

Masraf Al Rayan (MARK)

| Recommendation | MARKET PERFORM | Risk Rating | R-3 |
|----------------|----------------|--------------|---------|
| Share Price | QR43.35 | Target Price | QR46.00 |
| Implied Upside | 6.1% | | |

4Q2014 Estimates & Outlook for 2015-16; Market Perform

We are maintaining our Market Perform recommendation on Masraf Al Rayan (MARK). However, we are revising our bottom-line estimate for 2014 upward while lowering it for 2015 and 2016. This has resulted in a revised target price of QR46.00 from QR46.30.

Highlights

- **We estimate QR551.7mn in 4Q2014, up 5.6% QoQ and 22.1% YoY.** MARK reported a net profit of QR522.5mn in 3Q2014 vs. QR471.4mn in 2Q2014, up 10.8% QoQ. The results were influenced positively as MARK partially booked an investment gain of QR74.5mn in 3Q2014. Going forward, we expect another ~QR111.9mn in 4Q2014. This will allow the bottom-line to jump by 5.6% QoQ in 4Q2014. On the balance sheet front, MARK's loan book grew by 17.0% QoQ (+32.5% YTD) in 3Q2014, while total deposits (URIA & current accounts) declined by 0.6% QoQ (+16.3% YTD). For 4Q2014, we expect a relatively subdued performance on the loan book front (+0.2% QoQ).
- **We estimate a CAGR of 16.7% for the loan book over 2013-16e.** On the back of improved performance in the first nine months of 2014, we raise our loan book growth estimate for 2013-16 to 16.7% (previously 13.6%). However, we expect the loan book growth to slow down in 2015 and 2016. Overall, we expect MARK's loan book to grow to QR65.9bn in 2016e from QR54.9bn in 3Q2014.
- **We estimate a CAGR of 9.3% for the bottom-line over 2013-16e.** We expect MARK to post a bottom-line of QR1.98bn (previously QR1.93bn) in 2014. However, we expect net profit to reach QR2.17bn and QR2.23bn in 2015 and 2016, respectively (previously QR2.23bn and QR2.57bn). On the DPS front, we expect the bank to pay cash DPS of QR1.75 and QR2.00 for 2014 and 2015, respectively.

Catalysts

- **Expansion for long-term growth:** MARK recently acquired a majority stake in Islamic Bank of Britain (IBB) from QIIK. IBB was recently renamed as Al Rayan Bank. Al Rayan Bank has a high street presence with five branches (~50,000 customers). Any positive newsflow could act as a catalyst for MARK.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We rate MARK a Market Perform with a price target of QR46.00.** On the valuation front, MARK is trading at a P/E ratio of 15.0x and a P/B ratio of 2.7x on our 2015 estimates.
- **Risks:** Declining oil prices remain a substantial risk to regional equity prices. Company-specific risks include: 1) MARK loses market share in the government segment and 2) International expansion is not value accretive.

Key Financial Data and Estimates

| | FY2013 | FY2014e | FY2015e | FY2016e |
|----------------|--------|---------|---------|---------|
| EPS (QR) | 2.27 | 2.64 | 2.89 | 2.96 |
| EPS Growth | 13.2% | 16.2% | 9.7% | 2.5% |
| P/E (x) | 19.1 | 16.4 | 15.0 | 14.6 |
| BVPS (QR) | 14.03 | 15.19 | 16.33 | 17.30 |
| P/B (x) | 3.1 | 2.9 | 2.7 | 2.5 |
| DPS (QR) | 1.50 | 1.75 | 2.00 | 2.50 |
| Dividend Yield | 3.5% | 4.0% | 4.6% | 5.8% |

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

Key Data

| | |
|---------------------------|-------------------------|
| Dividend Yield (%) | 4.6 |
| Bloomberg Ticker | MARK QD |
| ADR/GDR Ticker | N/A |
| Reuters Ticker | MARK.QA |
| ISIN | QA000A0M8VM3 |
| Sector* | Banks & Financial Svcs. |
| 52wk High/52wk Low (QR) | 67.00/32.60 |
| 3-m Average Volume ('000) | 1,054.7 |
| Mkt. Cap. (\$ bn/QR bn) | 8.9/32.4 |
| Shares Outstanding (mn) | 750.0 |
| FO Limit* (%) | 49.0 |
| Current FO* (%) | 15.9 |
| 1-Year Total Return (%) | 34.01 |
| Fiscal Year End | December 31 |

