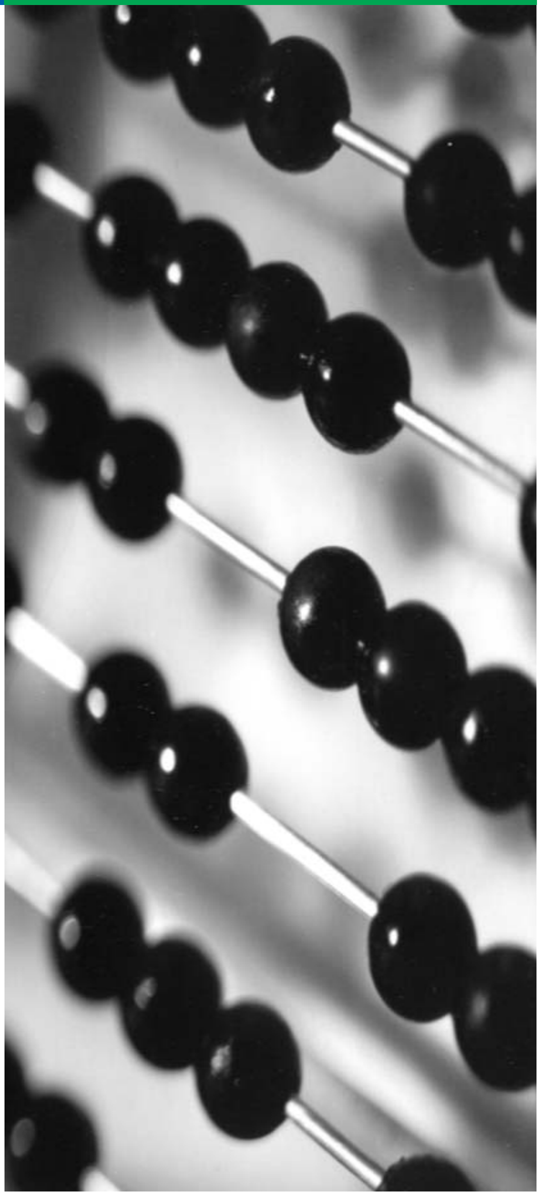
September 2008

BANKS
PAKISTAN



Allied Bank Limited

Company Update

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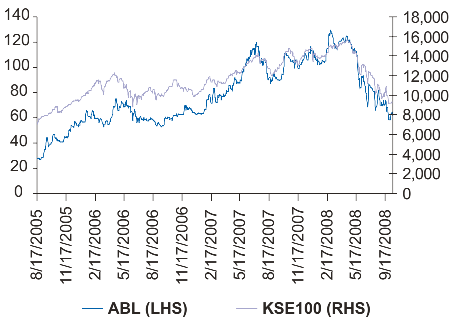
IGI Securities

Recommendation	NEUTRAL
Fair Value	PKR 55

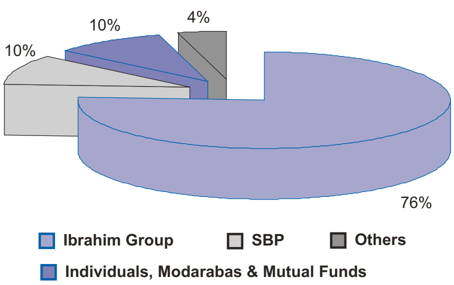
Bloomberg Code	*ABL PA*
Current Price (PKR)	*62.00*
Average Daily Volume (mn)	*0.64*
Market Capitalization (PKR bn)	*39.816*
Paidup Capital (PKR mn)	*6463.64*
Shares Outstanding (mn)	*646.364*
Weightage (%)	*1.57*
Average Price (PKR)	*99.26*
Free Float	*13%*

ABL: Price Performance



Source: Bloomberg & IGI Research

ABL: Shareholding Pattern



Source: Company Reports

ABL: Financial Highlights

	CY07A	CY08E	CY09E
EPS(PKR)	6.31	6.79	8.28
DPS(PKR)	2.5	3.50	3.50
BVPS(PKR)	30.7	34.86	39.76
PE(x)	9.84	9.07	7.44
PB(x)	2.00	1.77	1.55
ROAA	1.40	1.30	1.40
ROAE	21.70	20.70	22.20

