

# Day Break

Tuesday, 26 September 2017

## COMPANY UPDATE

### NATIONAL BANK OF PAKISTAN

#### COMMERCIAL BANKS

<b>Recommendation</b>	<b>SELL</b>
Target Price:	UR
Last Closing: 25-Sep-17	55.1
Upside:	-
Valuation Methodology:	Asset based Valuation / Dividend Discount Model (DDM)
Time Horizon:	Dec-17

#### Market Data

Bloomberg Tkr.	NBP PA
Shares (mn)	2,127.5
Free Float Shares (mn)	506.3
Free Float Shares (%)	23.8%
Market Cap (PKRbn   USDmn)	117.3   1,113.9
Exchange	KSE 100
<b>Price Info.</b>	90D 180D 365D
Abs. Return	(4.3) (22.8) (22.9)
Lo	53.6 53.6 53.6
Hi	62.3 75.2 82.7

#### Key Company Financials

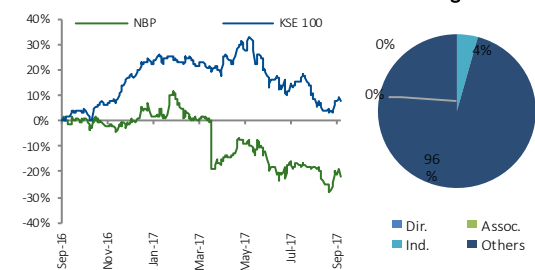
Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	84.8	83.1	88.6	101.2
Net Income	22.75	21.4	20.4	24.9
EPS (PKR)	10.7	10.1	9.6	11.7
DPS (PKR)	7.5	7.0	7.0	8.0
Total Assets	1,975.7	2,122.6	2,379.4	2,682.1
Total Equity	176.7	183.3	188.8	196.7

#### Key Financial Ratios

ROE (%)	12.9	11.7	10.8	12.6
P/E (x)	5.2	5.5	5.7	4.7
P/B (x)	0.7	0.6	0.6	0.6
DY (%)	13.6	12.7	12.7	14.5

#### Relative Price Performance & Shareholding



#### About the Company

The Bank was incorporated under the National Bank of Pakistan Ordinance 1949. The Bank is engaged in providing commercial banking and related services in Pakistan and Overseas. The bank also works as an agent to the State Bank of Pakistan.

Source: Bloomberg, PSX & IGI Research

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## Commercial Banks

### NBP: Adverse court ruling; Downgraded to 'Sell'

- As per the PSX notice, National Bank of Pakistan (NBP) has lost a pension related case in the Supreme Court.
- Resultantly, the bank will incur a onetime pension liability of PKR 47.7bn and a recurring increase in its pension expense.
- To recall, NBP filed an appeal against the LHC verdict in the Supreme Court (SC) of Pakistan, the decision of which was rendered against the Bank, resulting in a pension liability of PKR 47.7bn.
- The liability amounting to PKR 47.7bn translates into a book value of PKR ~14.6/share (tax-adjusted).
- We do not see any dividend disbursement in CY17 and limited disbursement in CY18, given CET1 ratios reaching trigger points.
- We downgrade our investment case on NBP from initial 'buy' call to 'Sell' call.

#### Court verdict to result in expense of minimum PKR 47.7bn against Pensions benefits to retired employees

As per the PSX notice, National Bank of Pakistan (NBP) has lost a pension related case in the Supreme Court. Resultantly, the bank will incur a onetime pension liability of PKR 47.7bn and a recurring increase in its pension expense. Although the bank, in its latest notification issued on PSX, has said to consider legal options to safeguard its interest, yet we have conducted preliminary impacts on bank's profitability and valuation. Expensing the said liability will not only dent profitability, but will also subsequently impact CAR ratio, dividend payout and bank's growth outlook.

