MCB Bank Limited(MCB):
Refocus on lending may compromise asset quality

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Reiterate 'BUY' with PT of PKR 200/share

- We reiterate our 'BUY' stance on MCB Bank Limited (MCB) after incorporating latest quarterly results. We have also rolled forward our PT to June-22 with revised PT of PKR 200, offering a decent upside of 28% from current levels along with a lucrative dividend yield of 13.5%.
- Due to recent dividend adjustment in stock price, we believe that MCB is now well placed for a fresh entry as MCB CY22F dividend yield now stands at 13.5%. The stock is currently trading at CY22F P/BV 1.0x, a discount of 14% from its historic (CY16-20) P/BV 1.2x.
- MCB reported impressive 1HCY21 results with net earnings growing by 19% YoY. The growth was mainly supported by reversals in provision and rebound in the fee and commission income post normalization of business activities. We expect MCB to post net earnings of PKR 23.2/ share and PKR 24.8/ share in CY21 and CY22, respectively.
- The bank has one of the highest CASA ratio amongst its peers (92.4% at end of June-21) which makes it's cost of funds upward sticky amidst rising interest rates, supporting NIMs accretion going forward.
- The management is going for an ambitious loan growth target of 19-20% in CY21 to meet the minimum ADR of 40%, which will provide impetus to earnings growth. MCB has to grow its loan book by 14% annually to keep its ADR above 40%.
- MCB's asset quality may witness stress going forward due to management's planned aggressive lending approach. We have assumed above 9% gross infection ratio in our forecast.
- Anticipating a hike in the interest rates, the bank has increased its floating rate PIB mix to 44% in 2QCY21 vs 17% in Dec-20. For T-bills, the concentration remains in the shorter tenure. Going forward we expect the share to decline as bank will tilt its deposits to lending.

Key Data	
Bloomberg	MCB.PA
Reuters	MCB.KA
PSX Ticker	**MCB**
Target Price (PKR)	200
Current Price (PKR)	156
Upside/(Downside) (%)	+ 28%
Dividend Yield (%)	13.5%
Total Return (%)	+ 41%
12-month High (PKR)	150
12-month Low (PKR)	202
Outstanding Shares (mn)	1,185.1
Market Cap (PKR mn)	184,679
Year End	December

Key Ratios	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
EPS	20.2	24.5	23.2	24.8	25.4	28.9
EPS Growth	13.2%	21.1%	-5.1%	6.6%	2.5%	13.6%
DPS	17.0	20.0	19.5	21.0	21.5	24.5
PER	7.7	6.4	6.7	6.3	6.1	5.4
Div. Yield	10.9%	12.8%	12.5%	13.5%	13.8%	15.7%
P/B	1.1	1.0	1.0	1.0	1.0	0.9
ROE	15.1%	16.2%	14.9%	16.0%	15.9%	17.5%