Source: Company Reports & IGI Research

Revised PO of PKR 55, Neutral to Underweight

Incorporating the key down side risk factors including i) margin contraction ii) rising NPLs & increased provisioning iii) lower loan growth iv) liquidity crunch along with recent 1H CY08 result update and insights from management meeting, we have revised our model assumptions and reiterate a netural stance on the scrip. Our price objective for ABL is PKR 55 per share based on normalized ROE analysis and 2009E book value. The scrip is currently trading at 2008E and 2009E leading PB multiple of 1.77x and 1.55x respectively and 11% premium to our target price.

Key factors underpinning bearish stance

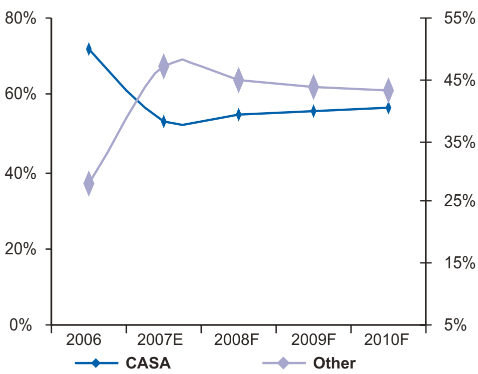
At current levels the market has largely discounted the downside risk factors and banking scrips have lost an estimated 40% during the current bearish spell. At present, in terms of valuations the banking sector is trading at a forward CY08E PB of 1.4x compared to historical average of 3x. Hence, current valuations which are at a significant discount to both past averages and regional peers may seem very attractive in terms of pricing and entry point. However, going forward more downside than upside value drivers underpin our "Neutral to under weight" recommendation. One key positive of higher asset yields as a result of significant uptick in KIBOR is more than offset by the following concerns:

- SBP's decision to introduce a floor rate of 5% saving deposits will significantly raise cost of deposits.
- A tight monetary policy stance is likely to ensue into slowdown in advances growth.
- Current macro deterioration and economic slowdown can result in a spike in NPLs and a sharp downturn in asset quality. This fact coupled with sizeable textile exposure (22%) may lead to surge in NPL provisioning thus hurting earnings growth.
- Lack of diversification in the form of over 80% corporate loans exposes ABL to concentration risk in credit portfolio.
- The yield on investment portfolio remains muted due to legacy HTM government secuties and other FIs amounting to PKR 16bn (20% of total), thus creating a drag on topline growth.
- Although ABL's management plans to rationalize its advances mix with increased penetration into consumer and SME segment, however, late entry, high risk aversion, and lack of brand equity are key risks to market penetration.
- Further hike in policy rate will lead to down ward revision in target price due to rise in opportunity cost of capital in valuation analysis.

NIM compression on the horizon

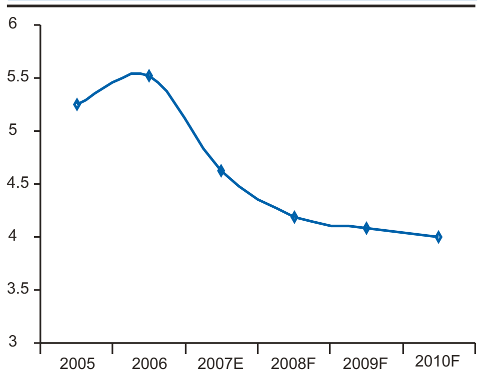
During CY07 we saw a compression in NIMs by 90bps to 4.6% on account of rising costs of deposits and marginal decline in average yield of assets. Over the past year, asset yields declined by 30bps to 9.3% whereas deposit rates posted an up-tick of 40bps. Moving forward we expect further NIM compression of 30-40bps in CY08E as the cost of deposits continues to rise. However this decline is likely to be restrained and we expect NIM to stabilize at 4.1% level as the proportion of CASA rises in the deposit mix. In CY07, CASA grew by 14% to PKR 139bn while during 1H CY08 the CASA base grew by 15% to PKR 160bn representing 55% of the deposit franchise. Going forward, we expect NII CAGR at 10% in CY08-CY10E.

