

Masraf Al Rayan (MARK)

Recommendation	REDUCE	Risk Rating	R-3
Share Price	QR41.90	Price Target	QR34.00
Implied Upside	(18.9%)		

Maintain Estimates & TP QR34.00 Post 2Q2017 Results

Masraf Al Rayan (MARK) is the second largest Shari'ah compliant bank among listed banks. It is currently in the due diligence process of merging with 2 unlisted banks, Barwa Bank and International Bank of Qatar (IBQ). When the merger goes through, the new bank will be the 2nd largest bank in Qatar. Incorporated in 2006, MARK is focused on the public sector, which dominates its loan portfolio. Public sector loans grew by a CAGR (2010-2016) of 22% and represents 48% (December 2016) of MARK's loan portfolio. Notably, MARK has the best asset quality with an NPL ratio of 0.16%, one of the highest RoE of ~17% and robust capitalization at 19%.

Highlights

- **MARK reports flat 2Q2017 net profit; in-line with our estimates.** Masraf Al Rayan (MARK) reported a net profit of QR509.6mn in 2Q2017 vs. QR510.2mn in 1Q2017 (QR505.4mn in 2Q2016), in-line our estimates of QR507.0mn (+0.5% variation).
- **MARK's flat QoQ net profit was supported by strong investment income as non-funded income dropped while opex increased.** Investment income expanded by 28.3% (+54.6% YoY) to QR200.7mn whereas, non-funded income dropped by 18.2% QoQ (-23.2% YoY) to QR95.6mn. On the other hand, opex climbed up by 5.6% QoQ (+6.4% YoY) to QR149.1mn. Having said this, MARK's efficiency is intact with its C/I ratio at 22.5% vs. 21.6% in 1Q2017 (23.6% in 2Q2016).
- **Margins came under pressure QoQ.** Net interest and investment income moved up by 5.6% and 20.8% QoQ and YoY to QR567.4mn, respectively. This was driven by investment income rather than net interest income. Regarding margins, net interest margin contracted by 9bps QoQ (+7bps YoY) to 2.17%. The QoQ contraction was led by a rise in cost of funds exceeding rise in yields. Cost of funds increased by 9bps QoQ (+35bps YoY) to 2.17%, whereas yields increased by only 5bps (+46bps YoY) to 4.44%. Thus, it appears that liquidity is beginning to take a toll on MARK. Hence, we still expect further margin pressure going forward.
- **Net Loans growth remained muted.** Net loans remained flattish QoQ and YTD at QR68.0bn, while deposits declined by 3.0% QoQ (+5.5% YTD) to QR61.2bn. As such MARK's LDR remained elevated at 111% vs. 107% in 1Q2017 (111% in FY2016). In our view, the bank needs to address its liquidity position.
- **Asset quality remains a non-issue and is immaterial.** The bank's NPL ratio dipped to 0.15% vs. 0.16% at the end of 2016.
- **Capitalization remained robust.** MARK ended 2Q2017 with a CAR of 19.4%.

Catalysts

- **Beyond a stabilization/recovery in oil prices, the following development could be perceived positively by the market:** 1) materialization of the merger.

Recommendation, Valuation and Risks

- **Recommendation and valuation: We maintain our Price Target of QR34.00 & Reduce recommendation.** MARK is trading at P/B and P/E of 2.4x and 15.4x on our 2017 estimates, respectively. The market is pricing a fundamental P/B (2.4x) and RoE (20.7%) vs. our estimates (P/B: 1.9x & RoE: 17.5%) which leads us to believe that the stock is trading at rich valuations. Moreover the name trades at a very expensive PEG of 2.1x based on 6.7% CAGR (2016-21e)
- **Risks:** 1) Volatility in oil prices remains the biggest risk for regional equities, 2) Geopolitical factors, 3) Increase in credit costs and 4) losing market share in the government segment.

Key Financial Data and Estimates

	FY2016	FY2017e	FY2018e	FY2019e
Headline EPS (QR)	2.77	2.72	3.01	3.29
EPS Growth (%)	0.1	-1.5	10.6	9.0
P/E (x)	15.1	15.4	13.9	12.8
Tangible BVPS (QR)	16.9	17.6	18.5	19.7
P/TB (x)	2.5	2.4	2.3	2.1
DPS (QR)	2.00	2.00	2.00	2.25
Dividend Yield (%)	4.8	4.8	4.8	5.4

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

Key Data

Current Market Price (QR)	41.90
Dividend Yield (%)	4.8
Bloomberg Ticker	MARK QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000A0M8VM3
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	45.40/33.05
3-m Average Volume ('000)	556.3
Mkt. Cap. (\$ bn/QR bn)	8.6/31.4
Shares Outstanding (mn)	750.0
FO Limit* (%)	49.0
Current FO* (%)	11.7
1-Year Total Return (%)	+22.1
Fiscal Year End	December 31

