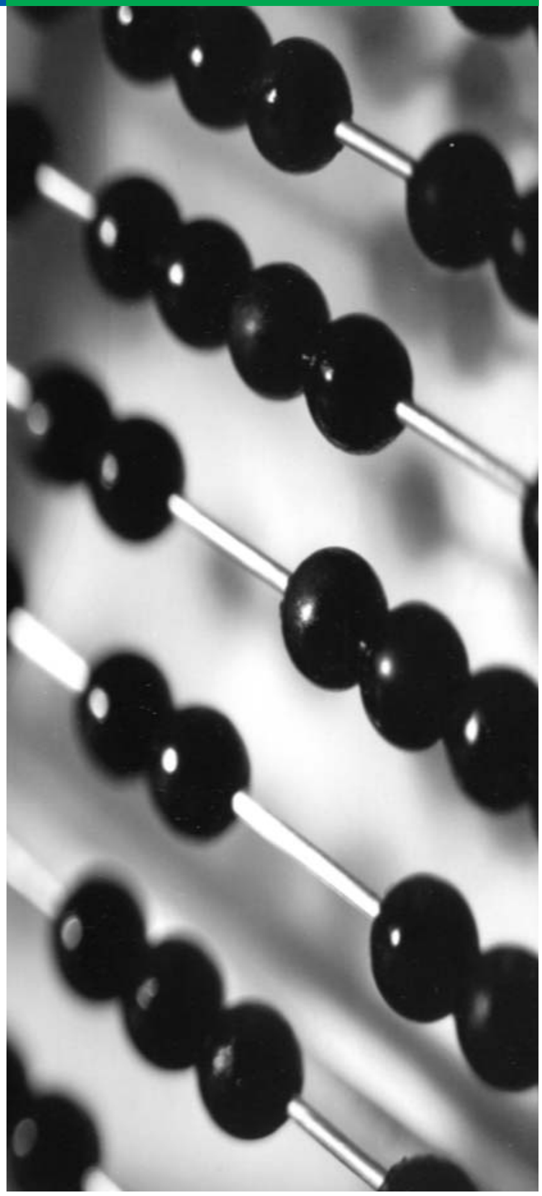
December 2007

BANKS
PAKISTAN

# Pakistan Banks Review

## Industry Update



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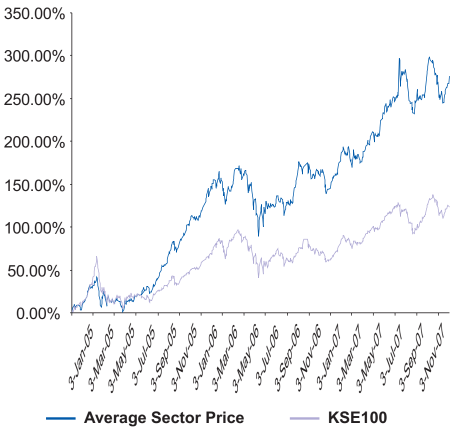
All prices are as of December 07, 2007

## Investment Consideration

| | |
|---|---|
| ***Commercial Banks*** | |
| *Market Capitalisation (PRsbn)* | *1,385* |
| *Market Capitalisation (US$bn)* | *23* |
| *Paid-up Capital (mn)* | *1,480,318* |
| *Turnover* | *75,557* |
| *Price-to-Earning Ratio* | *20.18* |
| *Price-to-Book Ratio* | *2.97* |

**Chart 1: Banking Sector vs. KSE100 Index**




*Source: Bloomberg*

**Robust growth but high valuations**
In the backdrop of strong underlying economic environment, the assets of the banking system have witnessed exceptional growth. Going forward, we expect the banking sector to post robust growth.

The strong fundamentals and earning power has already been discounted by the market, especially for large banks. Based on this, we maintain a 'Market Weight' stance on the banking sector.

**High margins likely to decline**
In wake of the tight monetary stance by the central bank and current rising interest rate scenario we foresee that the margins are going to eventually squeeze, however, being intact in the near term. Banks would need to find other avenues like strong fee generation for sustained profitability in the future.

**State Bank tightens NPL provisioning**
In the near term the after-tax profitability of most banks will decline significantly due to withdrawal of collateral's forced sale value benefit in determining NPL provisioning. The negative charge will vary from bank to bank depending upon the size of uncovered NPLs. Based on our analysis HBL will have the most significant impact on 2007E earnings per share.

**MCR – A moving target driving consolidation**
The banking industry has recently witnessed increasing trend of mergers and acquisitions in response to SBP's increased Minimum Capital Requirement (MCR). Although, major consolidation in the industry has already taken place, however, we may see some activity with regard to smaller banks in the future due to MCR shortfall.

**Changing Credit Mix – Mortgages on the rise**
In 1HCY07 consumer finance has experienced a slowdown after tremendous growth in past few years. A detailed analysis reveals slowdown in auto loans and a shift towards residential mortgage lending. The share of mortgage lending increased by 1.24% (18% growth) as compared to last year.

**Recommendation**
Within the region, Pakistan bank valuations are on the higher side. The banking sector has an average Price-to-Book (P/B) multiple of 2.97x. Based on our analysis using Normalized Required Return analysis with 2008E adjusted equity we make the following recommendation.

**Table 1: Recommendations**

| | |
|---|---|
| BUY | Habib Bank Limited |
| | United Bank Limited |
| | Bank of Punjab |
| | Mybank Limited |
| NEUTRAL | National Bank of Pakistan |
| | MCB Bank Limited |
| | Bank Alfalah |
| | Faysal Bank Limited |
| | Soneri Bank Limited |

*Source: IGI Research*

## Valuation Summary

Our valuation method is Normalized Required Return Analysis. The valuation has three parts:

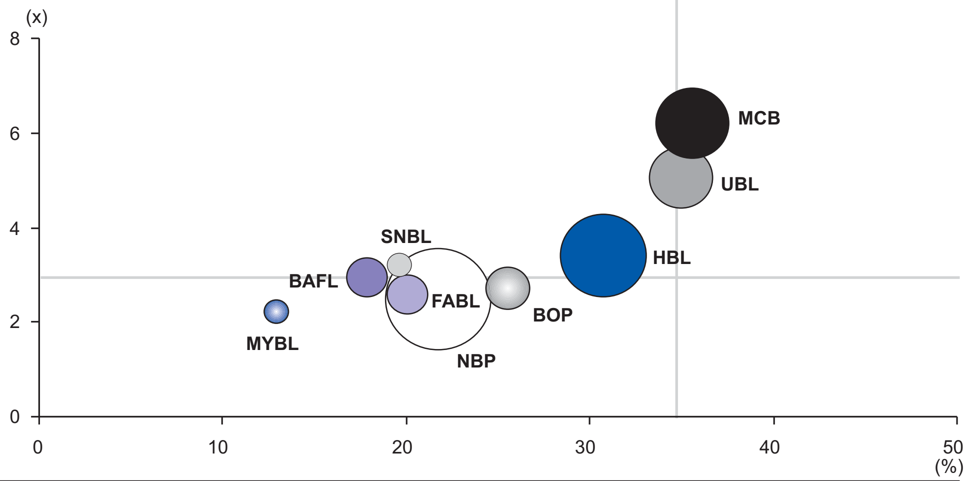
- We arrive at bank's Normalized Return on Equity through Du Pont Analysis.
- The required return is calculated through the Capital Asset Pricing Model (CAPM) using he 10 year Pakistan Investment Bond (PIB) rate as a proxy of risk free rate, and risk factors used are adjusted betas available on Bloomberg. Market Risk Premium of 7% is used as Pakistan is an emerging market.
- Growth adjustment of 10% to 15% is taken depending on the particular bank.

The above mentioned factors are used to calculate the Fair Price-to-Book multiple for the bank. The fair book value is multiplied with 2008E adjusted equity value of the bank to arrive at its net fair value.

Normalized P/B = (Normalized ROE – g) / (Required Return – g)

Our valuation approach entails adjustments for coverage on credit loss adjustment. Moreover, we consider coverage ratio (Loan loss reserves-to-NPLs) of 50% as prudent coverage. Coverage ratio lower than 50% warrants an adjustment to equity levels.

**Chart 2: ROE vs. Price-to-Book (2006)**



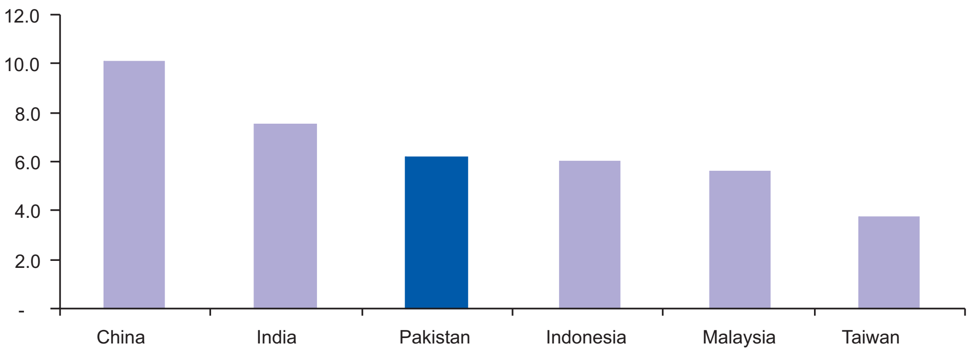

*Source: Company Reports & IGI Research*

## Sector Overview

### Macroeconomic Outlook

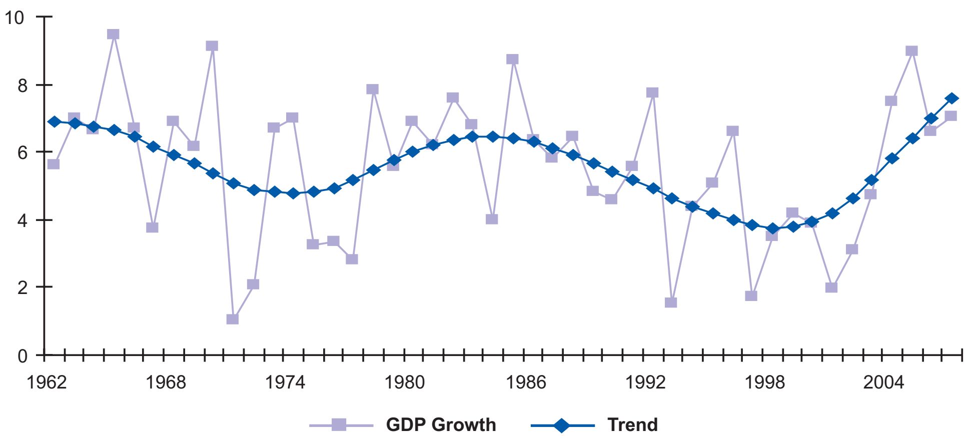
Pakistan's growth story continues with strong economic performance and the GDP growth posted at 7% in FY07. Going forward, we foresee a sustained strong economic outlook with accelerated growth, however, faced with a number of challenges on the political front. The Asian Development Bank (ADB) outlook for FY08 projects economy achieving 6.5% growth, while keeping most of its momentum intact. Similarly, the world economic outlook maintains an overall expansionary trend, with Pakistan's forecasted GDP growth in FY08 at 6.2%. The slight decline in growth forecast as compared to last year is largely attributed to political noise in the country, high international oil prices, and slow exports growth. However, the performance is satisfactory keeping in view the current global market turbulence, triggered by the sub-prime mortgage crisis in the United States (US) this summer and an unprecedented surge in oil prices reaching US$100 per barrel. Although, Pakistan has been isolated from the direct impacts of global economic downturn, however, a recession in U.S economy, Pakistan's largest trading partner, might have marginal adverse consequences over time.

**Chart 3: Regional Comparison - Real GDP Growth Rate 2008F (%)**




*Source: World Economic Outlook*

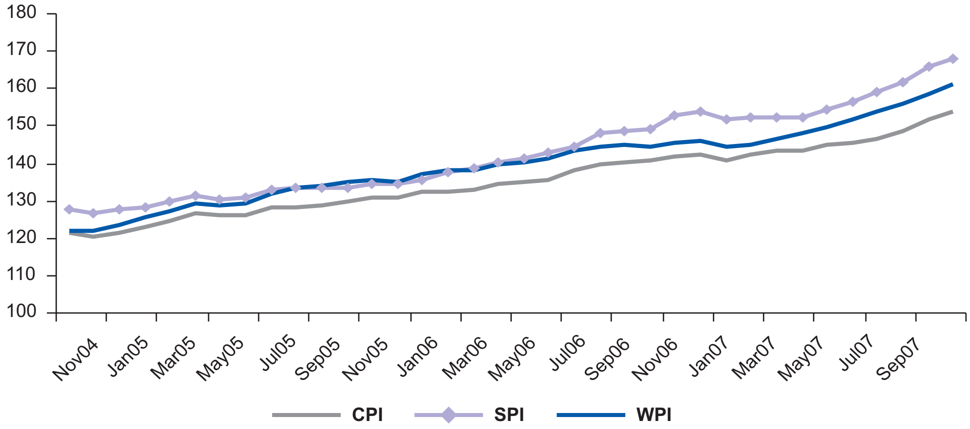
**Chart 4: Real GDP Growth (%)**




*Source: Asian Development Bank Outlook*

The robust and broad-based growth in key economic indicators is accompanied by a surging inflationary trend. The central bank has maintained an aggressively tight monetary policy to restrict aggregate demand and inflationary pressures at the cost of future growth. The inflation target for FY08 has been set at 6.5% which seems overly optimistic under current rising food prices throughout the region along with hike in international commodity prices exerting pressure on domestic price levels. High interest rates have prevailed as a result of tight stance by the central bank, and this has proved especially lucrative for the commercial banks. Banks profitability has soared backed by huge spreads resulting from asymmetry between rise in weighted average lending and deposit rates. Deposits rates have remained stagnant in the past, whereas, lending rates have risen over time. Going forward, we expect banking sector to post robust growth backed by strong economic performance. However, the unprecedented growth potential and earning power has already been discounted by the market and valuations are on the higher side, especially for larger banks.

**Chart 5: Monthly Inflation Trend (Base FY01=100)**

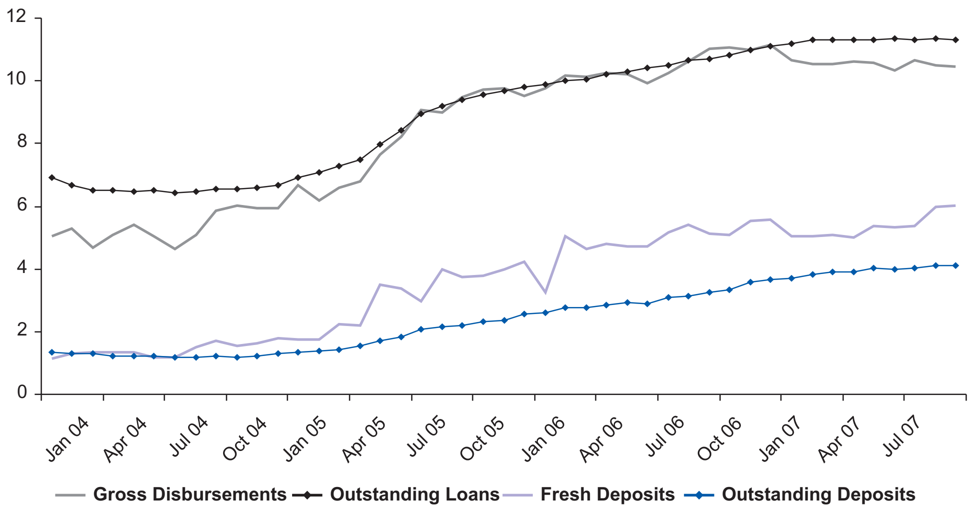



*Source: Federal Bureau of Statistics (FBS) & IGI Research*

## Banking Sector – Recent Developments

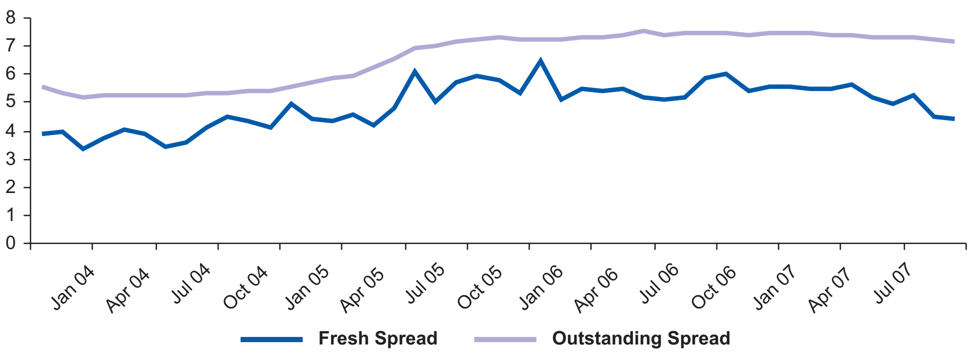
The banking sector has experienced strong growth in the past few years. The current rising interest rate scenario has enabled banks to enjoy favorable spreads and high profit margins. These spreads are unmatched across the world and we predict a positive future outlook for the industry. Banks are well capitalized and the regulator is reasonably vigilant in maintaining asset quality.

