

Commercial Bank of Qatar (CBQK)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	QR57.00	Current Target Price	QR72.00
Implied Upside	26.3%	Old Target Price	QR69.00

Compelling Long-Term Value; Upgrade to Outperform

Commercialbank is Qatar's 2nd largest lender with a focus on the corporate sector. As of FY2014, 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

- **We estimate CBQK to register a CAGR of 16.0% in net profit (attributable) for 2014-18e.** We see Commercialbank growing its net income by deploying its funds in the corporate segment and infrastructure projects. Our growth assumption is based on net operating income CAGR of 10.6% (2014-18e) coupled with a 7.0% decline in net provisions. We expect net interest income and income from associates along with help from net fees and commissions to drive future growth in profitability. We pencil in CAGRs (2014-2018e) of 12.0%, 10.0% and 6.3% for net interest income, income from associates and fees & commissions, respectively. We estimate an attributable net profit of QR1.92bn (Headline: QR2.09bn) in 2015, a growth of 12.3%. As far as 2016 is concerned, we expect CBQK's bottom-line to grow by 19.0%. We expect a drop of 6.6% in net provisions and impairments (which is also a primary driver for growth). Hence, we estimate a attributable net profit of QR2.29bn (Headline: QR2.47bn). Furthermore, we expect the bank to generate RoAE (attributable) of 13.5% and 14.9% in 2015 and 2016, respectively.
- **We estimate loans and deposits to grow by CAGRs of 10.9% and 15.7% for 2014-18e, respectively.** CBQK decreased its exposure to the real estate sector in 2014 to 26% of total loans from 2013's 32% and 2012's 33% (2011: 31%). It seems that management has adopted a conservative approach and wants the loan portfolio not to be skewed to real estate. We estimate net loan growth of 9.6% and 12.9% in 2015 and 2016, respectively. (*More details on Page 2*)
- **More Capital Needed.** CBQK issued Tier-1 perpetual capital notes worth QR2bn in December 2013 in order to boost its Tier-1 capital. Moreover, management indicated that they may issue more capital (CDs and or Tier-1 notes) this year.

Catalysts

- **Beyond a stabilization/recovery in oil prices, the following developments could be perceived positively by the market:** 1) Implementation of the 49% FOL limit, which was recently endorsed in the AGM and 2) Steady bottom-line growth without major asset quality issues

Recommendation, Valuation and Risks

- **Recommendation and valuation: We change CBQK to Outperform from Accumulate with a price target of QR72.00 vs. QR69.00 previously.** Our target price implies an upside of 26.3%.
- **Risks:** 1) Declining oil prices remains the biggest risk to CBQK and the banking sector; 2) Exposure to the real estate and SME (Turkey) segments and 3) New LDR requirement from the QCB could create short-term issues.

Key Financial Data and Estimates

	FY2013	FY2014	FY2015e	FY2016e
Headline EPS (QR)	4.91	5.39	6.04	7.19
EPS Growth (%)	-20.3	9.7	12.0	19.0
Attributable EPS (QR)	4.79	5.24	5.89	7.01
EPS Growth (%)	-20.3	9.4	12.3	19.0
Attributable P/E (x)	11.9	10.6	9.7	8.1
TBVPS (QR)	39.7	43.4	46.4	49.9
P/TB (x)	1.4	1.3	1.2	1.1
DPS (QR)	1.52	3.18	3.50	3.75
Dividend Yield (%)	2.7	5.6	6.1	6.6

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

Key Data

Current Market Price (QR)	57.00
Dividend Yield (%)	6.1
Bloomberg Ticker	CBQK QD
ADR/GDR Ticker	GBB39RMD9.L
Reuters Ticker	COMB.QA
ISIN	QA0007227752
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	69.82/54.90
3-m Average Volume ('000)	325.3
Mkt. Cap. (\$ bn/QR bn)	5.1/18.6
Shares Outstanding (mn)	326.6
FO Limit* (%)	25.0
Current FO* (%)	14.9
1-Year Total Return (%)	(1.6)
Fiscal Year End	December 31