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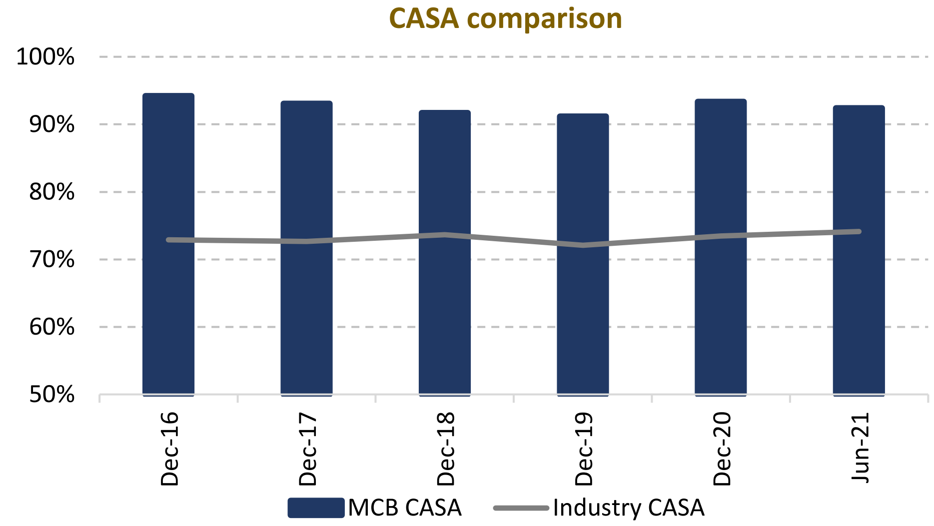
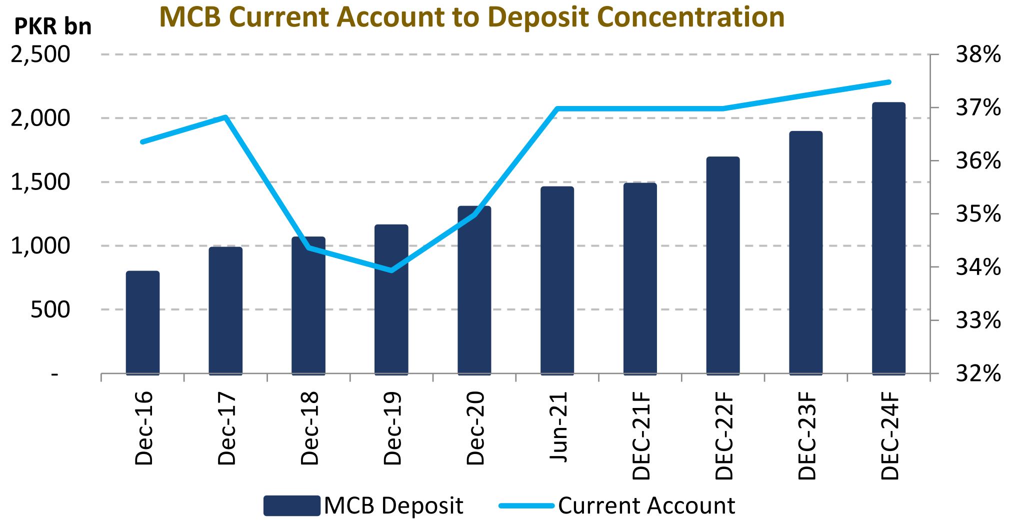
CASA ratio maintained above 90% since 2013

- Due to the proactive funds mobilization strategy of the management, MCB continues to enjoy one of the highest CASA mix in the banking industry. The differential remained around 20% on average from industry average CASA ratio in the last 5 years and currently stands at 92.4% (Industry CASA 73%).
- The bank is strategically focusing on fetching Current Account (CA) deposits as its growth outpaced (+18% YTD) Saving Accounts deposits growth (+4% YTD). The share of zero-cost Current Accounts has increased to an all-time high of 41% of the total deposit mix.
- MCB's current account deposits increased from 34% in CY17 to 37% in June-21. We believe, this may bode well for the bank in containing the cost of funds amidst rising interest rate scenario. Resultantly, there will be minimal pressure on bank's NIMs going forward. We expect NIMs to settle around 4.5% going forward as against 3.65% at present.
- We expect deposits to grow at 5-year CAGR of 13% during CY21-25. The bank witnessed same level of growth in last 5 years (CY16-20).