**Chart 6: Banks Lending & Deposit Rates** (%)




*Source: FBS & IGI Research*

**Chart 7: Banks Spreads** (%)

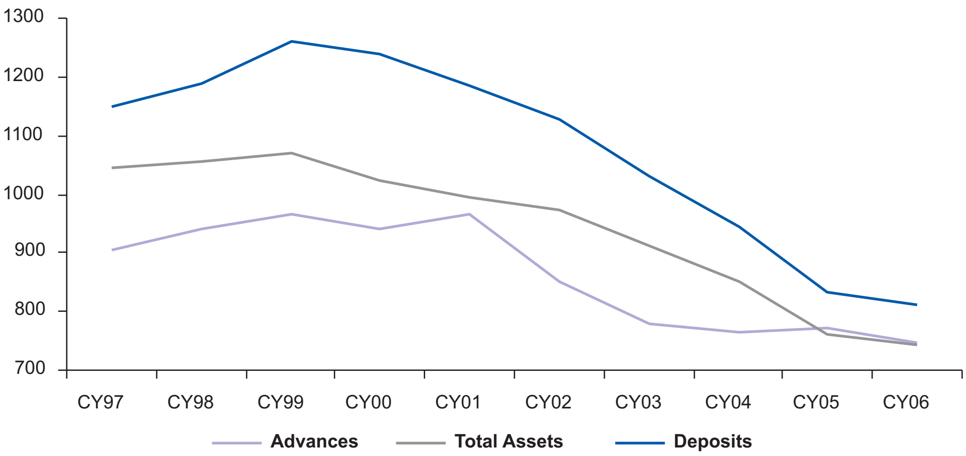



*Source: FBS & IGI Research*

The profitability of the banking sector continued to post a sustained growth trend in CY07. The Return on Assets (ROA) and Return on Equity (ROE) was reported at 2% and 20.6% respectively in 2QCY07. The year to date analysis of CY07 reveals that unprecedented growth in assets continued at an increasing rate, fueled with soaring deposits and increasing capital base. In recent past, advances have contributed the most prominent share in the revenues of the banks; however, investments formed the major share in later part of CY07 with its share in total assets increasing to 23.8% as compared to 19.3% in CY06. Important developments in the banking sector include, rapid growth in deposits of 15% in 1HCY07 (30% per annum), declining interest rate spread due to increasing cost of deposits, and visible shift in the composition of banking sector assets away from loans towards investments resulting in decline of Advances-to-Deposit ratio (ADR). However, the slowdown in credit off-take is a temporary phenomenon and is likely to reverse due to the low penetration of banking services across population and regions. According to the figures released by the central bank, the credit penetration is one of the lowest in Asia Pacific with Credit-to-GDP ratio of 27% in 2006. Consequently, notwithstanding the recent downturn in ADR we believe significant potential exists in the banking sector to be tapped.

The banking industry has recently witnessed increasing trend of mergers and acquisitions in response to SBP's increased Minimum Capital Requirement (MCR). Commercial banks are required to raise the capital gradually to the level of PRs6bn by the year 2009. Banks with low equity, especially smaller banks, may face difficulty in raising capital through retained earnings in order to meet the MCR. The industry has already witnessed few acquisitions by foreign operators, including Standard Chartered Bank, ABN Amro Bank, and Samba Financial Group. The Herfindahl Index, a measure of concentration, computed as sum of squared market shares, was 735 in 2006 for the banking sector indicating low concentration. Therefore the recent mergers in the industry appear to be justified, however, going forward after accounting for the consolidation we expect the index to rise to a concentration level that will no longer warrant further mergers. Although, the major consolidation in the industry has taken place, however, we may see some activity with regard to smaller banks in the future based on the fulfillment requirement of MCR.

**Chart 8: Herfindahl Index for Industry**




*Source: Banking System Review & IGI Research*

**Table 2: Mergers & Acquisitions** **(PRsbn)**

| Date | Acquirer | Target | shares (%) | Price-to-Book | PRs/Shares | Cash Consideration |
|---|---|---|---|---|---|---|
| Sep-06 | Standard Chartered | Union Bank | 95.3 | 5.4 | 91 | 29 |
| Mar-07 | SAMBA Group | Crescent Bank | 68.5 | - | - | 6.0 |
| May-07 | ABN Amro | PCBL | 93.4 | 4 | 54 | 13.8 |
| Jul-07 | NIB | PICIC | 63.4 | 5.3 | 78 | 20.5 |

*Source: Company Reports & IGI Research*

An important step taken by the State Bank of Pakistan (SBP) is the withdrawal of Forced Sale Value (FSV) benefit against all non-performing loans (NPLs) for calculating provisioning requirement with effect from 31 December 2007. This is expected to have a negative impact on the earnings of the banks in near term. Moreover, banks profitability in CY07 will be affected the most due to covering up of provisions short fall for prior years. This negative charge on earnings would vary from bank to bank depending upon the size of uncovered NPLs. In our opinion, this would most adversely affect the earnings of Habib Bank Limited with a significant impact of over PRs6 per share on 2007E EPS. On the flip side, banks would gain from this regulation by expediting recoveries on NPLs and becoming more prudent in extending credit and risk management. In essence, this is expected to result in reversals of NPLs and thus offset the impact of higher provisions in the future. In 2006, the NPLs for the industry stood at 5% of the total advances portfolio.

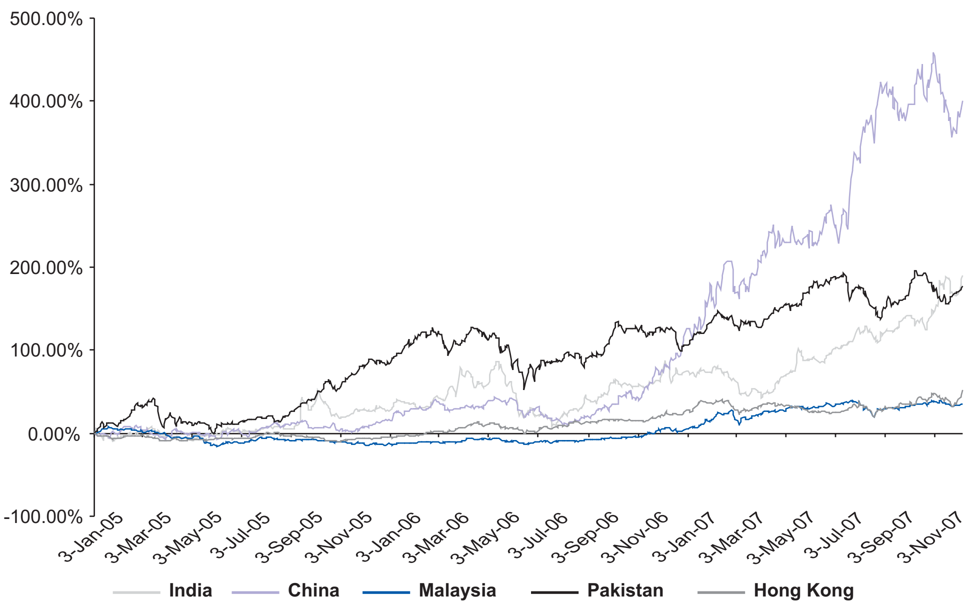
**Table 3: Impact of NPL Provisioning regulation on EPS - CY07E** **(PRs)**

| NBP | HBL | UBL | MCB | BOP | BAFL | FABL | MYBL | SNBL |
|---|---|---|---|---|---|---|---|---|
| (3.60) | (6.50) | (2.30) | 0.00 | (0.80) | (0.60) | (1.80) | (0.80) | (0.40) |

*Source: Company Reports & IGI Research*

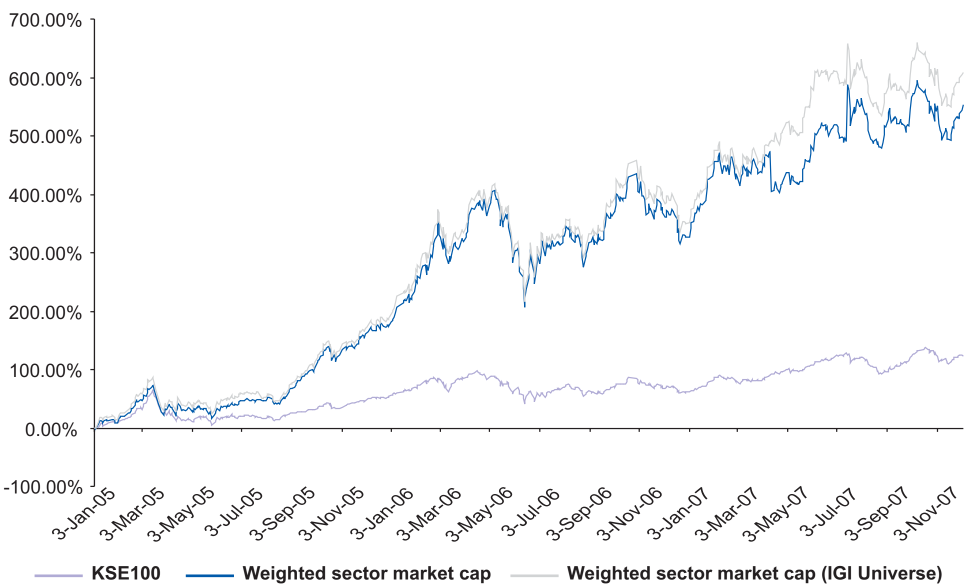
Within the region, Pakistan bank valuations are on the higher side. The banking sector has an average Price-to-Book (P/B) multiple of 2.97x. High P/B multiple for banks in India (P/B 3.03x) and China (P/B 8.99x) are justified because supernormal ROE expectations are backed by double digit GDP growth rate and higher price multiples for other sectors listed on the index. However, for Pakistan we believe the valuations are not justified because of stumbling political scenario and volatility in the market. Based on relative price performance analysis of the banking sector compared to the KSE-100 index further reinforces our stand on the banking sector scrips. Hence, we maintain a 'Market Weight' stance on the banking sector.

**Chart 9: Regional Comparison - Banking Sector**




*Source: Bloomberg*

**Chart 10: Relative Performance - KSE 100 vs Banking Sector**




*Source: Bloomberg*

Another important development is the expanding universe of Islamic Financial Institutions in the banking sector. However, according to central bank despite rapid expansion the share of Islamic Banking is a modest 3.2% of the total banking system. Moreover, the advances of the Islamic banking system are below 3% of the total banking system advances. Recently, the performance of Islamic banks has been encouraging, and the analysis of Year to Date 1HCY07 Balance Sheet reveals good asset quality with NPLs-to-Advances ratio at 0.1% and strong capital adequacy with Capital-to-Risk weighted assets at 21.8%. The global interest in the Islamic Banking industry has provided the much needed impetus for growth in the Islamic Banking industry. Although, currently the industry is in its nascent stage, however, going forward we see tremendous growth potential in the niche market with commercial banks also benefiting from window operations (Islamic Banking Branches Licenses).

## Financial Performance

In our analysis of banking sector's key financial indicators, we have conducted a comparison of key performance indicators of banks in our coverage.

- **Profitability of the banks remains strong.** Sector margins have soared over the years with large Tier-I public sector banks posting margins well over 5% in 2006. Moreover, banks have depicted increased reliance on Net Interest Revenue (NIR) and NIR posted double digit growth in 2006. Looking at individual banks, HBL (5.5%) and MCB (6.6%) posted the highest margins in 2006. The high margins in the sector are a result of large spreads (difference between average lending and average deposit rates) of around 7% in recent years. Going forward our view is that margins will eventually squeeze with rising cost of funding, however, remaining intact in the near term. Furthermore, the lending rates are expected to remain high in-line with the tight monetary stance by the central bank. In a regional comparison, we conclude that margins of around 5% for large Tier I banks are supernormal, compared to large Indian banks with margins in the range of 3%.

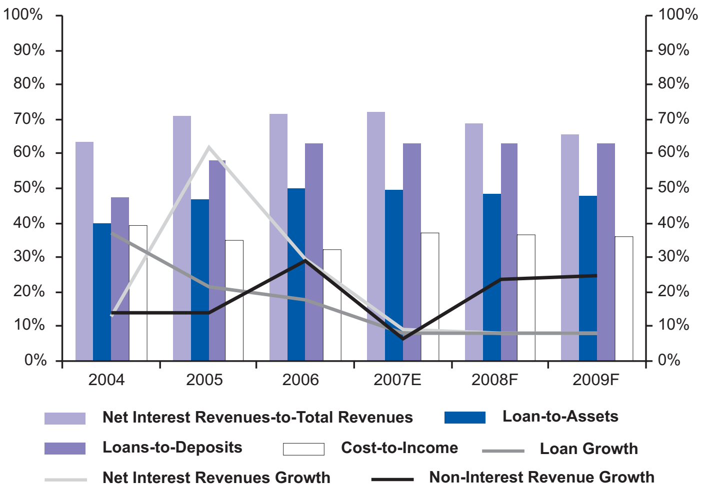
- **Declining trend in Loans-to-Assets Ratio.** The year to date analysis of CY07 reveals that unprecedented growth in assets continued at an increasing rate, fueled with surging growth in deposits (15% in 1HCY07). Recently, the asset mix of the banking system has changed with significant increase in investments share of total assets. Previously, advances have contributed the most prominent share in the revenues of banks; however, investments formed the major share in later part of CY07. Going forward, based on the low credit penetration in the country we expect loans-to-assets ratio to bounce back.

- **Pakistan banks show surprising cost efficiency.** The cost-to-income ratio has posted a declining trend over the years. The growth in operating costs has lagged the growth in revenues, which have compounded at an increasing rate, thus causing the cost-to-income ratio to decline. Looking at individual banks, larger banks like UBL and MCB have cut back on their expenses and aggressively sought to increase cost efficiency. Whereas, the ratio has increased for BAFL because of aggressive branch expansion. Going forward, as margins get squeezed we see further pressure on the cost ratios to rise. In a regional comparison, Pakistan banks have lower cost-to-income ratio primarily due to higher margins and not as a result of operating efficiency.

- **Level of NPLs on a decline-improved asset quality.** The level of Non-Performing Loans (NPLs) has posted a declining trend over the years implying improving asset quality. NPLs-to-Advances ratio has been decreasing over time, however, along with improved asset quality this decline is also attributed to the base effect of phenomenal growth in advances. The recent withdrawal of Forced Sale Value (FSV) benefit against NPLs for calculating provisioning requirement is expected to have a negative impact on the earnings of the banks. Profitability for CY07 will be affected the most due to covering up of provisions short fall for prior years. In our opinion HBL will experience the most adverse impact of over PRs6 per share. However, this regulation would eventually benefit the banks in the future in form of expediting recoveries, and exercise more prudence in extending credit and risk management.

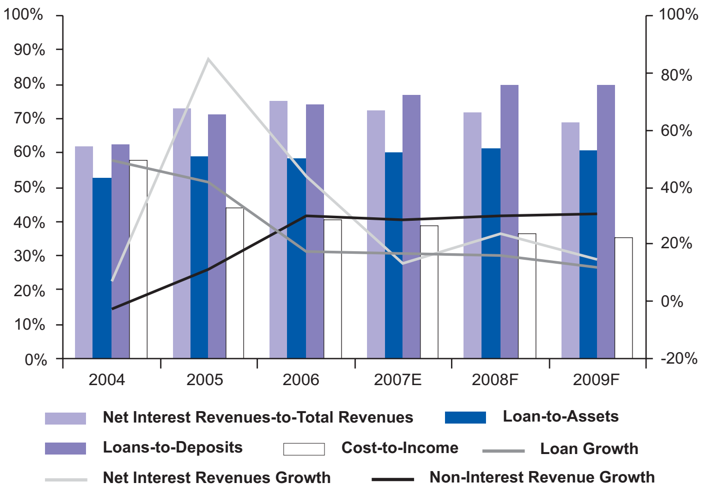
- **Capital ratios are generally high.** Capital Adequacy Ratios (CAR) of Pakistan banks have been on the rise in the wake of regulatory pressures. The central bank has pursued a strategy of strengthening the capital base in order to instill stability into the banking system. The central bank has set a moving target of the Minimum Capital Requirement (MCR) of PRs6bn by the year 2009. MCR of PRs3bn had to be achieved by December 2006. The requirement increases by PRs1bn in each subsequent year till 2009. In the current setting, larger banks are generally over capitalized while some smaller banks are short of the MCR.

