

1Q19 results review

Banks | UAE | 25 April 2019

RakBank reported 1Q19 net profit at AED270mn, a jump of 32% y-o-y and 20% ahead of our expectation. Earnings beat was driven by strong boost in non-interest income and lower credit cost. Core fee based income and Fx/derivative income recorded strong gains. Net interest income was subdued as benefit of asset re-pricing got diluted by shift towards more competitive wholesale banking segment, as well as stronger growth in high cost deposits. Cost to income ratio increased as operating expenses came slightly above our forecast on VAT related cost adjustment and higher other expenses. Its diversification strategy is on track as visible by increasing contribution of wholesale banking. This is also reflected in declining credit cost and improving asset quality. Further asset quality improvement should continue to support higher earnings growth and RoE improvement. Its high dividend yield (7.4%) makes the bank look attractive at current valuation (1.1x P/BV 2019E). We maintain Buy on RakBank.

► Margins under pressure but non-interest income supportive

Net interest income continues to witness subdued growth (+2% y-o-y) due to lower margins and increase in funding cost. NIMs were down 40bps y-o-y and we expect this trend to continue as bank shifts its focus towards corporate loan book. Higher funding cost came from stronger growth in deposits and that too driven by high cost fixed deposit (CASA mix at 59.5% versus 62% in 1Q18). Nevertheless, boost in non-interest income (+30% y-o-y) more than compensated for lower margins, driven by solid results from treasury and wholesale banking segments.

► Diversification strategy reflected in asset quality improvement

Credit costs declined further to 418bps in 1Q19 (-32 bps y-o-y and -49bps q-o-q). NPLs in absolute term were stable, while NPLs ratio improved to 4.0% (from 4.2% in 4Q18). Coverage ratio at 132% remains strong. Going forward, we expect credit cost to fall further on tight underwriting standards in the retail and SME segment as well as diversification towards corporate book. We estimate credit costs at 408bps in 2019E and 363bps in 2020E.

► Loan book grew modestly; deposits growth strong

Loan growth remained modest at 3.7% y-o-y. Loan book increase is mainly driven by Wholesale banking segment (+18% y-o-y and representing 23% of loan book) while retail banking (-1% y-o-y) and business banking (+2% y-o-y) segments continue to decline. Deposits growth was maintained at high level (6.4% y-o-y). Bank remains well capitalized with CET1 of 16.3% and CAR of 17.4%.

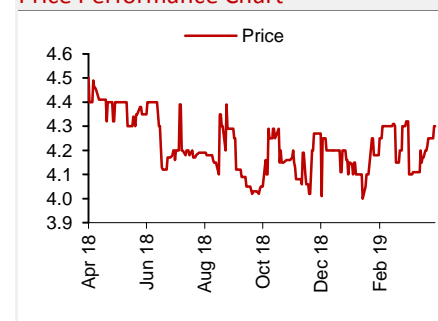
Key Financials	2017	2018	2019E	2020E
Net interest income (AEDm)	2,723	2,769	2,839	2,835
Total income (AEDm)	3,810	3,827	4,008	4,062
EPS (AED)	0.5	0.5	0.6	0.7
EPS (% Change)	21.4	14.0	17.2	7.1
P/E (x)	9.0	8.0	6.8	6.4
P/B (tangible)	1.0	1.1	1.1	1.0
Gross NPL (% of Loans and advances)	4.0	4.2	3.8	3.6
Dividend yield	7.3	7.3	7.4	8.0
ROAA (%)	1.8	1.8	2.0	2.0
RoAE (%)	10.4	12.2	14.5	14.4

Source: ADCB Securities Equity Research

Fundamentals

Recommendation	Buy
Target Price	AED 5.3
Price	AED 4.30
Price 12m High/Low	AED 4.50/4.00
Market Cap.	AED7,207mn
Bloomberg/Reuters	RAKBANK UH / RAKB.AD

Price Performance Chart



Source: Bloomberg

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Financials

Income Statement (AEDmn)	2018	2019E	2020E
Net interest income	2,769	2,839	2,835
Total non-interest income	1,058	1,169	1,227
Fee income	885	978	1,026
Trading income	27	37	39
Other income	147	154	162
Total income	3,827	4,008	4,062
Total operating expenses	1,488	1,558	1,631
Salaries and wages	927	974	1,022
Other operating expenses	458	476	495
Pre provision profit	2,339	2,450	2,431
Total provisions	1,421	1,375	1,281
Profit before tax and MI	918	1,074	1,150
Taxes	0	0	0
Minority interest	5	5	5
Reported net profit	913	1,070	1,145
Adjusted net profit	913	1,070	1,145

Balance Sheet (AEDmn)	2018	2019E	2020E
Loans and advances	32,861	34,490	36,101
Investments	7,189	7,908	8,857
Fixed assets	860	903	948
Other assets	1,682	1,909	2,258
Total assets	52,295	55,773	59,471
Total equity	7,114	7,647	8,206
Sub/hybrid/other debt	0	0	0
Minority interests	46	50	56
Deposits	34,140	36,530	39,087
Total borrowings	9,719	10,205	10,715
Total liabilities	45,524	48,483	51,638

Valuation and leverage metrics	2018	2019E	2020E
P/E (x)	8.0	6.8	6.4
P/PPE (x)	3.1	3.0	3.0
P/B (tangible)	1.1	1.1	1.0
Dividend yield (%)	7.3	7.4	8.0
Tier I ratio	16.0	16.2	16.4
Core tier I ratio	16.0	16.2	16.4
CAR (%)	17.2	17.3	17.5
Average assets/Equity (x)	6.8	7.4	7.3
Loan to deposit ratio (%)	96.3	94.4	92.4