Source: Bloomberg (as of July 19, 2017), *Qatar Exchange (as of July 18, 2017); Note: FO is foreign ownership

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Detailed Financial Statements

Ratios	FY2016	FY2017e	FY2018e	FY2019e
Profitability (%)				
RoAE (Attributable)	16.4	15.4	16.3	16.7
RoAA (Attributable)	2.3	2.1	2.2	2.2
RoRWA (Attributable)	3.4	3.4	3.5	3.2
NIM (% of IEAs)	2.35	2.33	2.37	2.45
NIM (% of RWAs)	3.26	3.46	3.54	3.31
NIM (% of AAs)	2.20	2.18	2.24	2.32
Spread	1.9	1.8	1.8	1.8
Efficiency (%)				
Cost-to-Income (Headline)	18.9	19.7	18.6	18.8
Cost-to-Income (Core)	19.5	20.4	19.3	19.6
Liquidity (%)				
LDR	116.6	111.6	107.6	98.6
Loans/Assets	73.9	71.7	72.3	72.3
Cash & Interbank Loans-to-Total Assets	9.6	7.1	5.9	6.6
Deposits to Assets	63.4	64.3	67.2	73.3
Wholesale Funding to Loans	28.2	28.1	24.2	15.8
IEAs to IBLs	127.8	125.6	123.9	123.0
Asset Quality (%)				
NPL Ratio	0.16	0.16	0.17	0.18
NPLs to Shareholder's Equity	0.89	0.90	0.97	1.07
NPLs to Tier 1 Capital	0.99	1.06	1.14	1.26
Coverage Ratio	44.8	43.9	57.8	67.9
ALL/Average Loans	0.1	0.1	0.1	0.1
Cost of Risk	0.00	0.00	0.03	0.03
Capitalization (%)				
Tier 1 Ratio	18.8	19.3	17.3	15.0
CAR	18.8	19.3	17.3	15.0
Tier 1 Capital to Assets	12.4	11.6	11.5	11.0
Tier 1 Capital to Loans	16.8	16.1	15.8	15.2
Tier 1 Capital to Deposits	19.6	18.0	17.1	15.0
Leverage (x)	7.2	7.3	7.4	7.7
Growth (%)				
Net Interest Income	-5.1	6.7	9.2	12.6
Non-Interest Income	34.5	-1.9	14.5	-3.3
OPEX	-16.2	9.1	4.1	10.5
Net Operating Income	6.5	3.9	11.8	9.0
Net Income (Attributable)	0.1	-1.5	10.6	9.0
Loans	8.1	2.4	8.0	10.0
Deposits	4.3	7.0	12.0	20.0
Assets	9.8	5.5	7.1	10.0
RWAs	4.8	-3.9	18.2	21.8

Source: Company data, QNBFS Research

Income Statement (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
Net Interest Income	1,920	2,049	2,238	2,520
Fees & Commissions	313	300	336	286
FX Income	134	121	139	152
Other Income	78	94	115	132
Non-Interest Income	525	514	589	570
Total Revenue	2,445	2,563	2,827	3,090
Operating Expenses	(463)	(505)	(526)	(581)
Net Operating Income	1,982	2,059	2,301	2,509
Net Provisions	(3)	(3)	(28)	(30)
Net Profit Before Taxes & Non-Recurring Items	1,979	2,056	2,274	2,479
Non-Recurring Income	93	0	0	0
Net Profit After Non-Recurring Income	2,072	2,056	2,274	2,479
Tax	4	(2)	(3)	(3)
Net Profit Before Minority Interest	2,076	2,054	2,271	2,476
Minority Interest	(1)	(10)	(11)	(12)
Net Profit (Headline/Reported)	2,075	2,043	2,260	2,464
Social & Sports Contribution Fund	(52)	(51)	(56)	(62)
Net Profit (Attributable)	2,023	1,992	2,203	2,402

Source: Company data, QNBFS Research

Balance Sheet (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
Assets				
Cash & Balances with Central Bank	3,126	3,415	3,477	4,172
Interbank Loans	5,692	3,464	2,619	3,291
Net Investments	14,012	19,303	21,299	22,838
Net Loans	67,635	69,281	74,819	82,280
Investment In Associates	509	529	556	585
Other Assets	409	443	494	477
Net PP&E	148	152	152	151
Total Assets	91,531	96,588	103,416	113,795
Liabilities				
Interbank Deposits	19,060	19,451	18,134	13,010
Customer Deposits	58,024	62,086	69,536	83,443
Other Liabilities	1,574	1,676	1,655	2,336
Total Liabilities	78,657	83,212	89,325	98,790
Total Shareholders' Equity	12,705	13,197	13,900	14,802
Total Liabilities & Shareholders' Equity	91,531	96,588	103,416	113,795

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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