Source: Bloomberg (as of April 09, 2015), *Qatar Exchange (as of April 09, 2015); Note: FO is foreign ownership

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1Q2015 Estimates & 2014 Results Review

1Q2015 Estimates

We expect CBQK's earnings to expand by 50.0% QoQ while posting a modest growth of 4.0% YoY. We estimate CBQK to post a net profit of QR555.3mn in 1Q2015 vs. QR370.1mn in 4Q2014 and QR533.9mn in 1Q2014. We expect growth in QoQ profitability on the back of lower provisions, in-line with the bank's historical trend. We expect QoQ growth in net profit to be attributed to fees, F/X income and investment income.

CBQK witnessed its 2014 attributable net profit increase by 9.4% YoY on the back of core banking income and a decline in investment impairments. Commercialbank posted a net profit (attributable) of QR1.92bn in 2014 vs. QR1.56bn in 2013, resulting in a rise of 9.4% YoY. Net profit was driven by net interest income, fees & commissions, income from associates and dip in investment impairments. CBQK posted net interest income of QR2.6bn vs. QR2.2bn in 2013, growing by 17.9%. The bank's NIMs receded by ~2bps to 2.65% vs. 2.67% in 2013. Moreover, yield on interest earning assets significantly improved while cost of funding also significantly increased. Interest expense continued to grow faster than interest income. Fees & commissions surged by 30.2% (+30.3% in 2013) to QR879.6mn vs. QR675.6mn in 2013. Income from associates was also determining factor in bottom-line growth. Income from associates grew by 17.3% YoY to QR381.2, contributing 22.2% to profitability. Furthermore, net provisions gained by 3.1% to QR622.8mn. However, a 54.7% plunge in investment impairments prevented the bank from posting a lackluster growth in profitability. Regarding expenses, operating expenses increased by 12.7% YoY (+39.8% in 2013) to QR1.6bn. Thus, CBQK's cost-to-income ratio marginally improved to 37.8% vs. 38.2% in 2013. As far as asset quality is concerned, NPLs increased by 13.3%, resulting in a deterioration of the NPL ratio to 3.79% vs. 3.65%. On the positive side, the coverage ratio significantly improved to 74.3% vs. 63.0% in 2013.