Source: Company Accounts & Akseer Research

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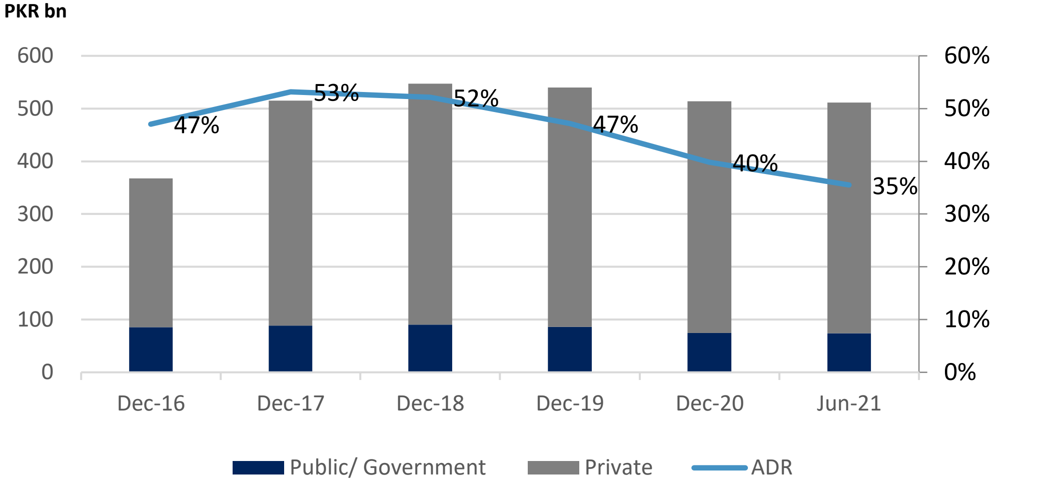
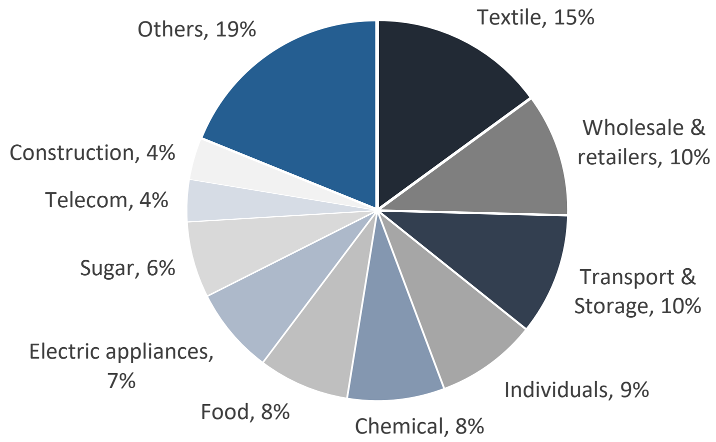
Ambitious loan growth target to meet 40% ADR threshold

- MCB has witnessed consistent decline in its loan book growth since CY17, with a negative CAGR of 2% over CY17-CY20, major reason being the bank's minimal participation in CPEC and energy sector related financing. The advances further shrunk by 6.5% in 1QCY21 compared to Dec-20, however, loan growth momentum turned positive in 2Q, with 6.5% QoQ jump to PKR 511bn. On CYTD, advances growth still remained flat.
- MCB's lending remained concentrated towards private sector, with main financing to Textile, wholesale & retail, and transportation & storage sectors. They cumulatively accounted for 35% of the bank's loans.
- Due to bank's conservative lending policy, MCB's ADR came down to 35% in June-21 below industry average of 43.1%, and MCB's last 5-year average of 48%. This also led to additional income tax charge in 2Q due to ADR being below 40%. The effective tax rate of the bank stood at 42% as against 40% in 1Q.
- The management is now aiming for ambitious advances growth target of 19-20% in 2HCY21 with demand emanating from working capital requirement due to economic recovery. Moreover, the bank is planning to lend additional PKR 13bn to the construction sector to meet SBP's sector specific lending targets. As per our estimates, MCB has to grow its loan book by 14% annually to keep its ADR above 40%.
- To recall, in order to facilitate the economic pickup, the government announced imposition of additional tax on the banks in June-21, which were not actively lending. The bank has to pay additional 2.5% tax if its ADR ranges between 40-50%, and 5% additional tax if the ADR is below 40%.