Deposits Composition



Source: Company Reports & IGI Research

Net Interest Margin (%)



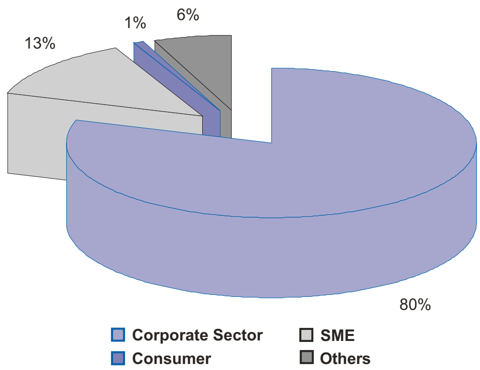
Source: Company Reports & IGI Research

Blue chips dominate loan portfolio

Corporate banking activities are the mainstay of ABL's business mix. Nearly 80% of ABL's loan portfolio comprises of blue chip corporates. Moreover, ABL has increased penetration into the SME segment to 15% of its loan book. ABL's senior management has already highlighted plans to diversify its asset mix with increasing focus on consumer banking. Going forward, the management plans to reduce the overbearing corporate exposure to 50% while targeting SME, retail and commercial to constitute the other 50% of the loan book. The initial plan to launch credit cards in Feb-Mar CY08 has been delayed. However, ABL recently launched its debit card while the re-launch of credit cards is expected later this year. Against this backdrop, with lack of aggressive penetration in the near term we expect consumer banking to remain largely untapped. Going forward, the lack of diversification in terms of sizeable consumer and commercial business portfolio is a key risk facing the bank.

Analyzing the advances portfolio in terms of loan type reveals that working capital and term loans constitute 45% each of the loan book while the remaining is attributed to Forex, export refinancing and others. Moreover, 40% of the loan book is priced in 3mo KIBOR while 40% is equally divided between 1mo and 6mo KIBOR. Hence, based on our estimates 60-70% of ABL's loan book has already been repriced in Jun'08 while the 6mo KIBOR based loans will be repriced in 3Q CY08.

ABL: Business Mix

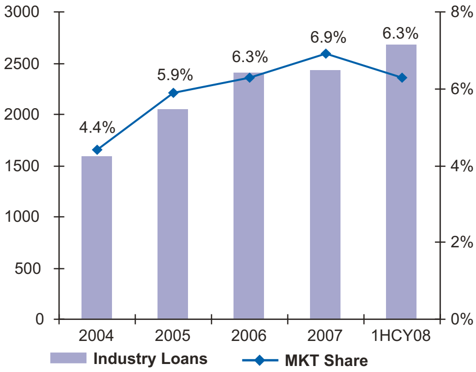


Source: Company Reports & IGI Research

Tapering advances growth

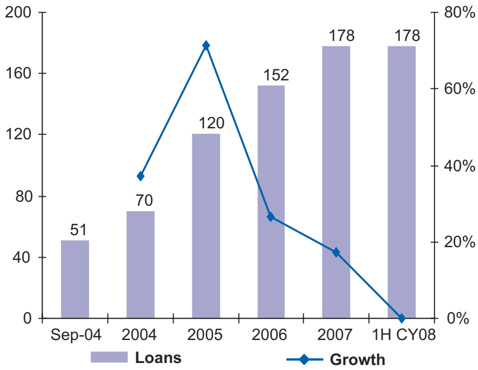
Post privatization, notwithstanding the low base effect, ABL's advance growth has remained buoyant averaging 23% during CY06-CY07. However during 1H CY08, ABL's advances remained virtually flat as compared to sectoral growth of 11% in the same period. The sectoral analysis reveals that high demand was witnessed from working capital loans and commodity sectors as they continued to battle high input costs. Meanwhile, ABL's stagnant loan book is largely attributed to hefty loan repayments near June end which offset advances growth and secondly due to shift towards TFC investments instead of incremental loans. During 1H CY08, investments in TFCs witnessed a manifold increase and surged to PKR 7,636mn as compared to 736mn in Dec'07. We expect loan growth to pick up in 2H CY08 on the back of seasonal working capital loans and expect full year growth of 9% in CY08E. Going forward we expect ADR of 60% and advances CAGR of 12.5% in CY08-CY10E.