## Chart 11: NBP



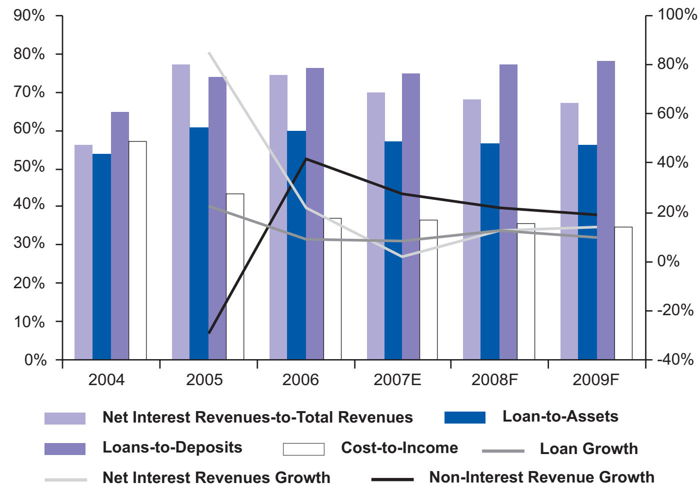

*Source: Company Reports & IGI Research*

## Chart 12: UBL



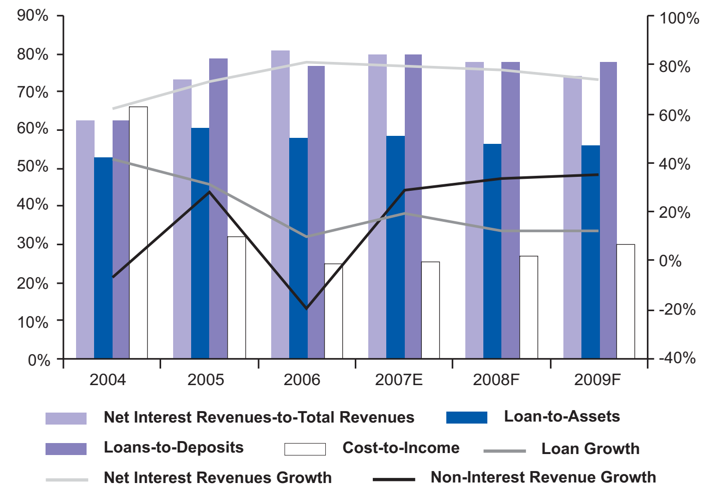

*Source: Company Reports & IGI Research*

## Chart 13: HBL



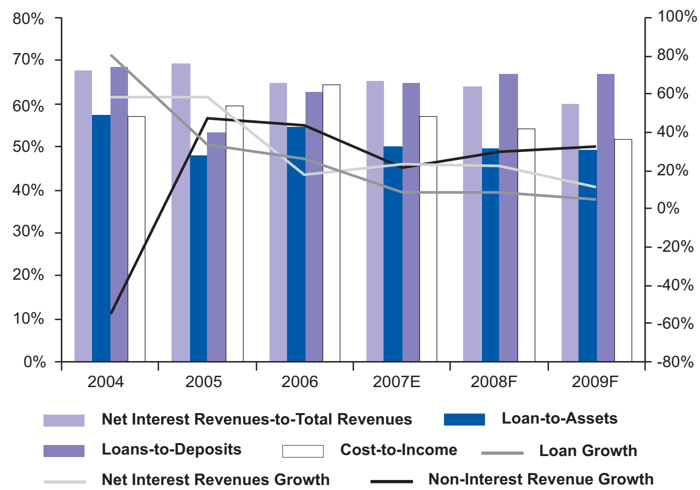

*Source: Company Reports & IGI Research*

## Chart 14: MCB



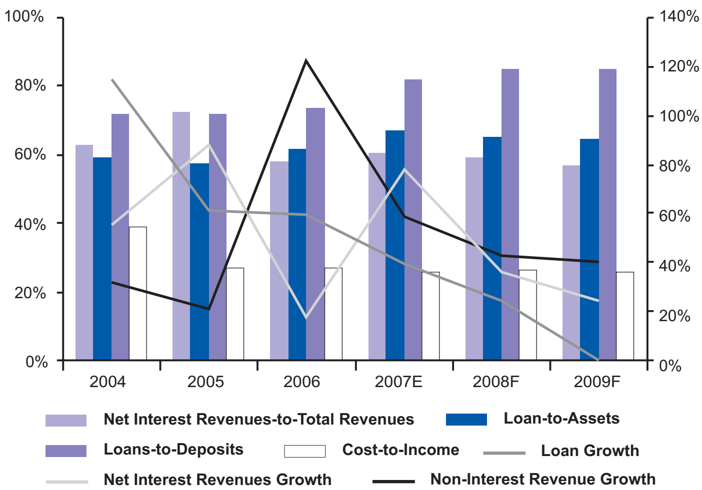

*Source: Company Reports & IGI Research*

## Chart 15: BAFL



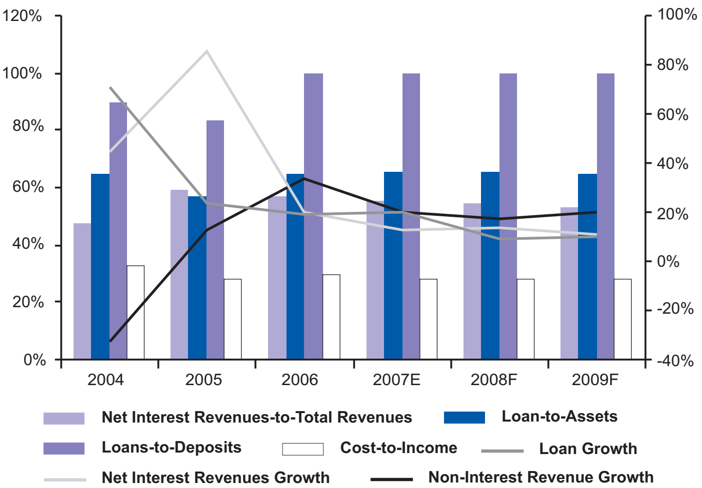

*Source: Company Reports & IGI Research*

## Chart 16: BOP



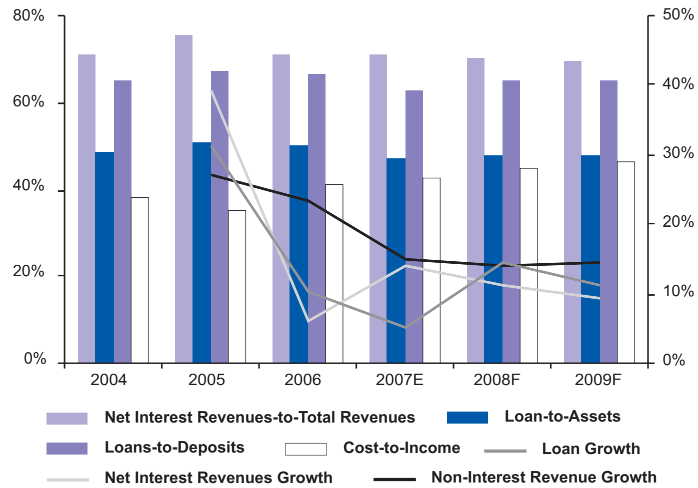

*Source: Company Reports & IGI Research*

## Chart 17: FABL



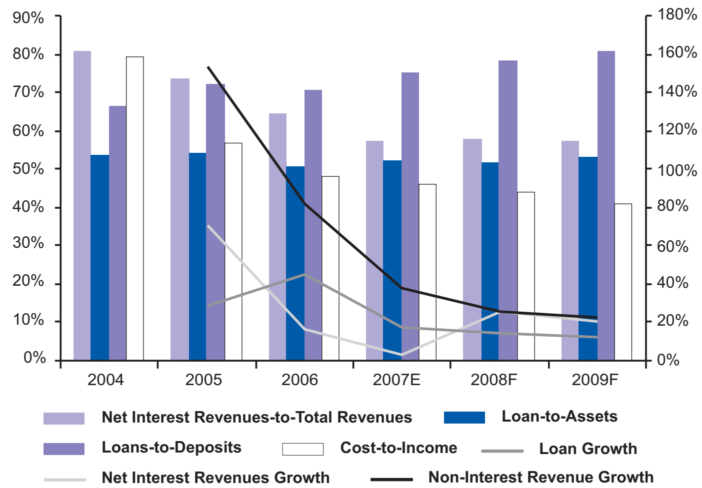

*Source: Company Reports & IGI Research*

## Chart 18: SNBL



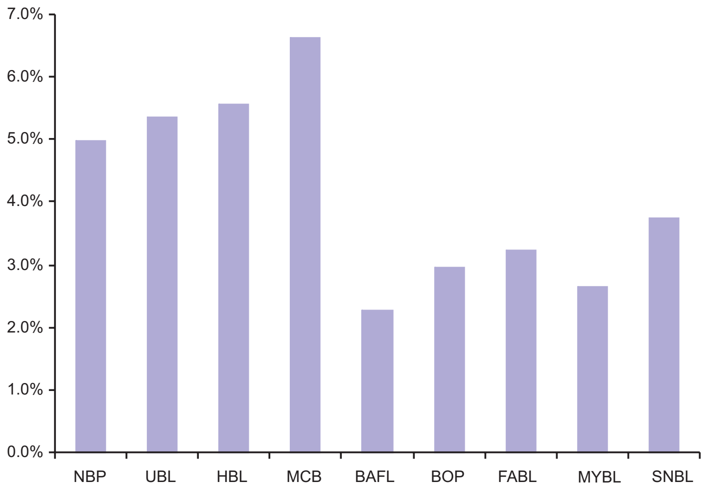

*Source: Company Reports & IGI Research*

## Chart 19: MYBL



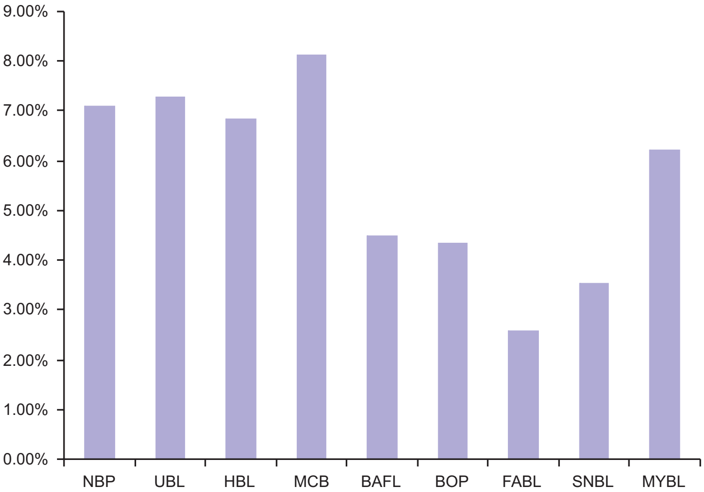

*Source: Company Reports & IGI Research*

## Chart 20: Margins - 2006



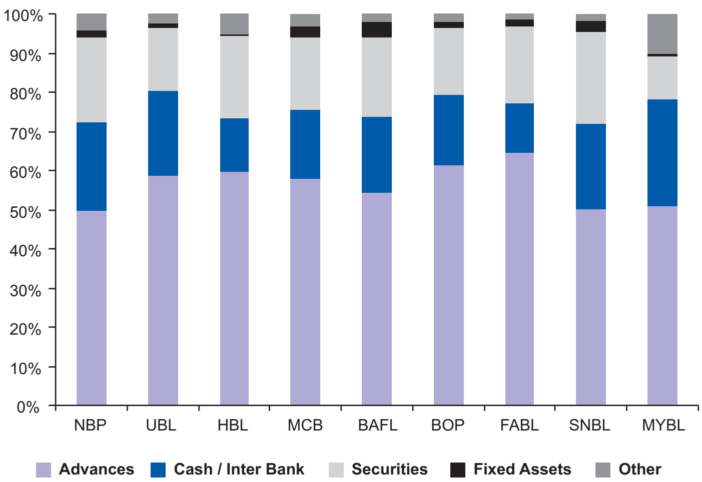

*Source: Company Reports & IGI Research*

## Chart 21: Spreads - 2006




*Source: Company Reports & IGI Research*

## Chart 22: Asset Breakup - 2006




*Source: Company Reports & IGI Research*

# Stock Summaries

# National Bank of Pakistan

**Recommendation: NEUTRAL**

**Fair Value: PRs271**

## Investment Positives

National Bank of Pakistan (NBP) is the largest bank in terms of assets as well as deposits. High proportion of low cost deposits has given rise to favorable funding costs and high Net Interest Margin.

NBP posted an Advances-to-Deposits Ratio of 63% in 2006 as compared to industry ADR of 74.6% in the same year. This is the lowest amongst the large Tier-I banks operating in the industry. Hence, going forward we see high growth potential in advances as compared to its peers. During the last 3 years the bank has recorded double digit growth in advances showing its aggressive stance.

NBP is the largest holder of National Investment Trust (NIT) units. The bank currently holds 365mn NIT units worth PRs5.6bn at book value; however, at market value the investment is worth around PRs21.9bn. In case NBP marks-to-market the NIT investment it would translate into a gain of PRs19.8 per share based on current prices. The government has planned to privatize NIT in near future; however, the timing is uncertain.

NBP holds 13.12mn shares in Bank Al-Jazira (BAJ) of Saudi Arabia, representing 5.83% holding in total equity of BAJ. NBP has plans to offload this investment and register a one time pre-tax gain of PRs12.7bn at current prices and exchange rates. This would translate into an impact of PRs11.9 on the earnings per share.

## Investment Risks

NBP has been trying to offload its investment in Bank Al-Jazira for some time now. However, all attempts to do so have been unsuccessful in getting an attractive selling price and thus the future of its holding stands uncertain.

ADR ratio has been low as compared to other Tier I banks indicating that the bank is not utilizing its full leverage and there is tremendous potential to take more risk.

Being a Tier I bank, NBP has access to low cost funding, however, with squeezing spreads in the future the margins are expected to decline.

## Valuation

We value NBP at PRs271 as the fair price per share based on 2008E book value, and make a 'NEUTRAL' recommendation. We have assumed the risk factor of 1.23, market premium of 7%, and a growth adjustment factor of 13.5%.

**Table 4: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 12,709 | 15.59 | 0.91 | 16.0 | 91.17 | 2.73 |
| 2006A | 17,022 | 20.88 | 1.81 | 11.9 | 100.56 | 2.47 |
| 2007F | 15,641 | 19.18 | 3.00 | 13.0 | 120.28 | 2.07 |
| 2008E | 19,180 | 23.52 | 2.80 | 10.6 | 144.95 | 1.72 |
| 2009E | 22,047 | 27.04 | 2.80 | 9.2 | 173.53 | 1.43 |

*Source : Company Reports & IGI Research*

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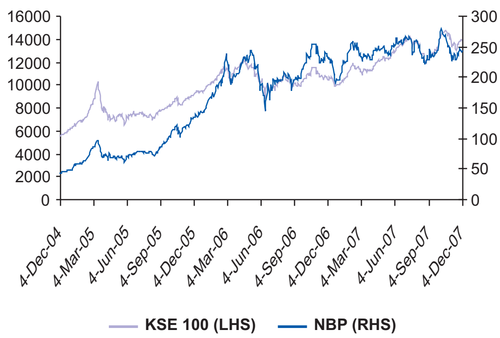
| | |
|---|---|
| *Bloomberg Code* | *NBP PA* |
| *Current Price (PRs per share)* | *248.8* |
| *Average daily Volume (shares)* | *10,906,544* |
| *Market Capitalization (PRs mn)* | *200,596.3* |
| *Market Capitalization (US$ mn)* | *3,276* |
| *Paidup Capital (PRs mn)* | *8,154.32* |
| *Shares Outstanding (mn)* | *815.432* |
| *Weightage in KSE100 (%)* | *5.283* |
| *Free Float (%)* | *20.30* |
| *Average Price Per Share (PRs per share)* | *244.06* |

**Chart 23: NBP: Price Performance**




*Source : Bloomberg*

**Table 5: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 26 |
| Required return | 19 |
| Fair price/book | 225 |
| Normalised price/book | 207 |
| Misvaluation | 9 |
| 12 month return potential | 28 |

*Source : Company Reports & IGI Research*

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**Table 6: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 14,388 | 62% | 23,312 | 29% | 30,154 | 9% | 32,895 | 8% | 35,465 | 8% | 38,303 |
| Commissions | 5,099 | -3% | 4,927 | 25% | 6,145 | 27% | 7,787 | 29% | 10,023 | 29% | 12,902 |
| Trading income | 2,283 | 28% | 2,924 | 85% | 5,395 | -22% | 4,206 | 9% | 4,581 | 9% | 4,991 |
| Other operating income | 875 | 80% | 1,574 | -60% | 628 | 50% | 941 | 50% | 1,412 | 50% | 2,118 |
| Total operating revenues | 22,645 | 45% | 32,737 | 29% | 42,321 | 8% | 45,829 | 12% | 51,482 | 13% | 58,314 |
| Operating costs | (8,919) | 28% | (11,457) | 19% | (13,634) | 25% | (17,021) | 11% | (18,888) | 11% | (21,051) |
| Operating profit | 13,726 | 55% | 21,280 | 35% | 28,687 | 0% | 28,808 | 13% | 32,594 | 14% | 37,263 |
| Provisions | (1,748) | 27% | (2,224) | 7% | (2,372) | 95% | (4,632) | | (2,950) | 0.08 | (3,186) |
| Extraordinary items | | | | | | | | | | | |
| Pre-tax profit | 11,978 | 59% | 19,056 | 38% | 26,315 | -8% | 24,176 | 23% | 29,645 | 15% | 34,077 |
| Tax (rate) | (5,782) | (33%) | (6,347) | (35%) | (9,288) | (35%) | (8,535) | (35%) | (10,465) | (15%) | (12,030) |
| Attributable net income | 6,195 | 105% | 12,709 | 34% | 17,027 | -8% | 15,641 | 23% | 19,180 | 15% | 22,047 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 553,231 | 4% | 577,719 | 10% | 635,133 | 9% | 692,402 | 10% | 759,873 | 10% | 834,304 |
| Average assets | 511,102 | 11% | 565,475 | 7% | 606,426 | 9% | 663,767 | 9% | 726,137 | 10% | 797,088 |
| Customer loans | 220,794 | 22% | 268,839 | 18% | 316,110 | 8% | 341,399 | 8% | 368,711 | 8% | 398,208 |
| Cash and interbank loans | 154,743 | -23% | 118,499 | 20% | 142,280 | 1% | 143,527 | 17% | 167,393 | 16% | 194,746 |
| Investments | 149,350 | 5% | 156,986 | -11% | 139,947 | 20% | 168,027 | 8% | 181,469 | 8% | 195,986 |
| Customer deposits | 465,572 | 0% | 463,427 | 8% | 501,872 | 8% | 542,022 | 8% | 585,384 | 8% | 632,214 |
| Interbank funding | 18,299 | -43% | 10,498 | 113% | 22,310 | -5% | 21,175 | 8% | 22,869 | 8% | 24,699 |
| Shareholders' equity | 46,246 | 61% | 74,341 | 10% | 81,954 | 20% | 98,080 | 21% | 118,197 | 20% | 141,500 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 2.8% | | 4.1% | | 5.0% | | 5.0% | | 4.9% | | 4.8% |
| Non-interest rev./total revenue | 36.5% | | 28.8% | | 28.8% | | 28.2% | | 31.1% | | 34.3% |
| Commissions/total revenue | 22.5% | | 15.0% | | 14.5% | | 17.0% | | 19.5% | | 22.1% |
| Commissions/ average assets | 1.0% | | 0.9% | | 1.0% | | 1.2% | | 1.4% | | 1.6% |
| Operating costs/average assets | 1.7% | | 2.0% | | 2.2% | | 2.6% | | 2.6% | | 2.6% |
| Cost/income | 39.4% | | 35.0% | | 32.2% | | 37.1% | | 36.7% | | 36.1% |
| Trading gains/total revenues | 10.1% | | 8.9% | | 12.7% | | 9.2% | | 8.9% | | 8.6% |
| Trading profits/pre-tax profit | 19.1% | | 15.3% | | 20.5% | | 17.4% | | 15.5% | | 14.6% |
| Trading profits/operating profit | 16.6% | | 13.7% | | 18.8% | | 14.6% | | 14.1% | | 13.4% |
| Customer loans/assets | 39.9% | | 46.5% | | 49.8% | | 49.3% | | 48.5% | | 47.7% |
| Cash and interbank loans/assets | 28.0% | | 20.5% | | 22.4% | | 20.7% | | 22.0% | | 23.3% |
| Investments/assets | 27.0% | | 27.2% | | 22.0% | | 24.3% | | 23.9% | | 23.5% |
| Loans/deposits | 47.4% | | 58.0% | | 63.0% | | 63.0% | | 63.0% | | 63.0% |
| Loan loss provisions/loans | 0.7% | | 0.9% | | 1.0% | | 1.4% | | 0.8% | | 0.8% |
| Loan loss reserves/loans | 13.2% | | 11.4% | | 10.2% | | 10.8% | | 10.8% | | 10.8% |
| NPL/Loans | 16.3% | | 12.5% | | 11.5% | | 12.0% | | 12.0% | | 12.0% |
| Loan loss reserves/NPLs | 80.5% | | 90.7% | | 88.9% | | 90.0% | | 90.0% | | 90.0% |
| Growth in NPLs | -9.2% | | -6.5% | | 7.5% | | 13.0% | | 8.0% | | 8.0% |
| Customer deposits/liabilities | 84.2% | | 80.2% | | 79.0% | | 78.3% | | 77.0% | | 75.8% |
| Time deposits/total deposits | 16.8% | | 17.5% | | 19.9% | | 15.0% | | 15.0% | | 15.0% |
| Interbank funding/liabilities | 3.3% | | 1.8% | | 3.5% | | 3.1% | | 3.0% | | 3.0% |
| Liquid assets/liabilities | 28.0% | | 20.5% | | 22.4% | | 20.7% | | 22.0% | | 23.3% |
| Equity/assets | 8.4% | | 12.9% | | 12.9% | | 14.2% | | 15.6% | | 17.0% |
| Total capital ratio | 12.8% | | 15.4% | | 16.5% | | 18.7% | | 20.8% | | 23.0% |
| Tier 1 capital ratio | 0.0% | | 9.1% | | 11.6% | | 13.7% | | 15.9% | | 18.1% |
| Internal capital growth rate | 22.4% | | 27.5% | | 22.9% | | 19.1% | | 19.5% | | 18.6% |
| Operating profit/average assets | 2.7% | | 3.8% | | 4.7% | | 4.3% | | 4.5% | | 4.7% |
| Return on average assets | 1.2% | | 2.2% | | 2.8% | | 2.4% | | 2.6% | | 2.8% |
| Return on average equity | 16.8% | | 21.1% | | 21.8% | | 17.4% | | 17.7% | | 17.0% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 7.60 | 105% | 15.59 | 34% | 20.88 | -8% | 19.18 | 23% | 23.52 | | 27.04 |
| Operating profit | 1,683 | 55% | 2,610 | 35% | 3,518 | 4% | 3,652 | 9% | 3,997 | | 4,570 |
| Gross dividend | 0.63 | 44% | 0.91 | 100% | 1.81 | 66% | 3.00 | -7% | 2.80 | | 2.80 |
| Net asset value | 56.71 | 61% | 91.17 | 10% | 100.56 | 20% | 120.28 | 21% | 144.95 | | 173.53 |
| Payout | 8% | -30% | 6% | 49% | 9% | 80% | 16% | -24% | 12% | | 10% |
| Average shares issued (mn) | 492 | 20% | 591 | 20% | 709 | 11% | 789 | 3% | 815 | | 815 |
| Year-end shares issued (mn) | 492 | 20% | 591 | 20% | 709 | 15% | 815 | 0% | 815 | | 815 |

*Source: Company Reports & IGI Research*

# Habib Bank Limited

**Recommendation: BUY**

**Fair Value: PRs303**

## Investment Positives

Habib Bank Ltd (HBL) has a dominant domestic presence being the largest bank in the country in terms of advances and branch network. In terms of deposits it stands second only to National Bank of Pakistan (NBP). In an industry where size does matter, HBL's size is expected to be a big advantage.

