

Commercial Bank of Qatar (CBQK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR45.00	Current Target Price	QR43.00
Implied Upside	(4.4%)	Old Target Price	QR55.00

Revising Estimates and Price Target on Muted Outlook

Commercial Bank is Qatar's 2nd largest conventional bank with a market share of ~12% and ~10% in loans and deposits, respectively. Focused on regional expansion, CBQK acquired 74.24% of Alternatifbank (ABank) & set forth a strategy that would improve Abank's efficiency and raise its market share.

Highlights

- Challenging environment ahead; we adjust some of our assumptions for 2016 and 2017.** We revise our 2016 net attributable income downward by 23.4% due to significantly lower income from associates (weak UAB), higher provisions (QR860mn vs. QR763mn previously) and payment on the second issuance of AT1 capital. Net interest income and opex remains unchanged at QR2.6bn and QR1.8bn, respectively. Net-net, we now forecast net profit of QR1.2bn vs. 1.6bn previously. As far as 2017 is concerned, we lower our forecast by 26.3% on the back of lower net interest income (5.3%), lower fees & commission (9.8%), lower income from associates, higher provisions (+7.4%) and payment on the second issuance of AT1 capital. On the other hand, we do not change our opex estimate. Thus, our new 2017 net profit comes out to QR1.4bn vs. 1.9bn previously.
- We forecast net loans to grow by 7.0% in 2016 (unchanged from previous estimate), and 8.7% in 2017 (unchanged from previous estimate) and 9.9% in 2018 with a CAGR of 9.8% during 2015-2020e vs. a CAGR of 17.9% (2010-2015).** We also expect this growth to be accompanied by further capital hikes (~QR3bn based on our estimates over 2017e-2020e) and aggressive deposit raising (CAGR of 12.0% during 2015-2020e). This aggressive deposit raising should lead to a gradual decline of the LDR to below 100% as per QCB's requirement and should lead to further compression in the NIMs. CBQK's LDR stood at 110% at the end of 2015 vs. 118% in 2014. The bank has one of the lowest RoEs vs. its domestic peers. What is important to note here is that based on our assumptions, CBQK's average RoE (2016e-2019e) amounts to 10.0% which is well below its cost of equity of 11.5%. As such, this is expected to lead to residual losses during 2016e-2019e in our residual income valuation method. However, we estimate RoE to go above the CoE from 2020 and onwards. *We have also made some changes to our valuation assumptions. We revised our cost of equity to 11.5% vs. 11.4% previously and changed our terminal growth rate to 5.0%. Moreover, our new forecasted average RoAE (2016e-2022e) is 11.8% vs. 13.3% previously. Based on our revised estimates, the WEV and RI methods yield a price target of QR44.00 and QR42.00 respectively, yielding a blended fair value of QR43.00.*

Catalysts

- Beyond a stabilization/recovery in oil prices, the following developments could be perceived positively by the market:** 1) Strengthening or stabilization of the Turkish Lira, 2) Steady bottom-line growth without major asset quality issues and 3) Significant improvement in RoE and NIMs.

Recommendation, Valuation and Risks

- Recommendation and valuation: We revise our Price Target to QR43.00 and maintain our Market Perform rating.** CBQK is trading at a 2016e P/TB and P/E of 1.0x and 11.9x, respectively. Moreover, the stock trades at a 2017e PEG of 1.0x, implying that it is fairly valued. The market is pricing in a sustainable RoE of 11.7% and P/B of 1.0x, in-line with our estimates. The stock offers a yield of 5.6% in both 2015 and 2016.
- Risks:** 1) Declining oil prices remains the biggest risk for CBQK and the banking sector, 2) Exposure to the retail & contracting segments, 3) Fluctuations of Turkish Lira, 4) LDR requirement from the QCB could create short-term issues and 5) Unexpected asset quality issues or impairments.

