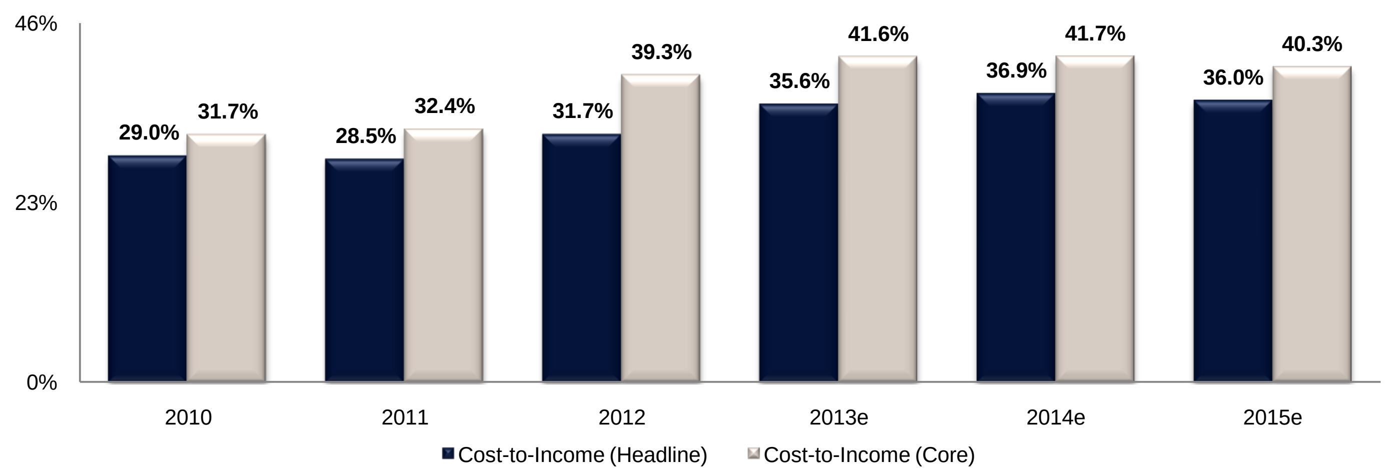


Source: Company data, QNBFS estimates

Efficiency

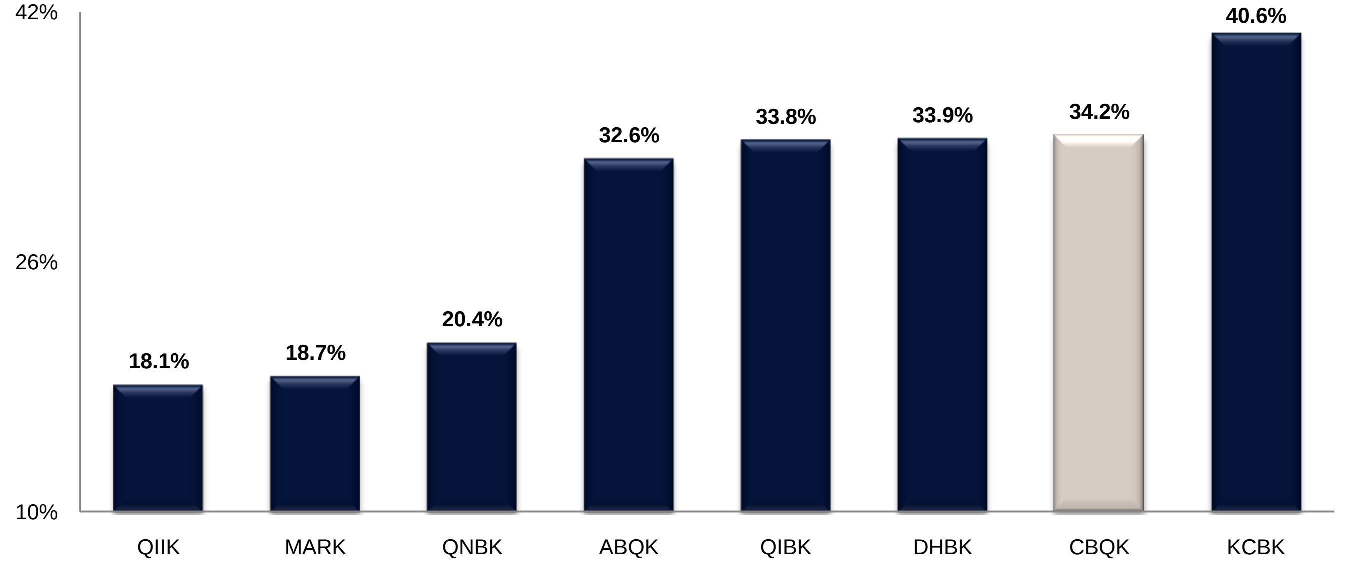
CBQK's cost-to-income ratio to remain elevated for the foreseeable future due to ABank consolidation. Historically, CBQK has maintained a healthy efficiency ratio at an average of 28.2% (2005-12), which is mostly in-line with its GCC peers. However, the bank's core cost-to-income ratio, measured as operating expenses divided by operating income less gains from investment securities and income from associates (a more conservative approach to analyzing cost efficiency since operating income is defined as a bank's income arising from core banking activities), remained at an elevated level of 40.4% in 9M2013 vs. 39.3% as of 2012. This was mainly attributed to significant gains from investments as the operating environment was somewhat slower than expected. This was a common theme among some domestic banks in 2012 and part of 2013. Furthermore, the recent jump in the cost-to-income ratio is due to the ABank deal. ABank's cost-to-income ratio has always been on the high side averaging 45.9% (2006-2012), while its core cost-to-income ratio has been slightly better at 43.2%. Nevertheless, ABank is a small bank and for the cost-to-income ratio to improve, operating income has to significantly grow in volume coupled with investment gains and FX income. Finally, we think CBQK's management is capable of optimizing ABank's efficiency but do not model it into our assumptions as it is too early to make that assessment. We estimate CBQK's efficiency ratio at an average of 35.6% (2013-17e) due to ABank's high cost-to-income ratio.