As per NBP note;

"In case this [Pensionary benefits to retired employees] matter is decided unfavourably, as per the advice of Actuaries, **the Bank might have a financial impact of Rs. 47.7 billion approximately as at year ended 31 December 2016,** arising out of the additional pension liability exclusive of any penalties or additional profit due to delayed payment. **Pension expense for the year 2017 and onwards may also increase.** No provision was made in the financial statements for the said amount as prima-facie the bank has a strong case on merits and legal grounds."

#### Years old pension case comes back to haunt NBP

To recall, a number of NBP employees, post retirement, filed a writ petition in Peshawar High Court (PHC) and Lahore High Court (LHC) asking for recalculation and increase in their pension benefits as per the Bank Circular No. 228(C) dated 26 Dec-1977 as well as for matching their increases with those allowed to federal employees by the federal government. The court proceedings started in 2010 and 2011 with PHC giving its verdict in favor of NBP on 3<sup>rd</sup> June 2014 and LHC giving its decision against NBP on 15<sup>th</sup> January 2016. Consequently, NBP filed intra court appeals which were rejected by LHC on 16th January 2017. Thereafter, NBP filed

an appeal against the verdict in the Supreme Court (SC) of Pakistan, the decision of which was rendered against the Bank, resulting in a pension liability of PKR 47.7bn.

#### Pension liability to impact profitability, payout and growth prospects

The liability amounting to PKR 47.7bn translates into a book value of PKR ~14.6/share (tax-adjusted). Based on our NBP's CY17E profitability of PKR 10.1/share, the said additional expense will lead to a loss of PKR 7.0/share (during 1HCY17 the bank reported profit of PKR 4/share with a standing book value of PKR 79.8/share), reducing bank's book value to PKR 76.1/share from estimated PKR 86.1/share (CY17E). Moreover, we expect the aforesaid expense to also hurt bank's dividend pay-out capacity, wherein, we do not see any dividend disbursement in CY17 and limited disbursement in CY18, given CET1 ratios reaching trigger points. In addition, lower CAR is expected to dent the bank's asset growth momentum.

Exhibit:

#### NBP may be required to restrict its pay-out ratios

	2016A	2017E	2018F	2019F
Pay-out Ratio	70%	0%	0%	34%
Unappropriated Profit	51,939	37,139	57,576	73,936
Shareholders Capital	21,275	21,275	21,275	21,275
Capital Equity (Tier I)	95,540	80,739	101,177	117,536
Risk-Weighted Assets (Actual)	805,252	908,028	1,009,861	1,124,811
CET 1 / RWA	<b>11.9%</b>	<b>8.9%</b>	<b>10.0%</b>	<b>10.4%</b>
CCB	1.25%	1.88%	2.50%	2.50%
CET1 / RWA - for calculation of distribution	<b>10.6%</b>	<b>7.0%</b>	<b>7.5%</b>	<b>7.9%</b>
Minimum Earnings to be retained (%)	-	40	20	20

Source: IGI Research, Company Financials & SBP

Exhibit:

#### Impact of Pension liability on NBP financials

	Amount (PKRbn)	Impact (PKR/share)	EPS		BV/share		P/E		P/B		Target Price (Dec-17)	Recom.
			CY17E	CY18F	CY17E	CY18F	CY17E	CY18F	CY17E	CY18F		
Pre-pension Liability	-	-	10.1	9.6	86.1	88.7	6.0	6.3	0.7	0.7	82.8	Buy
Post-pension Liability	47.7	14.6	- 7.0	9.6	75.1	85.7	- 8.0	5.8	0.7	0.7	45.7	SELL

Source: IGI Research, Target price as at Dec-17, Recom.= Recommendation, BV=Book Value

#### Recommendation

Despite the adverse verdict, NBP is considering all legal options available to safeguard its interest. However, we recommend investors to stay cautious as the decision is unlikely to be overturned in favour of NBP. Henceforth, we downgrade our investment case on NBP from initial 'buy' call to 'Sell' call. Based on our preliminary analysis, we value the bank with Dec-17 target price of PKR 45.7/share, implying an exit P/B of 0.6x.

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