

MCB

One of the largest beneficiaries of contractionary monetary policy

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We initiate our coverage on MCB Bank Ltd. (MCB) with a DDM based Dec-20 TP of Rs.223 which provides an upside potential of 31%. A dividend yield of 12%, if incorporated gives a total return of 43%

The deposit base of MCB bank has grown at a 5-year CAGR of 11% to Rs1.05tr in CY18. Furthermore, CASA and NIM stand at 86.04% and 3.15% respectively during the same period

Going forward, we expect the NIM to expand further to 3.38% in CY19, making MCB one of the largest beneficiaries of the interest rate hike. Furthermore, low operational cost, a lower proportion of government deposits, recoveries of NIB's NPLs, strong deposits' growth and high ROE has made the valuation of the company much more attractive

Sector Overview

According to the data updated by State Bank of Pakistan (SBP), total deposits of all banks showed a healthy growth of 10.68% or Rs 1.395 trillion in FY19 to reach an all-time high level of Rs. 14.46 trillion as of June 30, 2019 compared with Rs 13.062 trillion on June 30, 2018. The growth in deposits was mostly fueled in June 2019, mainly due to the amnesty scheme and seasonal targets. On a month-on-month basis, during June 2019, deposits grew by Rs. 998 billion or 7% to Rs 14.458 trillion up from Rs 13.46 trillion in May 2019.

The State Bank of Pakistan's latest data shows the government borrowed Rs1.367 trillion from July 1 to Aug 2 (33 days) as against net debt retirement of Rs20.2bn during the same period last fiscal year. This shift in government's borrowing to the private banks came as a result of SBP's decision to stop lending to the center and finance its cash shortages. Banking money's flow is now directed towards the government papers which is likely to hit the economic growth. However, this scenario is highly favorable for the banking sector of the country.

Banking profitability is set to recover strongly in 2019 on the back of expansion in NIM (net interest margin) coupled with growing deposits and rising interest rate. We expect that the interest rate has come to its peak now at 13.25% after an increase of 750 bps since Dec-17. Keeping the numbers of current account deficit, fiscal deficit and CPI inflation in view, we expect a rate cut of around 25-50 bps before Jun-20. (Dawn, 2019) (Islamabad, 2019) (TheNews, 2018)

Strong Growth in Deposits Likely to Continue

The deposit base of MCB bank has grown at a 5-year CAGR of 11% to Rs1.05tr in CY18. The robust growth in deposits has been made possible by the huge network of 1,387 branches, spread all over the country. Going forward, we expect the deposit base to grow at a 5-year CAGR of 10% to Rs1.69tr by CY23 on account of strong brand equity, and the government's efforts to document the economy.

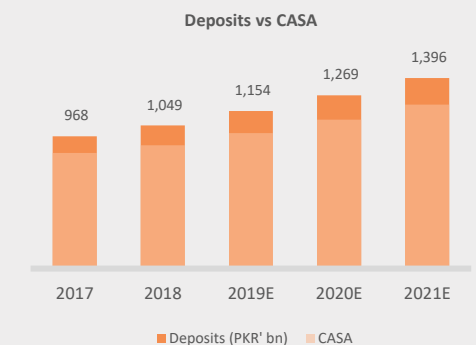
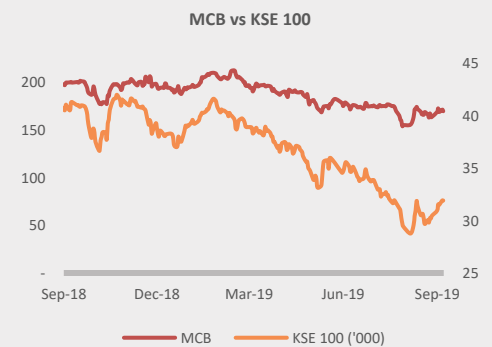
NIMs Likely to Expand Further

MCB has always been enjoying high net interest margins on account of the high proportion of CASA in deposits among its peers. The bank posted the NIM of 3.15% along with CASA to deposits ratio of 86.04% in CY18. Going forward, we expect the bank would be one of the largest beneficiaries of the rate hike as high CASA to deposits would help the bank to limit its interest expense which will result in the expansion of NIM by around 23 bps to 3.38% in CY19.

