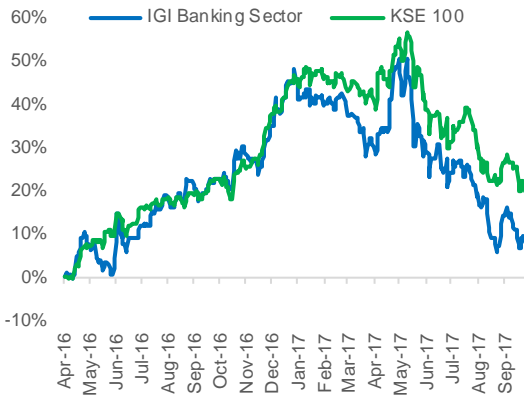


Day Break

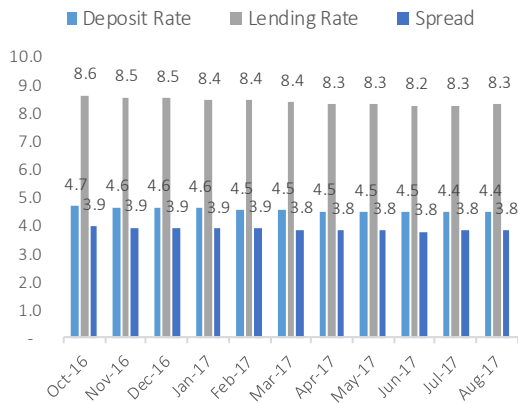
Wednesday, 18 October 2017

Sector Update

Relative Price Performance



Spreads on a Declining Trend



Source: Bloomberg, KSE 100 & IGI Research

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Commercial Banks

Banks: Gradual earnings recovery on quarterly basis expected in 3Q results; overshadowed by HBL hefty penalty

- On a quarterly basis, profitability is likely to increase by +2.5%, given higher tax provisions in last quarter on account of super tax. However, accounting for HBL penalty value of USD 225mn (or PKR 23.6bn), overall profitability is expected to experience a drop of 71%YoY to PKR 10.9bn.
- Amongst our coverage, we prefer UBL, HMB and BAHL. For NBP, pending decision on outstanding employees' pension payments (PKR ~48bn) will keep stock price under pressure, while we feel the decision likely to be against NBP.

Gradual earnings recovery on quarterly basis; overshadowed by HBL hefty penalty

We preview banking stock earnings for the 3QCY17. Overall profitability of IGI coverage banks is likely to fall by 6.6%YoY to PKR 34.5bn compared to PKR 36.9bn last year. On a quarterly basis, profitability is likely to increase by +2.5%, given higher tax provisions in last quarter on account of super tax. However, accounting for HBL penalty value of USD 225mn (or PKR 23.6bn), overall profitability is expected to experience a drop of 71%YoY to PKR 10.9bn. On a 9MCY17 basis, profitability is estimated to drop by 2.4% to PKR 106.7bn. Based on our estimates, we expect NBP, BAFL, BAHL and FABL to post earnings growth, with FABL leading the earnings growth chart. For HBL, penalty of USD 225mn is likely to result in quarterly loss of PKR 10.6/share, bringing 9MCY17 estimated earnings to PKR 0.14/share with no quarterly dividend (PKR 7/share announced in 1HCY17).

Exhibit:

Banking Sector earnings estimate

Bank	3QCY17E					9MCY17E		
	in PKR	EPS	DPS	BVPS	QoQ	YoY	EPS	DPS
HBL	-10.60	-	125.60	n.m.	n.m.	0.10	7.00	n.m.
UBL	5.30	3.00	127.60	8%	-7%	16.10	9.00	-7%
MCB	5.10	4.00	130.25	-25%	-16%	17.40	12.00	11%
ABL	2.60	1.75	88.30	4%	-17%	8.30	5.25	-22%
NBP	2.10	-	81.90	2%	12%	6.10	-	-3%
BAFL	1.50	-	41.30	17%	28%	4.60	-	17%
BAHL	1.60	-	40.50	-19%	19%	5.70	-	20%
FABL	1.00	-	29.30	32%	41%	3.20	-	11%
HMB	1.10	-	37.90	25%	-17%	3.30	-	-10%
Total				-68%	-71%			-24.00%
Total (ex-HBL penalty)				2.50%	-6.56%			-2.38%

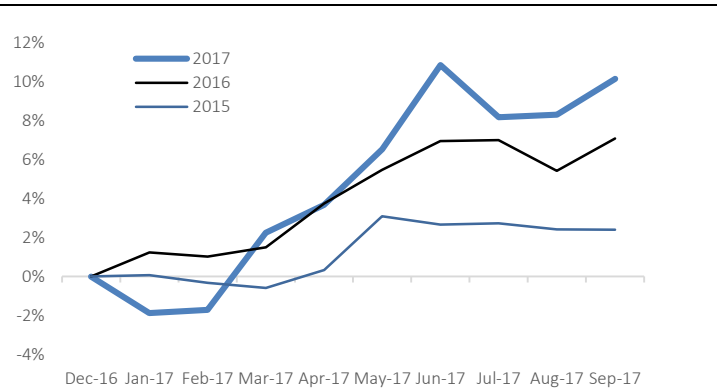
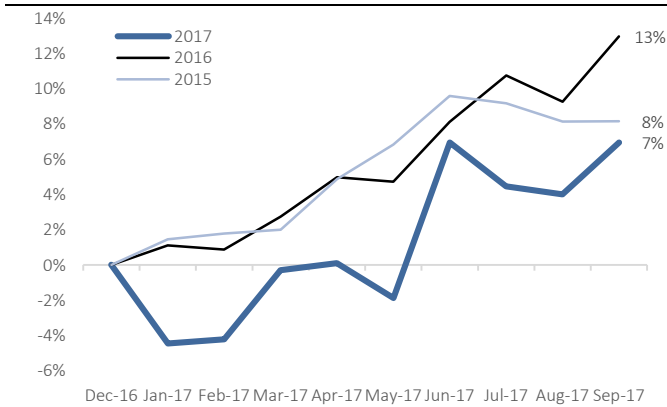
Source: IGI Research, Company Financials

