

PAKISTAN BANKS

MARKET VISTA

REP-019

MCB downgraded to Neutral from Buy

- Post release of detailed financials, we revise down our earnings estimates for MCB Bank Limited (MCB) by PkR1.6/1.1/sh for CY19/20F to PkR/sh 18.8/25.2 (CY19/20F ROE down by 1.3/0.9% to 14.3/18.0%) as we extend super tax to terminal year (CY23) at 4%.
- Resultantly, our valuation stance is revised to Neutral from Buy with a Dec'19TP of PkR207.1/sh (Previously: PkR224.7/sh), offering an upside of 6.5% from last close. Cumulated with dividend yield of 8.2%, the stock offers a total return of 14.7%.
- We expect bank's NIMs expansion to be a function of interest rates up-cycle (CY19-end policy rate: 11.5%) where we expect CY19/20F NIMs to expand by 24/85bps to 4.0/4.9% with potential PIB accumulation at higher yields coming into play in CY20, while pass through of rate hikes would be limited in CY19 due to re-pricing mismatch arising on the back of 51% SA deposits in the deposit mix (highest in our universe).
- Expanding NIMs could translate into 3y earnings CAGR of 20.5% with subsiding of cost pressures. Gross cost of provisioning is likely to avg. at 0.6% (CY19-21F) that could be neutralized by possible recoveries from NIB portfolio. Moreover, we expect normalization in operating cost growth to low-teens in the medium term as against 20% in CY18 which included certain one-offs.

CY19/20F EPS revised down by PkR1.6/1.1: Post release of detailed financials, we revise down our earnings estimates for MCB Bank Limited (MCB) by PkR1.6/1.1/sh for CY19/20F to PkR/sh 18.8/25.2 (CY19/20F ROE down by 1.3/0.9% to 14.3/18.0%) as we extend super tax to terminal year (CY23) at 4%. Resultantly, our valuation stance is revised to Neutral from Buy with a Dec'19TP of PkR207.1/sh (Previously: PkR224.7/sh). Incremental tax charge owing to reinstatement of super tax on CY17 earnings and imposition of flat 4% super tax from CY19 onwards (previously super tax was destined to gradually phase-out by CY21) reduces our CY19/20 EPS forecast by PkR/sh 1.4/0.8. We have not incorporated Workers' Welfare Fund (WWF) reversal in our CY19 estimates, the occurrence of which would positively impact our estimates. To highlight, MCB bank, unlike its peer banks (HBL/UBL/ABL), did not reverse WWF expense in 4QCY18, waiting for legal opinion on the same.

NIMs likely to expand to 4.0/4.9% in CY19/20F: We expect bank's NIMs expansion to be a function of interest rates up-cycle rather than balance sheet growth. MCB, through advances growth of 11.6% in CY18 (Gross ADR: 54.4%) and pulling-up its investment in shorter tenor bonds to 51.3% of deposits, has aligned its balance sheet to gain from interest rate upcycle. Consequently, we expect CY19/20F NIMs to expand by 24/85bps to 4.1/5.1% with potential PIB accumulation at higher yields coming into play in CY20 while the pass through of rate hikes would be limited in CY19 due to re-pricing mismatch arising on the back of 51% SA deposits in the deposit mix (highest in our universe). Possible deleveraging of balance sheet (CY18 borrowings stood at 17.0% of earning assets vs. ~7% in an interest rate upcycle previously) could pull down balance sheet growth in our view in CY19 (CY19F: 7.0% vs. 15.4% in CY18) with advances growth expected to remain flat (management expectation of ~7%). Importantly, NIMs net of provisioning are likely to stand at 4.4/4.5% in CY19/20F vs. CY18 4.3% (highest in our universe).

.... translating into 3y earnings CAGR of 20.5%: We expect 3y earnings CAGR of 20.5% with expanding NIMs translating into bottom-line through subsiding of cost pressures. Gross cost of provisioning likely to avg. at 0.6% (CY19-21F), however higher provisioning charge in the up cycle would be partially offset by the recoveries in NIB portfolio. We have incorporated staggered recoveries from NIB portfolio by CY22 foreseeing difficult economic environment as against management's expectation of meeting its recovery target by CY20 (Full NIB portfolio recovery was targeted at PkR12bn of which ~PkR3-4bn is recovered by CY18). Additionally, we expect normalization in opex growth to 11-13% in the medium term as against 20% growth in CY18 that included certain one-offs. We expect cost-to-income ratio of the bank to slip to below 50% in CY20 whereas reaching historical avg. of 40% by CY23.

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NEUTRAL

TARGET PRICE (PkR)	SHARE PRICE (PkR)
207.1	194.5
UPSIDE/DOWNSIDE	DIV. YIELD
6.5%	8.2%

Price Performance

	3M	6M	12M
Absolute (%)	-1.8	-1.9	8.6
Relative (%)	5.6	7.7	0.4

Source: PSX & AKD Research

Change in Estimates

	CY19F	CY20F	CY21F	TP
Current	18.8	25.2	29.7	207.1
Previous	20.4	26.3	33.2	224.7
Chg %	-7.8%	-4.2%	-10.6%	-7.8%

Source: AKD Research

Valuation Stats

	CY18A	CY19F	CY20F	CY21F
EPS	17.2	18.8	25.2	29.7
DPS	16.0	16.0	21.0	25.0
BVPS	127.7	136.6	144.8	158.1
P/E (x)	11.3	10.3	7.7	6.5
P/BV (x)	1.5	1.4	1.3	1.2
Div. Yield	8.2%	8.2%	10.8%	12.9%
Earn. Growth	-7.3%	9.6%	33.9%	17.9%
ROA	1.4%	1.4%	1.7%	1.9%
ROE	13.5%	13.9%	17.5%	18.9%
NIM	3.8%	4.0%	4.9%	5.4%

Source: Company Report & AKD Research



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New Rating Definitions

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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