

Masraf Al Rayan (MARK)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	QR4.369	Price Target	QR5.342
Implied Upside	22.3%	Old Price Target	QR6.100

Elevated CoR Remains an Overhang; Changing Price Target to QR5.342
Factoring in 1H2022 results, we lower our estimates for 2022 and 2023. A more subdued growth outlook, higher CoR, increased provisioning and one-time merger costs serve to lower our estimates despite cost synergies. We lower our 2022 EPS estimate from QR0.351 to QR0.225; our 2023 EPS estimate also changes from QR0.382 to QR0.300. Consequently, our RoE estimates for 2022/2023 declines from 14.5/14.6% to 9.4/12.3%. As such, we lower MARK's price target from QR6.100/share to QR5.342/share but maintain our Outperform rating. MARK boasts a healthy dividend yield (2022e: 4.6%), is cost-efficient, was a strong RoE generator pre-merger (having said that, we forecast RoE to pick up to 16/17% by 2025) and maintains healthy asset quality (given its large exposure to the public sector/GREs). MARK trades at 2022e/23e P/B of 1.8x (lower than its historical 5-year median of 2.2x and high of 2.5x). The stock has underperformed its peers on a YTD and 1-year TTR basis but we think a case of relative outperformance can be made given the quality of its franchise and improving results going forward.

Highlights

- We still expect double-digit growth in earnings:** We estimate bottom-line to grow from 2021's QR1.63bn to QR4.48bn by 2026e, driven by healthy growth in net operating income and normalizing CoR.
- MARK is expected to remain cost efficient; cost synergies should further enhance its efficiency ratio.** Management has guided to cost synergies of QR75mn in 2022, increasing to QR112.5mn in 2023 and QR150mn in 2024 (and thereafter). Hence, we expect the C/I ratio to drop from 2021's 21.5% to 18.9% in 2024.
- Although MARK's primary exposure is to the public sector, NPLs have spiked; management has been booking large precautionary provisions by allocating provisions across all stages of loans.** Previously, the NPL ratio hovered around the 1% level but has increased to 2.36% by the end of 1H2022 (remains manageable). Moreover, Stage 2 loans as a % of total loans increased from 2021's 14% to 18% as of 1H2022 and provisions allocated to Stage 2 loans is 36% of total provisions. Coverage of Stage 3 loans is at 54% and we expect that to increase. It is worth noting that MARK's new management is in the process of revising the risk management framework of existing exposures.
- CoR could stay on the high side near term.** CoR spiked from 37bps in 2020 to 87bps in 2021. We pencil in a CoR of 99bps for 2022 and 84bps in 2023 as management increases coverage of Stage 3 loans. We expect CoR to normalize at ~60bps by 2026.
- Loans are estimated to increase by a CAGR of 5.5% in 2021-26e.** We estimate loans to increase from 2021's QR120.8bn (pro forma) to QR158.2bn by the end of 2026. We note MARK's pre-merger loan growth was a 5-year CAGR of 6.6% (2015-2020). We expect loan growth to be driven by the public sector.
- CET1 to remain robust and highest among its peers.** MARK ended 2Q2022 with CET1/Tier-1 ratios of 18.0%/18.9%. Going forward, we estimate these ratios to hover around the 19.0% level.

Catalysts

- 1) Normalizing CoR, resulting in strong RoE ahead of expectations.

Recommendation, Valuation and Risks

- Recommendation and valuation: We lower our PT to QR5.342 and maintain our Outperform rating.** MARK is trading at P/TB and P/E of 1.8x and 15.0x on our 2023 estimates, respectively.
- Risks:** 1) Geopolitical factors & 2) Greater-than-expected increase in credit costs.

Key Financial Data and Estimates

	2021	2022e	2023e	2024e
EPS Attributable (QR)	0.17	0.22	0.29	0.35
EPS Growth (%)	-23.3	25.6	32.9	21.5
P/E (x)	25.0	19.9	15.0	12.3
Tangible BVPS (QR)	2.33	2.38	2.47	2.60
P/TBV (x)	1.9	1.8	1.8	1.7
RoE (%)	11.3	9.4	12.3	14.4
DPS (QR)	0.170	0.200	0.225	0.250
Dividend Yield (%)	3.9	4.6	5.1	5.7

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

Key Data

Current Market Price (QR)	4.369
Dividend Yield (%)	3.9
Bloomberg Ticker	MARK QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000AOM8VM3
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	5.980/3.820
3-m Average Volume (mn)	10.8
Mkt. Cap. (\$ bn/QR bn)	11.2/40.6
Shares Outstanding (mn)	930,000
FO Limit* (%)	100.0
Current FO* (%)	14.5
1-Year Total Return (%)	(0.3)
Fiscal Year End	December 31

Source: Bloomberg (as of September 05, 2022), *Qatar Exchange (as of September 04, 2022); Note: FO is foreign ownership

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Valuation

We value MARK using the Residual Income Model (RI) based on a fundamental P/B:

