



MCB Bank Limited

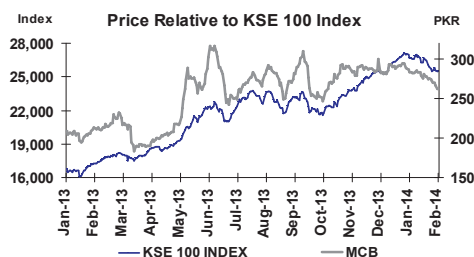
MCB - Expanding its wings

We reinstate our coverage on MCB Bank Ltd with 'BUY' recommendation for Dec'14 Target Price of Rs 334/share, currently offers an upside of 19% alongside dividend yield of 5% taking cumulative total stock return to 24%. Our recommendation is based on 1) stellar average earnings growth of 13% post CY13 onwards, 2) GDP growth to pace up going forward would increase credit demand of the bank, 3) Provisioning reversals and decline in NPLs to boost bottom-line and asset quality, 4) NIMs to scale up to 6.5% by CY16, up from 5.5% in CY13, 5) NII to grow by 13% on average for (CY14E-CY16E) as against last 3yrs negative average growth of -1.80%, 6) ROE is expected to stabilise at 21.4% for (CY14E-CY16E), 7) Acquisition of stake in Burj Bank Ltd. to open new arena for growth of the bank (earnings growth would increase to ~20% not incorporated in the model). Risks to our thesis are 1) Increase in MDR or further reduction MDR gap vs DR to affect NIMs as bank has 55% as savings deposit, 2) Political, law & order issues to affect business climate, 3) Macro economic challenges, 4) Lower capital gains due to under performance of market and 5) Discount rate crossing 11% may inflate provisions or asset quality.

KEY DATA

KATS Code	MCB
Reuters Code	MCB.KA
Current Price (Rs)	280.71
Year High, Low (Rs)	299, 260.65
Market Cap (Rs' bn)	284
Market Cap (US\$ mn)	2,840
Shares Outstanding (mn)	1,012
Free Float (%)	40%

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

MCB Financial Snapshot

	CY12A	CY13A	CY14E	CY15E
Profit after Taxation (Rs mn)	20,941	21,479	24,999	28,324
EPS (Rs)	20.70	21.24	24.71	27.99
Book Value (Rs/share)	100.56	108.94	120.17	133.95
DPS (Rs)	13.00	14.00	14.00	15.00
P/E x	13.72	13.38	11.50	10.15
P/ BV (x)	2.82	2.61	2.36	2.12
Dividend Yield (%)	5%	5%	5%	5%
Payout (%)	63%	66%	57%	54%
ROE (%)	22%	20%	22%	22%
ROA (%)	3%	3%	3%	3%

Source: Company Reports & WE Research



we invest in relationships™

Valuation: BUY with a Dec'14 Target Price of Rs 334

We have used a combination of valuation methodologies i.e. Justified Book Value Method and Distributable DDM to value MCB. Our Dec-14 target price arrives at Rs 334/share, offers an upside of 19%, along with Dividend Yield of 5%.

Justified Price to Book Value (JPBV)

For JPBV method, we have assumed at growth rate (g) of 9.8% based on the assumption that MCB has sustainable ROE of 21.78% and retention ratio of 50% at the terminal. The required rate of return of equity is 19.60% based on risk free rate of 13% derived from secondary market rate of 10yr PIB as a proxy and beta of 1.10 with risk premium of 6%, Thus, Justified PBV ratio for MCB stands at 2.36x and multiplying it with its forward book value of Rs 120.17/share, the target price of MCB comes to Rs 256.80/ share.

$$\text{Formula: Justified PBV} = \frac{(\text{ROE} - g)}{(r-g)}$$

Distributable Dividend Discount Model

Under this model, the total value of the Bank is calculated by estimating the present value of distributable earnings under a target CAR ratio. Our calculations incorporate target CAR of 22.23%, and a discount rate of 19.60%, a terminal growth rate of 9.8%, implying a Dec'14 target price of Rs411/share for MCB.