Key Statistics

Symbol	MCB
TP - Dec 20	223.00
LDCP	170.26
Upside	31%
Free Float (mn)	415
Market Cap. (Rs.mn)	201,758

Symbol	P.B
MEBL	2.57
ABL	1.12
UBL	1.11
HBL	0.89
Peer Average	1.42
MCB	1.37
Discount	4%

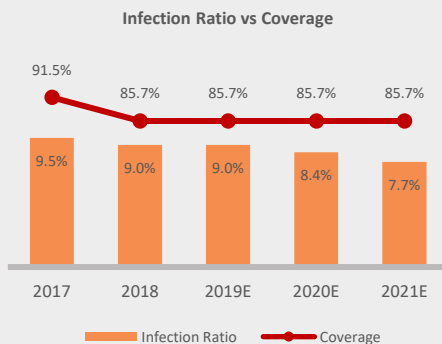
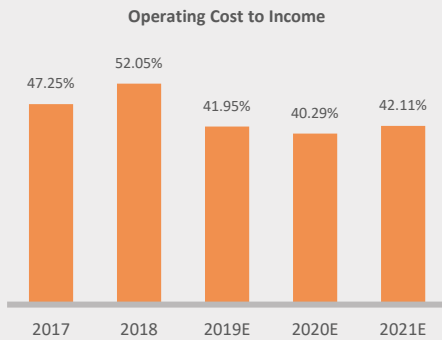
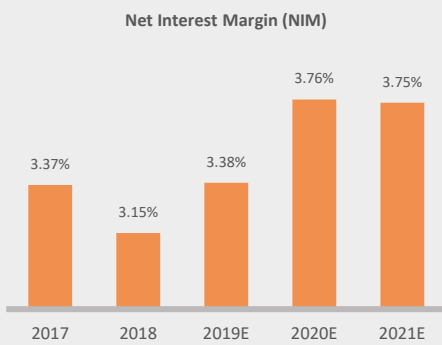
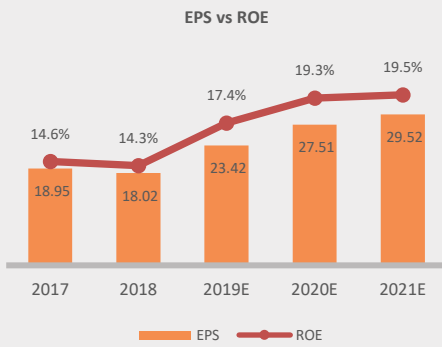


Sources: ACPL Research, Company Financials, PSX

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Key Statistics



Sources: ACPL Research, Company Financials, PSX

Cost Efficiency Has Always Remained a Key Strength

Despite having a huge network of 1,387 branches all over the country, MCB has successfully contained its operational expenses to 52.05% of total income in CY18 which is one of the lowest in its peers. Going forward, we expect the operational expenses to be confined at around 42% on account of the bank's firm commitment to bring further efficiency into its operations.

Lower Proportion of Government Deposits

MCB is one of the banks who have a lower proportion of government deposits in their deposit base. By the end of CY18, MCB had only 4.9% of government deposits which makes it one of the least affected banks in case of the formation of treasury single account (TSA) in the future.

NIB Recoveries to Bring Down the Infection Ratio

As MCB is one of the conservative banks in Pakistan having a consumer loan portfolio of around less than 4%, its infection ratio is expected to remain under control even in the rising interest rate regime. With regards to the recovery of NIB's NPL stock of Rs29.7bn (Acquired in mid-2017), the management is confident that large recoveries from two accounts are possible in 2HCY19. Therefore, we assume that the infection ratio of the bank would ultimately come down to below 8% by CY21 from 8.95% in CY18.

Valuation

MCB is offering CY20E ROE of 19.26% and is currently trading at CY20E PE of 6.19x. Furthermore, the script is trading at a CY20E P/B of 1.19x which offers a discount of 16% relative to its historical 5-year average of 1.42x. We have a **BUY** stance on the script with a DDM based Dec-20 TP of Rs.223 which provides an upside potential of 31%. Furthermore, it also offers an attractive dividend yield of 12% which makes the total return of 43%.