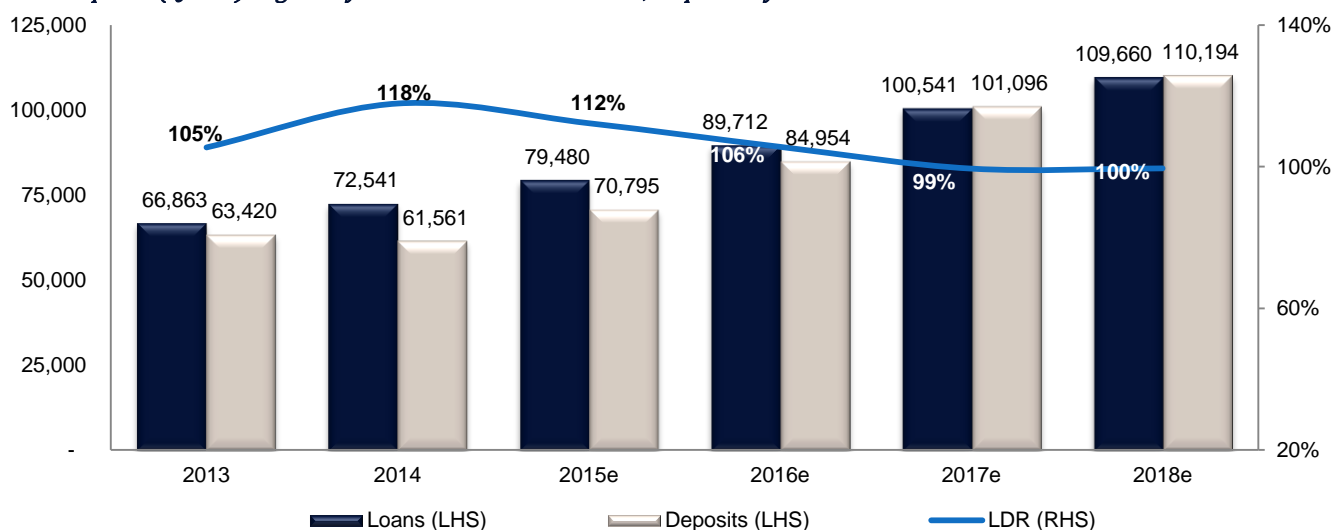
Net loans displayed healthy performance. CBQK's loan book grew by 8.5% vs. 13.1% for the Qatari banking sector (domestic loans) and 14.6% for the 8-listed banks (includes domestic and international loans). The slow growth in the loan book was due to management shedding real estate loans by 12.7%. As of 2014, real estate loans made up 26% of the loan portfolio vs. 32% in 2013. As such real estate loans to Tier-1 capital dropped to 148% (in-line with QCB's policy of 150%) from 183% in 2013. Retail loans expanded by 46% vs. a contraction of 19% in 2013. Corporate loans and public sector loans expanded by 17% and 11% (receded by 5% in 2013), respectively. On the other hand, deposits declined by 2.9% to QR61.6bn. The drop in deposits was due to two factors: 1) to management shed high cost deposits and 2) public sector deposits contracted by 14%. Thus, CBQK's LDR was lifted to 118% vs. 105% in 2013.

Key Forecasts

Loans & Deposits

We estimate loans and deposits to grow by CAGRs of 10.9% and 15.7% for 2014-18e, respectively. CBQK decreased its exposure to the real estate sector in 2014 to 26% of total loans from 2013's 32% and 2012's 33% (2011: 31%). It seems that management has adopted a conservative approach and wants the loan portfolio not to be skewed to real estate. It appears that this stance was adopted due to a problematic real estate loan from 2013. Hence, going forward we do not factor in a lot of weight from the real estate segment. We estimate net loan growth of 9.6% and 12.9% in 2015 and 2016, respectively. We expect the corporate segment (CBQK's historical niche) to drive loan growth going forward. We should remind the reader that in the beginning of 2004, the QCB issued a directive asking banks to comply with a simple LDR (denominator consists of only customer deposits excluding any wholesale funds) of 100% by the end of 2017 or Jan 01, 2018. Although banks are still in discussions with the QCB about amending variables in the ratio, nevertheless we assume the new policy goes into effect. Thus, CBQK would have to grow deposits by 15% in 2015, 20% (2016) and 19% (2017). This implies aggressive growth.

Loans & Deposits (QR mn) to grow by CAGRs of 10.9% and 15.7%, respectively



Source: Company Data, QNBFS Research

Operating Performance

We estimate CBQK to register a CAGR of 16.0% in net profit (attributable) for 2014-18e. We see Commercialbank growing its net income by deploying its funds in the corporate segment and infrastructure projects. Our growth assumption is based on net operating income CAGR of 10.6% (2014-18e) coupled with a 7.0% decline in net provisions. We expect net interest income and income from associates along with help from net fees and commissions to drive future growth in profitability. We pencil in CAGRs (2014-2018e) of 12.0%, 10.0% and 6.3% for net interest income, income from associates and fees & commissions, respectively. We base our assumptions on moderate expansion in NIMs in 2015 and beyond, supported by the Turkish operations. We estimate an attributable net profit of QR1.92bn (Headline: QR2.09bn) in 2015, a growth of 12.3%. This growth comes on the back of a 10.0% growth in net interest income, 12.0% growth in fees (after strong performance of +30.2% in 2014) and 12.0% growth from income from associates. The 10.0% growth in net interest income is due to highly competitive local market conditions. As far as 2016 is concerned, we expect CBQK's bottom-line to grow by 19.0% based on 2015's reasoning. However, we expect a drop of 6.6% in net provisions and impairments (which is also a primary driver for growth). In 2016, we expect net interest income to grow by 10.4%, fees & commissions (+15.0%) and income from associates (+12.0%). Hence, we estimate an attributable net profit of QR2.29bn (Headline: QR2.47bn). Furthermore, we expect the bank to generate RoAE (attributable) of 13.5% and 14.9% in 2015 and 2016, respectively. *As a note, our estimates and price target could be revised upward or downward based on how these variables materialize in the coming quarters; NIMs, investment income, fees, provisions and further capital hikes.*

