

## Masraf Al Rayan (MARK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR34.95	Current Target Price	QR34.00
Implied Upside	(2.72%)		

### 3Q2016 Net Profit Ahead of Estimates; Minor Tweaks

*Masraf Al Rayan (MARK) is the second largest Shari'ah compliant bank among listed banks. Incorporated in 2006, MARK is focused on the public sector, which dominates its loan portfolio. Public sector loans grew by a CAGR (2009-2015) of 28.2% and represents 50% (December 2015) of MARK's loan portfolio. On the other hand, retail loans make up an immaterial 8.3% of the loan book. Notably, MARK has the best asset quality with an NPL ratio of 0.05%, one of the highest RoAes of ~17% and robust capitalization at 18.0%.*

#### Highlights

- **MARK reported better than expected net profit.** MARK generated net profit of QR508.7mn, ahead of our estimate of QR470.9mn (+8.0% variation) and BBG consensus (QR473.3mn). The beat was primarily due to lower expenses vs. our low estimate and higher net reversals (QR14.0mn vs. our estimate of QR7.0mn). On the other hand, net interest & investment income was in-line at QR477.9mn vs. our estimate of QR464.0mn (+3.0% variation).
- **MARK's QoQ marginal increase in profitability was primarily driven significantly lower opex and higher net reversals.** MARK posted net profit of QR508.7mn, inching up by 0.6% QoQ (down 1.3% YoY). Net Interest income climbed up by 1.5% QoQ (down 14.0% YoY) to QR344.8mn. Hence, NIMs (based on loans only) remained stable at 2.10% QoQ, but decreased by ~6bps YoY. Investment income grew by 2.5% and 194.5% to QR133.1mn QoQ and YoY, respectively. Fees & commissions surprised on the upside, surging by 33.7% QoQ (+70.0% YoY) to QR89.0mn which could be due to one-off transactions.
- **We estimate the bottom-line to inch up by 1.3% to QR2.05bn in 2016e followed by a 2.7% (QR2.10bn) gain in 2017e and a rebound in 2018e (+8.5% to 2.28bn).** The marginal uptick in profitability for 2016 is mainly due to a 12.4% decline in opex, net reversal of QR29.1mn and other non-core/non-recurring income. As far as 2017 is concerned, we expect improved performance from MARK. We pencil in a growth of 7.3% (QR2.65bn) in total revenue driven by net interest income. We estimate net interest to grow by 6.9% to QR2.08bn. We estimate the NIM to marginally pick by 2bps to 2.40% after dropping by 26bps in 2016. We do not expect any significant provisions in 2016 and 2017. *(Continued on page 2)*

#### Catalysts

- **Beyond a stabilization/recovery in oil prices, the following developments could be perceived positively by the market:** 1) Improvement in NIMs and spreads and 2) seeking other business opportunities.

#### Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Price Target of QR34.00.** MARK is trading at a 2017e P/B and P/E of 1.9x and 12.5x, respectively. *Based on our 6.2% (5 year earnings CAGR), the stock trades at a PEG of 2.0x, indicating the stock is expensive.* However, the stock offers an attractive yield of 5.0% in 2016 and 2017.
- **Risks:** 1) Depressed oil prices remains the biggest risk for MARK and the banking sector, 2) Increase in credit costs, 3) MARK loses market share in the government segment and 4) LDR requirement from the QCB could create short-term issues.

#### Key Financial Data and Estimates

	FY2015	FY2016e	FY2017e	FY2018e
Attributable EPS (QR)	2.70	2.73	2.80	3.04
EPS Growth (%)	3.6	1.3	2.7	8.5
P/E (x)	13.0	12.8	12.5	11.5
Tangible BVPS (QR)	16.1	17.0	18.1	19.4
P/TB (x)	2.2	2.1	1.9	1.8
DPS (QR)	1.75	1.75	1.75	2.00
Dividend Yield (%)	5.0	5.0	5.0	5.7

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

#### Key Data

Current Market Price (QR)	34.95
Dividend Yield (%)	5.0
Bloomberg Ticker	MARK.QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000AOM8VM3
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	44.20/28.60
3-m Average Volume ('000)	606.5
Mkt. Cap. (\$ bn/QR bn)	7.2/26.2
Shares Outstanding (mn)	750.0
FO Limit* (%)	49.0
Current FO* (%)	10.8
1-Year Total Return (%)	(16.5)
Fiscal Year End	December 31

Source: Bloomberg (as of October 18, 2016), \*Qatar Exchange (as of October 18, 2016); Note: FO is foreign ownership

