

Masraf Al Rayan (MARK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR40.81	Price Target	QR34.00
Implied Upside	(16.7%)		

Updating Model for 2017; Retaining Market Perform

Masraf Al Rayan (MARK) is the second largest Shari'ah compliant bank among listed banks. It is currently in negotiations (due diligence process is over) with Barwa Bank and International Bank of Qatar (IBQ) regarding a three-way merger. Incorporated in 2006, MARK is focused on the public sector, which dominates its loan portfolio. Public sector loans grew by a CAGR (2010-2017) of 22% and represents 56% (December 2017) of MARK's loan portfolio. Notably, MARK has the best asset quality among Qatari banks with a NPL ratio of 0.47%, one of the highest RoEs of ~16% and robust capitalization at 19%.

Highlights

- **MARK delivered encouraging 2017 results in a challenging operating environment.** MARK reported attributable net income of QR1.98mn, receding by 2.3% YoY. However, when we remove the one-off sale of property from 2016, net profit was up by 2.4%. Net interest income aided the bottom-line, growing by 17.9% to QR2.26mn. On the other hand, fees and share of profit from associates was a drag on the bottom-line. Moreover, operating expenses and provisions significantly increased.
- **Margins improved:** Net interest margin increased by 13bps YoY to 2.48%. Improvement in the NIM was led by a rise in asset yields exceeding the increase in cost of funds. Yields on assets increased by 41bps YoY to 4.24%, whereas cost of funds increased by only 29bps to 2.18%. We expect MARK to generate a NIM of 2.40% in 2018 (lower than 2017 due to expectations of a rise in CoFs as the bank raises deposits), 2.50% (2019) and 2.51% (2020).
- **Provisions jumped due to IFRS 9; asset quality risks still remain negligible.** Net provisions surged to QR113.4mn vs. QR2.7mn in 2016. Moreover CoR jumped to 15bps vs. nil in 2016. However, we are under the impression that most of these provisions are reversible. As a result of IFRS 9, we pencil in a CoR of 18bps in 2018, 22bps (2019) and 25bps (2020). MARK's NPL ratio increased to 0.47% vs. 0.17% in 2016. We model in NPL ratios of 0.56% (2018), 0.80% (2019) and 1.0% (2020).
- **Net Loans and deposits experienced healthy growth; deposits need to increase significantly, however.** Net loans moved up by 6.6% YoY to QR72.1bn, while deposits increased by 7.8% YoY to QR62.5bn. Thus, MARK's LDR remained elevated at 115% vs. 114% in 3Q2017 (117% in FY2016). Loan growth was driven by the public sector as expected. We adjust our loan growth assumption to 6.2% from 8.0% (2018) and 9.2% from 10% (2019). We are of the opinion that the bank may increase its borrowings in order to enhance its liquidity profile/lower LDR.
- **We lowered our estimates for 2018 and 2019.** Estimates Table on page 2.

Catalysts

- News flow about the upcoming merger could act as a catalyst.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Price Target of QR34 and Market Perform recommendation.** MARK is trading at P/B and P/E of 2.2x and 14.8x on our 2018 estimates, respectively. The market is pricing a fundamental P/B (2.2x) and a sustainable RoE (20.0%) vs. our estimates (P/B: 1.8x & RoE: 17.0%). The name trades at a PEG of 1.9x based on 7.8% CAGR (2017-23e)
- **Risks:** 1) Volatility in oil prices remains the biggest risk for regional equities, 2) Geopolitical factors, 3) More than expected increase in credit costs and 4) losing market share in the government segment.

Key Financial Data and Estimates

	FY2017	FY2018e	FY2019e	FY2020e
Attributable EPS (QR)	2.64	2.75	3.04	3.32
EPS Growth (%)	-2.3	4.5	10.4	9.0
P/E (x)	15.5	14.8	13.4	12.3
Tangible BVPS (QR)	17.6	18.3	19.4	0.0
P/TB (x)	2.3	2.2	2.1	2.0
DPS (QR)	2.00	2.00	2.25	2.50
Dividend Yield (%)	4.9	4.9	5.5	6.1

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

Key Data

Current Market Price (QR)	40.81
Dividend Yield (%)	4.9
Bloomberg Ticker	MARK QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000A0M8VM3
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	45.40/33.32
3-m Average Volume ('000)	463.3
Mkt. Cap. (\$ bn/QR bn)	8.4/30.6
Shares Outstanding (mn)	750.0
FO Limit* (%)	49.0
Current FO* (%)	12.1
1-Year Total Return (%)	+4.8
Fiscal Year End	December 31

Source: Bloomberg (as of January 21, 2018), *Qatar Exchange (as of January 21, 2018); Note: FO is foreign ownership

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Change in Estimates

	2018e			2019e		
	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	2,465	2,412	-2.2	2,793	2,674	-4.3
Non Interest Income	548	504	-8.0	555	569	2.5
Net Operating Income	2,365	2,281	-3.6	2,365	2,548	7.8
Net Income (Attributable)	2,260	2,066	-8.6	2,515	2,281	-9.3