ABL: Advances Market Share



Source: Company Reports & IGI Research

ABL: Advances

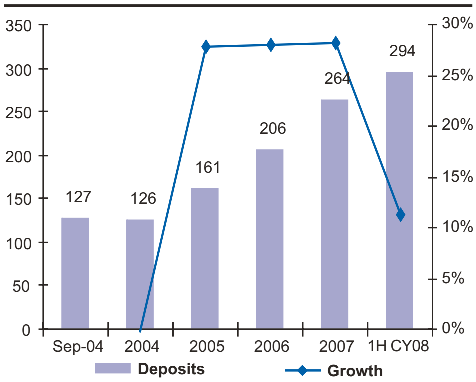


Source: Company Reports & IGI Research

Deposits growth remain strong

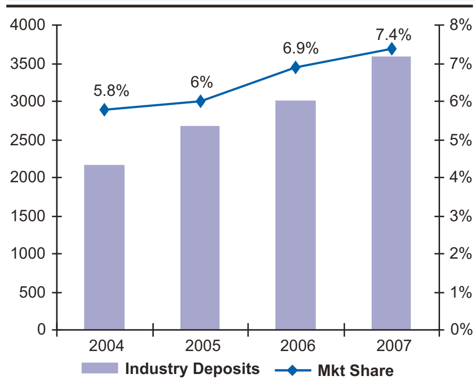
On the deposits front growth has remained robust averaging 28% in CY05-CY07. ABL's focus has been to utilize its strong branch network in shoring up both CASA and term deposits. As of Jun'08 ABL's deposits market share and CASA base stood at 7.6% and 55% as compared to 7.4% and 53% respectively in Dec'07. The 200bps improvement in the CASA base is a positive sign and this will help stabilize the urgent rise in cost of funding and translate into a more gradual increase in deposit costs moving forward. However, tighter inter-bank liquidity, slowdown in money supply & foreign inflows could result in moderate deposit growth and compel banks to offer high rates resulting in pressure on cost of deposits and NIMs. As a result, we expect ABL's deposit growth to moderate to a CAGR of 15% in CY08-CY10E.

ABL: Deposits Market Share



Source: Company Reports & IGI Research

ABL: Deposits (PKR bn)



Source: Company Reports & IGI Research

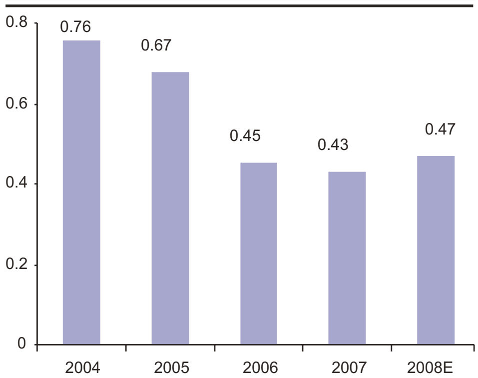
Fee Income driving profitability

Since corporate restructuring in Aug'04, ABL has generated robust growth in assets and stronger earnings. This is attributed to increase in fee income which grew by 52% during CY07, and at a 3yr CAGR of 19% as of Dec07. The key drivers behind this uptrend in non-fund based income are increased penetration in investment banking, trade-related financing and remittances business. Going forward, we expect fee income to grow by 15% in CY08-CY10E. Moreover, another source of non-core income which is expected to result in an earning surprise in CY08E, not yet reflected in 1H CY08 financials, is the return from investment in mutual funds. ABL has PKR 17.7bn invested in open-end income fund from which the bank expects a return of PKR 800-1,000mn to be booked in 4Q CY08.