Source: Bloomberg (as of January 4, 2015), *Qatar Exchange (as of January 4, 2015); Note: FO is foreign ownership

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Key Forecasts

Loan Book

We estimate a CAGR of 16.7% in loans over 2013-16e. Government and government-related agencies, the historical niche segments for the bank, will drive the growth. We note that management is focused on the government segment versus other players that are targeting the corporate and retail segments. In 9M2014, MARK's loan book posted an impressive performance, up 35.2% YTD. Going forward, we estimate a relatively subdued performance and expect loan book to grow by 9.6% and 9.2% YoY in 2015 and 2016, respectively. Overall, we expect the loan book to grow to QR65.9bn in 2016e from QR41.4bn in 2013 (QR54.9bn at the end of 3Q2014).

Deposit Book

We estimate a CAGR of 12.1% in combined deposits over 2013-16e. Government and term deposits dominate MARK's deposit book. Holders of unrestricted accounts (URIA) have been in the range of 87% to 93% over the last three years, while customer current accounts have been in the range of 7% to 13%. Furthermore, URIA is dominated by government deposits; the share has increased from 57.0% in 2012 to 64.1% in 2013. Within URIA, term accounts contribute 90% of the deposits followed by 6% in call accounts and 4% in savings accounts. Going forward, we estimate the same trends to drive MARK's deposit book.

Investment Book

We estimate a CAGR of 5.0% for MARK's investment book over 2013-16e. As of 3Q2014, unquoted debt forms ~78.8% of the investment portfolio followed by quoted debt of 17.4% and 4.0% in publicly listed equities. We believe management is focused on increasing the bank's exposure to government bonds as it is in line with its overall strategy. We do not see active participation in the equity markets by the bank. Hence, we expect the bond portfolio to grow to QR16.5bn in 2016 vs. QR13.8bn at the end of 2013.

Operating Performance

MARK sold 50% stake in Seef Lusail Real Estate Development Company: In 3Q2014, MARK sold its 50% stake in Seef Lusail Real Estate Development Co. to the real estate arm of the Gulf state's sovereign wealth fund. The sale price was around QR1.53bn, which would generate a gain of ~QR466.0mn for the bank spread over three years. As of the 2013 annual report, the total assets of Seef Lusail Real Estate Development Co. were worth QR2.13bn (50% share: QR1.06bn) with liabilities of QR44.59mn (50% share: QR22.48mn), revenue of only QR41,000 and net loss of QR6.4mn (50% share: QR3.2mn loss). Thus, the net book value was QR2.08bn (QR1.04bn to MARK). Furthermore, the payment will be made in three installments: 40% within a year from the signing the contract, 40% after 1-year of signing the contract and 20% after 2-years of signing the contract.

MARK to post net income of QR1.98bn in 2014 vs. QR1.7bn in 2013. We expect MARK to post a bottom-line of QR1.98bn (previously QR1.93bn) in 2014. However, we expect net profit to reach QR2.17bn and QR2.23bn in 2015 and 2016, respectively (previously QR2.23bn and QR2.57bn). In 2013, overall deposit rates declined for the bank helping it to post improved performance in net financing income despite a flat loan book (down 0.7% YoY) and slightly higher deposits (up 7.4% YoY). In 2014 and 2015, the sale of 50% stake in Seef Lusail Real Estate Development will assist the bottom-line growth. However, only 20% of the gain will be booked in 2016 vs. 40% in 2014 and 2015. In our view, this will result in lower YoY growth in 2016e. On the DPS front, we expect the bank to pay cash DPS of QR1.75 and QR2.00 for 2014 and 2015, respectively.

Recent Results Review

Masraf Al Rayan (MARK) posted a net profit of QR522.5mn in 3Q2014 vs. QR471.4mn in 2Q2014, up 10.8% QoQ. The results were driven by the fact that MARK partially booked an investment gain of QR74.5mn. Thus, another ~QR112mn in gains should be booked over the next three quarters (the timing of booking this gain is at management discretion). For modeling purposes, we expect this entire amount of roughly QR112mn to be booked in 4Q2014.

MARK's loan book increased by 17.0% QoQ: MARK's loan book grew by 17.0% QoQ (+32.5% YTD), while total deposits (URIA & current accounts) declined by 0.6% QoQ (+16.3% YTD). However, income from financing activities declined by 2.0% QoQ. Similarly, cost of unrestricted investment account holders (URIA) and finance expense together decreased by 2.0% QoQ. Overall, net financing income declined by 2.0% QoQ.