Advances Concentration Trend



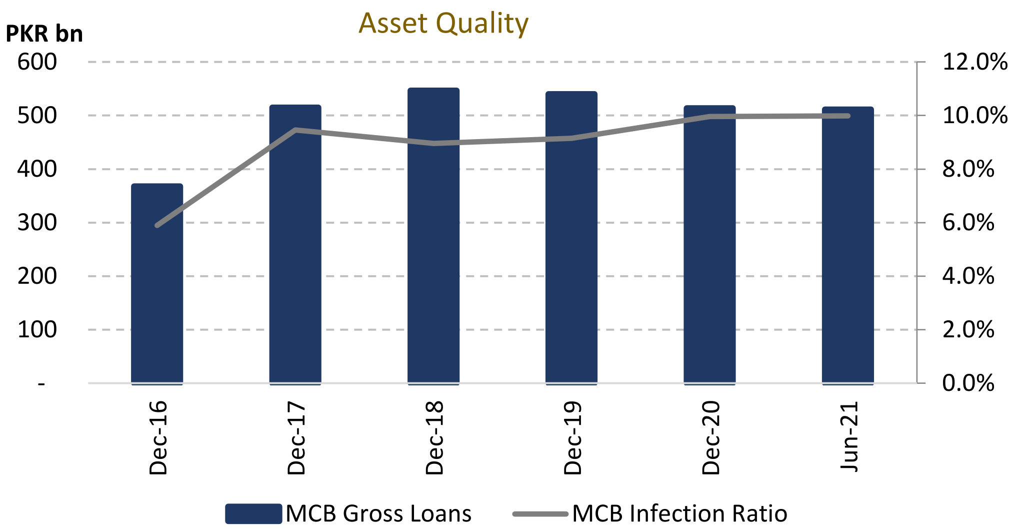
CY20 Advances breakup

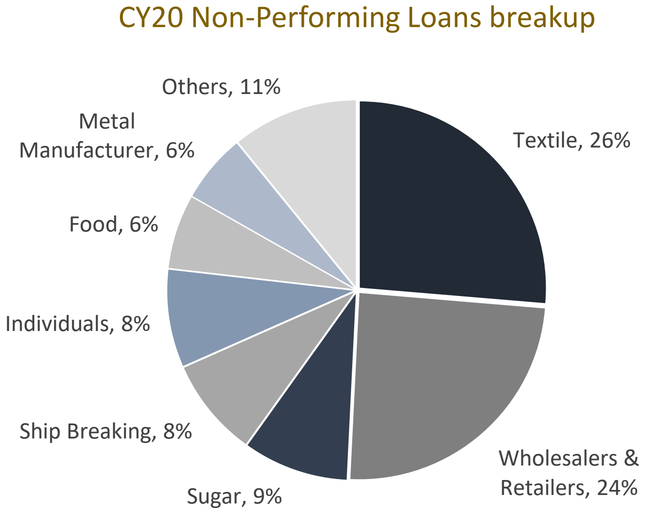


Source: Company Accounts & Akseer Research

Aggressive financing to have stress on asset quality

- Non-performing loans (NPLs) remained flat in 1HCY21 to PKR 51.1bn after whopping surge of 24% YoY in CY20, a consequence of both subjective provisioning related to COVID-19 probable delinquencies and NIB Bank's acquired infected portfolio. Despite surge in the NPLs, Gross Infection Ratio surged by only a percentage point YoY to ~10% in CY20.
- The bank prudently accounted for the provisions against the NPLs, with coverage ratio increasing to 99% in CY20 from 88% in CY19. To highlight, in last 5 years, MCB coverage ratio aggregated 92% compared to industry average of 85%.
- Higher subjective provisioning in CY20 resulted in reversals of PKR 2.0bn in 1HCY21. The management is expecting further reversals in 2H. We have conservatively assumed provisions of ~PKR 1.3bn in 2H considering the fact that MCB is gearing up to increase its ADR to 40% which will likely lead to additional provisions. We expect Gross Infection Ratio to remain above 9% from CY22 onwards on the back of potential hike in the NPLs.
- With regards to NIB delinquencies, around PKR 6.6bn have been recovered out of PKR 29.6bn as of June-21. The management is upbeat on further reversals from the NIB portfolio (which is not incorporated in our forecast). To note, NIB added around 3.6% to overall Gross Infection Ratio of the bank in CY17.