Key Financial Data and Estimates

	FY2015	FY2016e	FY2017e	FY2018e
Attributable EPS (QR)	3.88	3.79	4.26	4.79
EPS Growth (%)	-25.9	-2.4	12.3	12.4
P/E (x)	11.6	11.9	10.6	9.4
TBVPS (QR)	43.3	44.2	46.1	48.6
P/TB (x)	1.0	1.0	1.0	0.9
DPS (QR)	3.00	2.50	2.50	2.50
Dividend Yield (%)	6.7	5.6	5.6	5.6

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

Key Data

Current Market Price (QR)	45.00
Dividend Yield (%)	5.6
Bloomberg Ticker	CBQK QD
ADR/GDR Ticker	GBB39RMD9.L
Reuters Ticker	COMB.QA
ISIN	QA0007227752
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	63.18/36.90
3-m Average Volume ('000)	178.6
Mkt. Cap. (\$ bn/QR bn)	4.0/14.7
Shares Outstanding (mn)	326.6
FO Limit* (%)	49.0
Current FO* (%)	12.3
1-Year Total Return (%)	(24.2)

Fiscal Year End December 31

Source: Bloomberg (as of March 16, 2016), *Qatar Exchange (as of March 16, 2016); Note: FO is foreign ownership

Shahan Keushgerian

+974 4476 6509

shahan.keushgerian@qnbfs.com.qa

Saugata Sarkar

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Revising Estimates and Valuation

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Major Estimate Changes

	2016e			2017e		
	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	2,642	2,619	-0.9	2,899	2,745	-5.3
Non Interest Income	1,779	1,622	-8.8	1,991	1,784	-10.4
Net Operating Income	2,645	2,452	-7.3	2,999	2,648	-11.7
Net Income	1,618	1,239	-23.4	1,888	1,391	-26.3

Source: QNBFS estimates

Valuation

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 eight years, cost of equity (Ke) and expected long-term growth in earnings (g) 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 Commercial Bank's case, 103% of the fair value is derived from the bank's beginning BVPS vs. 4% from the terminal value. As mentioned previously, CBQK's PV of interim residuals is negative. Both valuation methodologies are based on a common Cost of Equity (CoE) assumption of 11.52%.

We calculate a risk free rate of 4.5% and factor in an adjusted beta of 1.00 vs. 0.85 (actual from Bloomberg) as we believe banks are a direct proxy for the economy. Finally, we add a local equity risk premium of 7.02% to arrive at a CoE of 11.52%.

Valuation Matrix

WEV	
Sustainable RoAE (%)	11.8%
Book Value of 2016e (QR)	44.05
Estimated Cost of Equity (%)	11.5%
Terminal Growth Rate (%)	5.0%
Intrinsic Value (QR)	44.00
Current Market Price (QR)	45.00
Upside/(Downside) Potential (%)	(2.2%)
Equity Value (QR mn)	14,372

RI	
Beginning TBVPS (2016) (QR)	43.26
Present Value of Interim Residuals (QR)	(0.74)
Present Value of Terminal Value (QR)	1.48
Terminal Growth Rate (%)	5.0%
Intrinsic Value (QR)	42.00
Current Market Price (QR)	45.00
Upside/(Downside) Potential (%)	(6.7%)
Equity Value (QR mn)	13,718

Source: Bloomberg, QNBFS estimates

Price Target Calculation

Methodology	Equity Value (QR mn)	Weight (%)	Fair Value (QR mn)
WEV	14,372	50	7,186
Residual Income	13,718	50	6,859
Blended Equity Value			14,045
Shares Outstanding (mn)			326.629
Target Price (QR)			43.00
Upside/(Downside)			(4.4%)

Source: Bloomberg, QNBFS estimates

We present below a scenario analysis of possible price targets based on a Base, Bull and Bear scenario

Scenario Analysis	Bear	Base	Bull
Sustainable RoAE	10.8%	11.8%	12.8%
G	3.5%	5.0%	5.5%
Ke	12.5%	11.5%	10.5%
P/B	0.81	1.05	1.46
Blended Fair Value Based on WEV & RI	36.00	43.00	66.00