Efficiency to Improve Over Time



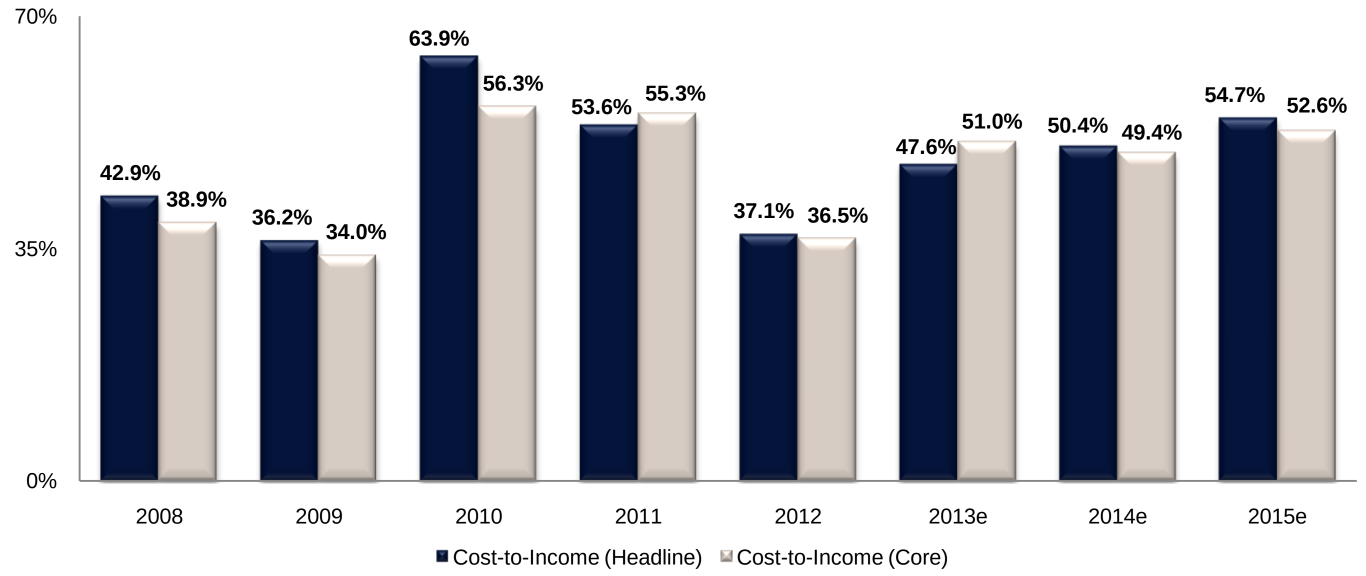
Source: Company data, QNBFS estimates

CBQK's Cost-to-Income Ratio is In-Line With Majority of Domestic Peers (9M2013)



Source: Company data, QNBFS estimates

ABank's Efficiency Ratio Requires Optimization

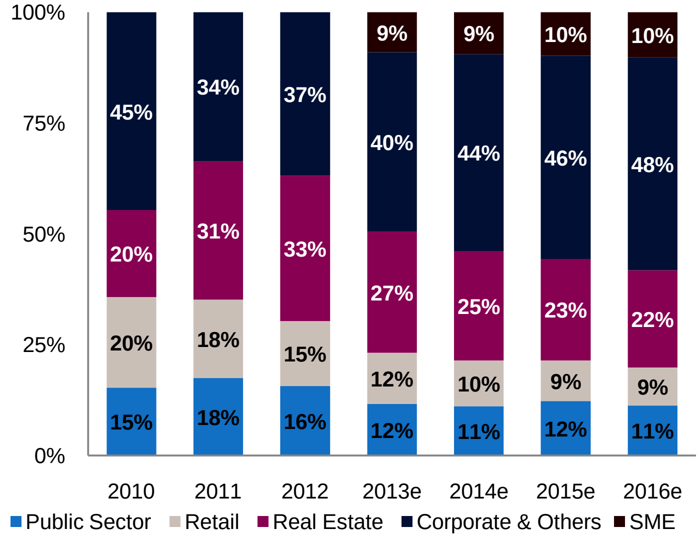


Source: Company data, QNBFS estimates

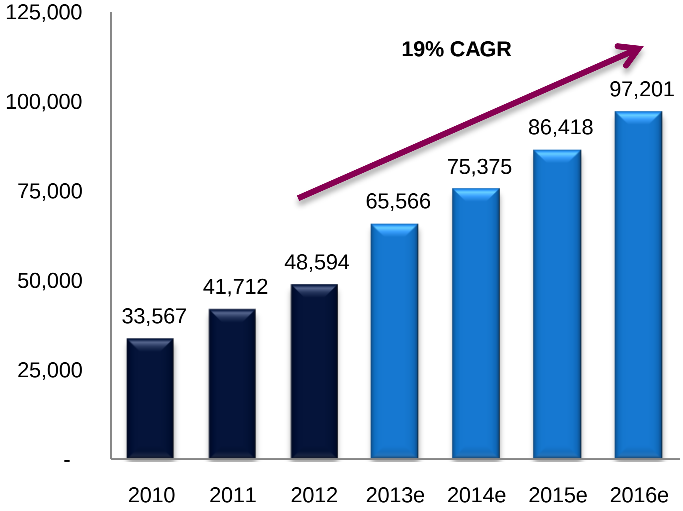
Loan Portfolio

We estimate net loans to grow at a CAGR of 18.9% during 2012-16e. We expect the bulk of the growth to come from the corporate sector with additional support from the SME, public and real estate sectors. It should be mentioned that CBQK is predominately a corporate focused bank while the SME contribution stems from ABank. Moreover, the bank is also focusing on booking deals from the public sector as the public sector has been the main engine of growth. Hence, we pencil in a CAGR of 27.2% and a CAGR of 9.7% (2012-2016e) for the corporate and public sectors, respectively. We believe this is attainable due to 1) CBQK's strong corporate franchise and 2) we believe most banks in Qatar will participate in financing the public sector/infrastructure projects. However, this will not come without challenges, as QNB Group and MARK are dominant players in the public sector space. On the SME front, we factor in a CAGR of 18.8% (2013e-16e) as this activity is ABank's core business model. This growth is also partly due to a low base effect. Thus, we estimate net loans to expand by 34.9% (high growth due to ABank consolidation), 15.0% and 14.7% in 2013, 2014 and 2015, respectively. We further assume that ABank would contribute an average of ~18% (2013e-16e) to Commercialbank's net loans.

