Day Break

Wednesday, 14 February 2018

Sector Update

Exhibit: Relative Price Performance

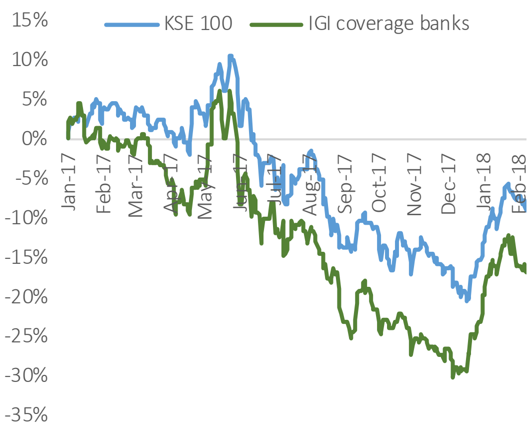
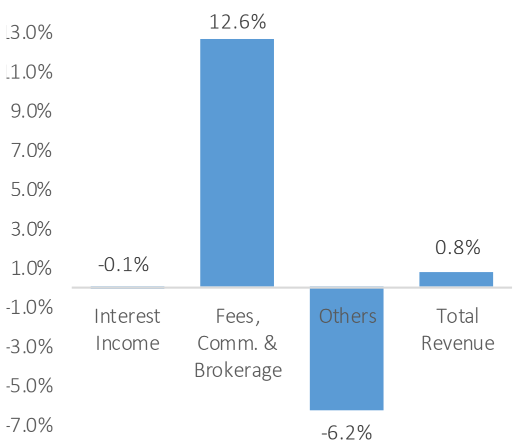


Exhibit: CY17E (full year) % change in revenue streams



Source: Bloomberg, KSE 100 & IGI Research

Syed Daniyal Adil
Research Analyst
daniyal.adil@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 973

Commercial Banks

Banks: Drop in 4Q earnings to further drag down sector profitability in CY17

- We preview banking stock earnings for the 4QCY17 (ex-HBL penalty). Overall profitability of IGI coverage banks is likely to fall by 5.3%YoY (down 1.8%QoQ) to PKR 37.0bn compared to PKR 39.1bn last year amid constantly falling earning yields.
- On a full year basis, BAFL, MCB and FABL are expected to top the earnings growth chart while HMB and NBP will be the biggest laggards (ex-HBL penalty).

Earnings to fall by 5.3%YoY in 4QCY17

We preview banking stock earnings for the 4QCY17 (ex-HBL penalty). Overall profitability of IGI coverage banks is likely to fall by 5.3%YoY (down 1.8%QoQ) to PKR 37.0bn compared to PKR 39.1bn last year amid constantly falling earning yields. Similarly, on a full year basis, profitability is estimated to drop by 1.7% to PKR 150.0bn in CY17. Moreover, accounting for HBL penalty value of USD 225mn (or PKR 23.7bn), overall profitability is expected to experience a drop of 17.3%YoY to PKR 126.3bn. Based on our estimates, we expect all banks except HBL (ex-penalty) and NBP to post earnings growth QoQ, with the growth chart led by BAHL and UBL. However, on a full year basis, BAFL, MCB and FABL are expected to top the earnings growth chart while HMB and NBP will be the biggest laggards (ex-HBL penalty).

Exhibit:

Banking Sector earnings estimate

in PKR			**4QCY17E**				**CY17E**	
Bank	EPS	DPS	BVPS	QoQ	YoY	EPS	DPS	YoY
HBL	5.5	-	128.5	n.m.	-4%	6.7	7.0	-71%
UBL	5.6	4.0	129.7	17%	6%	21.2	13.0	-6%
MCB	5.1	4.0	123.1	12%	37%	21.3	16.0	15%
ABL	2.9	1.8	89.7	3%	51%	11.4	7.0	-10%
NBP	2.1	7.5	84.4	-30%	-53%	9.1	7.5	-15%
BAFL	1.5	1.0	42.7	5%	47%	6.0	1.0	21%
BAHL	2.0	3.5	42.5	21%	-21%	7.8	3.5	7%
FABL	0.8	1.0	29.7	11%	96%	3.7	1.0	13%
AKBL	1.0	-	27.6	9%	25%	4.4	1.0	6%
HMB	1.1	3.0	38.8	13%	-48%	4.2	3.0	-28%
Total				**165%**	**-5%**			**-17%**
HBL (ex-penalty)	5.5	-	N/A	-14%	-3%	22.8	7.0	-2%
Total (ex-HBL penalty)				**-2%**	**-5%**			**-2%**

Source: IGI Research, Company Financials

9MCY17: Profitability continued its downward trajectory

To recall, IGI coverage banks (ex-HBL penalty) posted a slight decline in profitability (down 0.4%YoY) for the period 9MCY17 as a result of declining loan spreads, maturing high yield PIBs and rigid cost of deposits. On average, NIMs have come off by almost 70bps, dropping down to ~3.2% during 9MCY17 as compared to ~3.9% in Dec-16. Resultantly, net interest income fell by 0.8%YoY despite rapid balance sheet growth (Advances up by +17.2%YoY).