Low costs deposit base due to extensive branch network is a key advantage. HBL along with other Tier I banks continues to enjoy favorable interest rate spreads.

Fee income dominates Non-Interest Revenue which is expected to increase going forward, as the bank increases its penetration in the consumer finance segment.

Strong international presence and aspirations of becoming a universal bank provide the bank a focus towards trade finance.

Group backing is strong with management control and majority share (51%) resting with Agha Khan Fund for Economic Development (AKFED). Also, alliances in related insurance and microfinance businesses offer attractive opportunities for developing fee income. Moreover, strategic investments in subsidiaries and related business also provide support to the business in offering innovative banking solutions.

## Investment Risks

Net Interest Revenue (NIR) growth has lagged the average growth for Tier I banks. While HBL report NIR growth in 2006 at 22%, the average NIR growth for Tier I banks stood at 35%. This low growth can be attributed to decline in incremental credit disbursements during 2006.

Asset Quality has been a major concern post-privatization with a legacy of NPLs. Although HBL has actively pursued a policy of provisioning and recovering delinquent loans, the current NPL-to-Advances ratio stood at 9% in 2006.

High advances exposure to the textile sector may prove risky for the bank. The dismal performance of textile exports may result in default and advances leading to declining asset quality.

## Valuation

We value HBL at PRs303 as the fair price per share based on 2008E book value, and make a 'BUY' recommendation. We have assumed the risk factor of 0.91, market premium of 7%, and a growth adjustment factor of 13%.

**Table 7: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 8,916 | 12.92 | 0.00 | 20.2 | 57.58 | 4.54 |
| 2006A | 14,276 | 20.69 | 1.00 | 12.6 | 76.97 | 3.40 |
| 2007F | 12,296 | 17.82 | 2.00 | 14.7 | 93.96 | 2.78 |
| 2008E | 18,176 | 26.34 | 2.00 | 9.9 | 119.57 | 2.19 |
| 2009E | 21,458 | 31.10 | 2.50 | 8.4 | 149.55 | 1.75 |

*Source : Company Reports & IGI Research*

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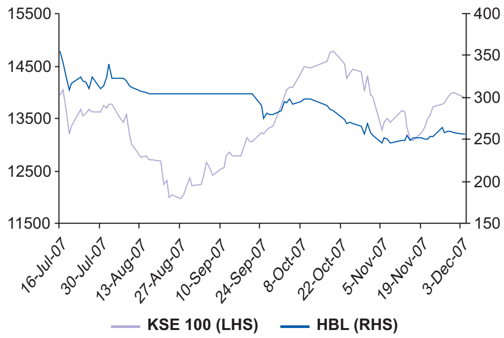
| | |
|---|---|
| *Bloomberg Code* | *HBL PA* |
| *Current Price (PRs per share)* | *261.50* |
| *Average daily Volume (shares)* | *2,152,007* |
| *Market Capitalization (PRs mn)* | *180,952.5* |
| *Market Capitalization (US$ mn)* | *2,955.7* |
| *Paidup Capital (PRs mn)* | *6,900* |
| *Shares Outstanding (mn)* | *690* |
| *Weightage in KSE100 (%)* | *0* |
| *Free Float (%)* | *7.5* |
| *Average Price Per Share (PRs per share)* | *289.27* |

**Chart 24: HBL: Price Performance**




*Source : Bloomberg*

**Table 8: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 24.2% |
| Required return | 16.7% |
| Fair price/book | 299% |
| Normalised price/book | 258% |
| Misvaluation | 16% |
| 12 month return potential | 33% |

*Source : Company Reports & IGI Research*

IGI Securities

**Table 9: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 13140 | 85% | 24301 | 22% | 29648 | 2% | 30242 | 13% | 34096 | 14% | 38785 |
| Commissions | 2321 | 17% | 2722 | 33% | 3608 | 40% | 5051 | 35% | 6819 | 30% | 8865 |
| Trading income | 5897 | -54% | 2712 | 61% | 4364 | 16% | 5060 | 13% | 5714 | 9% | 6252 |
| Other operating income | 1931 | -10% | 1740 | 25% | 2174 | 15% | 2501 | 13% | 2824 | 9% | 3089 |
| Total operating revenues | 23290 | 35% | 31475 | 26% | 39795 | 8% | 42853 | 15% | 49454 | 15% | 56991 |
| Operating costs | -13288 | 3% | -13687 | 8% | -14766 | 22% | -18032 | 14% | -20620 | 13% | -23199 |
| Operating profit | 10002 | 78% | 17788 | 41% | 25029 | -1% | 24821 | 16% | 28834 | 17% | 33792 |
| Provisions | -2317 | 30% | -3023 | -7% | -2802 | 159% | -7255 | -60% | -2868 | 9% | -3137 |
| Extraordinary items | 0 | | -1602 | | -1724 | | 0 | | 0 | | 0 |
| Pre-tax profit | 7685 | 71% | 13163 | 56% | 20503 | -14% | 17566 | 48% | 25966 | 18% | 30655 |
| Tax (rate) | -1814 | (32%) | -4247 | (30%) | -6227 | (30%) | -5270 | (30%) | -7790 | (30%) | -9196 |
| Attributable net income | 5870 | 52% | 8916 | 60% | 14276 | -14% | 12296 | 48% | 18176 | 18% | 21458 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 465129 | 9% | 506068 | 11% | 562916 | 12% | 630756 | 13% | 715260 | 10% | 786714 |
| Average assets | 465129 | 4% | 485598 | 10% | 534492 | 12% | 596836 | 13% | 673008 | 12% | 750987 |
| Customer loans | 250612 | 23% | 307603 | 9% | 335985 | 8% | 362773 | 13% | 409691 | 9% | 448213 |
| Cash and interbank loans | 59695 | 15% | 68591 | 11% | 76327 | 37% | 104484 | 21% | 126827 | 15% | 145850 |
| Investments | 130328 | -21% | 102984 | 16% | 119129 | 10% | 131042 | 10% | 143658 | 8% | 155151 |
| Customer deposits | 386333 | 8% | 416603 | 6% | 439724 | 10% | 483697 | 10% | 532066 | 8% | 574632 |
| Interbank funding | 33984 | 6% | 35855 | 55% | 55558 | 18% | 65299 | 18% | 76751 | 8% | 83034 |
| Shareholders' equity | 31463 | 26% | 39731 | 34% | 53112 | 22% | 64829 | 27% | 82500 | 25% | 103190 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 2.82% | | 5.00% | | 5.55% | | 5.07% | | 5.07% | | 5.16% |
| Non-interest rev./total revenue | 43.6% | | 22.8% | | 25.5% | | 29.4% | | 31.1% | | 31.9% |
| Commissions/total revenue | 10.0% | | 8.6% | | 9.1% | | 11.8% | | 13.8% | | 15.6% |
| Commissions/ average assets | 0.50% | | 0.56% | | 0.68% | | 0.85% | | 1.01% | | 1.18% |
| Operating costs/average assets | 2.86% | | 2.82% | | 2.76% | | 3.02% | | 3.06% | | 3.09% |
| Cost/income | 57.1% | | 43.5% | | 37.1% | | 42.1% | | 41.7% | | 40.7% |
| Trading gains/total revenues | 25.3% | | 8.6% | | 11.0% | | 11.8% | | 11.6% | | 11.0% |
| Trading profits/pre-tax profit | 76.7% | | 20.6% | | 21.3% | | 28.8% | | 22.0% | | 20.4% |
| Trading profits/operating profit | 59.0% | | 15.2% | | 17.4% | | 20.4% | | 19.8% | | 18.5% |
| Customer loans/assets | 53.9% | | 60.8% | | 59.7% | | 57.5% | | 57.3% | | 57.0% |
| Cash and interbank loans/assets | 12.8% | | 13.6% | | 13.6% | | 16.6% | | 17.7% | | 18.5% |
| Investments/assets | 28.0% | | 20.3% | | 21.2% | | 20.8% | | 20.1% | | 19.7% |
| Loans/deposits | 64.9% | | 73.8% | | 76.4% | | 75.0% | | 77.0% | | 78.0% |
| Loan loss provisions/loans | 0.76% | | 0.97% | | 0.85% | | 2.00% | | 0.70% | | 0.70% |
| Loan loss reserves/loans | 10.90% | | 9.05% | | 5.60% | | 5.50% | | 5.50% | | 5.50% |
| NPL/Loans | 15.3% | | 11.6% | | 8.0% | | 8.0% | | 7.0% | | 7.0% |
| Loan loss reserves/NPLs | 71.0% | | 78.2% | | 69.9% | | 70.0% | | 70.0% | | 70.0% |
| Growth in NPLs | 0.0% | | -7.4% | | -24.4% | | 7.8% | | -1.2% | | 9.4% |
| Customer deposits/liabilities | 83.1% | | 82.3% | | 78.1% | | 76.7% | | 74.4% | | 73.0% |
| Time deposits/total deposits | 15.9% | | 21.6% | | 27.5% | | 28.0% | | 28.0% | | 28.0% |
| Interbank funding/liabilities | 7.3% | | 7.1% | | 9.9% | | 10.4% | | 10.7% | | 10.6% |
| Liquid assets/liabilities | 12.8% | | 13.6% | | 13.6% | | 16.6% | | 17.7% | | 18.5% |
| Equity/assets | 6.8% | | 7.9% | | 9.4% | | 10.3% | | 11.5% | | 13.1% |
| Total capital ratio | - | | 9.9% | | 12.8% | | 12.4% | | 14.4% | | 16.8% |
| Tier 1 capital ratio | - | | 8.0% | | 11.0% | | 11.9% | | 13.8% | | 16.2% |
| Internal capital growth rate | | | 28.3% | | 35.9% | | 23.1% | | 28.0% | | 26.0% |
| Operating profit/average assets | 2.15% | | 3.66% | | 4.68% | | 4.16% | | 4.28% | | 4.50% |
| Return on average assets | 1.26% | | 1.84% | | 2.67% | | 2.06% | | 2.70% | | 2.86% |
| Return on average equity | 37.3% | | 25.0% | | 30.8% | | 20.9% | | 24.7% | | 23.1% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 8.51 | 52% | 12.92 | 60% | 20.69 | -14% | 17.82 | 48% | 26.34 | 18% | 31.10 |
| Operating profit | 1450 | 78% | 2578 | 41% | 3627 | -1% | 3597 | 16% | 4179 | 17% | 4897 |
| Gross dividend | 0.50 | -100% | 0.00 | - | 1.00 | 100% | 2.00 | 0% | 2.00 | 25% | 2.50 |
| Net asset value | 45.60 | 26% | 57.58 | 34% | 76.97 | 22% | 93.96 | 27% | 119.57 | 25% | 149.55 |
| Payout | 6% | -100% | 0% | - | 5% | 132% | 11% | -32% | 8% | 6% | 8% |
| Average shares issued (mn) | 690 | 0% | 690 | 0% | 690 | 0% | 690 | 0% | 690 | 0% | 690 |
| Year-end shares issued (mn) | 690 | 0% | 690 | 0% | 690 | 0% | 690 | 0% | 690 | 0% | 690 |

*Source: Company Reports & IGI Research*

December 2007

BANKS
PAKISTAN

# United Bank Limited

**Recommendation: BUY**

**Fair Value: PRs221**

## Investment Positives

United Bank Limited (UBL) is Pakistan's third largest bank in terms of assets as well as deposits. Post privatization in 2002, the bank has revamped its strategy and emerged as a strong market player in both corporate and consumer segments.

The bank has posted supernormal growth in Net Interest Revenues and the profitability has soared on the back of high margins. The bank enjoys wide spreads due to its low cost funding with average spreads of over 5% in 2006.

Although, the Cost-to-Income ratio has been high as compared to similar sized banks, however, the ratio has declined over time, and was posted at 40% in 2006.

The overall risk profile of the bank has vastly improved with Non-Performing Loans (NPLs) as a percentage of advances coming down from 19% in 2003 to 7% in 2006. However, the level of NPLs is still higher than the selected average of 5%. Coverage ratio of 83% in 2006 suggests that the bank is adequately covered against possible loan losses.

## Investment Risks

With rising cost of funding, margins are expected to squeeze for the bank. Hence, the supernormal margins may stabilize and come down to a more rational level.

The operating costs are expected to rise in the future with expected technological expenditure. We expect the bank's cost to remain on the higher side in the foreseeable future.

Although NPLs have followed a declining trend over the years, however, the NPL-to-Advances ratio was reported at 7% in 2006, much higher compared to similar sized Tier I banks.

## Valuation

We value UBL at PRs221 as the fair price per share based on 2008E book value, and make a 'BUY' recommendation. We have assumed the risk factor of 1.09, market premium of 7%, and a growth adjustment factor of 13%.

**Table 10: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 6,168 | 7.62 | 0.96 | 24.7 | 30.00 | 6.27 |
| 2006A | 9,211 | 11.39 | 0.00 | 16.5 | 36.91 | 5.09 |
| 2007F | 11,040 | 13.65 | 3.00 | 13.8 | 51.06 | 3.68 |
| 2008E | 15,795 | 19.52 | 2.50 | 9.6 | 68.66 | 2.74 |
| 2009E | 19,268 | 23.82 | 2.50 | 7.9 | 90.60 | 2.08 |

*Source : Company Reports & IGI Research*

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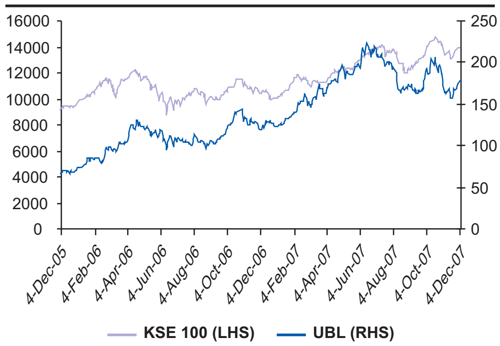
| | |
|---|---|
| *Bloomberg Code* | *UBL PA* |
| *Current Price (PRs per share)* | *188.00* |
| *Average daily Volume (shares)* | *1,145,480* |
| *Market Capitalization (PRs mn)* | *153,659.8* |
| *Market Capitalization (US$ mn)* | *2,501* |
| *Paidup Capital (PRs mn)* | *8,093.75* |
| *Shares Outstanding (mn)* | *809.375* |
| *Weightage in KSE100 (%)* | *4.047* |
| *Free Float (%)* | *3.37* |
| *Average Price Per Share (PRs per share)* | *176.03* |

**Chart 25: UBL: Price Performance**




*Source : Bloomberg*

| **Table 11: Required return analysis** | **(2008E)** |
|---|---|
| Normalised ROE | 32.1% |
| Required return | 18% |
| Fair price/book | 383 |
| Normalised price/book | 327 |
| Misvaluation | 17 |
| 12 month return potential | 35 |