1HCY17: Profitability continued its downward trajectory amid falling interest income

To recall, for the period 1HCY17, IGI coverage banks' profitability registered a meagre decline of 0.2%YoY amid declining earning yields, maturing high yield investment bond and inflexible cost of deposits. As a result, on average, NIMs have come off by almost 35bps, dropping down to ~3.4% by 1HCY17. Provision reversals lent the most support to the bottom line, posting PKR 0.55bn reversal compared to a charge of PKR 5.3bn in same period last year. Yet, rapid growth in operating expenses (up by +9.9%YoY) depressed sector profitability, with average cost to income ratio up by 460bpsYoY to 54.4% in 1HCY17.

Exhibit:
Deposit growth has been lower compared to past 2 years...

Exhibit:
...While advances growth has been higher, lending support to interest income

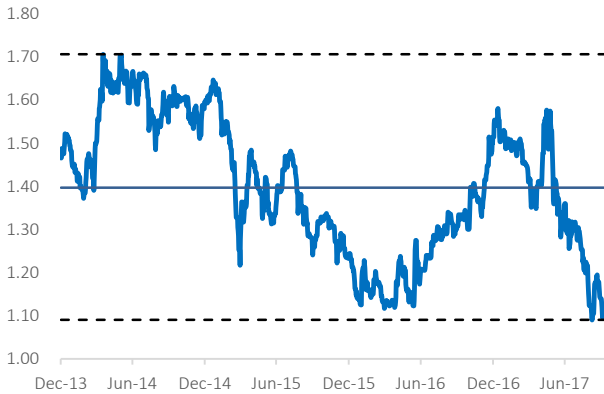


Source: IGI Research, Company Financials, SBP

Rising operating expense along with provision charge to hurt the bottom-line

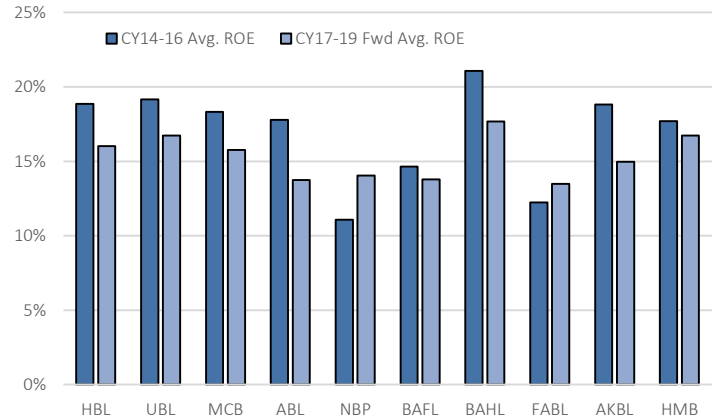
During 3QCY17, we expect similar trend to continue. Operating expenses are expected to grow by +8.4%YoY (ex-HBL penalty), lower than the expected cumulative growth for 9MCY17 (+9.3%YoY). However, we expect HBL to book the recently imposed penalty amount (USD 225mn or PKR 23.6bn) as part of other charges which will result in PKR 10.2bn pre-provisioning loss for the bank in 3QCY17E', dragging down 9MCY17E pre-provisioning profit to PKR 18.7bn. Banks' provision charge for non-performing loans, given increasing advances (advances growth of +20%YoY), is likely to go up, while due to subdued market performance, banks' are likely to incur higher mark to market losses against investments. Nevertheless, based on our estimates, provisioning charge for 3Q is expected to record PKR 2.8bn compared to a reversal of PKR 1.0bn in same period last year; further denting banks' bottom-line.

Exhibit:
Sector trading at a 5-year low P/B multiple of 1.1x...



Source: IGI Research, Company Financials

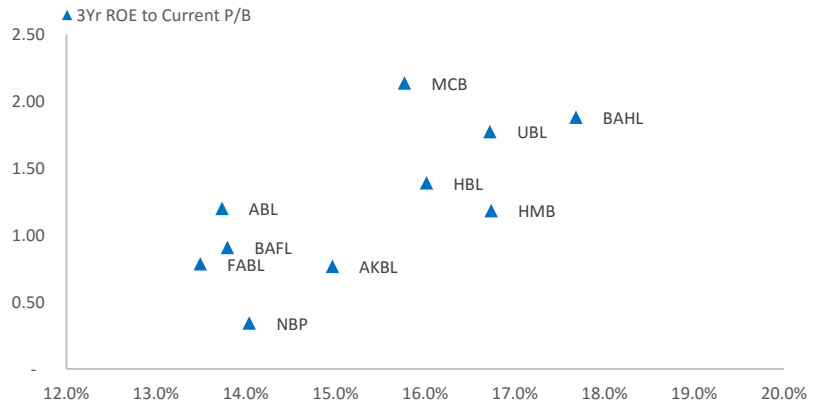
Exhibit:
...despite decent ROE, averaging ~15%



Recommendation

Amongst our coverage, we prefer UBL, HMB and BAHL. For NBP, pending decision on outstanding employees’ pension payments (PKR ~48bn) will keep stock price under pressure, while we feel the decision likely to be against NBP.

Exhibit:
3Yr forward ROE to current P/B



Source: IGI Research, Company Financials

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