We have used a combination of valuation methodologies i.e. Justified Book Value Method and Distributable DDM to value MCB. Our Dec-14 target price arrives at Rs 334/share, offers an upside of 19%, along with Dividend Yield of 5%.

Rs in million	CY14E	CY15E	CY16E	CY17E
Risk Assets	483,126	516,739	557,634	602,241
Increase in RWA	26,736	33,613	40,895	44,608
CAR	22.20%	22.22%	22.24%	22.26%
Additional capital required	5,935	7,469	9,095	9,930
Net profit	24,999	28,324	31,387	34,808
Available for dividends	19,063	20,855	22,292	24,879
PV of cashflows	19,063	17,979	16,567	15,939
Terminal Value	540,947			
Discounted Terminal Value	346,562			
Equity Value	416,110			
Shares Outstanding	1,012			
DDDM Target Price Dec-14 (Rs)		411		

Source: WE Estimates

Average Target Price Rs 334/Share



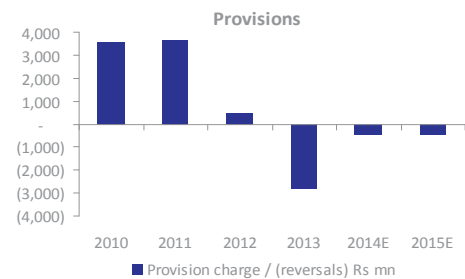
we invest in relationships™

Huge reversals the key for CY13

MCB Bank Limited (MCB) registered 4% YoY growth in earnings to Rs 21,479 million (EPS: Rs 21.24) in CY13 against versus Rs 20,941 million (EPS: Rs 20.70) in CY12. This was attributed due to reversal of provisions against NPL and rise in non-funded income. MCB bank reported provision reversals of Rs 2,820 million the highest ever in history of banking industry by any bank. Despite pressures from declining interest rate trend 9% in CY13 versus 11% in CY12 and MDR pegged with D/R further aggravated NIMs to 5.5% vs 6.8% in CY12. Having said that, bank still reported 4% YoY growth in bottom-line in CY13. MCB continued its conservative stance with regard to lending to only high profile clients as bank's net advances grew by only 4% YoY, whereas provisions declined due to reversals from Shakarganj group and other clients.

Provisioning Reversal to continue

We expect MCB to continue to post provisioning reversals in CY14 as well, largely due to reversals trend witnessed across the industry. Since ~18 months, discount rate continued its downward trend along with gradual improvement in economy supported the major sectors to payoff their default payments. Going forward D/R likely to remain between 9%-10% range, suggests reversals by defaulted parties to continue. MCB's management is also confident on economy's growth in medium to long run ahead and few of their clients likely to reschedule their loans in CY14.

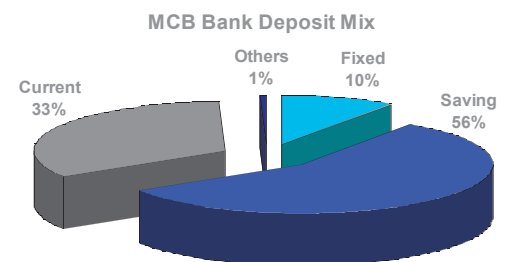


Source: Company Reports & WE Research

We expect MCB to continue to post provisioning reversals in CY14 as well, largely due to reversals trend witnessed across the industry. Since ~18 months, discount rate continued its downward trend along with gradual improvement in economy supported the major sectors to payoff their default payments.

Low Cost Deposit Base

The bank has a wide branch network with 1,208 branches, which is one of the bank's major assets and a major factor behind its low cost deposit base. Due to its low cost deposit base, the bank enjoys one of the highest spreads in the industry. Around 90% of the bank's deposits are low cost deposits as shown in the graph below.