Opex growth upbeat

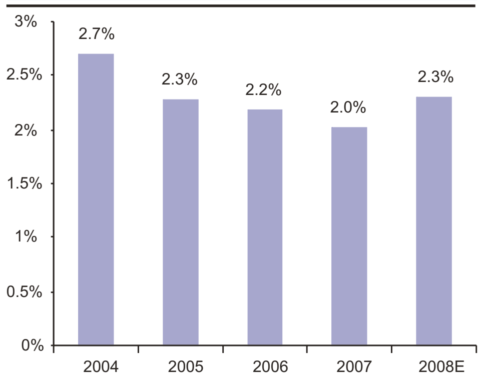
In CY07 operating costs surged by 17%, however the growth was slower than income growth resulting in a marginal down-tick in the cost/income ratio of 20bps to 42.6%. The growth trend in operating expenses, averaging 16% over the past 3 years, was largely incurred as a result of rising employee costs and technology initiatives being put on overdrive coupled with comprehensive brand building effort. In CY08, with the launch of consumer segment we expect operating cost to grow by 24% resulting in an uptick in cost/income ratio of 300bps to 46%. However in our opinion, in CY09-CY10E opex growth to stabilize as costs of this magnitude are unlikely to recur and major infrastructure expenditure has already been done.

Cost/Income ratio



Source: Company Reports & IGI Research

Cost/Assets ratio

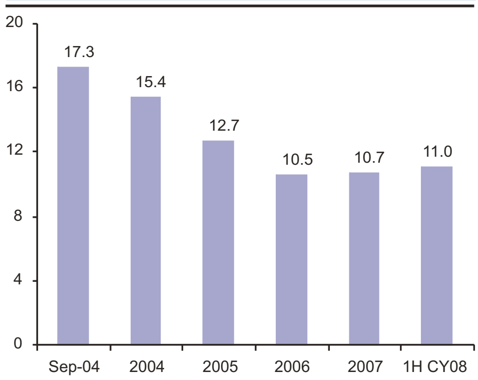


Source: Company Reports & IGI Research

Asset quality risks increasing

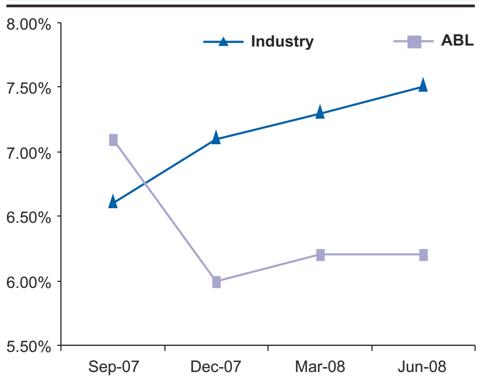
Since privatization, ABL's management has proactively pursued a declining NPL-to-Advances ratio; down to 6.2% from 10% in CY06. During CY07, ABL's non-performing loans grew by 8.4% as compared to advances growth of 17%, resulting in a dip in the NPL ratio. A key risk facing the banking sector are the rising levels of NPLs which surged to PKR 212bn in Jun'08 as compared to PKR 199bn in the first quarter. Going forward, we expect NPL formation to spike further as the full impact of hike in KIBOR of 300bps to 13.5% is not priced in up till now. Moreover, the dismal performance of corporate sector especially textiles might result in defaults and declining asset quality. As a result, ABL's over-reliance on the corporate sector including 22% exposure to textiles might result in rising NPLs and deterioration of asset quality. We expect gross NPL-to-Advances ratio of 6.5% in full year CY08 and an increase of 50bps to 7% in CY09-CY10E.

ABL: Non performing loan (PKR bn)



Source: Company Reports & IGI Research

Gross NPL-to-Advances ratio



Source: Company Reports & IGI Research

Valuation

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

- We arrive at the bank's Normalized Return on Equity through Du Pont Analysis.

- The required return is calculated through the Capital Asset Pricing Model (CAPM) using the 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 6% is used as Pakistan is an emerging market.

- We assume a growth adjustment factor of 12.5% for ABL.

The above mentioned factors are used to calculate the fair price-to-book multiple for the bank. The fair book value is multiplied with 2009E 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. 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.