Loan Book Profile



Loans (QR mn)



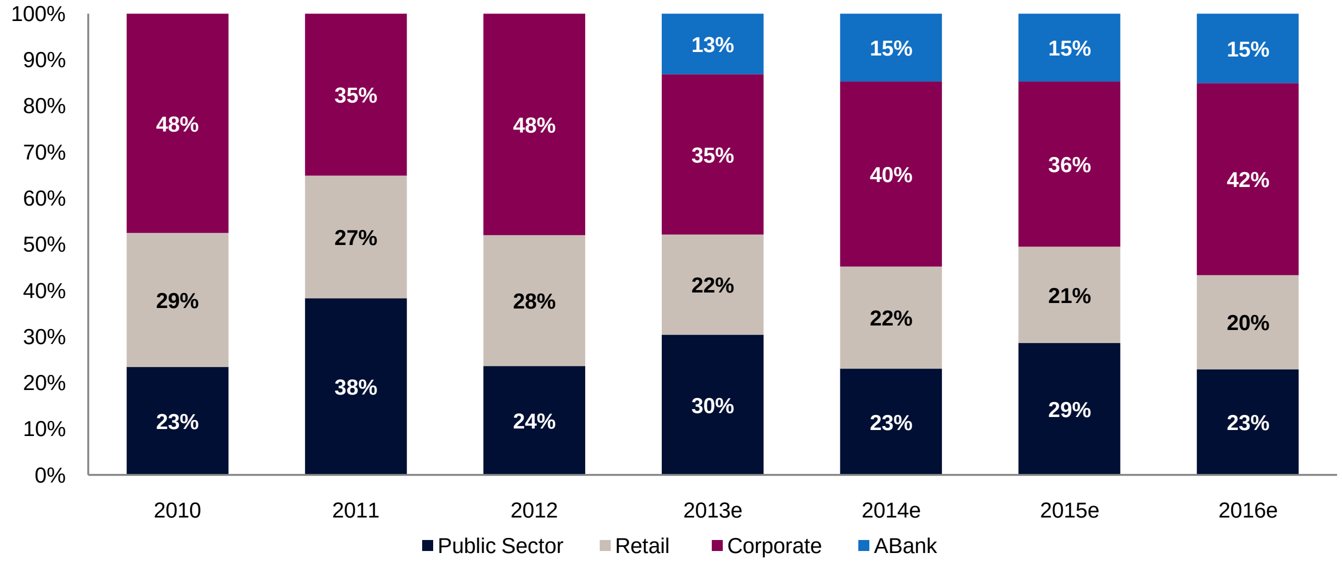
Source: Company data, QNBFS estimates

- **Real estate segment to exhibit modest growth.** The real estate segment was the growth engine for CBQK from 2007 to 2012, growing at a CAGR of 37.5%. Hence, in 2012 the real estate segment made up 31.3% of the bank's loan portfolio vs. 13.0% in 2007. Moreover, we expect the real estate segment to grow by 13.9% in 2013. In recent times, the QCB capped domestic banks' exposure to real estate at 150% of Tier-1 capital. In 2012, CBQK's real estate exposure stood at ~155% and we estimate this ratio to retreat to ~130% in 2013 (~153% excluding the QR2bn Tier-1 notes). Moreover, we assume, Commercialbank will not increase its exposure to real estate beyond 136% of Tier-1 capital (by 2016). Thus, we factor in growth for the real estate segment based on QCB's guideline. In this respect, we pencil in loan growth attributed to the real estate segment at a CAGR of 7.9% (2012-2016e).
- **ABank to help in the growth of consumer loans.** CBQK's retail loan book has been stagnant at best, inching up at a CAGR of 2.3% (2007-2012). Retail loans represented 34.1% of total loans in 2005 and has been consistently decreasing, reaching 14.7% in 2012. It should be noted that QCB's recent directive on consumer banking does not make it appealing for bankers to further expand their retail operations. The directive states that the maximum amount of credit that could be extended to Qatari and non-Qatari citizens is QR1 million and QR400 thousand, respectively. Moreover, rates applied to consumer loans should not exceed the QCB rate + 1.5%, which only translates into a 6% yield. Prior to this directive, bankers were charging consumers north of 6%. Consequently, we expect consumer credit growth to taper off. We assume a flattish loan growth (2012-2016e) for CBQK on a standalone basis. On the other hand, when we factor in ABank's contribution to CBQK's retail book, loan growth amounts to a CAGR of 4.2% (2012-2016e). Nevertheless, we estimate CBQK to allocate to retail around 10.0% (average) of its loan portfolio.

Deposit Book

CBQK enjoys a diversified deposit mix. The bank is known to be corporate oriented; as such corporate deposits dominate its book. It is evident that CBQK is less dependent on public sector deposits as opposed to some of its domestic peers. Having said this, the public sector still represents a considerable portion of its overall deposits. However, public sector deposits have generally been volatile at CBQK. Notwithstanding, as with all Qatari banks, the public sector is ready at all times to support local banks. To illustrate this picture, in 2011, the bank's corporate deposits contracted by ~16% as management shed high cost deposits; at the same time we note a considerable increase in public sector deposits (+87%). Going forward, we believe the public sector will continue playing a stabilizing role by providing soft landing solutions during critical junctures. Beginning with 2013 and following the acquisition of ABank the deposit picture has changed somehow with ABank's expected contribution of ~13% of the deposit base. Going forward, ABank's contribution to CBQK's deposit base is expected to increase at modest levels in the short to medium term.