*Source : Company Reports & IGI Research*

IGI
Securities

**Table 12: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 7,860 | 85% | 14,531 | 44% | 20,865 | 12% | 23,447 | 24% | 29,056 | 15% | 33,354 |
| Commissions | 1,891 | 49% | 2,820 | 37% | 3,877 | 37% | 5,329 | 39% | 7,433 | 41% | 10,515 |
| Trading income | 1,824 | -30% | 1,273 | 40% | 1,778 | 17% | 2,077 | 16% | 2,417 | 12% | 2,707 |
| Other operating income | 1,103 | 15% | 1,266 | 2% | 1,294 | 17% | 1,512 | 16% | 1,759 | 12% | 1,970 |
| Total operating revenues | 12,679 | 57% | 19,890 | 40% | 27,813 | 16% | 32,365 | 26% | 40,665 | 19% | 48,546 |
| Operating costs | (7,312) | 20% | (8,760) | 28% | (11,205) | 12% | (12,507) | 19% | (14,869) | 16% | -17,228 |
| Operating profit | 5,367 | 107% | 11,130 | 49% | 16,609 | 20% | 19,858 | 30% | 25,796 | 21% | 31,319 |
| Provisions | (357) | 301% | (1,434) | 62% | (2,317) | 25% | (2,890) | -48% | (1,513) | 12% | -1,695 |
| Extraordinary items | 0 | | 13 | -100% | 0 | - | 16 | 10% | 17 | 10% | 19 |
| Pre-tax profit | 5,010 | 94% | 9,709 | 47% | 14,292 | 19% | 16,984 | 43% | 24,300 | 22% | 29,643 |
| Tax (rate) | (1,189) | (36%) | (3,540) | (34%) | (4,824) | (35%) | (5,945) | (35%) | (8,505) | 22% | -10,375 |
| Attributable net income | 3,821 | 61% | 6,168 | 53% | 9,468 | 17% | 11,040 | 43% | 15,795 | 22% | 19,268 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 282,248 | 27% | 358,056 | 18% | 423,320 | 13% | 479,042 | 14% | 545,170 | 14% | 620,763 |
| Average assets | 253,818 | 26% | 320,152 | 22% | 390,688 | 16% | 451,653 | 13% | 512,106 | 14% | 582,966 |
| Customer loans | 148,225 | 42% | 210,153 | 18% | 247,310 | 17% | 288,971 | 16% | 336,257 | 12% | 376,608 |
| Cash and interbank loans | 66,480 | 6% | 70,699 | 31% | 92,546 | 5% | 96,939 | 8% | 105,077 | 20% | 126561.1 |
| Investments | 52,708 | 17% | 61,559 | 9% | 67,260 | 12% | 75,057 | 10% | 82,593 | 12% | 92,504 |
| Customer deposits | 237,054 | 25% | 296,499 | 13% | 335,078 | 12% | 375,287 | 12% | 420,322 | 12% | 470,760 |
| Interbank funding | 16,473 | 63% | 26,932 | 60% | 43,106 | 9% | 47,061 | 12% | 52,792 | 12% | 58,939 |
| Shareholders' equity | 19,379 | 25% | 24,274 | 23% | 29,863 | 38% | 41,309 | 34% | 55,545 | 32% | 73,292 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 3.1% | | 4.5% | | 5.3% | | 5.2% | | 5.7% | | 5.7% |
| Non-interest rev./total revenue | 38.0% | | 26.9% | | 25.0% | | 27.6% | | 28.5% | | 31.3% |
| Commissions/total revenue | 14.9% | | 14.2% | | 13.9% | | 16.5% | | 18.3% | | 21.7% |
| Commissions/ average assets | 0.7% | | 0.9% | | 1.0% | | 1.2% | | 1.5% | | 1.8% |
| Operating costs/average assets | 2.9% | | 2.7% | | 2.9% | | 2.8% | | 2.9% | | 3.0% |
| Cost/income | 57.7% | | 44.0% | | 40.3% | | 38.6% | | 36.6% | | 35.5% |
| Trading gains/total revenues | 14.4% | | 6.4% | | 6.4% | | 6.4% | | 5.9% | | 5.6% |
| Trading profits/pre-tax profit | 36.4% | | 13.1% | | 12.4% | | 12.2% | | 9.9% | | 9.1% |
| Trading profits/operating profit | 34.0% | | 11.4% | | 10.7% | | 10.5% | | 9.4% | | 8.6% |
| Customer loans/assets | 52.5% | | 58.7% | | 58.4% | | 60.3% | | 61.7% | | 60.7% |
| Cash and interbank loans/assets | 23.6% | | 19.7% | | 21.9% | | 20.2% | | 19.3% | | 20.4% |
| Investments/assets | 18.7% | | 17.2% | | 15.9% | | 15.7% | | 15.1% | | 14.9% |
| Loans/deposits | 62.5% | | 70.9% | | 73.8% | | 77.0% | | 80.0% | | 80.0% |
| Loan loss provisions/loans | 0.2% | | 0.7% | | 0.9% | | 1.0% | | 0.5% | | 0.5% |
| Loan loss reserves/loans | 10.9% | | 7.0% | | 6.4% | | 6.4% | | 6.4% | | 6.4% |
| NPL/Loans | 13.9% | | 8.3% | | 6.6% | | 6.5% | | 6.0% | | 5.8% |
| Loan loss reserves/NPLs | 78.7% | | 84.8% | | 83.4% | | 80.0% | | 80.0% | | 80.0% |
| Growth in NPLs | 8.6% | | -15.5% | | -6.5% | | 15.8% | | 7.4% | | 7.3% |
| Customer deposits/liabilities | 84.0% | | 82.8% | | 79.2% | | 78.3% | | 77.1% | | 2.6% |
| Time deposits/total deposits | 19.2% | | 19.0% | | 34.3% | | 19.0% | | 19.0% | | 75.8% |
| Interbank funding/liabilities | 5.8% | | 7.5% | | 10.2% | | 9.8% | | 9.7% | | 19.0% |
| Liquid assets/liabilities | 23.6% | | 19.7% | | 21.9% | | 20.2% | | 19.3% | | 9.5% |
| Equity/assets | 6.9% | | 6.8% | | 7.1% | | 8.6% | | 10.2% | | 20.4% |
| Total capital ratio | - | | 9.3% | | 11.1% | | 12.9% | | 15.0% | | 11.8% |
| Tier 1 capital ratio | - | | 6.3% | | 7.8% | | 9.5% | | 11.8% | | 17.5% |
| Internal capital growth rate | 22.8% | | 31.8% | | 39.0% | | 36.9% | | 38.2% | | 14.6% |
| Operating profit/average assets | 2.1% | | 3.5% | | 4.3% | | 4.4% | | 5.0% | | 5.4% |
| Return on average assets | 1.5% | | 1.9% | | 2.4% | | 2.4% | | 3.1% | | 3.3% |
| Return on average equity | 21.2% | | 28.3% | | 35.0% | | 31.0% | | 32.6% | | 29.9% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 4.72 | 61% | 7.62 | 53% | 11.70 | 17% | 13.65 | 43% | 19.52 | | 23.8 |
| Operating profit | 663 | 107% | 1,376 | 49% | 2,053 | 26% | 2,584 | 30% | 3,356 | | 4,074.6 |
| Gross dividend | 1.44 | -33% | 0.96 | 67% | 1.60 | 87% | 3.00 | -17% | 2.50 | | 2.5 |
| Net asset value | 23.95 | 25% | 30.00 | 23% | 36.91 | 38% | 51.06 | 34% | 68.66 | | 90.6 |
| Payout | 31% | -59% | 13% | 9% | 14% | 61% | 22% | -42% | 13% | | 10.5% |
| Average shares issued (mn) | 518 | 0% | 518 | 23% | 639 | 20% | 769 | 0% | 769 | | 768.6 |
| Year-end shares issued (mn) | 518 | 0% | 518 | 25% | 648 | 25% | 809 | 0% | 809 | | 809.0 |

*Source: Company Reports & IGI Research*

December 2007

BANKS
PAKISTAN

# MCB Bank Limited

**Recommendation: NEUTRAL**

**Fair Value: PRs383**

## Investment Positives

MCB Bank (MCB) is the fourth largest bank in terms of assets as well as deposits. It is one of the fastest growing banks in the industry with a strong backing of Nishat Group.

MCB enjoys one of the widest spreads in the industry backed by the lowest average deposit rates. In view of these exorbitantly high spreads the bank enjoys the highest interest margins in the banking sector. MCB posted a net interest margin of 6.6% in 2006.

Post privatization, MCB's focus has been on aggressive cost reduction. The cost-to-income ratio has declined over the years and in 2006 the ratio was reported at 25%.

The overall risk profile and asset quality has vastly improved over time with non-performing loan coming down from 11% in 2003 to 4.3% in 2007.

## Investment Risks

Average deposit rate is expected to rise in the near future, which will impact MCB's high margins by eroding its low cost funding sources. Future expansion through low cost funding sources would be difficult and consequently spreads will decline.

MCB's low market share in consumer banking has been one of the weaknesses of MCB. The late entry coupled with brand value and expertise of the existing players is a key shortcoming of the bank.

Weak fee generation and trading income is an impending problem for the bank. With squeezed margins in the future and lack of support from non-interest sources of income may affect earning power of the bank.

## Valuation

We value MCB at PRs383 as the fair price per share based on 2008E book value, and make a 'NEUTRAL' recommendation. We have assumed the risk factor of 1.13, market premium of 7%, and a growth adjustment factor of 14.5%.

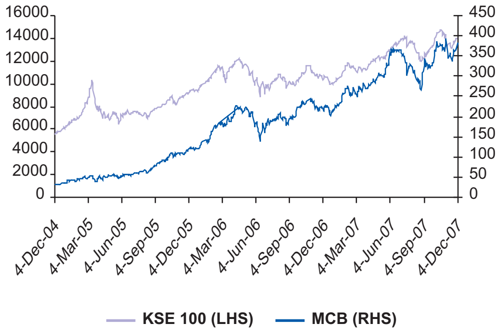
**Table 13: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 8,922 | 14.20 | 2.05 | 28.3 | 37.78 | 10.64 |
| 2006A | 12,148 | 19.34 | 5.87 | 20.8 | 65.01 | 6.18 |
| 2007F | 15,654 | 24.92 | 7.50 | 16.1 | 83.29 | 4.83 |
| 2008E | 18,648 | 29.68 | 8.50 | 13.5 | 104.46 | 3.85 |
| 2009E | 20,797 | 33.10 | 10.00 | 12.1 | 127.56 | 3.15 |

*Source : Company Reports & IGI Research*

| | |
|---|---|
| *Bloomberg Code* | *MCB PA* |
| *Current Price (PRs per share)* | *401.90* |
| *Average daily Volume (shares)* | *4,974,268* |
| *Market Capitalization (PRs mn)* | *252,504* |
| *Market Capitalization (US$ mn)* | *4,124* |
| *Paidup Capital (PRs mn)* | *6,282.77* |
| *Shares Outstanding (mn)* | *628.277* |
| *Weightage in KSE100 (%)* | *6.575* |
| *Free Float (%)* | *44.00* |
| *Average Price Per Share (PRs per share)* | *311.95* |

**Chart 26: MCB: Price Performance**




*Source : Bloomberg*

**Table 14: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 31.0% |
| Required return | 18.3% |
| Fair price/book | 438% |
| Normalised price/book | 460% |
| Misvaluation | (5)% |
| 12 month return potential | 13% |

*Source : Company Reports & IGI Research*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IGI Securities

**Table 15: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 7,026 | 113% | 14,975 | 42% | 21,253 | 19% | 25,301 | 18% | 29,947 | 11% | 33,170 |
| Commissions | 1,992 | 23% | 2,449 | -6% | 2,311 | 40% | 3,236 | 42% | 4,595 | 44% | 6,616 |
| Trading income | 1,665 | 13% | 1,880 | 12% | 2,110 | 20% | 2,525 | 25% | 3,146 | 25% | 3,941 |
| Other operating income | 576 | 88% | 1,085 | -47% | 571 | 19% | 682 | 26% | 861 | 26% | 1,084 |
| Total operating revenues | 11,259 | 81% | 20,388 | 29% | 26,244 | 21% | 31,743 | 21% | 38,549 | 16% | 44,811 |
| Operating costs | (7,436) | -12% | (6,566) | 0% | (6,561) | 22% | (8,014) | 29% | (10,376) | 29% | (13,384) |
| Operating profit | 3,824 | 262% | 13,822 | 42% | 19,683 | 21% | 23,730 | 19% | 28,173 | 12% | 31,427 |
| Provisions | (280) | 309% | (1,144) | 3% | (1,183) | 16% | (1,367) | 12% | (1,533) | 12% | (1,717) |
| Extraordinary items | 514 | -34% | 341 | -100% | 0 | | 0 | | 0 | | 0% |
| Pre-tax profit | 4,058 | 221% | 13,018 | 42% | 18,501 | 21% | 22,362 | 19% | 26,640 | 12% | 29,710 |
| Tax (rate) | (1,626) | (31%) | (4,096) | (34%) | (6,358) | (30%) | (6,709) | (30%) | (7,992) | (12%) | (8,913) |
| Attributable net income | 2,432 | 267% | 8,922 | 36% | 12,142 | 29% | 15,654 | 19% | 18,648 | 12% | 20,797 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 259,285 | 15% | 298,781 | 15% | 342,108 | 18% | 404,595 | 16% | 470,160 | 13% | 533,022 |
| Average assets | 265,804 | 5% | 279,033 | 15% | 320,445 | 18% | 378,592 | 16% | 437,378 | 15% | 501,591 |
| Customer loans | 137,318 | 31% | 180,323 | 10% | 198,239 | 19% | 236,865 | 12% | 265,585 | 12% | 297,455 |
| Cash and interbank loans | 40,507 | -13% | 35,130 | 71% | 60,125 | 1% | 60,777 | 32% | 80,283 | 22% | 97,910 |
| Investments | 67,195 | 3% | 69,481 | -9% | 63,486 | 35% | 85,864 | 19% | 102,148 | 12% | 114,406 |
| Customer deposits | 219,966 | 4% | 229,342 | 12% | 257,462 | 15% | 296,081 | 15% | 340,493 | 12% | 381,352 |
| Interbank funding | 16,261 | 121% | 35,914 | -14% | 31,033 | 38% | 42,750 | 14% | 48,822 | 12% | 54,681 |
| Shareholders' equity | 14,747 | 61% | 23,734 | 72% | 40,844 | 28% | 52,327 | 25% | 65,631 | 22% | 80,142 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 2.6% | | 5.4% | | 6.6% | | 6.7% | | 6.8% | | 6.6% |
| Non-interest rev./total revenue | 37.6% | | 26.6% | | 19.0% | | 20.3% | | 22.3% | | 26.0% |
| Commissions/total revenue | 17.7% | | 12.0% | | 8.8% | | 10.2% | | 11.9% | | 14.8% |
| Commissions/ average assets | 0.7% | | 0.9% | | 0.7% | | 0.9% | | 1.1% | | 1.3% |
| Operating costs/average assets | 2.8% | | 2.4% | | 2.0% | | 2.1% | | 2.4% | | 2.7% |
| Cost/income | 66.0% | | 32.2% | | 25.0% | | 25.2% | | 26.9% | | 29.9% |
| Trading gains/total revenues | 14.8% | | 9.2% | | 8.0% | | 8.0% | | 8.2% | | 8.8% |
| Trading profits/pre-tax profit | 41.0% | | 14.4% | | 11.4% | | 11.3% | | 11.8% | | 13.3% |
| Trading profits/operating profit | 43.5% | | 13.6% | | 10.7% | | 10.6% | | 11.2% | | 12.5% |
| Customer loans/assets | 62.4% | | 73.4% | | 81.0% | | 79.7% | | 77.7% | | 74.0% |
| Cash and interbank loans/assets | 53.0% | | 60.4% | | 57.9% | | 58.5% | | 56.5% | | 55.8% |
| Investments/assets | 15.6% | | 11.8% | | 17.6% | | 15.0% | | 17.1% | | 18.4% |
| Loans/deposits | 25.9% | | 23.3% | | 18.6% | | 21.2% | | 21.7% | | 21.5% |
| Loan loss provisions/loans | 62.4% | | 78.6% | | 77.0% | | 80.0% | | 78.0% | | 78.0% |
| Loan loss reserves/loans | 0.3% | | 0.7% | | 0.2% | | 0.6% | | 0.6% | | 0.4% |
| NPL/Loans | 4.9% | | 4.3% | | 3.6% | | 3.6% | | 3.6% | | 3.6% |
| Loan loss reserves/NPLs | 6.4% | | 4.7% | | 4.0% | | 4.0% | | 4.0% | | 4.0% |
| Growth in NPLs | 75.7% | | 93.1% | | 90.0% | | 90.0% | | 90.0% | | 90.0% |
| Customer deposits/liabilities | -19.7% | | -5.0% | | -1.2% | | 14.2% | | 12.1% | | 12.0% |
| Time deposits/total deposits | 84.8% | | 76.8% | | 75.3% | | 73.2% | | 72.4% | | 71.5% |
| Interbank funding/liabilities | 6.4% | | 5.8% | | 12.9% | | 9.0% | | 9.0% | | 9.0% |
| Liquid assets/liabilities | 6.3% | | 12.0% | | 9.1% | | 10.6% | | 10.4% | | 10.3% |
| Equity/assets | 15.6% | | 11.8% | | 17.6% | | 15.0% | | 17.1% | | 18.4% |
| Total capital ratio | 5.7% | | 7.9% | | 11.9% | | 12.9% | | 14.0% | | 15.0% |
| Tier 1 capital ratio | 9.7% | | 12.8% | | 21.3% | | 19.6% | | 21.0% | | 22.2% |
| Internal capital growth rate | 8.3% | | 11.0% | | 19.3% | | 17.7% | | 18.9% | | 20.1% |
| Operating profit/average assets | 21.8% | | 60.4% | | 51.0% | | 38.2% | | 35.5% | | 31.6% |
| Return on average assets | 1.4% | | 5.0% | | 6.1% | | 6.3% | | 6.4% | | 6.3% |
| Return on average equity | 0.9% | | 3.2% | | 3.8% | | 4.1% | | 4.3% | | 4.1% |
| | 18.8% | | 46.4% | | 37.6% | | 33.6% | | 31.6% | | 28.5% |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 3.87 | 267% | 14.20 | 36% | 19.33 | 29% | 24.92 | 19% | 29.68 | 12% | 33.10 |
| Operating profit | 609 | 262% | 2,200 | 84% | 4,047 | 0% | 4,040 | 11% | 4,484 | 12% | 5,002 |
| Gross dividend | 1.34 | 53% | 2.05 | 186% | 5.87 | 28% | 7.50 | 0% | 7.50 | 13% | 8.50 |
| Net asset value | 23.47 | 61% | 37.78 | 72% | 65.01 | 28% | 83.29 | 25% | 104.46 | 22% | 127.56 |
| Payout | 35% | -58% | 14% | 110% | 30% | -1% | 30% | -16% | 25% | 2% | 26% |
| Average shares issued (mn) | 322 | 19% | 382 | 27% | 486 | 21% | 587 | 7% | 628 | 0% | 628 |
| Year-end shares issued (mn) | 337 | 27% | 427 | 47% | 628 | 0% | 628 | 0% | 628 | 0% | 628 |

*Source: Company Reports & IGI Research*

# Bank Alfalah Limited

**Recommendation: NEUTRAL**

**Fair Value: PRs54**

## Investment Positives

Bank Alfalah Limited (BAFL) is Pakistan's fifth largest bank in terms of assets as well as deposits. It has been the fastest growth story in the industry. BAFL has shown excellent asset quality, sufficient capital levels and good profitability.

BAFL has a strong fee income generation capability and we view this as a positive factor in our valuation. It has the highest Fee Income-to-Total Revenues ratio in the sector over the years and during 9MCY07 results fee income accounted for 16% of total revenues.

BAFL has historically maintained above average asset quality with the low levels of Non-Performing Loans at 1.5% of total loans in 2006. However, the current trend shows surge in NPL-to-Advances ratio.