Simultaneously, provision reversals lent significant support to the bottom-line, posting PKR 3.7bn reversal compared to a charge of PKR 4.2bn in same period last year. Yet, rapid growth in operating expenses (up by +9.7%YoY) depressed sector profitability with average cost to income ratio up by +587bpsYoY to 53.8% in 9MCY17.

Exhibit:

Changing investment mix as well as declining loan spreads kept earning yields under pressure

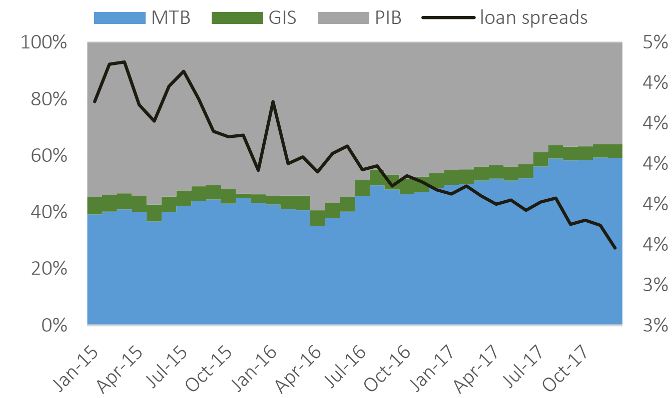
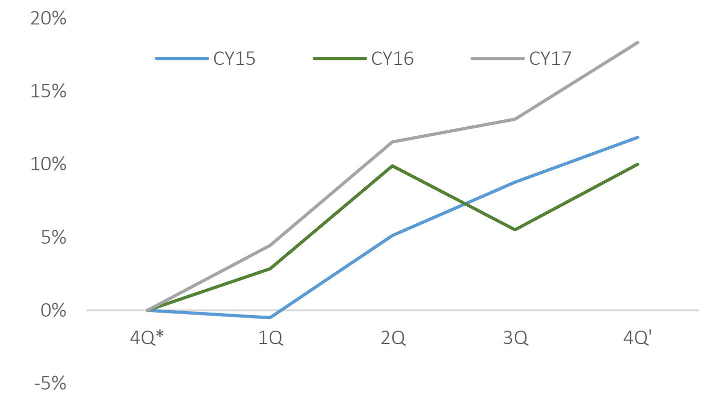


Exhibit:

Rising Interest earning assets supported revenues amid declining yields



Source: IGI Research, Company Financials, SBP
**Previous year quarter*
'Current Year quarter

4QCY17: Net interest income to fall; Expenses to rise

Despite lower earning yields (average earning yield down to 6.5% in Sep-17 compared to 7.4% in Dec-17) interest income for 4QCY17 is still expected to fall only meagerly by 2.6%YoY due to volumetric growth (earning assets expected to be up by +18.3%YoY) consistent with the 9MCY17 trend. For the full year CY17, we expect interest income to total PKR 362.8bn, down by a meagre 0.1%. However, the biggest support to revenues is expected to emanate from fee income, wherein we expect 4QCY17 fee income to grow by +11.7%YoY, leading to robust growth of +12.6%YoY for CY17.

We expect operating expenses to continue their upward trajectory, posting a growth of +5.0%YoY during 4QCY17, bringing full year growth to +8.9%YoY. However, as opposed to recent provisioning reversals, we expect banks to book provisions in 4QCY17 due to rapidly rising advances (up by +17.2%) and sluggish market performance in 4QCY17 (leading to potential mark to market losses in investments). Yet the full year provisioning expense is still expected to remain negative, supporting the bottom-line.

Recommendation

Since the start of CY18, IGI coverage banks have rallied by 8.2% while we see further upside based on favorable macroeconomic tailwinds. Amongst our coverage, we prefer BAHL and HMB based on sound fundamentals and attractive valuation.

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Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44

Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Rad
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44

Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Sialkot Office
Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762

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