CBQK's cost-to-income ratio to remain elevated in the coming two years, albeit some improvement. Historically, CBQK has maintained a healthy efficiency ratio at an average of ~28% (2005-12), which is mostly in-line with its GCC peers. However, it jumped to 38.2% in 2013 due to the ABank deal. ABank's cost-to-income ratio has always been on the high side averaging 46.6% (2006-2013). CBQK's efficiency ratio marginally improved in 2014 to 37.8%. Moreover, management indicated that bringing down the cost-to-income ratio to the mid-30s (%) is one of their primary objectives. Thus, we estimate a cost-to-income ratio of 36.5% in 2015, 36.0% in 2016 and 35% in 2017 and 2018.

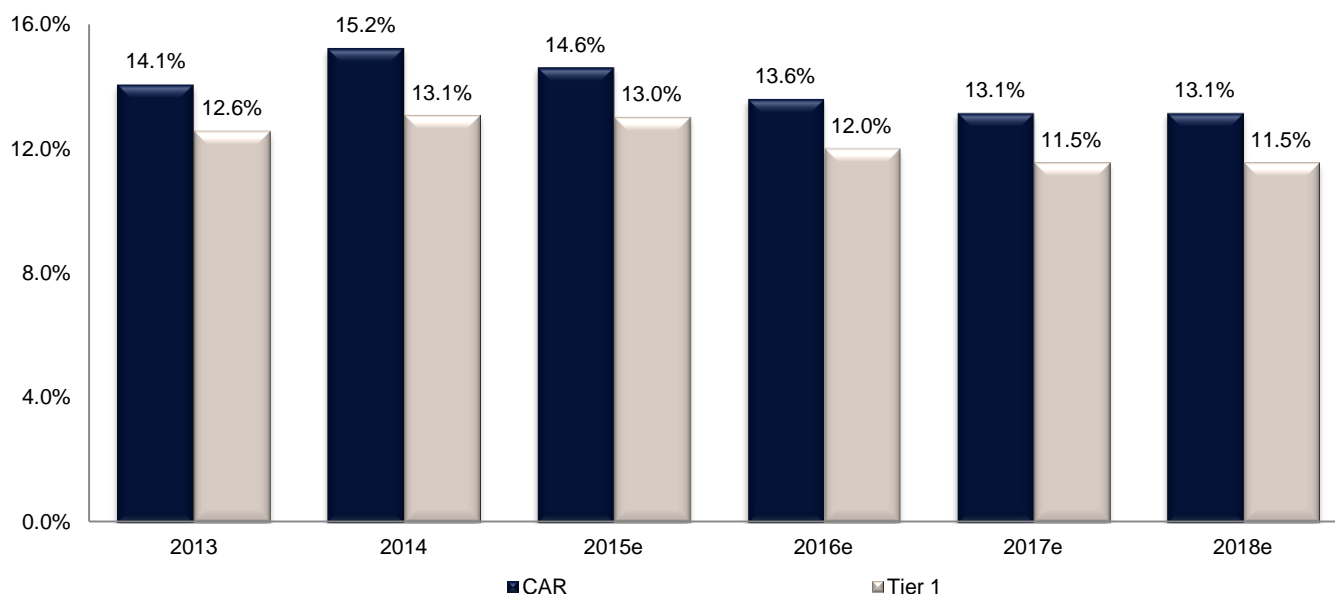
Asset Quality

Asset quality issues still not a major concern, in our view. CBQK was mired with asset quality issues mainly from the impairment of a domestic real estate loan (~QR1.1bn) in 2Q2013. Consequently, the NPL ratio spiked to 3.65% (2012: 1.09%) and the coverage ratio dropped to 63.0% (2012: 116.3%) as of 2013. In 2014, the bank's NPL ratio further deteriorated to 3.79%. However, the coverage ratio improved considerably to 74.3%. Currently the bank's management is still in remedial negotiations with the real estate company. Hence, management is confident that they could recover the majority of the loan in 1H2015. As such, we forecast a drop in 2015's NPL ratio to 2.8% while the coverage ratio climbs to 114.2% as the bank recovers a significant chunk of the loan.

Capitalization

Capital raising to enhance Tier-1 position. Commercialbank issued Tier-1 perpetual capital notes worth ~QR2bn in December 2013 in order to boost its Tier-1 capital. The bank ended 2013 with a Tier 1 ratio and CAR of 12.6% and 14.1%, respectively. Moreover, the bank's 2014 Tier-1 ratio and CAR rested at 13.1% and 15.2%, respectively. Moreover, the bank announced that it may raise Additional Tier-1 or Tier-2 capital up to a maximum of QR3.6bn and issue CDs. Currently, we do not