Key Risks to Valuation

- Earlier than expected cut in interest rate
- More than expected rise in NPLs

Key Ratios

Profitability Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Yield on Earning Assets	%	9.24	9.04	7.18	6.16	6.05	10.12	10.65	10.04	9.32	8.60
Interest Cost	%	4.42	3.76	2.72	2.79	2.90	6.74	6.89	6.29	5.69	5.09
Net Interest Margin	%	4.83	5.28	4.46	3.37	3.15	3.38	3.76	3.75	3.63	3.51
Operating Cost to Income	%	38.24	34.75	38.32	47.25	52.05	41.95	40.29	42.11	43.93	45.68
Return on Equity	%	18.70	18.54	15.46	14.62	14.31	17.44	19.26	19.50	19.28	18.14
Return on Assets	%	2.60	2.54	2.08	1.67	1.43	1.65	1.79	1.77	1.70	1.54
Balance Sheet Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Deposits Growth	%	8.86	1.23	12.14	23.94	8.32	10.00	10.00	10.00	10.00	10.00
CASA to Deposits	%	88.58	90.34	91.07	87.54	86.04	86.04	86.04	86.04	86.04	86.04
Advances to Deposits	%	44.10	43.65	44.53	48.46	48.00	56.23	55.97	55.65	55.33	55.10
Investments to Deposits	%	74.26	81.18	71.14	67.83	71.43	69.64	67.62	65.78	64.11	62.59
PIBs to Investments	%	68.36	54.05	39.25	36.00	17.70	17.70	17.70	17.70	17.70	17.70
T Bills to Investments	%	29.41	43.85	58.32	61.72	79.67	79.67	79.67	79.67	79.67	79.67
Gross Infection Ratio	%	6.80	6.32	5.90	9.47	8.95	8.95	8.40	7.70	7.00	6.50
Provisioning Coverage	%	82.84	87.63	87.32	91.46	85.68	85.68	85.68	85.68	85.68	85.68
Net Infection Ratio	%	1.24	0.83	0.79	0.89	1.39	1.19	1.12	1.03	0.94	0.88
Capital Adequacy Ratio	%	20.41	19.43	19.33	16.34	17.02	16.21	15.91	15.57	15.12	14.59
Leverage Ratio	%	9.08	8.23	8.59	7.52	6.54	6.14	5.98	5.80	5.58	5.33
Operational Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Market Share - Deposits	%	8.25	7.49	6.98	7.83	7.86	7.86	7.86	7.86	7.86	7.86
Market Share - Advances	%	7.23	6.75	6.60	7.89	6.93	6.93	6.93	6.93	6.93	6.93
Market Share - Investments	%	9.69	8.13	7.47	7.68	10.04	9.73	9.45	9.19	8.96	8.75
No. of Branches		1232	1223	1238	1444	1387	1401	1415	1429	1443	1458
Investment Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Dividend Per Share		14.00	16.00	16.00	16.00	16.00	16.00	20.00	22.00	24.00	24.00
Dividend Yield	%	8.22	9.40	9.40	9.40	9.40	9.40	11.75	12.92	14.10	14.10
Dividend Cover	x	1.47	1.35	1.15	1.18	1.13	1.46	1.38	1.34	1.28	1.26
Retention Ratio	%	31.79	25.78	13.38	15.57	11.23	31.69	27.29	25.48	21.85	20.75
Payout Ratio	%	68.21	74.22	86.62	84.43	88.77	68.31	72.71	74.52	78.15	79.25
No. of Shares	('m)	1185	1185	1185	1185	1185	1185	1185	1185	1185	1185
Earnings Per Share		20.53	21.56	18.47	18.95	18.02	23.42	27.51	29.52	30.71	30.29
Book Value Per Share		109.79	116.28	119.51	129.59	125.97	134.29	142.79	151.40	159.31	166.92
Price to Earnings	x	8.29	7.90	9.22	8.98	9.45	7.27	6.19	5.77	5.54	5.62
Price to Book Value	x	1.55	1.46	1.42	1.31	1.35	1.27	1.19	1.12	1.07	1.02

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	77,269	80,393	67,422	74,091	83,319	156,428	178,190	181,777	182,874	183,138
Mark-up / Return / Interest expensed	-33,757	-31,077	-23,655	-31,429	-37,305	-90,866	102,167	102,571	102,048	100,406
Net Mark-up / Interest Income	43,512	49,316	43,767	42,662	46,014	65,562	76,022	79,206	80,826	82,732
Fee and commission income	7,225	7,842	7,640	9,741	10,731	11,267	12,394	13,633	14,996	16,496
Dividend income	1,061	1,267	1,456	1,941	1,280	1,429	1,527	1,634	1,751	1,881
Foreign exchange income	1,443	946	959	1,636	3,420	2,500	1,180	1,180	1,180	1,180
(Loss) / gain from derivatives	0	0	0	15	12	0	0	0	0	0
(Loss) / gain on securities	1,648	4,429	5,679	4,741	1,293	-324	1,199	1,328	1,471	1,627
Other income	1,566	2,083	488	43	462	162	210	273	355	462
Total non-markup / interest income	12,944	16,566	16,222	18,118	17,198	15,034	16,510	18,049	19,754	21,646
Non mark-up / interest expenses										
Operating expenses	-20,612	-21,968	-22,074	-27,958	-32,091	-32,733	-36,006	-39,606	-42,775	-46,197
Workers' Welfare Fund	-979	-927	-916	-620	-641	-862	-1,017	-1,038	-1,040	-1,047
Other charges	0	0	0	-143	-170	-212	-255	-306	-367	-440
Profit Before Provisions	34,865	42,987	36,999	32,059	30,310	46,789	55,254	56,304	56,398	56,694
Provisions / (reversal of provisions)	1,864	-659	-925	-1,045	1,753	-1,288	-1,815	-768	-408	-1,478
Extraordinary / unusual items	0	0	0	0	0	0	0	0	0	0
Profit before income tax	36,729	42,329	36,075	31,014	32,064	45,501	53,439	55,536	55,989	55,216
Income tax expense	-12,405	-16,782	-14,184	-8,555	-10,704	-17,746	-20,841	-20,548	-19,596	-19,325
Profit for the year	24,325	25,546	21,891	22,459	21,360	27,756	32,598	34,988	36,393	35,890
EPS	20.53	21.56	18.47	18.95	18.02	23.42	27.51	29.52	30.71	30.29