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- **Significant QoQ drop in opex aided the bottom-line; we still expect cost containment in the near future.** MARK posted opex of QR101.1mn vs. QR140.1mn in 2Q2016 (QR102.5mn in 3Q2015), dropping by 27.9% and 1.4% QoQ and YoY, respectively. Thus, the bank's cost-to-income ratio declined to 16.9% vs. 23.6% in 2Q2016 (19.2% in 2Q2016). We expect opex to drop by 12.4% YoY to QR483.9mn for 2016e and further dip by 2.1% in 2017e. Due to the weak operating environment, we believe MARK will be prudent in managing costs in order to mitigate a further drop in the bottom-line. On the other hand we pencil in growth of 7.1% for 2018e as the bank grows, assuming a favorable operating environment vs. current market conditions. Hence, we expect the cost-to-income ratio to go down to 19.6% in 2016e (22.9% in 2015), 17.8% in 2017e and 17.6% in 2018e.
- **Asset quality remained robust.** MARK's NPLs ratio declined to a negligible 0.05% vs. 0.08% in 2Q2016 (0.09% in 1Q2016). On the other hand, the coverage ratio remained stable QoQ at 70% in 3Q2016 vs. 73% in 1Q2016 (89% in FY2015). We estimate the coverage to further drop to 61% and 60% on the back of reversals in 2016 and 2017, respectively. Moreover, we do not expect deterioration in the asset quality as MARK is heavily exposed to the public sector.
- **Net loans expanded QoQ while deposits declined.** MARK's loan book increased by 4.2% QoQ to QR67.0bn (+7.1% YTD). Conversely, deposits displayed negative performance, retrenching by 1.9% QoQ (+1.9% YTD) to QR56.7bn. Consequently, the bank's LDR was lifted to 118% vs. 111% in 2Q2016 (112% in FY2015). This move helped the bank's margins at the expense of its liquidity position. We estimate loan growth of 9.1%, 3.5% and 8.9% in 2016e, 2017e and 2018e, respectively. We also expect the LDR at 118%, 111% and 105% in 2016e, 2017e and 2018e, respectively.
- **Capitalization remained strong.** MARK generated a CAR of 17.9% in 3Q2016 vs. 18.0% in 2Q2016 (18.5% in 4Q2015), one of the highest domestically. We expect the bank's CAR to reach 17.4% and 18.1% in 2016e and 2017e, respectively

## Change in Estimates

	2016e			2017e			2018e		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	1,892	1,942	2.6	2,016	2,075	2.9	2,164	2,256	4.3
Non Interest Income	542	532	-1.9	616	579	-6.0	706	633	-10.4
Net Operating Income	1,929	1,990	3.2	2,115	2,181	3.1	2,317	2,382	2.8
Net Income	1,972	2,048	3.9	2,044	2,103	2.9	2,223	2,281	2.6

Source: QNBFS Estimates

## Detailed Financial Statements

Ratios	FY2015	FY2016e	FY2017e	FY2018e
<b>Profitability (%)</b>				
RoAE (Attributable)	17.3	16.5	16.0	16.3
RoAA (Attributable)	2.5	2.4	2.3	2.3
RoRWA (Attributable)	3.6	3.4	3.3	3.2
NIM (% of IEAs)	2.65	2.38	2.40	2.44
NIM (% of RWAs)	3.62	3.22	3.25	3.12
NIM (% of AAs)	2.48	2.26	2.28	2.31
Spread	2.4	2.0	2.0	2.1
<b>Efficiency (%)</b>				
Cost-to-Income (Headline)	22.9	19.6	17.8	17.6
Cost-to-Income (Core)	23.3	20.5	18.6	18.3
<b>Liquidity (%)</b>				
LDR	111.9	118.0	111.1	105.2
Loans/Assets	75.0	77.0	76.0	75.4
Cash & Interbank Loans-to-Total Assets	6.2	6.0	6.5	6.2
Deposits to Assets	67.0	65.2	68.4	71.7
Wholesale Funding to Loans	21.4	23.6	19.3	15.4
IEAs to IBLs	125.5	125.6	123.5	120.7
<b>Asset Quality (%)</b>				
NPL Ratio	0.09	0.05	0.05	0.06
NPLs to Shareholder's Equity	0.50	0.29	0.29	0.31
NPLs to Tier 1 Capital	0.56	0.33	0.34	0.36
Coverage Ratio	89.5	61.1	60.3	92.9
ALL/Average Loans	0.1	0.0	0.0	0.1
Cost of Risk	0.00	-0.04	0.00	0.02
<b>Capitalization (%)</b>				
Tier 1 Ratio	18.5	17.4	18.1	15.6
CAR	18.5	17.4	18.1	15.6
Tier 1 Capital to Assets	12.9	12.3	12.6	12.2
Tier 1 Capital to Loans	17.1	16.0	16.6	16.2
Tier 1 Capital to Deposits	19.2	18.9	18.4	17.0
Leverage (x)	6.9	7.0	6.9	7.0
<b>Growth (%)</b>				
Net Interest Income	3.5	-4.0	6.9	8.7
Non-Interest Income	5.6	36.3	8.9	9.3
OPEX	15.3	-12.4	-2.1	7.1
Net Operating Income	0.8	6.9	9.6	9.2
Net Income (Attributable)	3.6	1.3	2.7	8.5
Loans	7.5	9.1	3.5	8.9
Deposits	-11.1	4.0	10.0	15.0
Assets	3.7	6.5	4.8	9.7
RWAs	5.9	9.6	2.6	23.2