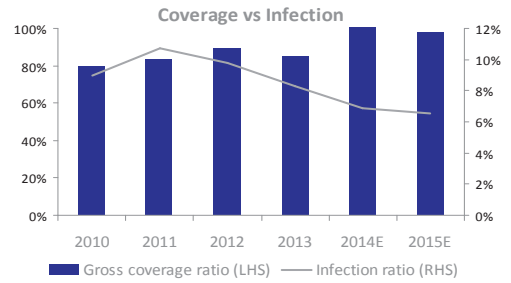
Source: Company Reports & WE Research



Coverage ratio approaching 90%

MCB's coverage ratio is at 86% as of Dec'13, which is expected to average above 90% going forward due to reversals and conservative lending approach. On top of it bank has one of the lowest infection ratio of 8% among peers. This indicates bank can increase its lending exposure to high yielding sectors, which would increase its earning yield in medium to long run. Low interest rate and declining inflation rates would increase demand for lending from corporate sector.

MCB's coverage ratio is at 86% as of Dec'13, which is expected to average above 90% going forward due to reversals and conservative lending approach.

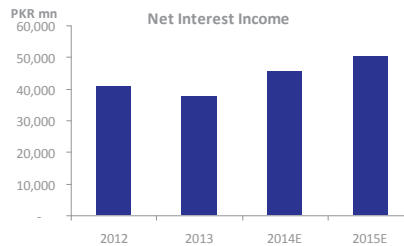


Source: Company Reports & WE Research

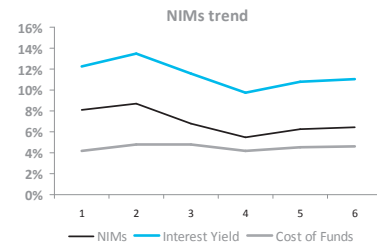
Net Interest Income expansion

MCB's interest yield fell by to 9.7% in CY13 from 11.5% in CY12, it decreased due to decline in discount rate YoY by ~200bps. Similarly cost of funds declined as well by just 60bps to 4.2% from 4.8% in CY12. Consequently NIMs of the bank depressed by 130bps to 5.5% in CY13 as against 6.8% in CY12. MCB's ADR further declined in CY13 to 39% down from 44% in CY12, which suppressed interest earnings yield. Going forward we expect ADR would continue to hover in same range as economy is gradually picking up, however NII to improve from change in deposit mix of the bank through increasing current accounts and curtailing savings deposits costing 7% currently. We expect NIMs to improve by 70bps to 6.2%.

We expect ADR would continue to hover in same range as economy is gradually picking up, however NII to improve from change in deposit mix of the bank through increasing current accounts and curtailing savings deposits costing 7% currently. We expect NIMs to improve by 70bps to 6.2%.



Source: Company Reports & WE Research



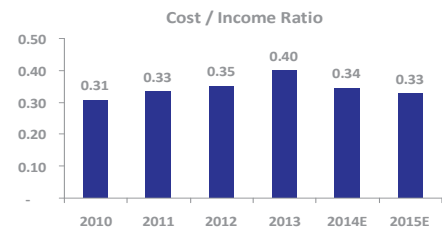
Source: Company Reports & WE Research



we invest in relationships™

Cost/Income lowest among peers

MCB enjoys lowest cost/income ratio among its peers, who average above ~0.50. Despite large branch network bank has managed its cost/income ratio lower which is commendable and provides room for bank to take aggressive strategy in rising economy through introduction of different innovative products. Bank's operating expenses increased significantly in 4QCY13, largely due to VSS offered and pension fund write backs.

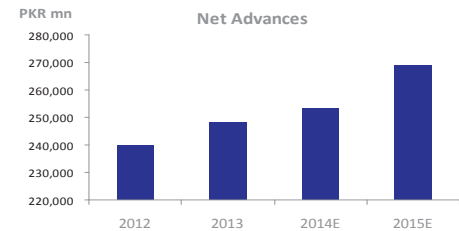


Source: Company Reports & WE Research

MCB's ADR ratio stands at 39% as of Dec'13, however the ratio would remain around this level but in absolute terms advances would grow at 5% rate for next 3 years (CY14-CY16) as against -1% growth in last 3 years (CY09-CY13).

Advances growth to augment

MCB's ADR ratio stands at 39% as of Dec'13, however the ratio would remain around this level but in absolute terms advances would grow at 5% rate for next 3 years (CY14-CY16) as against -1% growth in last 3 years (CY09-CY13). As per the management they would favour lending to Power Projects, Infrastructure development projects along with large corporate groups planning to expand as they see huge potential to pay back in these segments going forward. On the flip side bank is not interested in penetrating in consumer/micro finance lending which has high monitoring cost and recovery cost during defaults.