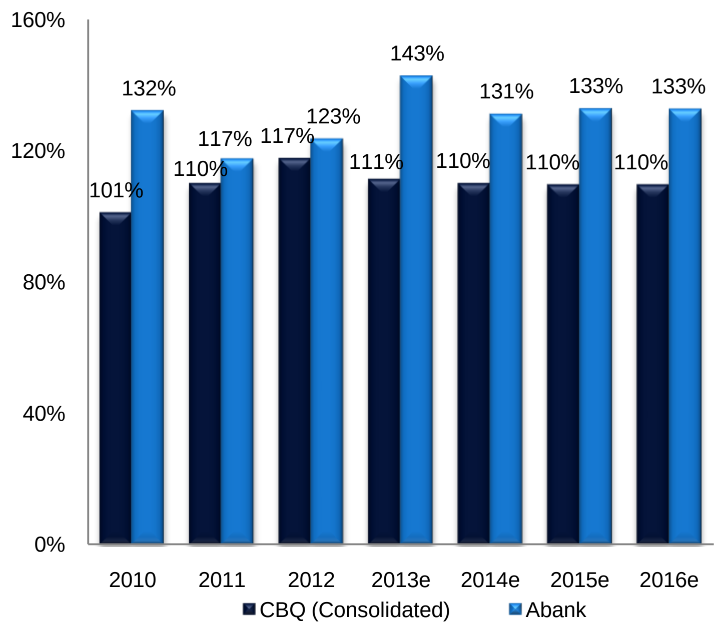
Deposits Profile



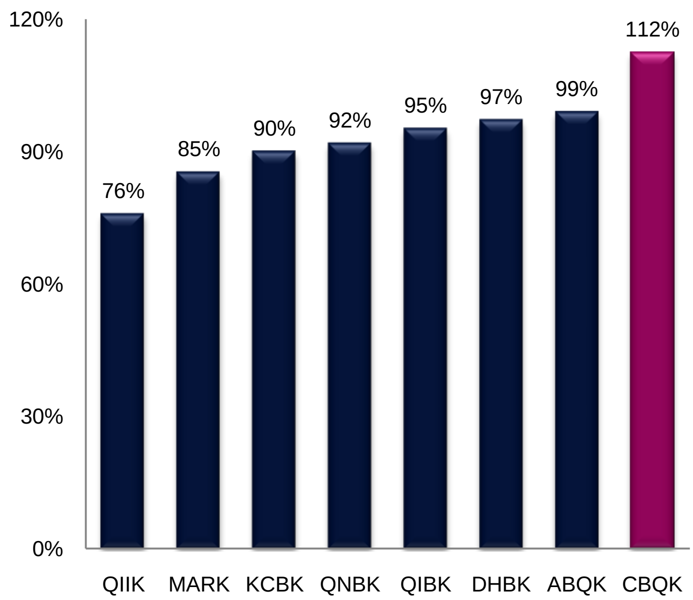
Source: Company data, QNBFS estimates

CBQK's loans-to-deposits ratio (LDR) remains on the high side. The bank's LDR has been north of 100% since 2006, although it went through ups and downs. Moving on to ABank, historically and presently the bank has operated with an LDR greater than 100%. Needless to say, we are of the view that management would have to raise deposits in order to bring the bank's LDR ratio in check. Foregoing lending opportunities is not a viable option.

LDR Needs to be Optimized



Highest LDR Among Domestic Peers (9M2013)

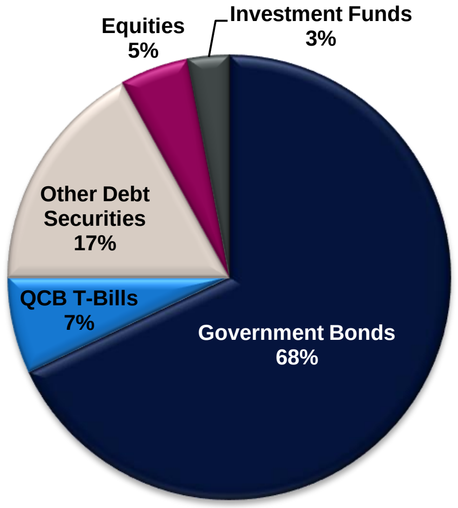


Source: Company data, QNBFS estimates

Investment Portfolio

CBQK manages a relatively safe portfolio. CBQK manages an investment portfolio worth QR14.3bn as of 9M2013, representing a hefty 13.5% of total assets and 22.0% of net loans. 92% of the portfolio consists of bonds and ~81% of the bond portfolio is deployed in sovereign Qatari and Turkish bonds. We estimate that ~90% of the sovereign bonds consist of Qatari government bonds, with, ~24% of CBQK's investment