

February 09, 2009

**Pakistan Market****MCB: 2008 full year earnings expectation & outlook**

KSE100 Index Closing 5597.44 ↑ (+63.19)

**MORNING BRIEFING**

The earnings announcement season has now started to gather pace with banking sector starting with MCB bank announcing their full year 2008 results. The board of directors of MCB bank will meet on Feb 10, 2009 to announce 2008 results. In today's report we discuss our earnings expectations for MCB along with stance on the scrip at current levels.

**2008E EPS of Rs23.8 (excluding impairment)**

We expect MCB to post earnings of Rs15.0bn (EPS of Rs23.8) in 2008 versus earnings of Rs15.3bn (diluted EPS of Rs24.3) last year – a negative growth of 2%YoY. The decline in earnings is mainly led by a sharp increase in administrative expenses due to lower actuarial gains on the pension plan. MCB recognized actuarial gains of Rs5.8bn in 2007 which significantly reduced admin expenses to Rs5.0bn in 2007. However, due to lower actuarial gains we expect admin expenses to increase by a massive 66% to Rs8.3bn in 2008.

The impact on higher admin expenses is likely to be negated considerably by another year of decent growth in net interest income. Driven by high spreads and strong advances growth, MCB net interest income is expected to increase to Rs27.4bn, a decent growth of 14%YoY. Along with the results, the bank is expected to announce a final cash dividend of Rs3-4/share thus taking the full year dividend to Rs12-13/ share.

**Impairment (IAS 39), key risk to reported earnings**

One of the key issues currently occupying all corporate stakeholders including regulators is impairment in investment value post stock market crash. MCB bank like many other companies, has a significant equity investment portfolio (listed equities and mutual funds investment of Rs11bn as of 2007 accounts) classified as Available for Sale (AFS) and accounted for under IAS 39. With the stock market falling by a massive 58% in 2008, these investments have witnessed a substantial/prolong decline in value, hence cumulative loss needs to be recognized in P&L, which would significantly dilute reported earnings for 2008.

**EPS to fall to Rs18 if impairment fully recognized**

According to our estimates, the cumulative loss on AFS investments during 2008 is likely to range between Rs5-6bn, however their remains a question mark over how the impairment would be recognized in the financial accounts. While IAS 39 requires full recognition in P&L, reports suggest that regulators and stakeholders are working on an amortization formula whereby impairment loss would be spread over 2 years, though no official announcement has been made in this regard. We have therefore resorted to sensitivity analysis to present our expectations for MCB's earnings with 50% and 100% impairment recognition in 2008 (see table below).

**Table: Sensitivity of impairment loss on 2008E EPS**

	No impairment	50% impairment	100% impairment
<b>EPS (Rs)</b>	23.8	21.0	18.2

As evident from the table above, if MCB recognizes the entire impairment loss in 2008, the reported earnings are likely to fall to Rs18.2/share (24% lower than earnings without impairment). However, if only 50% impairment is recognized, we estimate MCB's EPS at Rs21. It is important to mention though that the recognition of impairment loss in P&L is non cash in nature and only affects reported earnings. We therefore maintain our final dividend estimate at Rs3-4/share.

**Outlook: Downgrade to 'Hold'**

Due to the recent rally in banking stocks post changes in FSV mechanism, MCB bank has seen a sharp increase in its share price. As a result, we have downgraded our stance on MCB from 'Buy' to 'Hold' at current levels. The bank trades at 2009F PE and PBV of 5.3x and 1.2x, respectively. Moreover its also offer 2009F ROE of 24% and dividend yield of 10%.

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MCB Bank	
<b>Market Price:</b> Rs114.84	<b>Kats Code:</b> MCB
<b>Market Cap:</b> Rs72.2bn (US\$912mn)	<b>Bloomberg Code:</b> MCB PA
<b>1-yrs Avg. Daily Volume:</b> 3.0mn shares, Rs1.0bn (US\$13.3mn)	<b>Reuters Code:</b> MCB.KA
<b>1-year High/Low:</b> Rs480.50/77.76	

**Also in focus****Oil stabilizing at US\$40/bbl**

During last few days, WTI crude oil is hovering at US\$40.4/bbl on cash counter. There is no excitement in the oil markets despite the fact that OPEC will review the production levels in its upcoming meeting scheduled in March 2009. Oil markets, on the other hand, are looking at some big production cuts. As far as oil price are concerned, Oil Poll on Reuters is estimating average WTI crude price of US\$55/bbl for 2009, down 44% versus average WTI price last year.

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