Source: Company Accounts & Akseer Research

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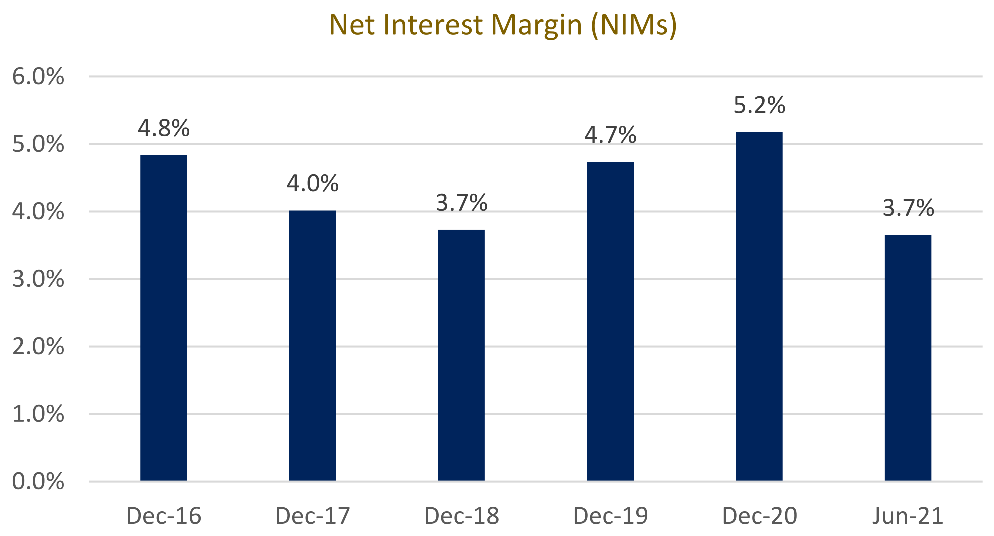
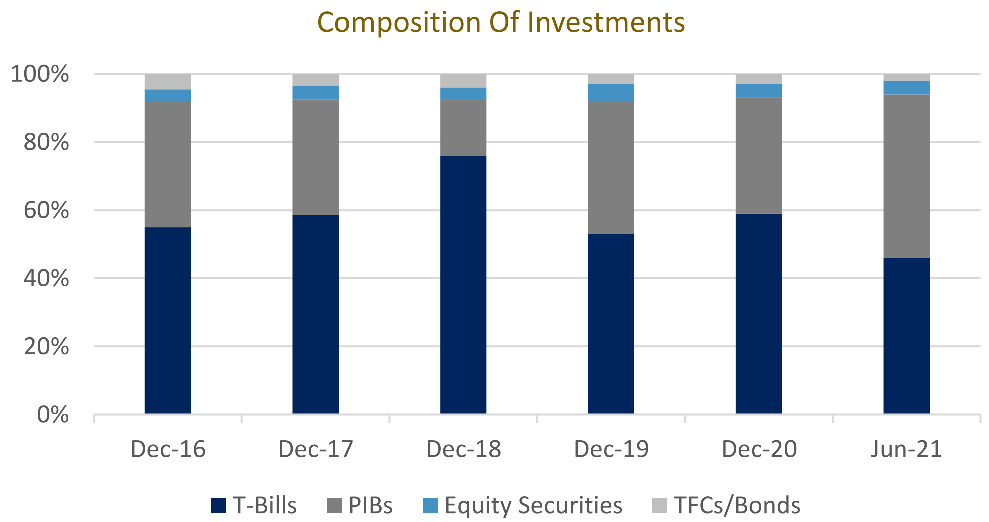
Well positioned investment book to support the NIMs

- **NIMs accretion to normalize to pre-COVID levels after rate hikes**
  - The aggressive expansionary monetary policy stance by the central bank (625bps) led to MCB's NIMs contraction of 100bps YoY to around 3.6% during 1HCY21. Yield on interest earning assets declined by 356bps while credit cost declined by 256bps during 1H.
  - However, on sequential basis, bank's overall spreads were up 18bps QoQ to 3.65% in 2Q as investment book was largely repriced in 1QCY21.
  - The bank in its recently held results call gave guidance on interest rate, with hike of 50bps in November-21. We have also assumed 50bps policy rate hike in November-21 monetary policy.
- **Investments tilted towards the shorter tenor bills/ floaters**
  - Anticipating the interest rate hike, the bank has increased its floating rate based PIBs mix to 44% in 2QCY21 vs 17% by end of Dec-20 in order to avoid major revaluation losses. With regards to T-bills, the concentration remains in the shorter tenor.
  - As per the June-21 financials, MCB's IDR came in at 76% while its last 5 year average IDR stood at 71%. We have assumed average IDR of 67% in our investment horizon (CY22-27) due to bank's gradual shift towards lending.





