

## Masraf Al Rayan (MARK)

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	QR35.80	Current Target Price	QR34.00
Implied Upside	(5.03%)		

### 2Q2016 Net Profit In-Line; Tweaking Estimates

*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 0.08%, one of the highest RoAEs of ~17% and robust capitalization at 18.0%.*

#### Highlights

- **MARK reported in-line net profit.** MARK generated net profit of QR505.4mn, in-line with our estimate of QR511.6mn (-1.2% variation). Moreover total revenue was also in-line at QR594.3mn vs. our estimate of QR600.5mn (-1.0% variation).
- **MARK's QoQ drop in profitability was due to higher opex, margin compression and weak investment income.** MARK posted net profit of QR505.4mn, dropping by 5.9% QoQ (+3.7% YoY). Net Interest income dropped by 2.7% QoQ (down 12.0% YoY) to QR339.9mn. Hence, NIMs (based on loans only) remained under pressure, dropping by 9bps and 43bps QoQ and YoY to 2.10%, respectively. Investment income declined by 3.5% and 18.9% to QR129.8mn QoQ and YoY, respectively.
- **We estimate the bottom-line to recede by 2.4% to QR1.97bn in 2016e followed by a 3.6% (QR2.04bn) gain in 2017e.** The drop in profitability in 2016 is mainly due to a 6.5% decline in net interest income as margins further get squeezed, a non-recurring loss of QR35.9mn and a final booking of QR93.1mn from the sale of real estate vs. 186.1mn in 2015. On the other hand we expect an 8.7% drop in opex to salvage the bottom-line. As far as 2017 is concerned, we expect improved performance from MARK. We pencil in a growth of 8.2% (QR2.6bn) in total revenue driven by net interest income. We estimate net interest to grow by 6.6% to QR2.0bn. We estimate the NIM to remain stable at 2.33% after dropping by 31bps in 2016. We do not expect 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 2016e P/B and P/E of 2.1x and 13.6x, respectively. Based on our 5.8% (5 year earnings CAGR), the stock trades at a PEG of 2.4x, indicating the stock is expensive. However, the stock offers an attractive yield of 4.9% 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	2.63	2.72	2.96
EPS Growth (%)	3.6	-2.4	3.6	8.8
P/E (x)	13.3	13.6	13.1	12.1
Tangible BVPS (QR)	16.1	16.9	17.9	19.1
P/TB (x)	2.2	2.1	2.0	1.9
DPS (QR)	1.75	1.75	1.75	2.00
Dividend Yield (%)	4.9	4.9	4.9	5.6

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

#### Key Data

Current Market Price (QR)	35.80
Dividend Yield (%)	4.9
Bloomberg Ticker	MARK QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000AOM8VM3
Sector*	Banks & Financial Svcs.
52wk High/52wk Low (QR)	45.90/28.60
3-m Average Volume ('000)	371.0
Mkt. Cap. (\$ bn/QR bn)	7.4/26.9
Shares Outstanding (mn)	750.0
FO Limit* (%)	49.0
Current FO* (%)	10.1
1-Year Total Return (%)	(17.6)
Fiscal Year End	December 31

Source: Bloomberg (as of July 25, 2016), \*Qatar Exchange (as of July 24, 2016); Note: FO is foreign ownership

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- **Although Opex jumped QoQ; we still expect it to be lower than FY2015.** MARK posted opex of QR140.1mn vs. QR119.5mn in 1Q2016 (QR165.1mn in 2Q2015), increasing by 17.2% QoQ but dropping by 15.2% YoY. As such, the bank's cost-to-income ratio climbed up to 23.6% vs. 19.5% in 1Q2016 (26.2% in 2Q2015). We expect opex to drop by 8.7% YoY to QR504.1mn for 2016e and slightly increase by 2.6% 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. Hence, we expect the cost-to-income ratio to go down to 20.7% in 2016e (22.9% in 2015) and 19.7% in 2017e.
- **Asset quality remained robust.** MARK's NPLs ratio remained negligible at 0.08% in 2Q2016 (0.09% in 1Q2016). On the other hand, the coverage ratio further dropped to 70% vs. 73% in 1Q2016 (89% in FY2015). We estimate the coverage to reach 74% and 61% 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 receded QoQ while deposits moved up.** MARK's loan book decreased by 1.8% QoQ to QR64.3bn (+3.2% YTD). Conversely, deposits displayed positive performance, gaining by 2.9% QoQ (+3.9% YTD) to QR57.8bn. Consequently, the bank's LDR dropped to 111% vs. 117% in 1Q2016 (112% in FY2015). This move helped the bank's liquidity position at the expense of its margins. We estimate loan growth of 6.4% and 8.2% in 2016e and 2017e, respectively. We also expect the LDR at 111% and 109% in 2016e and 2017e, respectively.
- **Capitalization remained strong.** MARK generated a CAR of 18.0% in 2Q2016 vs. 18.4% in 1Q2016, one of the highest domestically. We expect the bank's CAR to reach 17.5% and 17.6% in 2016e and 2017e, respectively