factor this in our model and we estimate a Tier-1 ratio and CAR of 13.0 and 14.6% in 2015, respectively. If we assume an additional QR3.6bn in 2015 then we end up with a Tier-1 ratio and CAR of 16.2% and 17.8%, respectively. The flow-through effect would be a Tier-1 and CAR of 14.7% and 16.3% in 2016, respectively

More Capital is Needed



Source: Company Data, QNBFS Research

Detailed Financial Statements

Ratios	2013	2014	2015e	2016e
Profitability (%)				
RoAE (Headline)	11.1	13.0	13.5	14.9
RoAE (Attributable)	10.8	11.8	12.4	13.8
RoAA (Headline)	1.7	1.6	1.7	1.8
RoAA (Attributable)	1.6	1.5	1.6	1.7
RoRWA (Headline)	3.6	3.1	2.7	3.3
RoRWA (Attributable)	3.6	3.1	2.7	3.2
NIM (% of IEAs)	2.7	2.7	2.8	2.8
NIM (% of RWAs)	2.7	2.7	2.7	2.6
NIM (% of AAs)	2.3	2.3	2.3	2.3
Spread	2.3	2.3	2.4	2.5
Efficiency (%)				
Cost-to-Income (Headline)	38.2	37.8	36.5	36.0
Cost-to-Income (Core)	44.6	43.6	41.8	40.9
Liquidity (%)				
LDR	105	118	112	106
Loans/Assets	59	63	63	63
Cash & Interbank Loans-to-Total Assets	1.0	0.9	0.9	0.7
Deposits to Assets	56	53	56	60
Wholesale Funding to Loans	44	46	41	36
IEAs to IBLs	111	114	112	110
Asset Quality (%)				
NPL Ratio	3.6	3.8	2.8	2.9
NPL to Shareholder's Equity	17.9	18.8	14.4	15.7
NPL to Tier-1 Capital	20.9	21.9	16.5	18.2
Coverage Ratio	63.0	74.3	114.2	114.0
ALL/Average Loans	2.7	2.9	3.3	3.5
Cost of Risk	1.0	0.9	0.9	0.7
Capitalization (%)				
Tier 1 Ratio	12.6	13.1	13.0	12.0
CAR	14.1	15.2	14.6	13.6
Tier 1 Capital to Assets	10.6	11.2	11.0	10.4
Tier 1 Capital to Loans	17.9	17.8	17.5	16.4
Tier 1 Capital to Deposits	18.8	21.0	19.6	17.4
Leverage (x)	8.1	7.7	7.9	8.3
Growth (%)				
Net Interest Income	17.3	17.9	10.0	10.4
Non-Interest Income	14.1	8.4	7.4	11.4
Total Income	15.9	14.0	8.9	10.8
Operating Expenses	39.8	12.7	5.1	9.1
Net Operating Income	4.9	14.7	11.2	11.7
Net Provisions & Impairments	253.7	-5.8	11.6	-6.6
Net Income (Headline)	-20.3	17.2	11.2	17.9
Net Income (Attributable)	-20.3	9.4	12.3	19.0
Loans	37.6	8.5	9.6	12.9
Deposits	53.2	-2.9	15.0	20.0

