Masraf Al Rayan (MARK)

Recommendation	Accumulate	Risk Rating	R-3
Share Price	QR2.678	Price Target	QR3.112
Implied Upside	16.2%	Old Price Target	QR5.342

Asset Quality Pressure Erodes RoE; Moving to Accumulate & Lower PT

Factoring in FY2022 results, we lower our estimates for 2023 and 2024. A more subdued growth outlook, provisioning and NIM compression serve to lower our estimates despite cost synergies. We lower our 2023 EPS estimate from QR0.29 to QR0.15; our 2024 EPS estimate also changes from QR0.35 to QR0.19. Consequently, our RoE estimates for 2023/2024 decline from 12.1/14.0% to 6.7/8.1%. As such, we lower MARK's price target from QR5.342/share to QR3.112/share and revise our rating from Outperform to Accumulate. Given MARK's asset quality situation, the stock is trading at 2023e/24e P/B of 1.1x (lower than its historical 5-year median of 2.2x and high of 2.5x). The stock has underperformed its peers on an YTD and 1-year TTR basis. We note that while MARK's current relative valuation looks attractive, the stock needs a strong catalyst. A 10-year analysis of MARK's valuation relative to peers and against its own historical performance shows that the stock is trading below normal levels (see page 2).

Highlights

- **We still expect double-digit growth in earnings:** We estimate MARK's bottom-line to grow from 2022's QR1.26bn to QR2.72bn by 2027e. The bank's earnings should be driven by healthy growth in net operating income and normalizing CoR (although CoR is expected to remain elevated vs. previous expectations).

- **RoE has eroded and it is a long road to recovery.** RoE declined from 11.3% in 2021 to 5.8% in 2022 (pre-merger RoE hovered at the 16% level). It will take a long time for RoE to pick up despite double-digit growth in earnings; thus, our RoE estimates for 2023/2024 decline from 12.1/14.0% to 6.7/8.1%.

- **Although MARK's primary exposure is to the public sector, asset quality has faced headwinds with NPLs spiking; the bulk/majority of NPLs appear to be attributed to the real estate segment.** Pre-merger, the NPL ratio hovered around 1% but has increased to 6.0% by the end of FY2022. NPLs surged from QR1.92bn in FY2021 to QR7.30bn (NPL formation of QR5.37bn). Moreover, Stage 2 loans, as a % of total loans, increased from 2021's 14% to 24% as of FY2022, and provisions allocated to Stage 2 loans are 53% of total provisions. At the same time, coverage of Stage 3 loans declined from 53% in FY2021 to 46% in FY2022.

- **CoR to stay on the high side (but lower than 2022's 127bps) in the near-to-medium term as MARK builds buffers to reach a coverage ratio of >100%; credit provisions surged by 71.0% to QR1.56bn in 2022.** CoR spiked from 87bps in 2021 to 127bps in 2022 on large impairments. We now pencil in a CoR of 114bps for 2023 and 94bps in 2024 (2025: 82bps) as management increases coverage of Stage 3 loans. We expect CoR to normalize at ~60bps by 2027, unchanged vs. our previous estimate.

- **Loans are estimated to increase by a CAGR of 5.6% in 2022-27e.** We estimate loans to increase from 2022's QR117.9bn to QR154.8bn by the end of 2027. We expect loan growth to be driven by the public sector.

- **CET1 to remain robust and highest among its peers.** MARK ended FY2022 with CET1/Tier-1 ratios of 18.6%/19.5%. Going forward, we estimate these ratios to hover around current levels.

Catalysts

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

Recommendation, Valuation and Risks

- **Recommendation and valuation:** *We lower our PT to QR3.112 and revise our rating from Outperform to Accumulate.* MARK is trading at P/TB and P/E of 1.1x and 17.5x on our 2023 estimates, respectively.

- **Risks:** 1) Geopolitical factors & 2) Greater-than-expected increase in credit costs.

Key Financial Data and Estimates

	2022	2023e	2024e	2025e
EPS Attributable (QR)	0.14	0.15	0.19	0.23
EPS Growth (%)	-22.4	12.9	24.6	21.7
P/E (x)	19.7	17.5	14.0	11.5
Tangible BVPS (QR)	2.30	2.35	2.42	2.50
P/TBV (x)	1.2	1.1	1.1	1.1
RoE (%)	5.8	6.7	8.1	9.6
DPS (QR)	0.100	0.125	0.150	0.175
Dividend Yield (%)	3.7	4.7	5.6	6.5