## Detailed Financial Statements

Ratios	FY2015	FY2016e	FY2017e	FY2018e
<b>Profitability (%)</b>				
RoAE (Attributable)	17.3	16.0	15.7	16.0
RoAA (Attributable)	2.5	2.3	2.2	2.2
RoRWA (Attributable)	3.6	3.3	3.2	3.0
NIM (% of IEAs)	2.65	2.34	2.33	2.31
NIM (% of RWAs)	3.62	3.16	3.15	2.95
NIM (% of AAs)	2.48	2.20	2.20	2.19
Spread	2.4	2.0	2.0	2.0
<b>Efficiency (%)</b>				
Cost-to-Income (Headline)	22.9	20.7	19.7	19.2
Cost-to-Income (Core)	23.3	21.8	20.7	20.3
<b>Liquidity (%)</b>				
LDR	111.9	111.3	109.5	103.6
Loans/Assets	75.0	74.3	75.9	75.3
Cash & Interbank Loans-to-Total Assets	6.2	8.5	6.5	6.3
Deposits to Assets	67.0	66.7	69.4	72.7
Wholesale Funding to Loans	21.4	22.5	18.5	14.7
IEAs to IBLs	125.5	123.8	122.8	119.9
<b>Asset Quality (%)</b>				
NPL Ratio	0.09	0.08	0.08	0.09
NPLs to Shareholder's Equity	0.50	0.46	0.48	0.52
NPLs to Tier 1 Capital	0.56	0.54	0.56	0.60
Coverage Ratio	89.5	73.7	61.2	72.3
ALL/Average Loans	0.1	0.1	0.1	0.1
Cost of Risk	0.00	-0.01	0.00	0.02
<b>Capitalization (%)</b>				
Tier 1 Ratio	18.5	17.5	17.6	15.1
CAR	18.5	17.5	17.6	15.1
Tier 1 Capital to Assets	12.9	12.2	12.2	11.8
Tier 1 Capital to Loans	17.1	16.4	16.1	15.7
Tier 1 Capital to Deposits	19.2	18.3	17.7	16.3
Leverage (x)	6.9	7.0	7.0	7.2
<b>Growth (%)</b>				
Net Interest Income	3.5	-6.5	6.6	7.3
Non-Interest Income	5.6	38.9	13.6	14.7
OPEX	15.3	-8.7	2.6	6.8
Net Operating Income	0.8	3.6	9.6	9.6

Net Income (Attributable)	3.6	-2.4	3.6	8.8
Loans	7.5	6.4	8.2	8.9
Deposits	-11.1	7.0	10.0	15.0
Assets	3.7	7.4	5.9	9.8
RWAs	5.9	8.2	5.4	23.2

Source: Company data, QNBFS estimates

Income Statement (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Net Interest Income	2,024	1,892	2,016	2,164
Fees & Commissions	238	267	294	338
FX Income	108	151	186	215
Other Income	44	124	136	153
<b>Non-Interest Income</b>	<b>390</b>	<b>542</b>	<b>616</b>	<b>706</b>
<b>Total Revenue</b>	<b>2,414</b>	<b>2,434</b>	<b>2,632</b>	<b>2,870</b>
Operating Expenses	(552)	(504)	(517)	(552)
<b>Net Operating Income</b>	<b>1,862</b>	<b>1,929</b>	<b>2,115</b>	<b>2,317</b>
Net Provisions	(47)	(2)	1	(16)
<b>Net Profit Before Taxes &amp; Non-Recurring Items</b>	<b>1,815</b>	<b>1,928</b>	<b>2,116</b>	<b>2,301</b>
Non-Recurring Income	186	57	0	0
<b>Net Profit After Non-Recurring Income</b>	<b>2,001</b>	<b>1,985</b>	<b>2,116</b>	<b>2,301</b>
Tax	25	(2)	(3)	(3)
<b>Net Profit Before Minority Interest</b>	<b>2,026</b>	<b>1,983</b>	<b>2,113</b>	<b>2,299</b>
Minority Interest	47	40	(17)	(19)
<b>Net Profit (Headline/Reported)</b>	<b>2,073</b>	<b>2,023</b>	<b>2,096</b>	<b>2,280</b>
Social & Sports Contribution Fund	(52)	(51)	(52)	(57)
<b>Net Profit (Attributable)</b>	<b>2,022</b>	<b>1,972</b>	<b>2,044</b>	<b>2,223</b>

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
<b>Assets</b>				
Cash & Balances with Central Bank	2,737	3,571	3,273	3,764
Interbank Loans	2,376	3,973	2,866	2,731
Net Investments	14,625	14,277	15,444	17,771
Net Loans	62,261	66,222	71,659	78,027
Investment In Associates	469	507	550	596
Other Assets	410	450	430	562
Net PP&E	147	178	177	177
<b>Total Assets</b>	<b>83,026</b>	<b>89,178</b>	<b>94,400</b>	<b>103,628</b>
<b>Liabilities</b>				
Interbank Deposits	13,345	14,921	13,264	11,447
Customer Deposits	55,623	59,517	65,469	75,289
Other Liabilities	1,700	1,786	1,964	2,259
<b>Total Liabilities</b>	<b>70,668</b>	<b>76,223</b>	<b>80,696</b>	<b>88,995</b>
<b>Total Shareholders' Equity</b>	<b>12,044</b>	<b>12,681</b>	<b>13,412</b>	<b>14,322</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>83,026</b>	<b>89,178</b>	<b>94,400</b>	<b>103,628</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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