Key Ratios (%)	2018	2019E	2020E
ROAA	1.8	2.0	2.0
RoAE	12.2	14.5	14.4
Net interest margin	5.5	5.3	5.0
Cost-income	38.9	38.9	40.2
CASA	56.9	55.9	54.8
Gross NPL (% of Loans and advances)	4.2	3.8	3.6
Loan loss coverage	133.1	130.5	126.3
Credit costs (% of avg loans)	4.4	4.1	3.6

Per-share data (AED)	2018	2019E	2020E
EPS	0.5	0.6	0.7
DPS	0.3	0.3	0.4
BVPS	3.9	4.2	4.5
Total no. of outstanding shares (mn)	1,676	1,676	1,676

Investment case

We recommend Buy on RakBank. We expect profitability to improve led by decline in credit costs and pick up in asset growth. Furthermore, management's transformation agenda is gaining traction, which focuses on diversifying the balance sheet and income base.

Upside case AED5.7

Upside case for the bank assumes sharp improvement in credit costs and pick up in asset growth. RakBank can trade at one standard deviation above its historical average at 1.4x P/FBV.

Downside case AED3.7

Downside case assumes further weakening in the macro situation, which could result in weaker asset quality and rising credit costs. We also assume further compression in margins due to intensified competition, particularly in wholesale banking, which is one of its key focus area. Multiple could drop to 0.9x P/FBV.

1Q19 results summary

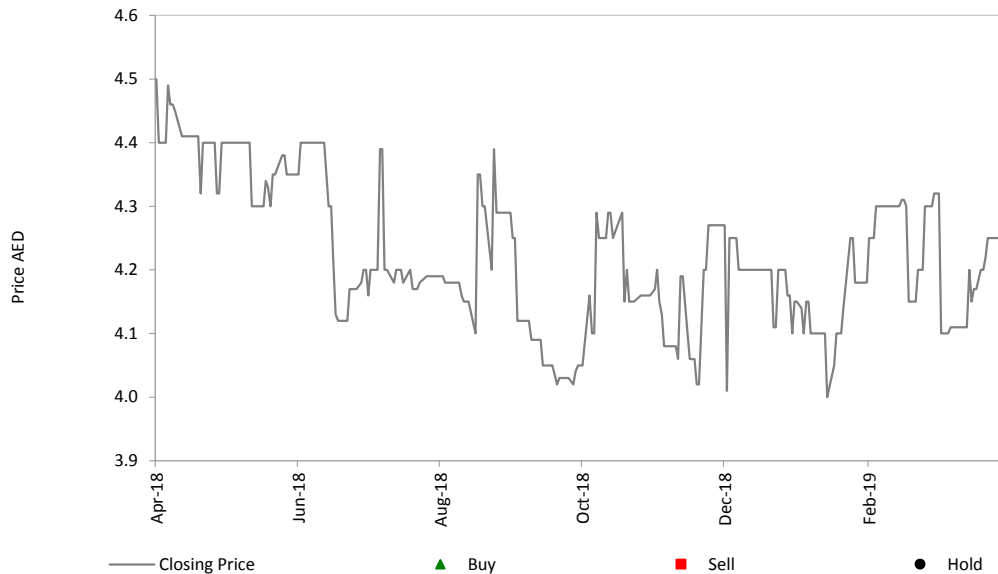
Fig. 1. 1Q19 results review

Income statement (AEDmn)	1Q18	4Q18	1Q19	% y-o-y	% q-o-q
Interest income	804	905	893	11.1	(1.4)
Interest expense	133	202	209	57.1	3.2
Net Interest Income	671	703	684	1.9	(2.7)
Non-interest Income	244	297	317	30.1	6.7
- Fee based income	202	237	266	31.8	12.5
- Trading revenue	19	2	17	(9.4)	965.0
Total income	915	1,000	1,001	9.4	0.1
Operating expenses	345	383	385	11.3	0.4
- Employee Exp.	220	233	224	1.7	(3.8)
- Other expenses	125	150	161	28.3	6.8
Pre-provision profit	569	617	616	8.3	(0.1)
Loan loss provisions	359	385	343	(4.4)	(11.0)
Profit before tax	205	246	270	31.7	10.0
Associate, taxes and minorities	1	2	0	(64.2)	(77.1)
Net Income	204	244	270	32.3	10.6
Balance sheet (AEDbn)				% y-o-y	% q-o-q
Loans	32	33	32.8	3.7	(0.2)
Deposits	33	34	35.4	6.4	3.8
- CASA ratio	62.0	56.9	59.5		
Ratios (%)				y-o-y (bps)	q-o-q (bps)
Cost/income ratio	37.8	38.3	38.4	65	11
NIM	5.7	5.2	5.3	(40)	10
Credit costs	4.49	4.66	4.18	(32)	(49)
RoAA	1.7	1.9	2.0	36	17
Tier I	17.5	16.0	16.3	(119)	25
CAR	18.6	17.2	17.4	(122)	24
Asset quality (AEDmn)				% y-o-y	% q-o-q
Gross NPA	1,385	1,478	1,397	0.9	(5.5)
Gross NPA (%)	4.1	4.2	4.0		
Coverage (%)	139.2	133.1	132.4		

Source: Company, ADCB Securities Equity Research

Recommendation history

RAK BANK (RAKBANK UH EQUITY)



Date	Recommendation	Target Price (AED)	Closing Price (AED)
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Rating Distribution

Rating	Coverage Universe %
Buy	75%
Hold	25%
Sell	0%

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