Source: QNBFS estimates

Detailed Financial Statements

Ratios	FY2015	FY2016e	FY2017e	FY2018e
Profitability (%)				
RoAE (Attributable)	8.5	8.3	9.1	9.8
RoAA (Attributable)	1.1	1.0	1.0	1.0
RoRWA (Attributable)	2.7	3.2	3.3	3.1
NIM (% of IEAs)	2.46	2.35	2.27	2.21
NIM (% of RWAs)	2.48	2.38	2.26	2.20
NIM (% of AAs)	2.12	2.04	1.98	1.94
Spread	2.2	2.1	2.0	2.0
Efficiency (%)				
Cost-to-Income (Headline)	43.0	42.2	41.5	41.0
Cost-to-Income (Core)	45.4	45.5	45.1	44.9
Liquidity (%)				
LDR	110	109	106	101
LDR (including CDs)	110	109	106	101
Loans/Assets	62	62	62	61
Cash & Interbank Loans-to-Total Assets	17.2	17.6	17.3	18.5
Deposits to Assets	57	57	58	60
Wholesale Funding to Loans	43	42	40	39
IEAs to IBLs	116	116	114	112
Asset Quality (%)				
NPL Ratio	4.2	4.4	4.5	3.5
NPLs to Shareholder's Equity	22.3	24.9	26.5	21.9
NPLs to Tier 1 Capital	26.3	26.3	28.1	23.2
Coverage Ratio	70.9	79.2	88.3	114.3
ALL/Average Loans	3.0	3.6	4.1	4.2
Cost of Risk	1.06	1.00	0.95	0.94
Capitalization (%)				
Tier 1 Ratio	11.8	12.4	11.7	11.2
CAR	13.5	13.9	13.2	12.7
Tier 1 Capital to Assets	10.1	10.7	10.2	9.6
Tier 1 Capital to Loans	16.3	17.3	16.5	15.7
Tier 1 Capital to Deposits	17.9	18.8	17.4	15.8
Leverage (x)	8.4	8.8	9.3	9.8
Growth (%)				
Net Interest Income	-1.8	3.4	4.8	7.7
Non-Interest Income	-15.8	13.1	10.0	10.1
Total Revenue	-7.4	6.9	6.8	8.7
Operating Expenses	5.2	4.9	5.1	7.4
Net Operating Income	-15.0	8.3	8.0	9.6
Net Provisions & Investment Impairments	27.9	0.0	3.0	7.6
Net Income (Headline/Reported)	-24.2	6.0	10.4	10.6
Net Income (Attributable)	-25.9	-2.4	12.3	12.4
Loans	5.6	7.0	8.7	9.9
Deposits	13.4	8.0	12.0	15.0
Assets	6.7	7.6	8.8	11.3
RWAs	6.8	8.5	11.7	9.7

Source: Company data, QNBFS estimates

Income Statement (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Net Interest Income	2,534	2,619	2,744	2,956
Fees & Commissions	971	1,058	1,143	1,246
FX Income	141	158	182	200
Other Income	322	405	459	518
Non-Interest Income	1,434	1,622	1,784	1,964
Total Income	3,968	4,241	4,528	4,920
Operating Expenses	(1,705)	(1,789)	(1,881)	(2,019)
Net Operating Income	2,264	2,452	2,647	2,901
Net Provisions & Impairments	(860)	(860)	(886)	(953)
Net Profit Before Taxes & Non-Recurring Items	1,403	1,592	1,762	1,948
Non-Recurring Income	90	0	0	0
Net Profit After Non-Recurring Income	1,493	1,592	1,762	1,948
Tax	(36)	(40)	(44)	(49)
Net Profit Before Minority Interest	1,458	1,552	1,718	1,900
Minority Interest	(32)	(42)	(52)	(57)
Net Profit (Headline/Reported)	1,425	1,510	1,666	1,843
Interest on Tier-1 Note	(120)	(240)	(240)	(240)
Social & Sports Contribution Fund	(36)	(32)	(36)	(40)
Net Profit (Attributable)	1,269	1,239	1,391	1,563

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Assets				
Cash & Balances with Central Bank	5,424	6,783	6,753	8,737
Interbank Loans	15,831	16,622	18,285	21,027
Net Investments	15,854	17,698	20,264	22,630
Net Loans	76,630	82,003	89,133	97,976
Investment In Associates	4,423	4,533	4,659	4,809
Other Assets	3,304	3,280	3,565	3,919
Net PP&E	1,345	1,334	1,323	1,311
Goodwill & Other Intangibles	638	586	533	481
Total Assets	123,449	132,840	144,515	160,890
Liabilities				
Interbank Deposits	12,456	13,154	13,240	14,210
Certificate of Deposits	-	-	-	-
Customer Deposits	69,788	75,371	84,415	97,077
Term Loans	20,524	20,934	22,400	24,192
Tier-1 Perpetual Notes	2,000	4,000	4,000	4,000
Other Liabilities	3,370	3,769	4,221	4,368
Total Liabilities	108,137	117,227	128,358	143,930
Shareholders' Equity				
Total Shareholders' Equity	14,767	15,026	15,600	16,347
Total Liabilities & Shareholders' Equity	123,449	132,840	144,515	160,890

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

Contacts

Saugata Sarkar

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

Zaid Al Nafoosi

Senior Research Analyst

Tel: (+974) 4476 6535

zaid.alnafoosi@qnbfs.com.qa

QNB Financial Services SPC

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

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