Company Description

MARK is a full-service bank offering commercial banking services to retail and corporate customers in accordance with Shari'a principles. Established in January 2006, the bank is structured into three main business divisions. These include: (1) Retail Banking, (2) Wholesale Banking and (3) Private Banking. As of December 2013, MARK had a total of 11 branches along with 52 ATMs.

Detailed Financial Statements

| Income Statement (In QR mn) | FY2013 | FY2014e | FY2015e | FY2016e |
|---|--------------|--------------|--------------|--------------|
| Income From Financing Activities | 1,743 | 2,050 | 2,287 | 2,467 |
| Unrestricted Investments Profit Sharing | 553 | 538 | 566 | 596 |
| Net Financing Income | 1,190 | 1,512 | 1,720 | 1,870 |
| Income from Investing Activities | 709 | 582 | 587 | 603 |
| Fees and Commission Income | 148 | 185 | 195 | 204 |
| Fees and Commission Expense | 1 | 1 | 1 | 2 |
| Net Fees and Commission Income | 147 | 184 | 193 | 203 |
| Gain/(Loss) on Foreign Exchange Activities | 60 | 72 | 76 | 80 |
| Other Operating Income | 22 | 196 | 192 | 98 |
| Total Operating Income | 2,129 | 2,546 | 2,769 | 2,854 |
| General and Administrative Expenses | 384 | 460 | 483 | 508 |
| Depreciation | 16 | 21 | 27 | 30 |
| Provision for Impairment - Due from Financing Activities | (11) | 35 | 32 | 35 |
| Provision for Impairment - Financial Investments & Others | 1 | - | - | - |
| Profit after Tax | 1,739 | 2,030 | 2,226 | 2,281 |
| Minority Interest | 37 | 52 | 57 | 58 |
| Profit for Shareholders | 1,702 | 1,978 | 2,170 | 2,223 |
| EPS (QR) | 2.27 | 2.64 | 2.89 | 2.96 |

Source: Company data, QNBFS estimates

| Balance Sheet (In QR mn) | FY2013 | FY2014e | FY2015e | FY2016e |
|---|---------------|---------------|---------------|---------------|
| Assets | | | | |
| Cash and Balances with Central bank | 3,511 | 3,584 | 3,845 | 3,740 |
| Due from Banks and Other Financial Institutions | 4,335 | 3,321 | 2,156 | 503 |
| Financial Investments | 15,017 | 15,307 | 16,326 | 17,407 |
| Due from Financing Activities | 41,440 | 55,036 | 60,340 | 65,879 |
| Investment Property | 91 | 91 | 91 | 91 |
| Investment in Associates | 1,457 | 418 | 418 | 418 |
| Property and Equipment (Net) | 55 | 131 | 130 | 128 |
| Other Assets | 642 | 389 | 434 | 469 |
| Total Assets | 66,548 | 78,278 | 83,741 | 88,635 |
| Equity | | | | |
| Share Capital | 7,500 | 7,500 | 7,500 | 7,500 |
| Legal Reserve | 633 | 633 | 633 | 633 |
| General Reserve | 27 | 27 | 27 | 27 |
| Risk Reserve | 875 | 875 | 875 | 875 |
| Fair Value Reserve | 27 | 44 | 44 | 44 |
| Retained Earnings | 1,461 | 2,315 | 3,172 | 3,895 |
| Proposed Cash Dividend | 0 | 0 | 0 | 0 |
| Total Equity Attributable to Equity Holders of the Parent | 10,523 | 11,394 | 12,251 | 12,975 |
| Minority Interests | 181 | 244 | 257 | 269 |
| Total Shareholders' Equity and Minority Interests | 10,704 | 11,638 | 12,508 | 13,244 |
| Liabilities | | | | |
| Customers Current Accounts | 3,514 | 5,307 | 5,572 | 5,851 |
| Other Liabilities | 7,512 | 6,906 | 7,143 | 7,389 |
| Unrestricted Investment Depositors Accounts | 44,817 | 54,427 | 58,518 | 62,152 |
| Total Liabilities | 55,843 | 66,640 | 71,233 | 75,391 |
| Equity and Liabilities | 66,548 | 78,278 | 83,741 | 88,635 |

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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