Source: Company Accounts & Akseer Research

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Risk - Return Profile

Valuation Basis

- Our PT for MCB has been computed on dividend discounting method using Justified P/BV for the calculation of terminal value. We have used sustainable ROE of 21.4% to arrive to calculate exit P/BV, along with a risk free rate of 11%, beta of 1.0 and market risk premium of 6% to arrive at cost of equity of 17%.

Investment Thesis

- Our investment case on MCB is based on:

1) NIMs expansion to support core earnings of the bank.
2) One of the highest CASA in the industry.
3) Balance sheet ideally positioned to benefit from the rising interest rate scenario going forward.

Risks

- Key risks to our investment thesis are

1) Lower than anticipated hike in interest rates.
2) Lower than anticipated growth in advances and deposits, and
3) Higher than anticipated provisioning.

Relative price performance

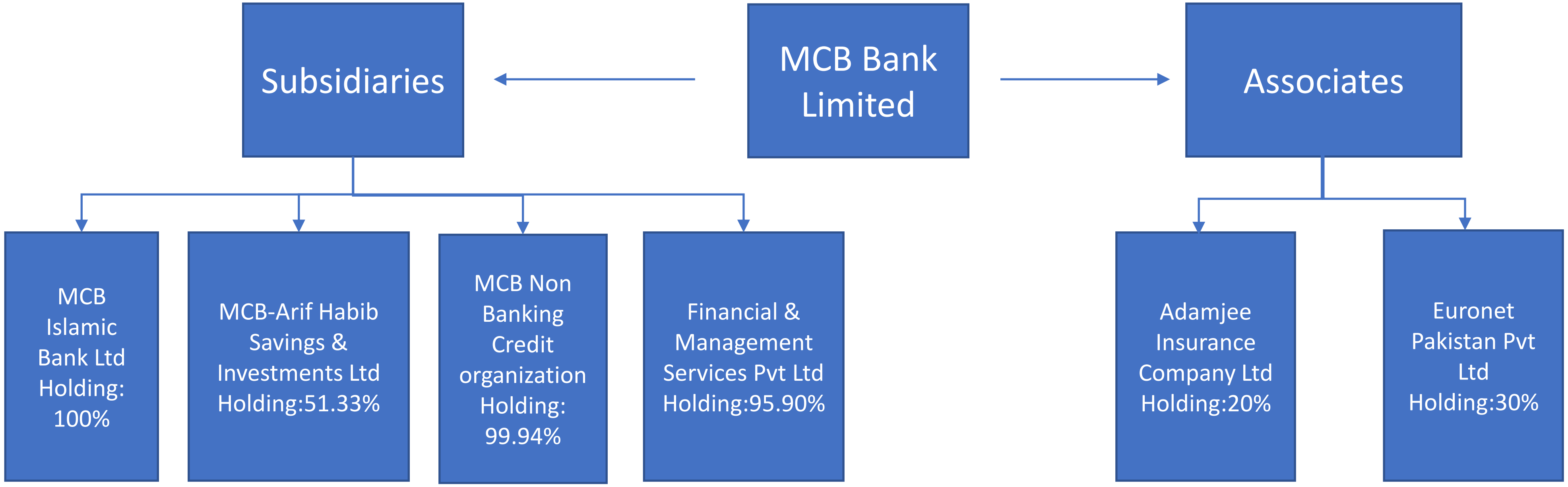
Source: PSX & Akseer Research

Comparative Ratios - CY21	MCB	HBL	UBL	BAFL	BAHL	MEBL
EPS	23.2	22.8	20.8	7.8	17.1	19.1
EPS Growth	-5.1%	9.0%	21.8%	33.0%	6.0%	21.7%
DPS	19.5	9.0	14.0	4.25	6.75	7.25
PER	6.7	5.2	5.9	4.1	4.0	7.4
Div. Yield	12.5%	7.5%	11.4%	13.2%	9.8%	5.1%
P/B	1.0	0.7	0.8	0.6	0.8	1.5
ROE	14.9%	12.7%	13.9%	14.8%	22.0%	37.4%

