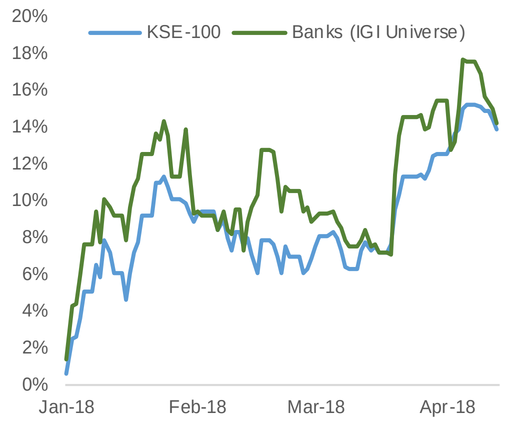
Day Break

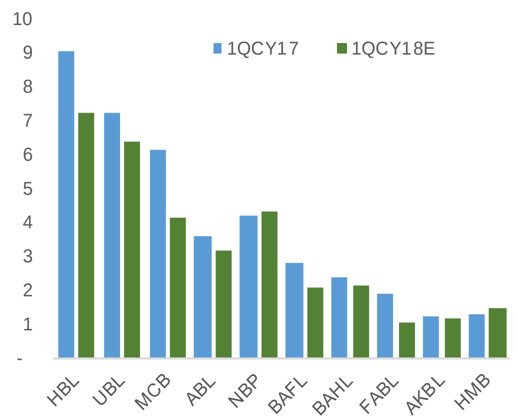
Tuesday, 17 April 2018

Sector Update

Relative Price Performance



Profits in PKR bn for IGI coverage banks



Source: Bloomberg, PSX & IGI Research

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Commercial Banks

Banks: Earnings to fall as opex expected to outpace stunted revenue growth

- We preview banking stock earnings for the 1QCY18. Overall profitability of IGI coverage banks is likely to fall by 17%YoY to PKR 33.1bn compared to PKR 39.8bn same period last year
- We expect only HMB and NBP to register YoY growth in profitability whereas, HBL, UBL, MCB, ABL, BAFL, BAHL, FABL and AKBL are all expected to post lower YoY profits
- Primary reasons for the decline in YoY earnings are expected to be high opex growth coupled with lower capital gains realized, in our view

Opex growth and lower capital gains to drag down overall sector profits

We preview banking stock earnings for the 1QCY18. Overall profitability of IGI coverage banks is likely to fall by 17%YoY to PKR 33.1bn compared to PKR 39.8bn same period last year. On a quarterly basis, profitability is likely to fall by 4%QoQ. Based on our estimates, we expect only HMB and NBP to register YoY growth in profitability whereas, HBL, UBL, MCB, ABL, BAFL, BAHL, FABL and AKBL are all expected to post lower YoY profits. Primary reasons for the decline in YoY earnings are expected to be high opex growth coupled with lower capital gains realized, in our view.

Exhibit:

Banking Sector earnings estimates

in PKR	1QCY17	1QCY18E				
Bank	EPS	EPS	DPS	BVPS	QoQ	YoY
HBL	6.16	4.93	1.50	132.65	17.4%	-20.0%
UBL	5.93	5.20	3.00	131.33	0.6%	-12.3%
MCB	5.19	3.51	4.00	129.09	25.1%	-32.4%
ABL	3.15	2.75	1.75	94.19	5.1%	-12.8%
NBP	1.98	2.02	-	84.45	-47.6%	2.2%
BAFL	1.73	1.29	-	40.67	74.5%	-25.4%
BAHL	2.12	1.90	-	40.18	-3.6%	-10.2%
FABL	1.23	0.70	-	26.55	53.5%	-43.2%
AKBL	0.98	0.91	-	27.11	8.9%	-7.0%
HMB	1.23	1.41	-	37.06	-34.6%	14.4%

Source: IGI Research, Company Financials

CY17: Profitability down by 3.3% (ex-HBL penalty) due to soft revenue growth and robust opex rise

To recall, for the period CY17, IGI coverage banks registered a significant decline in earnings amid contracting earning yields, maturing high yield investment bond and inflexible cost of deposits. Profits declined by 3.3%YoY (ex-HBL penalty) as, on average, NIMs came off by almost 32bps, dropping down to 3.3% by CY17 end. Provision reversals dented profits further, posting PKR 3.3bn compared to a charge of PKR 5.4bn in same period last year. Simultaneously, rapid growth in operating expenses (up by +10.2%YoY) depressed sector profitability, with cost to income ratio up by 260bpsYoY to 51.8% in CY17.