Source: Company data, QNBFS estimates

Income Statement

(In QR mn)	2013	2014	2015e	2016e
Net Interest Income	2,188	2,581	2,838	3,132
Fees & Commissions	676	880	985	1,133
FX Income	179	120	134	142
Other Income	715	704	709	762
Non-Interest Income	1,570	1,703	1,829	2,037
Total Income	3,759	4,284	4,666	5,169
Operating Expenses	(1,437)	(1,620)	(1,704)	(1,859)
Net Operating Income	2,322	2,663	2,962	3,309
Net Provisions	(714)	(673)	(751)	(701)
Net Profit Before Taxes & Non-Recurring Items	1,608	1,991	2,212	2,608
Tax	(2)	(50)	(55)	(65)
Net Profit Before Minority Interest	1,605	1,940	2,157	2,543
Minority Interest	(1)	(60)	(65)	(76)
Net Profit (Headline/Reported)	1,604	1,880	2,092	2,467
Interest on Tier-1 Note	-	(120)	(120)	(120)
Social & Sports Contribution Fund	(40)	(49)	(49)	(59)
Net Profit (Attributable)	1,564	1,712	1,923	2,288

Source: Company data, QNBFS estimates

Balance Sheet

(In QR mn)	2013	2014	2015e	2016e
Assets				
Cash & Balances with Central Bank	6,903	6,941	7,787	8,495
Interbank Loans	15,178	15,494	15,896	17,942
Net Investments	14,706	11,621	12,958	14,816
Net Loans	66,863	72,541	79,480	89,712
Investment In Associates	4,198	4,447	4,660	4,899
Other Assets	2,984	2,438	3,179	3,588
Net PP&E	1,283	1,311	1,330	1,363
Goodwill & Intangible Assets	996	860	860	860
Total Assets	113,112	115,652	126,151	141,676
Liabilities				
Interbank Deposits	12,599	14,125	13,844	13,635
Customer Deposits	63,420	61,561	70,795	84,954
Term Loans	17,105	18,884	18,884	18,884
Tier-1 Perpetual Note	2,000	2,000	2,000	2,000
Other Liabilities	3,432	3,386	3,894	4,248
Total Liabilities	98,557	99,956	109,418	123,722
Shareholders' Equity				
Share Capital	2,474	2,969	3,266	3,266
Statutory Reserves	8,820	8,820	8,820	8,820
General Reserves	27	27	27	27
Banking Risk Reserve	1,316	1,709	1,872	2,113
Fair Value Reserve	(147)	91	91	91
Foreign Currency Translation Reserve	(233)	(411)	(322)	(322)
Other Equity	(513)	(724)	(724)	(724)
Other Reserves	836	1,098	1,098	1,098
Proposed Dividends	495	1,039	1,143	1,225
Proposed Bonus Shares	495	297	-	-
Retained Earnings	392	113	729	1,551
Total Shareholders' Equity	13,963	15,028	16,001	17,146
Total Liabilities & Shareholders' Equity	113,112	115,652	126,151	141,676

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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