portfolio coming from ABank's investment book. Consequently, the only risk visible to us other than the inherent risk attributable to bonds in general is the volatility of the TL/USD FX rate. Other debt securities consist of corporate bonds.

Investment Portfolio (9M2013)



Source: Company data

Key Financial Data and Estimates

	2010	2011	2012	2013e	2014e
Profitability (%)					
RoAE	13.3	14.1	13.8	11.8	14.6
NIM	3.8	3.6	2.9	2.8	2.8
RoRWA	3.3	3.1	3.0	2.0	2.2
Efficiency (%)					
Cost-to-Income (Headline)	29.0	28.5	31.7	35.6	36.9
Cost-to-Income (Core)	31.7	32.4	39.3	41.6	41.7
Liquidity (%)					
LDR	100.9	109.8	117.4	111.0	109.9
Loans/Assets	53.7	58.2	60.7	61.5	63.0
Cash & Interbank Loans-to-Total Assets	20.7	16.5	16.5	15.8	15.7
Asset Quality (%)					
NPL Ratio	3.16	1.20	1.10	3.63	3.51
Coverage Ratio	89.7	107.8	116.3	60.8	64.5
Cost of Risk	0.5	0.6	0.3	0.8	0.5
Capitalization (%)					
Tier-1 Ratio	16.6	16.4	15.4	13.0	12.4
CAR	18.5	17.9	17.0	14.6	14.0
Growth (%)					
Net Interest Income	7.0	9.0	-3.7	19.5	22.3
Net Operating Income	-7.3	12.9	5.7	11.9	15.8
Net Income	7.3	15.2	6.8	-14.3	24.1
Loans	5.1	24.3	16.5	34.9	15.0
Deposits	26.7	14.1	8.9	42.7	16.1