Source: QNBFS Research

The lower estimates in the bottom-line is due to surges in provisions (IFRS 9)

Detailed Financial Statements

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Net Interest Income	2,264	2,412	2,674	2,921
Fees & Commissions	274	291	326	349
FX Income	143	153	168	188
Other Income	56	60	75	99
Non-Interest Income	473	504	569	637
Total Revenue	2,736	2,916	3,243	3,558
Operating Expenses	(577)	(636)	(695)	(754)
Net Operating Income	2,159	2,281	2,548	2,804
Net Provisions	(113)	(146)	(191)	(234)
Net Profit Before Taxes & Non-Recurring Items	2,045	2,135	2,357	2,570
Non-Recurring Income	0	0	0	0
Net Profit After Non-Recurring Income	2,045	2,135	2,357	2,570
Tax	(5)	(3)	(3)	(3)
Net Profit Before Minority Interest	2,041	2,132	2,354	2,567
Minority Interest	(13)	(13)	(15)	(16)
Net Profit (Headline/Reported)	2,028	2,119	2,340	2,551
Social & Sports Contribution Fund	(51)	(53)	(58)	(64)
Net Profit (Attributable)	1,977	2,066	2,281	2,487

Source: Company data, QNBFS Research

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Assets				
Cash & Balances with Central Bank	2,800	3,188	3,719	4,106
Interbank Loans	3,312	3,446	3,344	4,673
Net Investments	23,423	24,466	23,830	25,044
Net Loans	72,097	76,585	83,601	93,460
Investment In Associates	520	536	558	578
Other Assets	636	689	543	561
Net PP&E	160	168	167	167
Total Assets	102,949	109,078	115,763	128,588
Liabilities				
Interbank Deposits	25,123	24,469	21,898	21,911
Customer Deposits	62,531	66,408	74,377	85,534
Other Liabilities	1,905	4,232	4,723	5,563
Total Liabilities	89,559	95,109	100,998	113,007
Total Shareholders' Equity	13,191	13,757	14,538	15,338
Total Liabilities & Shareholders' Equity	102,949	109,078	115,763	128,588

Source: Company data, QNBFS Research

Ratios	FY2017	FY2018e	FY2019e	FY2020e
Profitability (%)				
RoAE (Attributable)	15.9	16.6	17.3	15.9
RoAA (Attributable)	2.1	2.2	2.2	2.1
RoRWA (Attributable)	3.4	3.4	3.2	3.4
NIM (% of IEAs)	2.43	2.48	2.58	2.43
NIM (% of RWAs)	3.58	3.74	3.59	3.58
NIM (% of AAs)	2.27	2.35	2.45	2.27
Spread	2.0	2.0	2.0	2.0
Efficiency (%)				
Cost-to-Income (Headline)	21.1	21.5	21.4	21.1
Cost-to-Income (Core)	21.9	22.1	22.3	21.9
Liquidity (%)				
LDR	113.7	109.6	100.5	113.7
Loans/Assets	68.3	68.8	68.9	68.3
Cash & Interbank Loans-to-Total Assets	6.7	5.5	6.2	6.7
Deposits to Assets	60.1	62.8	68.5	60.1
Wholesale Funding to Loans	36.4	32.9	24.3	36.4
IEAs to IBLs	124.3	122.6	122.0	124.3
Asset Quality (%)				
NPL Ratio	0.14	0.17	0.18	0.14
NPLs to Shareholder's Equity	0.77	0.97	1.05	0.77
NPLs to Tier 1 Capital	0.91	1.13	1.23	0.91
Coverage Ratio	50.5	57.8	67.9	50.5
ALL/Average Loans	0.1	0.1	0.1	0.1
Cost of Risk	0.00	0.03	0.03	0.00
Capitalization (%)				
Tier 1 Ratio	18.2	17.1	15.0	18.2
CAR	18.2	17.1	15.0	18.2
Tier 1 Capital to Assets	11.1	11.0	10.7	11.1
Tier 1 Capital to Loans	16.2	16.0	15.6	16.2
Tier 1 Capital to Deposits	18.5	17.6	15.6	18.5
Leverage (x)	7.6	7.7	7.9	7.6
Growth (%)				
Net Interest Income	14.0	12.6	13.3	14.0
Non-Interest Income	-0.2	4.7	1.3	-0.2
OPEX	23.5	13.5	10.7	23.5
Net Operating Income	8.0	10.5	11.3	8.0
Net Income (Attributable)	2.2	9.3	11.3	2.2
Loans	2.4	8.0	10.0	2.4
Deposits	5.0	12.0	20.0	5.0
Assets	10.8	7.2	9.9	10.8
RWAs	2.4	13.4	22.1	2.4

Source: Company data, QNBFS Research

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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