Bank's Overview

- MCB Bank Limited is a banking company incorporated in Pakistan providing commercial banking and related services in Pakistan and outside the country. The bank was incorporated in 1947 and is based in Lahore, Pakistan. As of June 30, 2021, MCB is operating through 1,419 branches in Pakistan and 11 branches outside the country, including Karachi Export Processing Zone. Maybank International Trust (Labuan) Berhad has a majority holding in the bank at 18.8% followed by associated companies having 18.4% stake in the bank.

- **Group Structure**



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Financial Highlights

Income Statement (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Mark-up/interest earned	138,292	136,076	118,209	144,856	179,779	201,297
Mark-up/interest expensed	78,676	64,741	55,312	72,075	95,020	106,835
Net interest income	**59,616**	**71,334**	**62,896**	**72,781**	**84,760**	**94,462**
Non-interest income	**16,679**	**18,136**	**18,785**	**18,450**	**18,874**	**19,238**
Provision charged	2,484	7,313	(675)	4,021	9,590	9,473
Operating expenses	32,671	32,646	34,652	37,113	42,495	45,765
Profit/loss to shareholders	**23,977**	**29,037**	**27,551**	**29,378**	**30,113**	**34,211**
Ratios						
EPS	20.2	24.5	23.2	24.8	25.4	28.9
DPS	17.0	20.0	19.5	21.0	21.5	24.5
PER	7.7	6.4	6.7	6.3	6.1	5.4
Dividend yield	10.9%	12.8%	12.5%	13.5%	13.8%	15.7%
NIMs	4.7%	5.2%	4.0%	4.3%	4.5%	4.5%
Cost/Income Ratio	43%	36%	42%	41%	41%	40%

Source: Company Accounts & Akseer Research

Financial Highlights

Balance Sheet (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Cash & Treasury Balances	132,705	122,181	145,035	165,340	185,180	207,402
Investments	748,765	1,015,869	1,038,932	1,170,737	1,292,114	1,425,366
Advances	496,679	462,942	537,841	616,142	700,399	797,913
Operating Fixed Assets	59,229	58,966	57,960	56,809	55,681	54,576
Other Assets	77,775	97,504	103,466	117,952	132,106	147,959
Total Assets	**1,515,152**	**1,757,462**	**1,883,233**	**2,126,979**	**2,365,481**	**2,633,216**
Borrowings from FIs	89,506	164,002	135,036	153,941	172,414	193,104
Deposits	1,144,763	1,289,502	1,470,033	1,675,837	1,876,938	2,102,170
Other Liabilities	111,968	113,857	98,680	110,413	123,632	138,557
Total Liabilities	1,346,237	1,567,361	1,703,748	1,940,191	2,172,984	2,433,831
Equity	168,915	190,102	179,485	186,788	192,497	199,385
Total Liabilities & Equities	**1,515,152**	**1,757,462**	**1,883,233**	**2,126,979**	**2,365,481**	**2,633,216**
Ratios						
P/BV	1.1	1.0	1.0	1.0	1.0	0.9
BVPS	142.5	160.4	151.5	157.6	162.4	168.2
ROE	15.1%	16.2%	14.9%	16.0%	15.9%	17.5%
ROA	1.7%	1.9%	1.6%	1.5%	1.4%	1.4%
ADR	47.2%	39.8%	40.0%	40.0%	40.7%	41.4%
IDR	65%	79%	71%	70%	69%	68%
NPL/Gross Loan	9.2%	10.0%	9.3%	9.0%	10.1%	9.5%
Deposit Growth	9.1%	12.6%	14.0%	14.0%	12.0%	12.0%
Loan Growth	-1.4%	-6.8%	16.2%	14.6%	13.7%	13.9%

Source: Company Accounts & Akseer Research

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Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

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