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement

(In QR mn)	2010	2011	2012	2013e	2014e	2015e
Net Interest Income	1,778	1,938	1,866	2,230	2,727	3,109
Fees & Commissions	526	586	519	625	725	777
FX Income	123	130	156	154	166	159
Other Income	290	414	702	619	581	584
Non-Interest Income	**939**	**1,129**	**1,376**	**1,398**	**1,473**	**1,519**
Operating Income	**2,717**	**3,067**	**3,243**	**3,628**	**4,200**	**4,628**
Operating Expenses	(787)	(875)	(1,028)	(1,291)	(1,550)	(1,668)
Net Provisions	(295)	(308)	(202)	(575)	(394)	(358)
Net Profit Before Taxes & Non-Recurring Items	**1,635**	**1,884**	**2,012**	**1,762**	**2,255**	**2,602**
Tax	-	-	-	(17)	(54)	(52)
Net Profit Before Minority Interest	**1,635**	**1,884**	**2,012**	**1,745**	**2,201**	**2,550**
Minority Interest	-	-	-	(21)	(61)	(60)
Net Profit	**1,635**	**1,884**	**2,012**	**1,724**	**2,140**	**2,490**

Source: Company data, QNBFS estimates

Balance Sheet

(In QR mn)	2010	2011	2012	2013e	2014e	2015e
Assets						
Cash & Balances with Central Bank	8,703	2,576	3,448	5,733	6,192	6,216
Interbank Loans	4,238	9,272	9,732	11,091	12,587	14,423
Net Investments	10,024	11,733	11,162	15,356	16,100	17,063
Net Loans	33,567	41,712	48,594	65,566	75,375	86,418
Investment In Associates	3,840	3,926	4,054	4,216	4,393	4,584
Other Assets	1,081	1,348	1,850	2,483	2,771	3,108
Net PP&E	1,069	1,070	1,197	1,203	1,264	1,333
Goodwill & Intangible Assets	-	-	-	1,006	1,006	1,006
Total Assets	**62,520**	**71,638**	**80,038**	**106,654**	**119,687**	**134,150**
Liabilities						
Interbank Deposits	4,461	6,989	9,856	11,537	13,999	16,763
Customer Deposits	33,281	37,989	41,386	59,069	68,578	78,865
Term Loans	10,994	11,054	12,177	16,248	16,248	16,248
Tier-1 Perpetual Note				2,000	2,000	2,000
Other Liabilities	1,285	1,376	1,680	2,903	3,146	3,439
Total Liabilities	**50,020**	**57,408**	**65,098**	**91,757**	**103,972**	**117,316**
Minority Interest	**-**	**-**	**-**	**621**	**661**	**659**
Shareholders' Equity						
Share Capital	2,268	2,474	2,474	2,474	2,474	2,474
Statutory Reserves	7,332	8,741	8,741	8,741	8,741	8,741
General Reserves	27	27	27	27	27	27
Banking Risk Reserve	648	806	925	1,574	1,809	2,074
Fair Value Reserve	57	(69)	163	(153)	(153)	(153)
Foreign Currency Translation Reserve	-	-	-	(76)	(76)	(76)
Other Equity	-	-	-	(590)	(590)	(590)
Other Reserves	470	556	674	753	753	753
Proposed Dividends	1,588	1,485	1,485	1,362	1,370	1,494
Retained Earnings	111	211	452	165	700	1,431
Total Shareholder's Equity	**12,500**	**14,230**	**14,939**	**14,276**	**15,054**	**16,175**
Total Liabilities & Shareholder's Equity	62,520	71,638	80,038	106,654	119,687	134,150

Source: Company data, QNBFS estimates

Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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