Horizontal Analysis

	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	18.76%	4.04%	-16.13%	9.89%	12.45%	87.75%	13.91%	2.01%	0.60%	0.14%
Mark-up / Return / Interest expensed	24.12%	-7.94%	-23.88%	32.86%	18.70%	143.58%	12.44%	0.40%	-0.51%	-1.61%
Net Mark-up / Interest Income	14.90%	13.34%	-11.25%	-2.52%	7.86%	42.48%	15.95%	4.19%	2.05%	2.36%
Total non-markup / interest income	15.87%	27.99%	-2.08%	11.69%	-5.08%	-12.59%	9.82%	9.32%	9.45%	9.58%
Non mark-up / interest expenses										
Operating expenses	10.16%	6.58%	0.48%	26.66%	14.78%	2.00%	10.00%	10.00%	8.00%	8.00%
Workers' Welfare Fund	5.43%	-5.26%	-1.28%	-32.25%	3.38%	34.35%	18.10%	1.98%	0.27%	0.65%
Other charges	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	18.90%	25.00%	20.00%	20.00%	20.00%	20.00%
Profit Before Provisions	18.59%	23.29%	-13.93%	-13.35%	-5.46%	54.37%	18.09%	1.90%	0.17%	0.52%
Provisions / (reversal of provisions)	-35.45%	-135.33%	40.42%	13.00%	267.77%	-173.46%	40.94%	-57.69%	-46.83%	261.92%
Profit before income tax	13.75%	15.24%	-14.77%	-14.03%	3.38%	41.91%	17.44%	3.92%	0.82%	-1.38%
Income tax expense	14.93%	35.29%	-15.48%	-39.68%	25.12%	65.78%	17.44%	-1.40%	-4.63%	-1.38%
Profit for the year	13.16%	5.02%	-14.31%	2.59%	-4.89%	29.95%	17.44%	7.33%	4.02%	-1.38%
EPS	13.16%	5.02%	-14.31%	2.59%	-4.89%	29.95%	17.44%	7.33%	4.02%	-1.38%

Source: ACPL Research, Company Financials

Advances Analysis

For the Year 2018	Gross Advances	Infection Ratio	NPLs Coverage
Manufacture of textiles	13.6%	16.7%	95.4%
Transportation and storage	11.1%	0.8%	79.2%
Manufacture of food & beverages products	8.8%	6.1%	98.0%
Wholesale and retail traders	7.5%	26.4%	61.5%
Electricity, gas, steam and air conditioning supply	7.4%	0.8%	99.5%
Individuals	6.8%	10.4%	92.6%
Manufacture of chemicals and chemical and pharmaceutical products	6.8%	0.9%	97.2%
Manufacture of sugar	6.4%	6.4%	74.2%
Others	4.5%	3.0%	92.2%
Construction	3.7%	1.5%	99.0%
Manufacture of coke and refined petroleum products	3.7%	1.6%	99.8%
Telecommunications	2.9%	0.3%	92.1%
Financials	2.5%	4.8%	99.7%
Manufacture of cement	2.5%	2.6%	100.0%
Manufacture of basic metals and metal products	2.4%	15.3%	99.8%
Services	1.8%	10.5%	90.8%
Agriculture, forestry and fishing	1.5%	8.5%	95.7%
Ship Breaking	1.5%	33.0%	100.0%
Electronics and electrical appliances	1.0%	2.0%	95.2%
Manufacture of rubber and plastics product	0.8%	14.8%	60.2%
Human health and social work activities	0.7%	1.2%	70.7%
Manufacturing of Pulp, Paper, Paperboard	0.7%	6.3%	88.9%
Footwear and Leather garments	0.6%	5.0%	99.8%
Mining and quarrying	0.4%	0.4%	99.4%
Manufacture of machinery, equipment and transport Equipment	0.4%	21.1%	96.1%
Total	100.0%	8.0%	85.7%

Source: ACPL Research, Company Financials

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TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

VALUATION METHODOLOGY

To arrive at our Target Price, Abbasi & Company (Private) Limited uses different valuation methods which include:

- I. Discounted Cash Flow Model
- II. Dividend Discount Model
- III. Relative Valuation Model
- IV. Sum of Parts Valuation

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BUY	Greater than 15%
HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

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