The bank entered into an agreement to sell 48.8mn shares of Warid Telecom to Singtel at an approximate price of PRs2,284mn. This will become part of bank's year end earnings and result in one time increase in EPS of PRs2.88. The pre-tax unrealized gains on currently held stake amount to PRs15.8 per share.

BAFL's Capital Adequacy Ratio (CAR) has been low as compared to other banks in the sector. However, CAR has improved over time and was posted at 9.5% in 2006. Moreover, the recent divestment of its stake in telecommunication company Warid will provide a boost to its capital adequacy.

## Investment Risks

Over the years BAFL has consistently increased its reliance on fixed deposits and reduced the proportion of current and saving deposits. This is primarily responsible for higher than average funding costs. Going forward we foresee funding costs going up and margins to decline.

BAFL has one of the highest Cost-to-Income ratio in our selection. However, in view of aggressive expansion coupled with high growth, we do not view this as overly concerning for the bank.

## Valuation

We value BAFL at PRs54 as the fair price per share based on 2008E book value, and make a 'NEUTRAL' recommendation. We have assumed the risk factor of 1.30, market premium of 7%, and a growth adjustment factor of 13%.

**Table 16: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 1,702 | 2.62 | 0.55 | 21.1 | 11.49 | 4.82 |
| 2006A | 1,762 | 2.71 | 0.00 | 20.4 | 18.84 | 2.94 |
| 2007F | 2,181 | 3.36 | 1.50 | 16.5 | 19.35 | 2.86 |
| 2008E | 3,568 | 5.49 | 1.88 | 10.1 | 23.10 | 2.40 |
| 2009E | 4,594 | 7.07 | 2.34 | 7.8 | 27.97 | 1.98 |

*Source : Company Reports & IGI Research*

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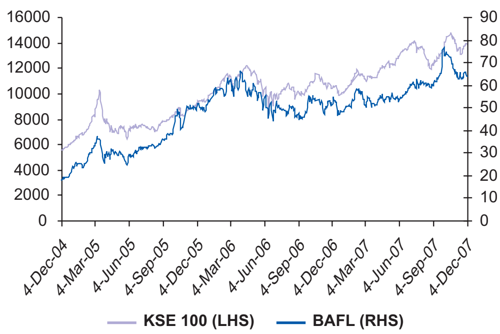
| | |
|---|---|
| *Bloomberg Code* | *BAFL PA* |
| *Current Price (PRs per share)* | *55.40* |
| *Average daily Volume (shares)* | *10,145,870* |
| *Market Capitalization (PRs mn)* | *35,977.5* |
| *Market Capitalization (US$ mn)* | *588* |
| *Paidup Capital (PRs mn)* | *6,500* |
| *Shares Outstanding (mn)* | *650* |
| *Weightage in KSE100 (%)* | *0.947* |
| *Free Float (%)* | *30.00* |
| *Average Price Per Share (PRs per share)* | *50.06* |

**Chart 27: BAFL: Price Performance**




*Source : Bloomberg*

| **Table 17: Required return analysis** | **(2008E)** |
|---|---|
| Normalised ROE | 31.3% |
| Required return | 19.5% |
| Fair price/book | 284% |
| Normalised price/book | 290% |
| Misvaluation | (2)% |
| 12 month return potential | 17.3% |

*Source : Company Reports & IGI Research*

IGI Securities

**Table 18: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | Change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 3,186 | 58% | 5,042 | 18% | 5,959 | 23% | 7,338 | 22% | 8,984 | 11% | 10,002 |
| Commissions | 676 | 71% | 1,159 | 56% | 1,805 | 40% | 2,527 | 42% | 3,588 | 44% | 5,167 |
| Trading income | 271 | 26% | 342 | 24% | 424 | 9% | 462 | 8% | 500 | 5% | 525 |
| Other operating income | 573 | 30% | 745 | 13% | 842 | 9% | 918 | 8% | 993 | 5% | 1,043 |
| Total operating revenues | 4,706 | 55% | 7,287 | 24% | 9,030 | 25% | 11,244 | 25% | 14,066 | 19% | 16,737 |
| Operating costs | (2,679) | 62% | (4,344) | 36% | (5,918) | 8% | (6,417) | 18% | (7,604) | 14% | (8,649) |
| Operating profit | 2,026 | 45% | 2,943 | 6% | 3,112 | 55% | 4,827 | 34% | 6,462 | 25% | 8,089 |
| Provisions | (373) | 2% | (380) | 84% | (699) | 110% | (1,471) | -34% | (973) | 5% | (1,022) |
| Extraordinary items | | | | | | | | | | | |
| Pre-tax profit | 1,654 | 55% | 2,563 | -6% | 2,412 | 39% | 3,356 | 64% | 5,488 | 29% | 7,067 |
| Tax (rate) | (562) | (34%) | (861) | (33%) | (803) | (35%) | (1,175) | 35% | (1,921) | 29% | (2,473) |
| Attributable net income | 1,092 | 56% | 1,702 | -5% | 1,609 | 36% | 2,181 | 64% | 3,568 | 29% | 4,594 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 154,835 | 60% | 248,314 | 11% | 275,685 | 18% | 325,025 | 10% | 356,787 | 6% | 377,539 |
| Average assets | 126,894 | 59% | 201,574 | 30% | 262,000 | 15% | 300,355 | 14% | 340,906 | 8% | 367,163 |
| Customer loans | 88,931 | 34% | 118,864 | 26% | 149,999 | 9% | 163,465 | 8% | 176,919 | 5% | 185,765 |
| Cash and interbank loans | 22,892 | 169% | 61,552 | -14% | 53,048 | 10% | 58,363 | 21% | 70,735 | 8% | 76,549 |
| Investments | 35,503 | 62% | 57,426 | -2% | 56,502 | 51% | 85,505 | 5% | 89,780 | 5% | 94,269 |
| Customer deposits | 129,715 | 71% | 222,345 | 8% | 239,509 | 5% | 251,484 | 5% | 264,059 | 5% | 277,262 |
| Interbank funding | 14,958 | -36% | 9,578 | 20% | 11,485 | 278% | 43,444 | 36% | 59,004 | 5% | 61,954 |
| Shareholders' equity | 5,261 | 42% | 7,464 | 64% | 12,242 | 3% | 12,575 | 19% | 15,013 | 21% | 18,176 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 2.5% | | 2.5% | | 2.3% | | 2.4% | | 2.6% | | 2.7% |
| Non-interest rev./total revenue | 32.3% | | 30.8% | | 34.0% | | 34.7% | | 36.1% | | 40.2% |
| Commissions/total revenue | 14.4% | | 15.9% | | 20.0% | | 22.5% | | 25.5% | | 30.9% |
| Commissions/ average assets | 0.5% | | 0.6% | | 0.7% | | 0.8% | | 1.1% | | 1.4% |
| Operating costs/average assets | 2.1% | | 2.2% | | 2.3% | | 2.1% | | 2.2% | | 2.4% |
| Cost/income | 56.9% | | 59.6% | | 65.5% | | 57.1% | | 54.1% | | 51.7% |
| Trading gains/total revenues | 5.8% | | 4.7% | | 4.7% | | 4.1% | | 3.6% | | 3.1% |
| Trading profits/pre-tax profit | 16.4% | | 13.3% | | 17.6% | | 13.8% | | 9.1% | | 7.4% |
| Trading profits/operating profit | 13.4% | | 11.6% | | 13.6% | | 9.6% | | 7.7% | | 6.5% |
| Customer loans/assets | 57.4% | | 47.9% | | 54.4% | | 50.3% | | 49.6% | | 49.2% |
| Cash and interbank loans/assets | 14.8% | | 24.8% | | 19.2% | | 18.0% | | 19.8% | | 20.3% |
| Investments/assets | 22.9% | | 23.1% | | 20.5% | | 26.3% | | 25.2% | | 25.0% |
| Loans/deposits | 68.6% | | 53.5% | | 62.6% | | 65.0% | | 67.0% | | 67.0% |
| Loan loss provisions/loans | 0.4% | | 0.3% | | 0.5% | | 0.9% | | 0.6% | | 0.6% |
| Loan loss reserves/loans | 1.5% | | 1.3% | | 1.5% | | 1.8% | | 1.8% | | 1.8% |
| NPL/Loans | 3.3% | | 0.9% | | 1.5% | | 1.5% | | 1.5% | | 1.5% |
| Loan loss reserves/NPLs | 46.3% | | 146.5% | | 96.9% | | 120.0% | | 120.0% | | 120.0% |
| Growth in NPLs | 3.2% | | -63.9% | | 117.9% | | 6.1% | | 8.2% | | 5.0% |
| Customer deposits/liabilities | 83.8% | | 89.5% | | 86.9% | | 77.4% | | 74.0% | | 73.4% |
| Time deposits/total deposits | 16.9% | | 36.1% | | 37.1% | | 40.0% | | 40.3% | | 40.0% |
| Interbank funding/liabilities | 9.7% | | 3.9% | | 4.2% | | 13.4% | | 16.5% | | 16.4% |
| Liquid assets/liabilities | 14.8% | | 24.8% | | 19.2% | | 18.0% | | 19.8% | | 20.3% |
| Equity/assets | 3.4% | | 3.0% | | 4.4% | | 3.9% | | 4.2% | | 4.8% |
| Total capital ratio | 8.2% | | 8.7% | | 9.5% | | 10.3% | | 11.2% | | 12.2% |
| Tier 1 capital ratio | 4.6% | | 5.4% | | 6.2% | | 6.0% | | 6.7% | | 7.8% |
| Internal capital growth rate | 22.9% | | 32.3% | | 21.6% | | 17.7% | | 28.3% | | 37.4% |
| Operating profit/average assets | 1.6% | | 1.5% | | 1.2% | | 1.6% | | 1.9% | | 2.2% |
| Return on average assets | 0.9% | | 0.8% | | 0.6% | | 0.7% | | 1.0% | | 1.3% |
| Return on average equity | 21.8% | | 26.8% | | 16.3% | | 17.6% | | 25.9% | | 30.2% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 1.68 | 56% | 2.62 | -5% | 2.48 | 36% | 3.36 | 64% | 5.49 | | 7.07 |
| Operating profit | 312 | 45% | 453 | 6% | 479 | 55% | 743 | 34% | 994 | | 1,245 |
| Gross dividend | 0.77 | -28% | 0.55 | -100% | 0.00 | | 1.50 | 25% | 1.88 | | 2.34 |
| Net asset value | 8.10 | 42% | 11.49 | 64% | 18.84 | 3% | 19.35 | 19% | 23.10 | | 27.97 |
| Payout | 46% | -54% | 21% | -100% | 0% | | 45% | -24% | 34% | | 33% |
| Average shares issued (mn) | 225 | 22% | 275 | 64% | 450 | 44% | 650 | 0% | 650 | | 650 |
| Year-end shares issued (mn) | 250 | 20% | 300 | 67% | 500 | 30% | 650 | 0% | 650 | | 650 |

*Source: Company Reports & IGI Research*

# Faysal Bank Limited

**Recommendation: NEUTRAL**

**Fair Value: PRs66**

## Investment Positives

FABL is a small sized private bank, with a share of 2.7% in the assets of total banking system in 2006. FABL has one of the most consistent dividend payout stream in the banking sector.

The bank has one of the highest Advances-to-Deposits ratio (ADR) of over 100% in 2006. With low credit penetration in the country, we expect the advances to dominate total assets of the bank.

Faysal Bank holds 167mn NIT units. It is one of the three holders of Letter of Comfort (LoC) from the Government of Pakistan. In case FABL marks-to-market the NIT investment, it would translate into a gain of PRs13.4 per share based on current prices. The government has planned to privatize NIT in near future; however, the timing is uncertain.

## Investment Risks

Low coverage ratio is a major concern for the bank. The coverage ratio was reported at 44% in 2006 which is lower than our bare minimum benchmark of 50%. Moreover, the NPL-to-Advances ratio was reported at 5% in 2006 which is on the higher side.

FABL has problems of a small deposit base, and low ROE as compared to its peers. Going forward, the bank does not show signs of any dramatic increase in efficiency and returns.

## Valuation

We value FABL at PRs66 as the fair price per share based on 2008E book value, and make a 'NEUTRAL' recommendation. We have assumed the risk factor of 1.30, market premium of 7%, and a growth adjustment factor of 12.5%.

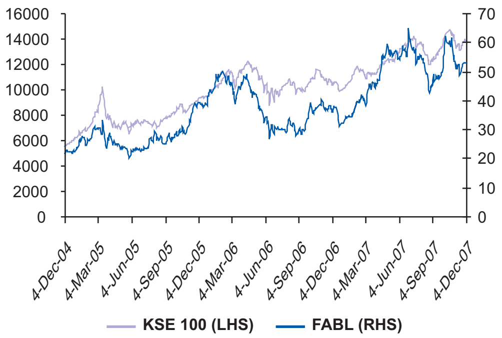
**Table 19: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 3,070 | 5.80 | 1.37 | 11.6 | 26.92 | 2.49 |
| 2006A | 2,816 | 5.32 | 2.00 | 12.6 | 26.05 | 2.57 |
| 2007F | 2,829 | 5.34 | 3.50 | 12.6 | 28.83 | 2.33 |
| 2008E | 4,115 | 7.77 | 4.38 | 8.6 | 32.71 | 2.05 |
| 2009E | 4,782 | 9.03 | 5.47 | 7.4 | 39.91 | 1.68 |

*Source : Company Reports & IGI Research*

| | |
|---|---|
| *Bloomberg Code* | *FABL PA* |
| *Current Price (PRs per share)* | *67.10* |
| *Average daily Volume (shares)* | *2,446,636* |
| *Market Capitalization (PRs mn)* | *36,360.09* |
| *Market Capitalization (US$ mn)* | *594* |
| *Paidup Capital (PRs mn)* | *5,296.44* |
| *Shares Outstanding (mn)* | *529.644* |
| *Weightage in KSE100 (%)* | *0.958* |
| *Free Float (%)* | *30.40* |
| *Average Price Per Share (PRs per share)* | *58.71* |

**Chart 28: FABL: Price Performance**




*Source : Bloomberg*

| Table 20: Required return analysis | (2008E) |
|---|---|
| Normalised ROE | 29.8% |
| Required return | 19.5% |
| Fair price/book | 249% |
| Normalised price/book | 316% |
| Misvaluation | (21)% |
| 12 month return potential | (2)% |

*Source : Company Reports & IGI Research*

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**Table 21: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 1,635 | 85% | 3,026 | 20% | 3,639 | 13% | 4,108 | 14% | 4,675 | 11% | 5,194 |
| Commissions | 397 | 47% | 582 | 4% | 603 | 45% | 874 | 47% | 1,285 | 47% | 1,889 |
| Trading income | 1,429 | 4% | 1,480 | 15% | 1,702 | 16% | 1,975 | 7% | 2,123 | 8% | 2,285 |
| Other operating income | 5 | -81% | 1 | | 448 | 0% | 448 | 0% | 448 | 0% | 448 |
| Total operating revenues | 3,467 | 47% | 5,090 | 26% | 6,391 | 16% | 7,405 | 15% | 8,531 | 15% | 9,816 |
| Operating costs | (1,136) | 26% | (1,431) | 33% | (1,899) | 10% | (2,088) | 14% | (2,390) | 13% | (2,709) |
| Operating profit | 2,331 | 57% | 3,659 | 23% | 4,492 | 18% | 5,317 | 16% | 6,141 | 16% | 7,107 |
| Provisions | (124) | -351% | 310 | -301% | (622) | 130% | (1,430) | -66% | (487) | 10% | (536) |
| Extraordinary items | | | | | | | | | | | |
| Pre-tax profit | 2,207 | 80% | 3,969 | -2% | 3,870 | 0% | 3,887 | 45% | 5,654 | 16% | 6,571 |
| Tax (rate) | (454) | (23%) | (899) | (27%) | (1,054) | (27%) | (1,059) | (27%) | (1,540) | (16%) | (1,789) |
| Attributable net income | 1,753 | 75% | 3,070 | -8% | 2,816 | 0% | 2,829 | 45% | 4,115 | 16% | 4,782 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 78,538 | 40% | 110,281 | 5% | 115,471 | 17% | 135,283 | 9% | 148,051 | 11% | 164,934 |
| Average assets | 63,072 | 50% | 94,410 | 20% | 112,876 | 11% | 125,377 | 13% | 141,667 | 10% | 156,493 |
| Customer loans | 50,542 | 23% | 62,324 | 19% | 74,469 | 20% | 89,362 | 9% | 97,405 | 10% | 107,145 |
| Cash and interbank loans | 13,030 | 50% | 19,485 | -25% | 14,699 | 6% | 15,612 | 11% | 17,282 | 17% | 20,225 |
| Investments | 12,334 | 98% | 24,412 | -8% | 22,525 | 17% | 26,342 | 11% | 29,200 | 14% | 33,191 |
| Customer deposits | 56,460 | 32% | 74,737 | 0% | 74,414 | 20% | 89,296 | 9% | 97,333 | 10% | 107,066 |
| Interbank funding | 9,384 | 76% | 16,489 | 18% | 19,481 | 15% | 22,426 | 9% | 24,337 | 10% | 26,771 |
| Shareholders' equity | 10,214 | 40% | 14,260 | -3% | 13,797 | 11% | 15,271 | 13% | 17,327 | 22% | 21,138 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 2.6% | | 3.2% | | 3.2% | | 3.3% | | 3.3% | | 3.3% |
| Non-interest rev./total revenue | 52.8% | | 40.5% | | 43.1% | | 44.5% | | 45.2% | | 47.1% |
| Commissions/total revenue | 11.5% | | 11.4% | | 9.4% | | 11.8% | | 15.1% | | 19.2% |
| Commissions/ average assets | 0.6% | | 0.6% | | 0.5% | | 0.7% | | 0.9% | | 1.2% |
| Operating costs/average assets | 1.8% | | 1.5% | | 1.7% | | 1.7% | | 1.7% | | 1.7% |
| Cost/income | 32.8% | | 28.1% | | 29.7% | | 28.2% | | 28.0% | | 27.6% |
| Trading gains/total revenues | 41.2% | | 29.1% | | 26.6% | | 26.7% | | 24.9% | | 23.3% |
| Trading profits/pre-tax profit | 64.8% | | 37.3% | | 44.0% | | 50.8% | | 37.6% | | 34.8% |
| Trading profits/operating profit | 61.3% | | 40.5% | | 37.9% | | 37.2% | | 34.6% | | 32.2% |
| Customer loans/assets | 64.4% | | 56.5% | | 64.5% | | 66.1% | | 65.8% | | 65.0% |
| Cash and interbank loans/assets | 16.6% | | 17.7% | | 12.7% | | 11.5% | | 11.7% | | 12.3% |
| Investments/assets | 15.7% | | 22.1% | | 19.5% | | 19.5% | | 19.7% | | 20.1% |
| Loans/deposits | 89.5% | | 83.4% | | 100.1% | | 100.1% | | 100.1% | | 100.1% |
| Loan loss provisions/loans | 0.2% | | -0.5% | | 0.4% | | 1.6% | | 0.5% | | 0.5% |
| Loan loss reserves/loans | 2.1% | | 1.7% | | 2.1% | | 2.1% | | 2.0% | | 2.0% |
| NPL/Loans | 4.8% | | 4.0% | | 4.7% | | 5.2% | | 5.0% | | 5.0% |
| Loan loss reserves/NPLs | 44.2% | | 42.3% | | 44.4% | | 40.0% | | 40.0% | | 40.0% |
| Growth in NPLs | -24.6% | | 2.8% | | 42.1% | | 31.5% | | 4.8% | | 10.0% |
| Customer deposits/liabilities | 71.9% | | 67.8% | | 64.4% | | 66.0% | | 65.7% | | 64.9% |
| Time deposits/total deposits | 41.6% | | 44.5% | | 46.6% | | 44.3% | | 44.3% | | 44.3% |
| Interbank funding/liabilities | 11.9% | | 15.0% | | 16.9% | | 16.6% | | 16.4% | | 16.2% |
| Liquid assets/liabilities | 16.6% | | 17.7% | | 12.7% | | 11.5% | | 11.7% | | 12.3% |
| Equity/assets | 13.0% | | 12.9% | | 11.9% | | 11.3% | | 11.7% | | 12.8% |
| Total capital ratio | - | | 13.6% | | 12.4% | | 11.9% | | 12.5% | | 14.0% |
| Tier 1 capital ratio | - | | 10.4% | | 9.6% | | 9.2% | | 9.8% | | 11.5% |
| Internal capital growth rate | 21.9% | | 30.0% | | 19.7% | | 20.4% | | 26.8% | | 27.4% |
| Operating profit/average assets | 3.7% | | 3.9% | | 4.0% | | 4.2% | | 4.3% | | 4.5% |
| Return on average assets | 2.8% | | 3.3% | | 2.5% | | 2.3% | | 2.9% | | 3.1% |
| Return on average equity | 19.3% | | 25.1% | | 20.1% | | 19.5% | | 25.2% | | 24.9% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 3.31 | 75% | 5.80 | -8% | 5.32 | 0% | 5.34 | 45% | 7.77 | | 9.03 |
| Operating profit | 440 | 57% | 691 | 23% | 848 | 18% | 1,004 | 16% | 1,160 | | 1,342 |
| Gross dividend | 1.00 | 38% | 1.37 | 45% | 2.00 | 75% | 3.50 | 25% | 4.38 | | 5.47 |
| Net asset value | 19.29 | 40% | 26.92 | -3% | 26.05 | 11% | 28.83 | 13% | 32.71 | | 39.91 |
| Payout | 30% | -21% | 24% | 59% | 38% | 74% | 66% | -14% | 56% | | 61% |
| Average shares issued (mn) | 291 | 26% | 368 | 8% | 396 | 20% | 477 | 25% | 596 | | 662 |
| Year-end shares issued (mn) | 291 | 26% | 368 | 15% | 424 | 25% | 530 | 25% | 662 | | 662 |