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

Key Data

Current Market Price (QR)	2.678
Dividend Yield (%)	3.7
Bloomberg Ticker	MARK QD
ADR/GDR Ticker	N/A
Reuters Ticker	MARK.QA
ISIN	QA000A0M8VM3
Sector*	Banks & Fin. Svcs.
52wk High/52wk Low (QR)	5.815/2.678
3-m Average Volume (mn)	18.9
Mkt. Cap. ($ bn/QR bn)	6.8/24.9
Shares Outstanding (mn)	9,300
FO Limit* (%)	100.0
Current FO* (%)	14.7
1-Year Total Return (%)	(44.9)
Fiscal Year End	December 31

Source: Bloomberg (as of February 01, 2023), *Qatar Exchange (as of February 01, 2023); Note: FO is foreign ownership

Shahan Keushgerian
+974 4476 6509
shahan.keushgerian@qnbfs.com.qa

Saugata Sarkar, CFA, CAIA
+974 4476 6534
saugata.sarkar@qnbfs.com.qa

MARK's Current Relative Valuation Looks Attractive

A 10-year analysis of MARK's valuation relative to peers and against its own historical performance shows that the stock is trading below normal levels. While the erosion in its RoE should justify MARK's valuation discount, as ROE improves in the future, we expect the stock to begin to trade more in-line with its peers/historical norms.

MARK Trading Below Peers

Price to Book

Return on Equity

Legend: ━━ MARK ── -1std ── +1std ┅ Peer Median
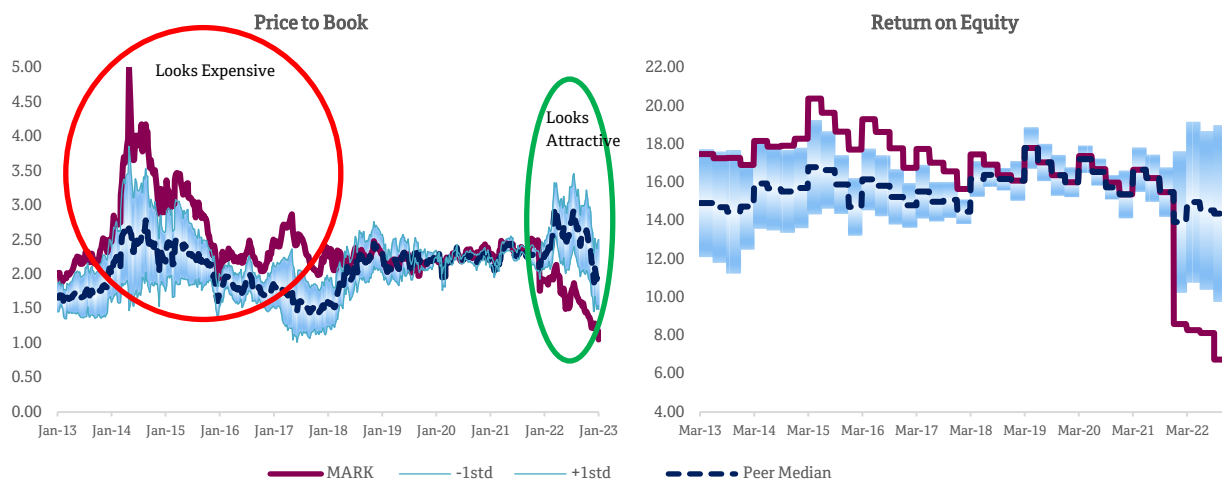
- **MARK is trading below its peers (QIBK & QIIK),** as well as below or outside one standard deviation of its peer group average. While it traded above peers between 2013 and 2018, the valuation had realigned to trade within the peer average range since 2018 until early 2022.

MARK Trading Below its Historical Average

Price to Book

Return on Equity

Legend: ━━ MARK ── -1std ── +1std ┅ MARK Median (12M MA)

- Similarly, **MARK is trading below is 12-month trailing average** and below or outside one standard deviation of its historical fundamental average price.

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 1.6x.*

We add Qatar's 10-year CDS rate of 0.76% to the 10-year US government bond yield (3.5%) to arrive at a risk free rate of 4.3%. 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 11.26%. However, we use a Ke of 10.2% for the terminal year.

