JS Research

June 14, 2010

Pakistan Market

MORNING BRIEFING

MCB: 19% upside to our fair value/'Buy'

KSE100 Index: Closing 9471.12 ↑ (+91.34)

We reiterate our liking for MCB Bank, as its performance at the bourse (down 8.7% since May) has now led the scrip to trade at an attractive 2010E PBV of 1.8x, compared to its 5yr average historical PBV of 2.7x; offering a 19% upside to our fair value of Rs230. Although overall macro recovery is still at an early stage, we remain confident on the bank's overall standing to weather this phase via continued focus on internal efficiencies including liability management and deposit reallocation. Over the next few quarters, we expect earnings growth will predominantly come from lower provisioning expense and rising fee income; while we expect Interest income to remain flat on lower yields. We thus recommend a 'Buy' stance on MCB at current levels.

Lower provisioning, rising fee Income to dominate

We expect loan provisioning to maintain a downward momentum over the next three quarters, albeit slowly, as was the case in 1Q2010 – where provision from NPLs were down 52%YoY and 45%QoQ. Moreover, NPL's were up only slightly (0.3%) in 1Q2010, while coverage increased by 4ppt to 71%, allowing a possible breather in case NPLs unexpectedly jump, going forward.

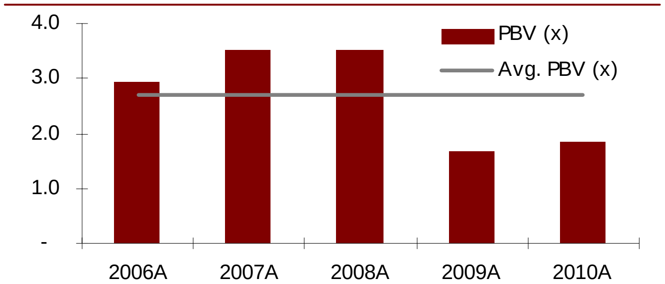
With economic activity picking up, Non Interest Income, in our view, is expected to grow on a QoQ basis, primarily driven by fee income. The latter recorded an increase of 15%YoY and 8%QoQ to Rs972mn in 1Q2010.

Interest Income growth may taper off

Interest Income growth may taper off, at least on a YoY basis, as yields on earning assets are expected to remain at current levels, at least in the short term. NIMs have lost an average 40bps each quarter since 1Q2009 (9.7%) to stand at 8.3% in 1Q2010.

The management has continued its focus on maintaining a low cost CASA base, at 83% - the highest in the industry – which has helped keep cost of funds at a considerably low level.

MCB: 5-year PBV trend



Source: JS Research

PBV: MCB vs industry

	5-Yr Average	2010E	2011F
MCB	2.7	1.8	1.6
Banking Sector	1.9	1.0	0.9

Source: JS Research

Outlook: 'Buy' at current levels

The recent bearish run at the bourse - both the broader Index and Banking sector down 9.2% and 13% since April – has opened up room for valuation play, we believe. However, there are still concerns on the sectoral front, particularly on subdued loan growth amid high interest rates & accretion in NPLs, albeit at a slower pace. That said MCB having an advantage of its low cost deposit franchise and one of the lowest infection ratio leads it to become one of the preferred plays in our banking universe. The stock currently trades at a discount to its average 5-yr PBV multiple, 2010E PBV of 1.8x vs 5 yr average PBV of 2.7x, and offers 19% upside to our fair value of Rs230.

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Also in focus

Agreement reached for Pak-Iran gas pipeline

Pakistan and Iran, on Sunday, formally signed the export deal pertaining to supply of natural gas to Pakistan. According to the agreement, Iran will start exporting 742mmcfd of natural gas to Pakistan from 2014. Iran immediately seeks to start building the 300km pipeline from the city of Iranshahr to Pakistan border, whereas Pakistani authority would conduct 1 year feasibility before commencing the construction of its part of the pipeline. The agreed quantity is likely to add 18% to the current gas supply of the country.

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