*Source: Company Reports & IGI Research*

# Bank of Punjab

**Recommendation: BUY**

**Fair Value: PRs127**

## Investment Positives

Bank of Punjab (BOP) is a public sector bank with extensive branch network and favorable funding mix. The low cost deposits form more than 55% of total deposits. The Government of Punjab holds the majority stake in the bank.

BOP currently holds PRs3.5bn worth of NIT units at book value. Moreover, the bank holds 8.78bn in mutual funds as of 1HCY07. As a result, the bank is expected to register windfall capital gains in the near future. BOP is expected to acquire Punjab Provincial Cooperative Bank (PPCB). This merger with PPCB (not-listed), agriculture specialized bank, will add 150 branches to BOP operations. Moreover, this will aid in country wide expansion and increased customer base.

The advances portfolio of the bank has witnessed tremendous growth in the last few years. Despite growth in the advances portfolio the bank has been able to maintain asset quality with NPL-to-Advances ratio at just under 2%.

BOP is one of the most cost-efficient bank in our selection. The Cost-to-Income ratio stood at 27% and is on a declining trend over the years. The low cost is attributed to low marketing expenditure and lower cost of operating branches in rural areas.

The capital adequacy ratio has stood at 10.06% in 2006. Although, the ratio has declined over the years, however, this can be attributed to increasing asset base and aggressive expansion.

## Investment Risks

High advances exposure to the textile sector may prove risky for the bank. The dismal performance of textile exports may result in defaults leading to declining asset quality.

Low coverage ratio is a major concern for the bank. The coverage ratio was reported at 49% in 2006 which is lower than our bare minimum benchmark of 50%. The management has a policy of not making any provisions in excess of required provisions. Being a public sector bank, BOP is not solely a profit focused bank and has a public service mission as well. The bank's strategy to expand based on volumes and geographically at the same time may cause a lag on future growth.

## Valuation

We value BOP at PRs127 as the fair price per share based on 2008E book value, and make a 'BUY' recommendation. We have assumed the risk factor of 1.02, market premium of 7%, and a growth adjustment factor of 10%.

**Table 22: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 2,353 | 5.56 | 0.00 | 18.5 | 32.32 | 3.18 |
| 2006A | 3,804 | 8.99 | 0.00 | 11.4 | 38.13 | 2.69 |
| 2007F | 5,773 | 13.65 | 0.00 | 7.5 | 54.25 | 1.89 |
| 2008E | 8,660 | 20.48 | 0.00 | 5.0 | 75.49 | 1.36 |
| 2009E | 11,482 | 27.15 | 0.00 | 3.8 | 101.48 | 1.01 |

*Source : Company Reports & IGI Research*

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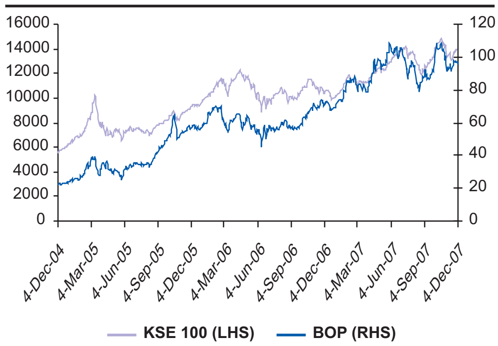
| | |
|---|---|
| *Bloomberg Code* | *BOP PA* |
| *Current Price (PRs per share)* | *102.8* |
| *Average daily Volume (shares)* | *13,065,780* |
| *Market Capitalization (PRs mn)* | *43,361.38* |
| *Market Capitalization (US$ mn)* | *708* |
| *Paidup Capital (PRs mn)* | *4,230.38* |
| *Shares Outstanding (mn)* | *423.038* |
| *Weightage in KSE100 (%)* | *1.142* |
| *Free Float (%)* | *41.00* |
| *Average Price Per Share (PRs per share)* | *91.56* |

**Chart 29: BOP: Price Performance**




*Source : Bloomberg*

**Table 23: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 25.0% |
| Required return | 17.5% |
| Fair price/book | 200% |
| Normalised price/book | 204% |
| Misvaluation | (2)% |
| 12 month return potential | 16% |

*Source : Company Reports & IGI Research*

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**Table 24: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | Change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 1,836 | 88% | 3,456 | 18% | 4,070 | 78% | 7,234 | 36% | 9,857 | 24% | 12,244 |
| Commissions | 173 | 48% | 255 | 85% | 473 | 70% | 805 | 72% | 1,386 | 74% | 2,414 |
| Trading income | 596 | 42% | 847 | 92% | 1,626 | 45% | 2,360 | 29% | 3,040 | 24% | 3,775 |
| Other operating income | 328 | -30% | 229 | 274% | 855 | 79% | 1,528 | 49% | 2,274 | 40% | 3,183 |
| Total operating revenues | 2,933 | 63% | 4,787 | 47% | 7,025 | 70% | 11,927 | 39% | 16,556 | 31% | 21,616 |
| Operating costs | (1,150) | 12% | (1,291) | 46% | (1,882) | 65% | (3,101) | 41% | (4,360) | 27% | (5,527) |
| Operating profit | 1,783 | 96% | 3,496 | 47% | 5,142 | 72% | 8,826 | 38% | 12,196 | 32% | 16,089 |
| Provisions | (47) | 603% | (331) | 13% | (374) | 202% | (1,129) | -42% | (650) | 20% | (780) |
| Extraordinary items | | | | | | | | | | | |
| Pre-tax profit | 1,736 | 82% | 3,165 | 51% | 4,769 | 61% | 7,697 | 50% | 11,547 | 33% | 15,310 |
| Tax (rate) | (368) | (26%) | (812) | (20%) | (965) | (25%) | (1,924) | (25%) | (2,887) | (33%) | (3,827) |
| Attributable net income | 1,368 | 72% | 2,353 | 62% | 3,804 | 52% | 5,773 | 50% | 8,660 | 33% | 11,482 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 66,320 | 68% | 111,154 | 48% | 164,855 | 28% | 211,051 | 27% | 268,029 | 22% | 326,317 |
| Average assets | 54,971 | 61% | 88,737 | 56% | 138,005 | 36% | 187,953 | 27% | 239,540 | 24% | 297,173 |
| Customer loans | 39,439 | 61% | 63,624 | 59% | 101,320 | 39% | 141,171 | 24% | 175,603 | 20% | 210,723 |
| Cash and interbank loans | 8,717 | 195% | 25,749 | 15% | 29,624 | -6% | 27,936 | 47% | 41,122 | 22% | 50,195 |
| Investments | 16,198 | 11% | 18,026 | 57% | 28,233 | 22% | 34,432 | 20% | 41,318 | 26% | 52,061 |
| Customer deposits | 54,724 | 62% | 88,465 | 56% | 137,728 | 25% | 172,160 | 20% | 206,591 | 20% | 247,910 |
| Interbank funding | 3,099 | 135% | 7,269 | 8% | 7,846 | 53% | 11,984 | 106% | 24,698 | 20% | 29,638 |
| Shareholders' equity | 7,839 | 74% | 13,670 | 18% | 16,126 | 42% | 22,943 | 39% | 31,929 | 34% | 42,921 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 3.3% | | 3.9% | | 2.9% | | 3.8% | | 4.1% | | 4.1% |
| Non-interest rev./total revenue | 37.4% | | 27.8% | | 42.1% | | 39.3% | | 40.5% | | 43.4% |
| Commissions/total revenue | 5.9% | | 5.3% | | 6.7% | | 6.8% | | 8.4% | | 11.2% |
| Commissions/ average assets | 0.3% | | 0.3% | | 0.3% | | 0.4% | | 0.6% | | 0.8% |
| Operating costs/average assets | 2.1% | | 1.5% | | 1.4% | | 1.7% | | 1.8% | | 1.9% |
| Cost/income | 39.2% | | 27.0% | | 26.8% | | 26.0% | | 26.3% | | 25.6% |
| Trading gains/total revenues | 20.3% | | 17.7% | | 23.1% | | 19.8% | | 18.4% | | 17.5% |
| Trading profits/pre-tax profit | 34.3% | | 26.8% | | 34.1% | | 30.7% | | 26.3% | | 24.7% |
| Trading profits/operating profit | 33.4% | | 24.2% | | 31.6% | | 26.7% | | 24.9% | | 23.5% |
| Customer loans/assets | 59.5% | | 57.2% | | 61.5% | | 66.9% | | 65.5% | | 64.6% |
| Cash and interbank loans/assets | 13.1% | | 23.2% | | 18.0% | | 13.2% | | 15.3% | | 15.4% |
| Investments/assets | 24.4% | | 16.2% | | 17.1% | | 16.3% | | 15.4% | | 16.0% |
| Loans/deposits | 72.1% | | 71.9% | | 73.6% | | 82.0% | | 85.0% | | 85.0% |
| Loan loss provisions/loans | 0.1% | | 0.5% | | 0.4% | | 0.8% | | 0.4% | | 0.4% |
| Loan loss reserves/loans | 1.3% | | 1.3% | | 1.1% | | 1.1% | | 1.0% | | 1.0% |
| NPL/Loans | 3.0% | | 2.1% | | 2.3% | | 1.8% | | 1.7% | | 1.7% |
| Loan loss reserves/NPLs | 44.3% | | 61.0% | | 49.1% | | 50.0% | | 55.0% | | 60.0% |
| Growth in NPLs | -4.2% | | 16.6% | | 72.5% | | 8.3% | | 17.5% | | 20.0% |
| Customer deposits/liabilities | | | | | | | | | | | |
| Time deposits/total deposits | 82.5% | | 79.6% | | 83.5% | | 81.6% | | 77.1% | | 76.0% |
| Interbank funding/liabilities | 17.3% | | 40.6% | | 39.3% | | 44.0% | | 44.0% | | 44.0% |
| Liquid assets/liabilities | 4.7% | | 6.5% | | 4.8% | | 5.7% | | 9.2% | | 9.1% |
| Equity/assets | 13.1% | | 23.2% | | 18.0% | | 13.2% | | 15.3% | | 15.4% |
| Total capital ratio | 11.8% | | 12.3% | | 9.8% | | 10.9% | | 11.9% | | 13.2% |
| Tier 1 capital ratio | | | 12.8% | | 10.1% | | 11.8% | | 13.5% | | 16.1% |
| Internal capital growth rate | | | 12.6% | | 8.1% | | 9.9% | | 11.9% | | 14.6% |
| Operating profit/average assets | 26.3% | | 30.0% | | 27.8% | | 35.8% | | 37.7% | | 36.0% |
| Return on average assets | 3.2% | | 3.9% | | 3.7% | | 4.7% | | 5.1% | | 5.4% |
| Return on average equity | 2.5% | | 2.7% | | 2.8% | | 3.1% | | 3.6% | | 3.9% |
| | 21.0% | | 21.9% | | 25.5% | | 29.6% | | 31.6% | | 30.7% |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 3.23 | 72% | 5.56 | 62% | 8.99 | 52% | 13.65 | 50% | 20.48 | 33% | 27.15 |
| Operating profit | 422 | 96% | 827 | 47% | 1,216 | 72% | 2,087 | 38% | 2,884 | 32% | 3,804 |
| Gross dividend | | | | | | | | | | | |
| Net asset value | 18.54 | 74% | 32.32 | 18% | 38.13 | 42% | 54.25 | 39% | 75.49 | 34% | 101.48 |
| Payout | 0% | | 0% | | 0% | | 0% | | 0% | | 0% |
| Average shares issued (mn) | 126 | 54% | 193 | 43% | 276 | 29% | 357 | 34% | 478 | 28% | 613 |
| Year-end shares issued (mn) | 151 | 56% | 235 | 24% | 290 | 46% | 423 | 26% | 533 | 30% | 693 |

*Source: Company Reports & IGI Research*

# Soneri Bank Limited

**Recommendation: NEUTRAL**

**Fair Value: PRs40**

## Investment Positives

Soneri Bank (SNBL) is especially prudent in maintaining asset quality with NPLs-to-Advances ratio of 1% and a Coverage ratio of 118% in 2006, however, at the cost of future growth.

SNBL's credit portfolio is characterized by low Advances-to-Deposit ratio over the years. SNBL's overall strategy can be described as focused towards trade finance. The lending practices traditionally have been prudent. We view this conservative stance positively in terms of asset quality, however, this entails a possibility of loss in market share in the future.

## Investment risk

A key risk to the bank is its excessive reliance on trade financing. In case of worsening of political scenario and unlikely event of trade sanctions the bank may lose out on its market share.

The bank enjoys a high quality low credit risk rating for its long term and short term debt issues. In essence, this reflects bank's conservative stance and risk averseness. In our opinion, this can be an undermining factor for future growth in an ever aggressive market place, and in retaining its relative standing amongst peers, amidst intense competition.

## Valuation

We value SNBL at PRs40 as the fair price per share based on 2008E book value, and make a NEUTRAL recommendation. We have assumed the risk factor of 0.75, market premium of 7%, and a growth adjustment factor of 12.5%. Based on our valuation the Fair Price-to-Book ratio is 2.3x. The price objective, however, can go up significantly in case of any acquisition interest in the bank. Assuming the recent mergers and acquisitions in the sector as a bench mark; we foresee SNBL to go up to a value of PRs86.5.