Valuation Methodology

Fundamental P/B	
Sustainable RoE (%)	13.5
Estimated Cost of Equity (%)	10.2
Terminal Growth Rate (%)	5.0
Fundamental P/B	1.6x

RI Based on Fundamental P/B	
Beginning BVPS (2023) (QR)	2.48
Present Value of Interim Residuals (QR)	(0.27)
Present Value of Terminal Value (QR)	1.00
Less: Goodwill	0.09
Fundamental P/B	1.6x
Intrinsic Value (QR)	3.112
Current Market Price (QR)	2.678
Upside/(Downside) Potential (%)	+16.2%

Source: QNB FS Research

Forecasts

	2023e	2024e	2025e	2026e	2027e	2028e	Terminal
Beginning BVPS	2.48	2.54	2.60	2.68	2.77	2.86	2.97
Attributable EPS	0.15	0.19	0.23	0.26	0.29	0.31	0.32
DPS	0.10	0.13	0.15	0.18	0.20	0.20	0.23
Adjustment	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Ending BVPS	2.54	2.60	2.68	2.77	2.86	2.97	3.07
Equity Charge	0.28	0.29	0.29	0.30	0.31	0.32	0.30
Residual Income	**-0.13**	**-0.09**	**-0.06**	**-0.04**	**-0.02**	**-0.01**	**0.02**
Terminal Value (Based on Fundamental P/B)							1.95
Discounted Interim Residuals	**-0.11**	**-0.08**	**-0.04**	**-0.03**	**-0.01**	**-0.01**	**0.01**
Discounted Terminal Value							**1.00**

Source: QNB FS Research

Change in Estimates

In QR mn	2023e Old	New	Change (%)	2024e Old	New	Change (%)
Net Interest Income	4,335	3,528	-18.6	4,852	3,612	-25.6
Non Interest Income	754	736	-2.3	781	793	1.5
Revenue	5,089	4,265	-16.2	5,633	4,404	-21.8
Opex	(1,008)	(1,143)	13.4	(1,067)	(1,141)	6.9
Net Operating Income	4,081	3,122	-23.5	4,566	3,263	-28.5
Net Income (Reported)	2,834	1,509	-46.8	3,433	1,868	-45.6
Net Income (Attributable)	2,715	1,425	-47.5	3,299	1,775	-46.2

Source: QNB FS Research

Detailed Financial Statements

Income Statement (In QR mn)	2021	2022	2023e	2024e	2025e	2026e
Net Interest Income	**3,113**	**3,607**	**3,528**	**3,612**	**3,800**	**3,984**
Fees & Commissions	324	432	401	441	494	569
FX Income	173	271	288	309	328	351
Other Income	19	46	47	42	48	50
Non-Interest Income	**516**	**748**	**736**	**793**	**871**	**969**
Total Revenue	**3,629**	**4,355**	**4,265**	**4,404**	**4,670**	**4,954**
Operating Expenses	(780)	(1,126)	(1,143)	(1,141)	(1,219)	(1,288)
Net Operating Income	**2,849**	**3,229**	**3,122**	**3,263**	**3,451**	**3,665**
Net Provisions & Impairments	(1,097)	(1,710)	(1,571)	(1,343)	(1,124)	(1,061)
Net Profit Before Taxes & Minority Interest	**1,752**	**1,519**	**1,551**	**1,921**	**2,327**	**2,605**
Tax	(5)	(22)	(23)	(29)	(35)	(39)
Net Profit Before Minority Interest	**1,747**	**1,497**	**1,528**	**1,892**	**2,292**	**2,566**
Minority Interest	(13)	(19)	(19)	(24)	(29)	(32)
Non-Recurring Items	(16)	(134)	-	-	-	-
Net Profit (Reported/Headline)	**1,718**	**1,344**	**1,509**	**1,868**	**2,263**	**2,533**
Interest Expense on AT1 Bond	(48)	(46)	(46)	(46)	(46)	(46)
Social & Sports Contribution Fund	(43)	(36)	(38)	(47)	(57)	(63)
Net Profit (Attributable)	**1,627**	**1,263**	**1,425**	**1,775**	**2,161**	**2,424**