We derive MARK's fair value by employing the RI valuation technique (*based on a fundamental P/B*), which is calculated based on the sum of its beginning book value, present value of interim residuals (net income minus equity charge) and the present value of the terminal value (we apply a fundamental P/B multiple based on the Gordon Growth Model to the ending book value at the end of our forecast horizon). We derive the P/B from the Gordon Growth Model: $P/B = (RoE-g)/(Ke-g)$. This model uses sustainable return on equity (RoE) based on the median over our forecast period, cost of equity (Ke) and expected long-term growth in earnings (g) to arrive at fundamental/justified P/B. **Based on this method, we arrive at a fundamental P/B of 2.3x.**

We add Qatar's 10-year CDS rate of 0.76% to the 10-year US government bond yield (3.2%) to arrive at a risk free rate of 4.0%. We factor in an adjusted beta of 1.0x. Finally, we add a local equity risk premium of 7.0% to arrive at a Ke of 10.96%. However, we use a Ke of 10.2% for the terminal year.

Valuation Methodology

Fundamental P/B		RI Based on Fundamental P/B	
Sustainable RoE (%)	16.8	Beginning BVPS (2021) (QR)	2.52
Estimated Cost of Equity (%)	10.2	Present Value of Interim Residuals (QR)	0.52
Terminal Growth Rate (%)	5.0	Present Value of Terminal Value (QR)	2.49
Fundamental P/B	2.3x	Less: Intangibles & Goodwill	0.19
		Fundamental P/B	2.3x
		Intrinsic Value (QR)	5.342
		Current Market Price (QR)	4.369
		Upside/(Downside) Potential (%)	+22.3%

Source: QNB FS Research

Forecasts

	2022e	2023e	2024e	2025e	2026e	2027e	2028e	Terminal
Beginning BVPS	2.52	2.57	2.66	2.79	2.96	3.14	3.41	3.71
Attributable EPS	0.22	0.29	0.35	0.42	0.48	0.54	0.58	0.61
DPS	0.17	0.20	0.23	0.25	0.30	0.28	0.28	0.30
Adjustment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Ending BVPS	2.57	2.66	2.79	2.96	3.14	3.41	3.71	4.03
Equity Charge	0.28	0.28	0.29	0.31	0.32	0.34	0.37	0.38
Residual Income	-0.06	0.01	0.06	0.11	0.16	0.20	0.21	0.23
Terminal Value (Based on Fundamental P/B)								5.07
Discounted Interim Residuals	-0.05	0.01	0.05	0.08	0.10	0.11	0.11	0.11
Discounted Terminal Value								2.49

Source: QNB FS Research

Change in Estimates

In QR mn	2022e			2023e		
	Old	New	Change (%)	Old	New	Change (%)
Net Interest Income	4,741	3,913	-17.5	5,008	4,335	-13.4
Non Interest Income	719	721	0.2	676	754	11.5
Revenue	5,460	4,633	-15.1	5,684	5,089	-10.5
Opex	(1,079)	(932)	-13.6	(1,115)	(1,008)	-9.6
Net Operating Income	4,381	3,701	-15.5	4,569	4,081	-10.7
Net Income (Reported)	3,403	2,145	-37.0	3,688	2,834	-23.2
Net Income (Attributable)	3,265	2,043	-37.4	3,552	2,715	-23.6

Source: QNB FS Research

Detailed Financial Statements

Income Statement (In QR mn)	2019	2020	2021	2022e	2023e	2024e
Net Interest Income	2,300	2,773	3,118	3,913	4,335	4,852
Fees & Commissions	388	261	324	408	436	463
FX Income	162	158	167	217	231	248
Other Income	42	37	19	95	86	70
Non-Interest Income	593	456	510	721	754	781
Total Revenue	2,892	3,229	3,628	4,633	5,089	5,634
Operating Expenses	(659)	(694)	(780)	(932)	(1,008)	(1,067)
Net Operating Income	2,234	2,535	2,848	3,701	4,081	4,567
Net Provisions & Impairments	(45)	(352)	(1,097)	(1,367)	(1,221)	(1,102)
Net Profit Before Taxes & Minority Interest	2,189	2,183	1,752	2,335	2,860	3,464
Tax	(1)	(2)	(5)	(9)	(11)	(14)
Net Profit Before Minority Interest	2,188	2,181	1,747	2,325	2,848	3,450
Minority Interest	(10)	(5)	(13)	(12)	(14)	(17)
Non-Recurring Items			(16)	(169)	0	0
Net Profit (Reported/Headline)	2,178	2,175	1,718	2,145	2,834	3,433
Interest Expense on AT1 Bond			(48)	(48)	(48)	(48)
Social & Sports Contribution Fund	(54)	(54)	(43)	(54)	(71)	(86)
Net Profit (Attributable)	2,124	2,121	1,627	2,043	2,715	3,299