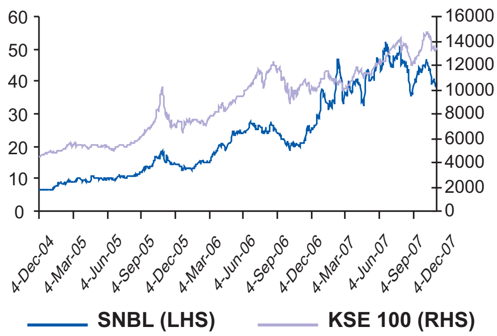
**Table 25: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 920 | 2.2 | 1 | 20 | 27 | 4.1 |
| 2006A | 985 | 2.4 | 0 | 18 | 18 | 3.2 |
| 2007F | 1039 | 2.5 | 0 | 17 | 16 | 2.7 |
| 2008E | 1157 | 2.8 | 0 | 16 | 20 | 2.2 |
| 2009E | 1230 | 3.0 | 0 | 15 | 23 | 1.9 |

*Source : Company Reports & IGI Research*

| | |
|---|---|
| *Bloomberg Code* | *SNBL PA* |
| *Current Price (PRs per share)* | *43.75* |
| *Average daily Volume (shares)* | *925,540* |
| *Market Capitalization (PRs mn)* | *16,395.19* |
| *Market Capitalization (US$ mn)* | *268* |
| *Paidup Capital (PRs mn)* | *4,114.23* |
| *Shares Outstanding (mn)* | *411.42* |
| *Weightage in KSE100 (%)* | *1.19* |
| *Free Float (%)* | *31.52* |
| *Average Price Per Share (PRs per share)* | *42.67* |

**Chart 30: SNBL: Price Performance**




*Source: Company Reports & IGI Research*

**Table 26: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 19.62% |
| Required return | 15.60% |
| Fair price/book | 230% |
| Normalised price/book | 253% |
| Misvaluation | (9.1)% |
| 12 month return potential | 6.5% |

*Source : Company Reports & IGI Research*

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**Table 27: Valuation Summary**

| | 2004 | change | 2005 | change | 2006 | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income Statement -PRs '000** | | | | | | | | | | | |
| Net Mark-up / return / interest income | 1,195 | 39.46% | 1,667 | 6.04% | 1,767 | 14.11% | 2,017 | 11.35% | 2,246 | 9.38% | 2,456 |
| Fee, commission and brokerage income | 177 | 23.19% | 218 | 11.21% | 242 | 16.00% | 281 | 16.00% | 326 | 16.00% | 379 |
| Other income | 163 | 14.03% | 186 | 17.48% | 218 | 18.00% | 258 | 18.00% | 304 | 18.00% | 359 |
| Total Revenue | 1,690 | 30.28% | 2,201 | 12.90% | 2,485 | 14.51% | 2,846 | 12.14% | 3,192 | 10.90% | 3,539 |
| Other charges | 1 | 614.22% | 9 | -14.70% | 8 | 0.00% | 8 | 0.00% | 8 | 0.00% | 8 |
| Profit before taxation | 1,046 | 33.77% | 1,400 | 3.49% | 1,448 | 9.78% | 1,590 | 6.91% | 1,700 | 6.33% | 1,808 |
| Tax rate | 38.0% | -9.93% | 34.3% | -6.63% | 32.0% | 0.01% | 32.0% | 0.00% | 32.0% | 0.00% | 32.0% |
| Profit after taxation | 648 | 41.93% | 920 | 7.07% | 985 | 9.77% | 1,039 | 6.91% | 1,156 | 6.33% | 1,229 |
| | | | | | | | | | | | |
| **Balance Sheet - PRs '000** | | | | | | | | | | | |
| Total Assets | 49,851 | 27.07% | 63,345 | 11.66% | 70,729 | 12.22% | 79,370 | 12.00% | 88,893 | 11.19% | 98,841 |
| Advances - net | 24,375 | 31.49% | 32,052 | 10.48% | 35,412 | 5.13% | 37,230 | 14.52% | 42,637 | 11.00% | 47,327 |
| Balances with other banks | 2,793 | -12.16% | 2,453 | 169.11% | 6,603 | -3.79% | 6,352 | 3.26% | 6,559 | 11.00% | 7,281 |
| Investments - net | 13,982 | 17.22% | 16,390 | 2.04% | 16,724 | 27.21% | 21,274 | 7.92% | 22,958 | 11.00% | 25,484 |
| Deposits and other accounts | 37,383 | 27.34% | 47,605 | 11.33% | 53,000 | 11.50% | 59,095 | 11.00% | 65,596 | 11.00% | 72,811 |
| Lending's to financial and other institutions | 3,585 | 35.15% | 4,845 | -34.10% | 3,193 | 29.54% | 4,136 | 11.00% | 4,591 | 11.00% | 5,096 |
| Total Equity | 3,043 | 44.24% | 4,389 | 27.84% | 5,611 | 19.95% | 6,731 | 24.12% | 8,355 | 14.42% | 9,559 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net Margin | 3.1% | 23.26% | 3.8% | -8.49% | 3.5% | 3.73% | 3.6% | -0.73% | 3.6% | -1.93% | 3.6% |
| Net Interest Revenue/Total Revenue | 70.7% | 7.05% | 75.7% | -6.08% | 71.1% | -0.35% | 70.9% | -0.71% | 70.4% | -1.37% | 69.4% |
| Commisions/Total Revenue | 10.5% | -5.44% | 9.9% | -1.50% | 9.8% | 1.30% | 9.9% | 3.44% | 10.2% | 4.60% | 10.7% |
| Operating Costs/Average Assets | 1.3% | 9.74% | 1.4% | 9.19% | 1.5% | 8.18% | 1.7% | 5.94% | 1.8% | 4.06% | 1.8% |
| Cost / Assets | 1.3% | 9.74% | 1.4% | 9.19% | 1.5% | 3.43% | 1.6% | 6.25% | 1.7% | 5.88% | 1.8% |
| Advances / Total Assets | 48.9% | 3.48% | 50.6% | -1.05% | 50.1% | -6.31% | 46.9% | 2.26% | 48.0% | -0.17% | 47.9% |
| Cost / Income (Total Operating Expenses) | 38.4% | -8.37% | 35.2% | 16.77% | 41.1% | 3.39% | 42.5% | 5.88% | 45.0% | 3.33% | 46.5% |
| Investment/Assets | 28.0% | -7.75% | 25.9% | -8.62% | 23.6% | 13.36% | 26.8% | -3.64% | 25.8% | -0.17% | 25.8% |
| Advances/Deposits | 65.2% | 3.26% | 67.3% | -0.76% | 66.8% | -5.71% | 63.0% | 3.17% | 65.0% | 0.00% | 65.0% |
| LLR / Loans | 1.3% | -7.98% | 1.2% | -4.32% | 1.2% | 2.12% | 1.2% | 0.00% | 1.2% | 0.00% | 1.2% |
| LLP / Loans (Yearly Charge to Loans) | -0.1% | 454.75% | 0.2% | -52.80% | 0.1% | -3.30% | 0.3% | 0.00% | 0.1% | 0.00% | 0.1% |
| NPL/Loans | 1.1% | 1.52% | 1.1% | -9.13% | 1.0% | 0.69% | 1.0% | 0.00% | 1.0% | 0.00% | 1.0% |
| NPL Growth | -11.8% | 383.86% | 33.5% | -98.82% | 0.4% | 1379.93% | 5.9% | 148.05% | 14.5% | -24.26% | 11.0% |
| Equity/Assets | 6.1% | 13.52% | 6.9% | 14.50% | 7.9% | 6.89% | 8.5% | 10.83% | 9.4% | 2.90% | 9.7% |
| Total Capital Ratio | - | - | 12.0% | 11.57% | 13.4% | 3.20% | 13.8% | 8.19% | 14.9% | 1.58% | 15.2% |
| Tier I Ratio | - | - | 8.4% | 22.60% | 10.3% | 8.07% | 11.2% | 13.02% | 12.6% | 4.01% | 13.1% |
| Tier II Ratio | - | - | 3.6% | -14.51% | 3.0% | -13.30% | 2.6% | -12.23% | 2.3% | -11.62% | 2.1% |
| Coverage Ratio (LLR / NPL) | 124% | -9.36% | 112% | 5.29% | 118% | 1.43% | 120% | 0.00% | 120% | 0.00% | 120% |
| ROA(average) | 1.3% | 25.01% | 1.6% | -9.60% | 1.5% | -1.95% | 1.4% | -4.63% | 1.4% | -4.70% | 1.3% |
| ROE(average) | 21.3% | 16.22% | 24.8% | -20.43% | 19.7% | -11.05% | 16.9% | -12.53% | 15.3% | -10.46% | 13.7% |
| | | | | | | | | | | | |
| **Data Per Share - PRs** | | | | | | | | | | | |
| Earning Per Share | 1.58 | 41.9% | 2.24 | 7.1% | 2.39 | 9.8% | 2.63 | 6.9% | 2.81 | 6.3% | 2.99 |
| NAV | - | - | 10.7 | 27.8% | 13.6 | 19.9% | 16.4 | 24.1% | 20.3 | 14.4% | 23.2 |

*Source: Company Reports & IGI Research*

# Mybank Limited

**Recommendation: BUY**

**Fair Value: PRs31**

## Investment Positives

Mybank (MYBL) is a small sized private bank with total assets less than 1% of the total banking system. MYBL operates a network of 60 branches in all major cities of Pakistan.

MYBL posted margins of 3.75% in 2006, and enjoys one of the highest spreads in the industry backed by low cost of funding. MYBL registered a spread of 6.22% in 2006.

In view of the recent mergers and acquisition trend in the industry, led by the increased Minimum Capital Requirement, the bank may be an acquisition target. Consequently, based on the acquisition interest the price objective may significantly go up. However, discussions with management suggest as that know such deal is presently in the offering.

## Investment Risks

Low coverage ratio is a major concern for the bank. The coverage ratio was reported at 40% in 2006 which is lower than our bare minimum benchmark of 50%.

Although NPLs have followed a declining trend over the years, however, the NPL-to-Advances ratio was reported at 7% in 2006, much higher compared to its peers.

## Valuation

We value MYBL at Rs31 as the fair price per share based on 2008E book value, and make a 'BUY' recommendation. We have assumed the risk factor of 0.70, market premium of 7%, and a growth adjustment factor of 12 %.

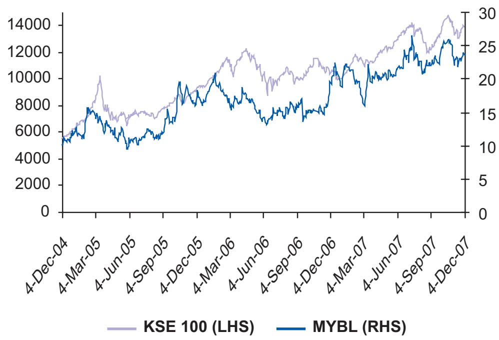
**Table 28: Valuation Highlights (2008E)**

| | Net income (PRs mn) | EPS (PRs) | Dividend (PRs) | PE Rating (x) | NAV (PRs) | Price/Book (x) |
|---|---|---|---|---|---|---|
| 2005A | 274 | 0.59 | 0.00 | 40.5 | 5.51 | 4.36 |
| 2006A | 493 | 1.06 | 0.22 | 22.5 | 10.94 | 2.19 |
| 2007F | 357 | 0.77 | 0.15 | 31.1 | 13.27 | 1.81 |
| 2008E | 728 | 1.57 | 0.31 | 15.3 | 17.16 | 1.40 |
| 2009E | 939 | 2.03 | 0.41 | 11.8 | 13.91 | 1.73 |

*Source : Company Reports & IGI Research*

| | |
|---|---|
| *Bloomberg Code* | *MYBL PA* |
| *Current Price (PRs per share)* | *24* |
| *Average daily Volume (shares)* | *198,102* |
| *Market Capitalization (PRs mn)* | *10,414.31* |
| *Market Capitalization (US$ mn)* | *170* |
| *Paidup Capital (PRs mn)* | *4,339.29* |
| *Shares Outstanding (mn)* | *433.929* |
| *Weightage in KSE100 (%)* | *0.219* |
| *Free Float (%)* | *22.68* |
| *Average Price Per Share (PRs per share)* | *21.84* |

**Chart 31: MYBL: Price Performance**




*Source : Bloomberg*

**Table 29: Required return analysis (2008E)**

| | |
|---|---|
| Normalised ROE | 18.9% |
| Required return | 15.3% |
| Fair price/book | 213% |
| Normalised price/book | 163% |
| Misvaluation | 31% |
| 12 month return potential | 46% |

*Source : Company Reports & IGI Research*

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**Table 30: Valuation Summary**

| | 2004A | change | 2005A | change | 2006A | change | 2007E | change | 2008F | change | 2009F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Income statement - (PRs mn)** | | | | | | | | | | | |
| Net interest income | 411 | 71% | 703 | 17% | 820 | 3% | 842 | 26% | 1060 | 20% | 1274 |
| Commissions | 45 | 51% | 68 | 69% | 116 | 50% | 173 | 35% | 234 | 30% | 304 |
| Trading income | 13 | 718% | 109 | 144% | 266 | 29% | 344 | 24% | 426 | 21% | 517 |
| Other operating income | 40 | 80% | 72 | -1% | 70 | 50% | 106 | 14% | 121 | 12% | 136 |
| Total operating revenues | 510 | 87% | 952 | 34% | 1272 | 15% | 1465 | 26% | 1840 | 21% | 2231 |
| Operating costs | -403 | 34% | -539 | 14% | -612 | 10% | -676 | 20% | -808 | 13% | -916 |
| Operating profit | 106 | 290% | 414 | 60% | 661 | 20% | 790 | 31% | 1033 | 27% | 1315 |
| Provisions | -30 | 570% | -203 | -81% | -38 | 779% | -332 | -70% | -100 | 12% | -112 |
| Extraordinary items | 11 | | 0 | | 0 | | 0 | | 0 | - | |
| Pre-tax profit | 87 | 143% | 211 | 196% | 623 | -27% | 458 | 104% | 933 | 29% | 1204 |
| Tax (rate) | -3 | -(30%) | 63 | (21%) | -130 | (22%) | -101 | (22%) | -205 | (29%) | -265 |
| Attributable net income | 84 | 228% | 274 | 80% | 493 | -28% | 357 | 104% | 728 | 29% | 939 |
| | | | | | | | | | | | |
| **Balance sheet - (PRs mn)** | | | | | | | | | | | |
| Total assets | 13436 | 28% | 17219 | 54% | 26549 | 13% | 30074 | 16% | 35028 | 8% | 37925 |
| Average assets | 13436 | 14% | 15327 | 43% | 21884 | 29% | 28312 | 15% | 32551 | 12% | 36476 |
| Customer loans | 7245 | 28% | 9294 | 45% | 13487 | 17% | 15815 | 14% | 18092 | 12% | 20291 |
| Cash and interbank loans | 3372 | -1% | 3349 | 116% | 7243 | 11% | 8069 | 19% | 9642 | 2% | 9824 |
| Investments | 1937 | 68% | 3253 | -9% | 2961 | 10% | 3257 | 28% | 4175 | 8% | 4509 |
| Customer deposits | 10923 | 18% | 12857 | 49% | 19169 | 10% | 21086 | 10% | 23195 | 8% | 25050 |
| Interbank funding | 746 | 115% | 1606 | 15% | 1850 | 18% | 2188 | 40% | 3069 | 2% | 3138 |
| Shareholders' equity | 1649 | 55% | 2550 | 99% | 5066 | 24% | 6263 | 27% | 7943 | 11% | 8850 |
| | | | | | | | | | | | |
| **Ratios** | | | | | | | | | | | |
| Net interest margin | 3.06% | | 4.59% | | 3.75% | | 2.98% | | 3.25% | | 3.49% |
| Non-interest rev./total revenue | 19.3% | | 26.1% | | 35.5% | | 42.5% | | 42.4% | | 42.9% |
| Commissions/total revenue | 8.9% | | 7.2% | | 9.1% | | 11.8% | | 12.7% | | 13.6% |
| Commissions/ average assets | 0.34% | | 0.45% | | 0.53% | | 0.61% | | 0.72% | | 0.83% |
| Operating costs/average assets | 3.00% | | 3.51% | | 2.79% | | 2.39% | | 2.48% | | 2.51% |
| Cost/income | 79.2% | | 56.6% | | 48.1% | | 46.1% | | 43.9% | | 41.0% |
| Trading gains/total revenues | 2.6% | | 11.4% | | 20.9% | | 23.5% | | 23.1% | | 23.2% |
| Trading profits/pre-tax profit | 15.3% | | 51.7% | | 42.7% | | 75.2% | | 45.6% | | 43.0% |
| Trading profits/operating profit | 12.5% | | 26.3% | | 40.3% | | 43.6% | | 41.2% | | 39.3% |
| Customer loans/assets | 53.9% | | 54.0% | | 50.8% | | 52.6% | | 51.7% | | 53.5% |
| Cash and interbank loans/assets | 25.1% | | 19.4% | | 27.3% | | 26.8% | | 27.5% | | 25.9% |
| Investments/assets | 14.4% | | 18.9% | | 11.2% | | 10.8% | | 11.9% | | 11.9% |
| Loans/deposits | 66.3% | | 72.3% | | 70.4% | | 75.0% | | 78.0% | | 81.0% |
| Loan loss provisions/loans | 0.42% | | 2.15% | | 0.23% | | 2.10% | | 0.55% | | 0.55% |
| Loan loss reserves/loans | 3.63% | | 4.50% | | 2.99% | | 4.00% | | 4.00% | | 4.00% |
| NPL/Loans | 13.2% | | 14.1% | | 7.5% | | 10.0% | | 10.0% | | 10.0% |
| Loan loss reserves/NPLs | 27.5% | | 31.9% | | 39.9% | | 40.0% | | 40.0% | | 40.0% |
| Growth in NPLs | 0.0% | | 37.3% | | -23.0% | | 56.4% | | 30.0% | | 30.0% |
| Customer deposits/liabilities | 81.3% | | 74.7% | | 72.2% | | 70.1% | | 66.2% | | 66.1% |
| Time deposits/total deposits | 6.0% | | 17.8% | | 23.4% | | 24.0% | | 24.0% | | 24.0% |
| Interbank funding/liabilities | 5.6% | | 9.3% | | 7.0% | | 7.3% | | 8.8% | | 8.3% |
| Liquid assets/liabilities | 25.1% | | 19.4% | | 27.3% | | 26.8% | | 27.5% | | 25.9% |
| Equity/assets | 12.3% | | 14.8% | | 19.1% | | 20.8% | | 22.7% | | 23.3% |
| Total capital ratio | - | | 18.9% | | 19.3% | | 19.7% | | 22.1% | | 25.4% |
| Tier 1 capital ratio | - | | 18.6% | | 16.8% | | 19.6% | | 22.1% | | 22.8% |
| Internal capital growth rate | | | 16.6% | | 19.3% | | 7.0% | | 11.6% | | 11.8% |
| Operating profit/average assets | 0.79% | | 2.70% | | 3.02% | | 2.79% | | 3.17% | | 3.61% |
| Return on average assets | 0.62% | | 1.79% | | 2.25% | | 1.26% | | 2.24% | | 2.57% |
| Return on average equity | 10.1% | | 13.1% | | 12.9% | | 6.3% | | 10.2% | | 11.2% |
| | | | | | | | | | | | |
| **Data per share - PRs** | | | | | | | | | | | |
| Earnings | 0.18 | 228% | 0.59 | 80% | 1.06 | -28% | 0.77 | 104% | 1.57 | | 2.03 |
| Operating profit | 23 | 290% | 89 | 60% | 143 | 20% | 171 | 31% | 223 | | 284 |
| Gross dividend | 0.00 | - | 0.00 | - | 0.22 | -31% | 0.15 | 104% | 0.31 | | 0.41 |
| Net asset value | 3.56 | 55% | 5.51 | 99% | 10.94 | 24% | 13.53 | 27% | 17.16 | | 19.12 |
| Payout | 0% | - | 0% | - | 21% | -4% | 20% | 0% | 20% | | 20% |
| Average shares issued (mn) | 102 | 118% | 223 | 17% | 261 | 62% | 424 | 30% | 550 | | 622 |
| Year-end shares issued (mn) | 152 | 35% | 205 | 50% | 309 | 50% | 463 | 25% | 579 | | 636 |

*Source: Company Reports & IGI Research*

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## Analyst Certification

We, Sobia Muhammad Din and Ahmed Raza Khan, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject, securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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