Source: Company data, QNB FS Research

Balance Sheet (In QR mn)	2021	2022	2023e	2024e	2025e	2026e
Assets						
Cash & Balances with Central Bank	5,221	5,088	5,312	5,465	5,957	6,434
Interbank Loans	9,156	6,109	7,130	6,253	7,393	4,347
Net Investments	32,753	31,477	34,975	32,204	36,194	39,075
Net Loans	120,880	117,859	118,829	125,054	134,412	144,903
Investment In Associates	349	346	355	365	375	382
Other Assets	3,280	4,074	4,072	3,940	3,809	3,901
Net PP&E	715	902	954	994	1,055	1,103
Goodwill & Intangibles	1,802	1,679	1,679	1,679	1,679	1,679
Total Assets	**174,155**	**167,533**	**173,305**	**175,954**	**190,873**	**201,823**
Liabilities						
Interbank Deposits	23,247	28,805	26,692	17,737	19,911	17,811
Customer Deposits	106,956	97,292	102,156	109,307	119,145	128,676
Sukuks & Borrowings	13,436	11,525	13,830	17,565	20,375	22,820
Other Liabilities	5,850	5,629	5,830	5,912	5,214	5,459
AT1 Notes	1,000	1,000	1,000	1,000	1,000	1,000
Total Liabilities	**150,488**	**144,251**	**149,508**	**151,521**	**165,645**	**175,767**
Minority Interest	200	198	217	241	270	303
Total Shareholders' Equity	**23,467**	**23,084**	**23,579**	**24,192**	**24,957**	**25,754**
Total Liabilities & Shareholders' Equity	**174,155**	**167,533**	**173,305**	**175,954**	**190,873**	**201,823**
Risk Weighted Assets	**104,741**	**111,079**	**116,461**	**120,529**	**133,611**	**143,294**

Source: Company data, QNB FS Research

Ratios/KPIs	2021	2022	2023e	2024e	2025e	2026e
Profitability (%)						
RoE	11.3	5.8	6.7	8.1	9.6	10.4
RoAA	1.1	0.7	0.8	1.0	1.2	1.2
RoRWA	1.9	1.2	1.3	1.5	1.7	1.8
NIM (% of IEAs)	2.30	2.31	2.27	2.25	2.24	2.19
NIM (% of RWAs)	3.61	3.34	3.10	3.05	2.99	2.88
NIM (% of AAs)	2.11	2.11	2.07	2.07	2.07	2.03
Spread	2.1	2.0	1.9	1.8	1.7	1.6
Efficiency (%)						
Cost-to-Income (Headline)	21.5	25.8	26.8	25.9	26.1	26.0
Cost-to-Income (Core)	21.6	26.0	27.1	26.1	26.4	26.3
Liquidity (%)						
LDR (Loans to Stable Sources of Funds)	100	108	102	99	96	96
Loans/Assets	69.4	70.3	68.6	71.1	70.4	71.8
Cash & Interbank Loans-to-Total Assets	8.3	6.7	7.2	6.7	7.0	5.3
Deposits to Assets	61.4	58.1	58.9	62.1	62.4	63.8
Wholesale Funding to Loans	30.3	34.2	34.1	28.2	30.0	28.0
IEAs to IBLs	118.1	118.9	118.4	120.5	118.9	118.8
Asset Quality (%)						
NPL Ratio	1.57	5.99	6.10	5.80	5.40	5.00
NPL to Shareholders' Equity	8.19	31.60	31.98	31.41	30.62	29.72
NPL to Tier 1 Capital	9.04	33.70	32.96	31.38	29.74	28.13
Coverage Ratio	95.1	46.3	63.4	78.6	92.9	106.6
ALL/Average Loans	1.7	2.6	3.6	4.3	4.8	5.1
Cost of Risk (bps)	87	127	114	94	82	72
Capitalization (%)						
CET1 Ratio	19.4	18.6	18.8	19.3	18.5	18.3
Tier-1 Ratio	20.3	19.5	19.6	20.1	19.2	19.0
CAR	21.2	20.3	20.4	20.9	20.0	19.8
Leverage (x)	7.4	7.3	7.4	7.3	7.6	7.8
Growth (%)						
Net Interest Income	12.4	15.9	-2.2	2.4	5.2	4.9
Non-Interest Income	11.9	45.1	-1.6	7.6	9.9	11.3
Opex	12.3	44.3	1.6	-0.2	6.9	5.7
Net Operating Income	12.4	13.4	-3.3	4.5	5.8	6.2
Net Income (Reported)	-21.0	-21.7	12.2	23.8	21.2	11.9
Net Income (Attributable)						
Loans	40.2	-2.5	0.8	5.2	7.5	7.8
Deposits	55.2	-9.0	5.0	7.0	9.0	8.0
Assets	43.7	-3.8	3.4	1.5	8.5	5.7
RWAs	54.8	6.1	4.8	3.5	10.9	7.2

Source: Company data, QNB FS Research

Recommendations		Risk Ratings	
Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price		*Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
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

Contacts

QNB Financial Services Co. W.L.L.
Contact Center: (+974) 4476 6666
info@qnbfs.com.qa
Doha, Qatar

Saugata Sarkar, CFA, CAIA
Head of Research
saugata.sarkar@qnbfs.com.qa

Shahan Keushgerian
Senior Research Analyst
shahan.keushgerian@qnbfs.com.qa

Phibion Makuwerere, CFA
Senior Research Analyst
phibion.makuwerere@qnbfs.com.qa