Exhibit:
Falling outstanding spread; Rising fresh spreads may resist further decline

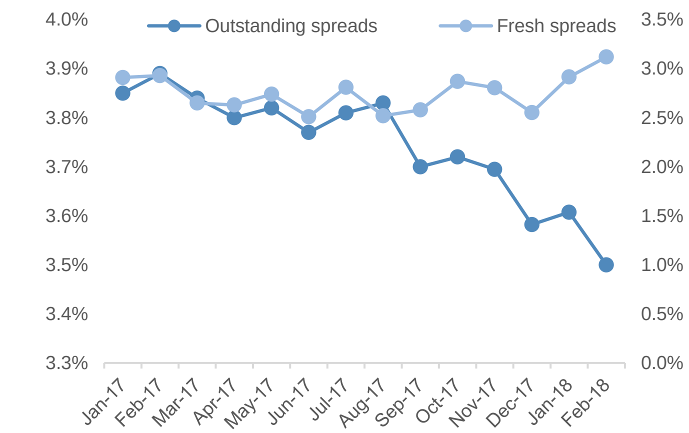
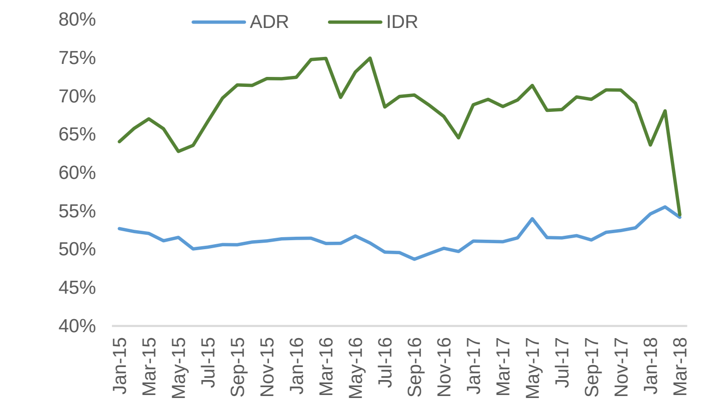


Exhibit:
Heavy maturities in 1QCY18 dragged down IDR with little reinvestment in government securities



Source: IGI Research, Company Financials, SBP

Rising operating expense along with lower capital gains to hurt bottom line
During 1QCY18, although net interest income is expected to rebound by +8.2%YoY (down 0.7%QoQ) as a result of low base effect in 1QCY17 as well as the recent rate hike at the start of CY17 and fee income is expected to grow by +18.8%YoY, yet total revenues are still expected to remain flattish (up +0.1%YoY; down 3.2%QoQ) as capital gains are estimated to decline significantly (down 85.8%YoY; down 60.3%QoQ). Operating expenses are expected to outpace revenue growth, rising by +14.5%YoY (down 0.9%QoQ), much higher than cumulative growth for CY17 at +10.2%YoY and primarily due to low base effect from 1QCY17. Banks' provision reversal, although expected to decline considerably from last year same period, but given the trend in recoveries as well as market performance, is anticipated to be flattish. Henceforth, based on our estimates, we expect a meagre provisioning reversal for 1QCY18 at PKR 70mn, primarily led by expected recoveries in MCB, compared to a reversal of PKR 1.5bn in same period last year.

Recommendation
Given the macro tailwinds in support of the banking sector, we maintain our overweight stance. Amongst our coverage, we prefer MCB, BAHL and FABL as our top picks based on sound fundamentals and attractive valuation.

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