Source: Company data, QNBFS estimates

<b>Income Statement (In QR mn)</b>	<b>FY2015</b>	<b>FY2016e</b>	<b>FY2017e</b>	<b>FY2018e</b>
Net Interest Income	2,024	1,942	2,075	2,256
Fees & Commissions	238	279	304	322
FX Income	108	132	157	182
Other Income	44	122	119	129
<b>Non-Interest Income</b>	<b>390</b>	<b>532</b>	<b>579</b>	<b>633</b>
<b>Total Revenue</b>	<b>2,414</b>	<b>2,474</b>	<b>2,654</b>	<b>2,889</b>
Operating Expenses	(552)	(484)	(474)	(507)
<b>Net Operating Income</b>	<b>1,862</b>	<b>1,990</b>	<b>2,181</b>	<b>2,382</b>
Net Provisions	(47)	26	(4)	(20)
<b>Net Profit Before Taxes &amp; Non-Recurring Items</b>	<b>1,815</b>	<b>2,016</b>	<b>2,177</b>	<b>2,362</b>
Non-Recurring Income	186	57	0	0
<b>Net Profit After Non-Recurring Income</b>	<b>2,001</b>	<b>2,073</b>	<b>2,177</b>	<b>2,362</b>
Tax	25	(2)	(3)	(3)
<b>Net Profit Before Minority Interest</b>	<b>2,026</b>	<b>2,071</b>	<b>2,174</b>	<b>2,359</b>
Minority Interest	47	30	(18)	(19)
<b>Net Profit (Headline/Reported)</b>	<b>2,073</b>	<b>2,101</b>	<b>2,157</b>	<b>2,340</b>
Social & Sports Contribution Fund	(52)	(53)	(54)	(58)
<b>Net Profit (Attributable)</b>	<b>2,022</b>	<b>2,048</b>	<b>2,103</b>	<b>2,281</b>

Source: Company data, QNBFS estimates

<b>Balance Sheet (In QR mn)</b>	<b>FY2015</b>	<b>FY2016e</b>	<b>FY2017e</b>	<b>FY2018e</b>
<b>Assets</b>				
Cash & Balances with Central Bank	2,737	2,603	3,182	3,659
Interbank Loans	2,376	2,732	2,828	2,695
Net Investments	14,625	14,086	15,184	17,450
Net Loans	62,567	68,288	70,711	76,989
Investment In Associates	469	502	541	582
Other Assets	410	376	424	554
Net PP&E	147	154	153	153
<b>Total Assets</b>	<b>83,331</b>	<b>88,740</b>	<b>93,024</b>	<b>102,082</b>
<b>Liabilities</b>				
Interbank Deposits	13,345	16,115	13,633	11,871
Customer Deposits	55,623	57,848	63,633	73,178
Other Liabilities	2,005	1,735	1,909	2,195
<b>Total Liabilities</b>	<b>70,973</b>	<b>75,698</b>	<b>79,175</b>	<b>87,245</b>
<b>Total Shareholders' Equity</b>	<b>12,044</b>	<b>12,757</b>	<b>13,547</b>	<b>14,516</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>83,331</b>	<b>88,740</b>	<b>93,024</b>	<b>102,082</b>

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*

<b>OUTPERFORM</b>	Greater than +20%
<b>ACCUMULATE</b>	Between +10% to +20%
<b>MARKET PERFORM</b>	Between -10% to +10%
<b>REDUCE</b>	Between -10% to -20%
<b>UNDERPERFORM</b>	Lower than -20%

### Risk Ratings

*Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*

<b>R-1</b>	Significantly lower than average
<b>R-2</b>	Lower than average
<b>R-3</b>	Medium / In-line with the average
<b>R-4</b>	Above average
<b>R-5</b>	Significantly above average

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