

PAKISTAN BANKS

MARKET VISTA

REP-019

Offering best-in-class ROE

We initiate coverage on Meezan Bank Limited (MEBL), Pakistan's 7th largest bank in terms of deposit size, with a 'Buy' stance and a Dec'19 TP of PkR115.8/sh, offering an upside of 16.8% from last close. Dividend yield stands at 4.0%, taking total return to 20.8%. Resolution of regulatory hurdles with ADT-1 (PkR7bn) and Tier-II (PkR7bn) strengthening CAR to 14.6% (CY18), has adequately placed MEBL to capitalize on financing demand with interest rate hikes also (CY19F end: 11.5%) contributing in expanding NIMs (CY19/20F: 4.4/4.9% vs. 3.7% in CY18). We expect advances to depict a 3y CAGR (CY19-21F) of 10.4% (Industry growth expected at 7.7%), lower than CY18 growth of 22.0% amid economic slowdown, however, low cost of deposits for MEBL (CY19F: 4.1% vs. ~5.0% for conventional banks) places the bank at an advantage over conventional peers. Additionally, Government's intent to tap Islamic Banking Industry to generate funds as indicated by recent Sukuk issuance of PkR200bn (with additional PkR400bn in the pipeline) for resolution of circular debt, should favor the bank that was clogged with lack of good fund deployment opportunities few years back. Coverage of 139% in CY18 frames the bank as a safe play in a fragile economic environment where we expect provisioning costs to avg. at 0.6% in CY19-21F vs. industry's 1.1%. Resultantly, earnings growth is expected to register a 3y CAGR (CY19-21F) of 27.5% transcending into 3y avg. ROE of 29.3%, highest in our universe.

(Detailed Report to be released shortly)

Interest rate hikes and balance sheet mix to grow NIMs : The low cost of deposits for MEBL (CY19F: 4.1% vs. ~5.0% for conventional banks) due to presence of CA deposits (37.0% of total deposits) and non-applicability of minimum deposit rate requirement as in the case of conventional banks, provides competitive advantage to the bank for capitalizing on financing demand (CY18 yield on advances: 3M KIBOR-0.6% vs. industry's yield of 3M KIBOR+0.5%). Additionally, issuance of Additional Tier-1 Capital (ADT-1) and Tier-II capital of PkR7bn each beefed-up bank's CAR to 14.6% in CY18. We expect the bank's advances growth to register a 3y CAGR of 10.4 % vs. industry's 7.7% that along with Government's intent to tap Islamic industry to generate funds (eg. Sukuk issuance of PkR200bn for resolution of circular debt) and Ijara Sukuk rollover at higher yields (~35% of total outstanding Sukuks in CY19) positions the bank to gain from interest rate hikes with NIMs likely to stand at CY19/20F 4.4/4.9% vs. 3.7% in CY18.

Lower risk profile courtesy superior asset quality: We expect the recent aggressive interest rate hikes to trigger industry-wide asset quality issues by 2HCY19 with economic slowdown persisting at least in the medium run. While provisioning cost increase can be witnessed across the industry, we expect little drag on MEBL's profitability despite ADR standing at 65.0% in CY18. We foresee provisioning cost for MEBL at 0.64% (CY19-21F), significantly lower than the previous economic down cycle (CY09-11) avg. of 2.74%. Our ameliorate assumption is based on, i) the bank learning from the previous economic cycle loading coverage ratio to 139.0% in CY18 vs. 69.3% in CY09 and ii) diversifying financing base with public/private split at 26.0/74.0% in CY18 vs. 0/100% in CY09 whereas banks usually get waiver on provisioning expense on public sector defaults.

Premium valuations justified: MEBL is currently trading at a CY19F P/B of 2.3x vs. industry weighted avg. of 1.03x. Premium valuations are justified in our view with bank's fwd. 3y avg. ROE ascending to 29.3% vs. 23.8% in CY18 and industry avg. of 14.0% on the back of 3y avg. income growth of 27.5% underpinned by NII growth of 22.0%. Resultantly, cost-to-income ratio of the bank is expected to fall to 45.5% by CY21F vs. previous 5y avg of ~60%. We have a 'Buy' stance on the stock with a Dec'19 TP of PkR115.8/sh, offering an upside of 16.8%. Dividend payout could enter a new normal at around 40% vs. 50-60% previously due to limited CAR buffer, pulling down dividend yield to 4.0% (CY19F) where we do not rule out continuation of bonus issue.

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BUY

TARGET PRICE (PkR)	SHARE PRICE (PkR)
115.8	99.1
UPSIDE/DOWNSIDE	DIV. YIELD
16.8%	4.0%

MEBL: Valuations stats

	CY18	CY19F	CY20F
EPS (PKR)*	7.7	10.7	14.3
DY (%)*	3.5	4.0	6.1
BVPS	36.3	43.1	51.4
P/B (x)	2.7	2.3	1.9
P/E (x)	12.9	9.2	6.9
ROE (%)*	23.8	27.9	31.1
ROA (%)	1.0	1.3	1.5

*On CY18A results.

Source: PSX & AKD Research

KATS Code	MEBL
Bloomberg Code	MEBL.PA
Free Float Shares (mn)	292.30
Market Cap (PkRmn)	115,867.72
Market Cap (US\$m)	839.6
Shares (mn)	1,169.19
3M High (PkR)	99.60
3M Low (PkR)	83.64
1Yr High (PkR)	99.60
1Yr Low (PkR)	72.17
3M Avg Turnover '000	633.33
1 Yr Avg Turnover '000	513.83
3M Avg DT Value (PkR'000)	57.41
3M Avg DT Value (US\$'000)	0.41
1Yr Avg DT Value (PkR'000)	45,113.89
1Yr Avg DT Value (US\$'000)	324.56



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Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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