Based on our valuation we expect ABL to post a Normalized ROE of 23%. The required return based on CAPM is 19%. Keeping in view all the assumptions, we arrive at a fair price-to-book multiple of 1.72x for ABL 2008E adjusted book value. The fair value is computed at PKR 55 per share. At current levels, we make a 'Neutral to under weight' recommendation on ABL.

Valuation

Normalised ROE	23%	Fair P/B	1.72	Misvaluation	-8.3%
Required return	19%	Normalised P/B	1.87	12 mo Return	10.6%

Source: Company Reports & IGI Research

Valuation Summary

	CY06A	%chng	CY07A	%chng	CY08E	%chng	CY09E	%chng	CY10E
Income Statement									
Net Interest Income	10,422	7.3%	11,182	8.2%	12,102	10.9%	13,417	12.1%	15,041
Non-Interest Income	2,449	60.1%	3,920	4.1%	4,081	8.8%	4,439	10.8%	4,921
Provisioning Expenses	705	284.9%	2,713	-45.8%	1,470	-1.1%	1,454	15.0%	1,672
Operating Expenses	5,506	16.9%	6,435	23.7%	7,963	2.6%	8,166	12.0%	9,143
Profit Before Tax	6,661	-10.6%	5,955	13.4%	6,750	22.0%	8,236	11.1%	9,147
Profit After Tax	4,397	-7.3%	4,078	7.6%	4,388	22.0%	5,354	11.1%	5,945
Balance Sheet									
Advances	144,034	16.9%	168,407	9.1%	183,725	13.1%	207,762	15.0%	238,926
Deposits	206,031	28.1%	263,972	16.0%	306,208	15.0%	352,139	15.0%	404,960
Investments	46,953	78.8%	83,958	9.4%	91,862	15.0%	105,642	15.0%	121,488
Lending to FI's	19,050	-3.3%	18,419	49.6%	27,559	15.0%	31,693	15.0%	36,446
Bills Payable	2,278	53.4%	3,494	-10.6%	3,123	33.0%	4,155	15.0%	4,779
Borrowings	18,410	24.6%	22,934	-19.9%	18,372	13.1%	20,776	15.0%	23,893
Total Assets	252,027	27.0%	320,068	13.1%	361,920	14.8%	415,657	14.8%	477,216
Total Equity	17,688	12.2%	19,847	13.5%	22,531	14.1%	25,699	13.4%	29,140
Key Ratios									
Net Interest Margin	5.5%		4.6%		4.2%		4.1%		4.0%
Net Interest Revenue/Total Revenue	81.0%		74.0%		74.8%		75.1%		75.4%
Non-Interest Revenue / Total Revenues	19.0%		26.0%		25.2%		24.9%		24.6%
Commisions/Total Revenue	10.5%		13.7%		14.7%		15.3%		15.7%
Cost / Assets	2.5%		2.2%		2.3%		2.1%		2.1%
Advances / Total Assets	57%		53%		51%		50%		50%
Advances/Deposits	70%		64%		60%		59%		59%
Equity/Assets	7.0%		6.2%		6.2%		6.2%		6.1%
Investment/Assets	19%		26%		25%		25%		26%
Gross NPL/Loans	6.9%		6.0%		6.5%		7.0%		7.0%
LLR / Loans	5.2%		5.9%		5.9%		5.5%		5.6%
LLP / Loans	0.5%		1.6%		0.8%		1%		1%
ROA(average)	2.0%		1.4%		1.3%		1.4%		1.3%
ROE(average)	27.3%		21.7%		20.7%		22.2%		21.7%
Data Per Share - PKR									
EPS	6.80		6.31		6.79		8.28		9.20
DPS	1.74		2.50		3.00		3.50		4.00
BVPS	27.37		30.71		34.86		39.76		45.1
PE(x)	9.06		9.76		9.07		7.44		6.70
PB(x)	2.25		2.01		1.77		1.55		1.37

Source: Company Reports & IGI Research

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Analyst Certification

I, Ahmed Raza Khan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my 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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