Source: Company Reports & WE Research



we invest in relationships™

MCB has declared an intention to acquire 55% stake in Burj Bank Ltd. The bank has 74 branches with deposit base of Rs 34 billion and MCB has 27 Islamic operation branches this would take the tally to ~100 branches.

MCB to acquire Burj Bank Ltd.

MCB in its CY13 results announced to go for wholly owned Islamic Bank subsidiary with paid up capital of Rs 10 billion. Following this announcement, MCB has declared an intention to acquire 55% stake in Burj Bank Ltd. The bank has 74 branches with deposit base of Rs 34 billion and MCB has 27 Islamic operation branches this would take the tally to ~100 branches. MCB is heading in right direction as post acquisition the bank would aggressively enter into Islamic banking operations, as compared to start a new Islamic Bank. Burj Bank Ltd. book value is Rs 7/share, we believe that atleast at P/BV 1.0x the bank would be acquired making a total of Rs 3.1 billion (55% stake). Burj bank Ltd. is short of MCR and post this deal it would easily be met, moreover we believe the bank would register growth in double digits for next 5-8 years due to MCB's backing. We believe MCB's earnings on consolidated basis would grow by 15-20% from CY15 onwards due to decline in cost of funds on Islamic deposits (Islamic bank deposits are exempted from MDR).

MCB Islamic Banking Operation

MCB is operating with 27 Islamic banking branches at the end of December 31, 2013. MCB Islamic operation posted 118% growth in profitability during CY13 as profit after taxation increase to Rs 258 million from Rs 118 million in CY12. Growth in earning mainly attributed to lower return on deposits as Islamic deposits are exempted from MDR.

Islamic P&L Statement

Rs in million	CY13	CY12	% Chg
Profit Earned	1,120	1,200	-6.7%
Return on Deposits	656	882	-25.6%
Net Spread Earned	464	318	45.8%
Provisions	(0.1)	0.1	NM
Other Income	429	256	67.7%
Other Expenses	636	456	39.4%
Profit before Taxation	258	118	117.9%
Profit after Taxation	258	118	117.9%

Source: WE Research

Islamic Balance Sheet

Rs in million	CY13	CY12
Deposits	6,555	7,106
Financings	11,207	9,908
Investment	2,812	1,955
Total Assets	16,353	13,968
Total Liabilities	14,577	12,540
Net Assets	1,776	1,428



Key Risk

Political/Law & Order

Democracy has rooted firmly now which is positive in long run for the country and economy, but suicide bombing and TTP talks related negative developments can badly hurt investor's confidence and overall business climate if unfriendly conditions are agreed upon. A positive breakthrough from dialogues would reduce this risk.

Macro economic challenges

IMF has extended to Pakistan the 2nd tranche and satisfied with overall performance. Currency has appreciated by more than 5% in Mar'13, which is a very positive signal. Govt. has failed to achieve its revenue targets in FY14, moreover no positive developments related to privatization. PML has huge challenges before economy trails back on the track.

MDR gap reduction vs D/R

If SBP plans to increase MDR gap versus D/R to 250bps as against current gap of 300bps, this would hurt earnings and valuations. However MCB's earnings estimates would decline by 10-12% if MDR gap is reduced by 50bps.

DR crossing 11% mark

Interest rate trend has been unpredictable in last 2 years or so, firstly rates were rising up to 11% in 2012, followed by improved inflation numbers resulting in cut to 9% in 1H CY13. Inflation started to move up gradually along with PKR depreciation forced SBP to D/R to 10% in Nov'13. With recent PKR appreciation and expected inflation to remain around 8% can lead to a cut of 50bps in D/R May'14 MP. Bank's interest earning yields would remain volatile difficult in short run due to volatile D/R moves, but if it crosses 11% asset quality of the bank would start deteriorating in shape of defaults.