Source: Company data, QNB FS Research

Balance Sheet (In QR mn)	2019	2020	2021	2022e	2023e	2024e
Assets						
Cash & Balances with Central Bank	3,123	7,071	5,221	6,212	7,214	8,061
Interbank Loans	6,035	6,308	9,156	6,093	7,758	7,932
Net Investments	21,379	20,586	32,542	31,176	33,660	37,312
Net Loans	74,837	85,983	120,553	121,863	129,292	139,164
Investment In Associates	527	534	349	359	367	378
Other Assets	267	362	3,253	4,061	3,870	4,008
Net PP&E	228	271	715	782	836	892
Goodwill			2,251	1,759	1,759	1,759
Total Assets	106,397	121,115	174,039	172,305	184,754	199,507
Liabilities						
Interbank Deposits	19,367	27,979	23,247	25,420	28,781	30,559
Customer Deposits	65,613	68,918	106,956	103,534	110,988	120,311
Sukuks & Borrowings	5,336	7,294	13,315	11,983	12,343	14,194
Other Liabilities	1,949	2,332	5,850	5,985	6,157	6,500
AT1 Notes			1,000	1,000	1,000	1,000
Total Liabilities	92,265	106,523	150,368	147,922	159,268	172,564
Minority Interest	213	227	200	211	226	243
Total Shareholders' Equity	13,919	14,365	23,472	24,173	25,260	26,699
Total Liabilities & Shareholders' Equity	106,397	121,115	174,039	172,305	184,754	199,507
Risk Weighted Assets	62,179	67,746	105,137	113,722	122,861	135,265

Source: Company data, QNB FS Research

Ratios/KPIs	2019	2020	2021	2022e	2023e	2024e
Profitability (%)						
RoE	16.0	15.2	11.3	9.4	12.1	14.0
RoAA	2.1	1.9	1.1	1.2	1.5	1.7
RoRWA	3.4	3.3	1.9	1.9	2.3	2.6
NIM (% of IEAs)	2.37	2.60	2.30	2.49	2.66	2.75
NIM (% of RWAs)	3.65	4.27	3.61	3.58	3.66	3.76
NIM (% of AAs)	2.26	2.44	2.11	2.26	2.43	2.53
Spread	1.8	2.3	2.1	2.2	2.4	2.5
Efficiency (%)						
Cost-to-Income (Headline)	22.8	21.5	21.5	20.1	19.8	18.9
Cost-to-Income (Core)	23.1	21.7	21.6	20.5	20.1	19.2
Liquidity (%)						
LDR (Loans to Stable Sources of Funds)	105	113	100	105	105	103
Loans/Assets	70.3	71.0	69.4	70.7	70.0	69.8
Cash & Interbank Loans-to-Total Assets	8.6	11.0	8.3	7.1	8.1	8.0
Deposits to Assets	61.7	56.9	61.5	60.1	60.1	60.3
Wholesale Funding to Loans	33.0	41.0	30.3	30.7	31.8	32.2
IEAs to IBLs	122.2	117.2	118.1	119.8	120.2	119.7
Asset Quality (%)						
NPL Ratio	1.01	1.13	1.67	2.48	2.54	2.42
NPL to Shareholders' Equity	5.45	6.82	8.73	12.82	13.42	13.08
NPL to Tier 1 Capital	6.20	7.37	9.61	13.69	13.94	13.25
Coverage Ratio	84.0	93.8	89.2	98.6	122.0	146.3
ALL/Average Loans	0.8	1.1	1.7	2.3	3.0	3.5
Cost of Risk (bps)	7	37	87	99	84	70
Capitalization (%)						
CET1 Ratio	19.7	19.6	19.3	19.0	19.0	18.7
Tier-1 Ratio	19.7	19.6	20.3	19.9	19.8	19.5
CAR	20.3	20.3	21.1	20.8	20.7	20.4
Leverage (x)	7.6	8.4	7.4	7.1	7.3	7.5
Growth (%)						
Net Interest Income	1.4	20.6	12.4	25.5	10.8	11.9
Non-Interest Income	13.9	-23.1	11.9	41.2	4.6	3.6
Opex	-1.5	5.4	12.3	19.5	8.1	5.9
Net Operating Income	5.4	13.5	12.4	29.9	10.3	11.9
Net Income (Reported)	2.3	-0.1	-21.0	24.9	32.1	21.1
Net Income (Attributable)						
Loans	3.2	14.9	40.2	0.9	6.1	7.6
Deposits	6.6	5.0	55.2	-3.2	7.2	8.4
Assets	9.4	13.8	43.7	-1.0	7.2	8.0
RWAs	-2.8	9.0	54.8	8.2	8.0	10.1

Source: Company data, QNB FS Research

Recommendations		Risk Ratings	
<i>Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price</i>		<i>Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals</i>	
OUTPERFORM	Greater than +20%	R-1	Significantly lower than average
ACCUMULATE	Between +10% to +20%	R-2	Lower than average
MARKET PERFORM	Between -10% to +10%	R-3	Medium / In-line with the average
REDUCE	Between -10% to -20%	R-4	Above average
UNDERPERFORM	Lower than -20%	R-5	Significantly above average

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