Bank Introduction

MCB Bank Limited is a banking company incorporated in Pakistan and is engaged in commercial banking and related services. MCB Bank, incorporated in 1947, is one of the leading banks of Pakistan with a deposit base of Rs 632 billion and total assets of Rs 816 billion as on December 31, 2013. In 1974, MCB was nationalized along with all other private sector banks. The Bank's ordinary shares are listed on all the stock exchanges in Pakistan whereas its Global Depository Receipts (GDRs) representing two ordinary shares (2012: two ordinary shares) are traded on the International Order Book (IOB) system of the London Stock Exchange. The Bank operates 1,208 branches including 27 Islamic banking branches.



Financial statements

Key Ratio Analysis

	CY12A	CY13A	CY14E	CY15E
EPS (Rs)	20.70	21.24	23.90	27.19
DPS (Rs)	13.00	14.00	14.00	15.00
Book Value (Rs/share)	100.56	108.94	119.36	132.35
Dividend Yield (%)	5	5	5	5
Dividend Payout (%)	63	66	59	55
ROE (%)	22	20	21	22
ROA (%)	3	3	3	3
IDR (%)	64	74	71	72
PAT Growth (%)	9	15	8	3
NII Growth (%)	21	-8	-7	20
Non int. exp Growth (%)	29	13	22	2
Deposit Growth (%)	14	11	16	4
Net Advances Growth (%)	-11	6	4	2
Investment Growth (%)	49	27	12	5
NPLs/Gross Advances (%)	11	10	8	8

ESource: Company Reports & WE Research

Income Statement

Rs in million	CY12A	CY13A	CY14E	CY15E
Interest Earned	68,356	65,064	76,780	83,326
Interest Expensed	27,500	27,196	31,119	32,995
Interest Income	40,856	37,868	45,661	50,331
Provisions	478	(2,820)	(503)	(459)
Interest Income after Provisions	40,378	40,688	46,163	50,789
Non Interest Income	9,153	11,171	11,392	12,878
Non Interest Expense	16,099	18,138	18,140	19,137
Profit before Taxation	32,054	32,272	37,894	42,934
Taxation	11,113	10,793	12,896	14,610
Profit after Taxation	20,941	21,479	24,999	28,324

Source: WE Research & Company Reports



we invest in relationships™

Balance Sheet

Rs in million	CY12A	CY13A	CY14E	CY15E
Cash & Bank balances	57,420	59,946	64,174	68,115
Balances with other banks	1,192	1,537	1,915	2,032
Lending to FIs	1,551	1,224	3,926	4,167
Investments	402,069	449,006	473,437	510,631
Advances	239,583	248,243	253,367	268,928
Operating Fixed Assets	23,738	28,595	28,995	29,395
Other Assets	40,345	26,956	28,230	30,194
Total Assets	765,899	815,508	854,044	913,462
Bills Payable	9,896	10,139	11,411	12,843
Borrowings	78,951	38,543	35,881	38,085
Deposits	545,061	632,330	660,122	700,664
Other Liabilities	21,098	20,064	20,837	22,131
Total Liabilities	664,148	705,277	732,454	777,925
Share Capital	9,199	10,118	10,118	10,118
Reserves	78,958	87,153	97,986	111,385
Total Tier 1 Equity	88,157	97,272	108,105	121,504
Surplus on Revaluation of Assets	13,594	12,959	13,485	14,033
Total Shareholder Equity	101,751	110,231	121,590	135,537

Source: Company Reports & WE Research



we invest in relationships™

WE Financial Services

Corporate Office

506, Fifth Floor,
Karachi Stock Exchange Building,
Stock Exchange Road,
Karachi - 74000,
Pakistan

URL: www.we.com.pk

Disclaimer: All information contained in this publication has been researched and compiled from sources believed to be accurate and reliable at the time of publishing. However, we do not accept any responsibility for its accuracy & completeness and it is not intended to be an offer or a solicitation to buy or sell any securities. WE Financial Services & its employees will not be responsible for the consequence of reliance upon any opinion or statement herein or for any omission. All opinions and estimates contained herein constitute our judgment as of the date mentioned in the report and are subject to change without notice.

For live markets, historical data, charts/graphs and investment/technical analysis tools, please visit our website www.weonline.biz
URL: www.we.com.pk