

# Day Break

Tuesday, 14 November 2017

## COMPANY UPDATE

### HABIB BANK LIMITED

#### COMMERCIAL BANKS

#### Recommendation

BUY

Target Price:

225.8

Last Closing: 13-Nov-17

168.1

Upside:

34.4

Valuation Methodology: Asset based Valuation / Dividend Discount Model (DDM)

Time Horizon:

Dec-17

#### Market Data

Bloomberg Tkr.

HBL PA

Shares (mn)

1,466.9

Free Float Shares (mn)

660.1

Free Float Shares (%)

45.0%

Market Cap (PKRbn | USDmn)

246.5

2,346.3

Exchange

KSE 100

#### Price Info.

90D

180D

365D

Abs. Return

(25.9)

(45.3)

(31.5)

Lo

152.9

152.9

152.9

Hi

226.6

308.0

308.6

#### Key Company Financials

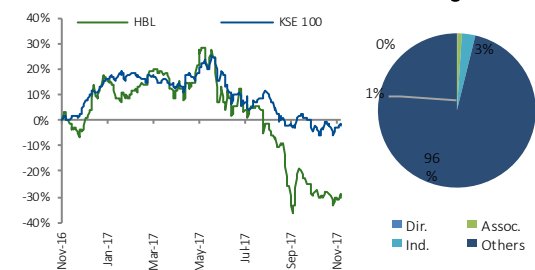
Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	113.0	115.5	120.5	134.9
Net Income	34.2	9.0	36.6	41.5
EPS (PKR)	23.3	6.1	24.9	28.3
DPS (PKR)	14.0	7.0	12.0	17.0
Total Assets	2,507.2	2,758.0	3,165.6	3,630.1
Total Equity	196.3	194.6	214.2	231.4

#### Key Financial Ratios

ROE (%)	17.4	4.6	17.1	17.9
P/E (x)	7.2	27.3	6.7	5.9
P/B (x)	1.3	1.3	1.2	1.1
DY (%)	8.3	4.2	7.1	10.1

#### Relative Price Performance & Shareholding



#### About the Company

The Bank is incorporated in Pakistan and is engaged in commercial banking and asset management services in Pakistan and overseas. The Bank operates 1677 branches domestically, 45 Islamic banking branches and 54 branches outside the Country.

Source: Bloomberg, PSX & IGI Research

#### Syed Daniyal Adil

Research Analyst

daniyal.adil@igi.com.pk

Tel: (+92-21) 111-234-234 Ext.: 973

## Commercial Banks

### HBL in safe harbor; attractive valuation keeps 'Buy' call intact

- Following New York State Department of Financial Services (NYSDFS) penalty, HBL's 9MCY17 earnings and management brief provides an opportunity to gauge progress made towards business restructuring.
- De-risking of loan portfolio and low interest environment is likely to keep pressure on bank's NIM.
- we remain confident on bank's fee income growth, wherein, we project ~11% CAGR over the next 5 years
- We expect admin cost growth restricted to under ~8% for the next 3 years forward, on average, which under tough revenue environment should help drive EPS growth
- In the management's view, maintaining CAR around ~15% is the utmost priority of the bank
- We expect dividend payout to normalize starting CY18, albeit comprising of a slightly lower payout ratio - 50% compared to historical 60-65%
- While making provision for 3QCY17 tax, the bank has not considered penalty amount as tax deductible despite believing it to be so, after consultation with its advisors (per share impact of PKR 5.7), which we have not incorporated in our valuation.
- With Dec-17 target price of 225.8/share, we see 34.4% upside from its last close

#### "Overweight" stance intact despite penalty led dent on growth prospects

Following New York State Department of Financial Services (NYSDFS) penalty, HBL's 9MCY17 earnings and management brief provides an opportunity to gauge progress made towards business restructuring. To recall, on a yearly basis and excluding the USD 225mn penalty charge, the bank's earnings dropped by ~2% to PKR 25.2bn (or PKR 17.0/share) in 9MCY17. However, as a result of this one-time penalty, the stock has massively underperformed - down by 38.5%YTD.

Evidently, the penalty has dented bank's capital, but management's view to reduce the risk across its portfolio should help consolidate capital position. Moving forward, given tough revenue environment, management focus on cost cutting without compromise on growth levers would be key driver of earnings growth. Resultantly, we remain positive on bank's performance outlook and maintain our overweight stance on HBL.

#### Margin compression likely to persist as asset yields taper off

For the period under review, bank's NIM compressed by 38bps to 3.9%, dragged down by weak yields across its loan portfolio and maturing investment bonds – earnings yield dropped to average 6.4% in 9MCY17 compared to 7.1% last year. On expense side, deposit cost hiked by ~11%YoY despite higher deposits falling into CASA category – +16% YoY growth in CA to PKR 602bn in 9MCY17. Looking

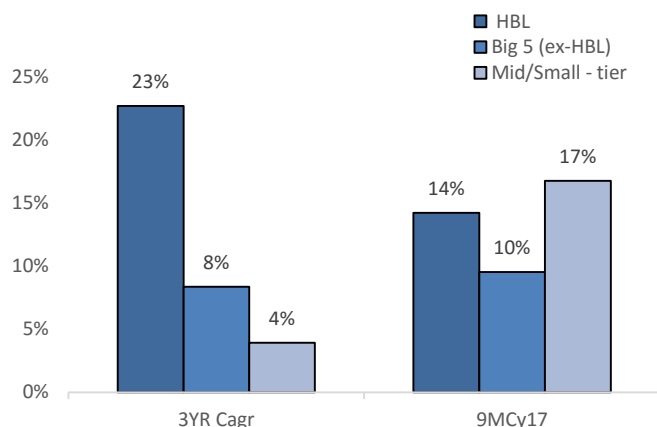
ahead, de-risking of loan portfolio and low interest environment is likely to keep pressure on bank's NIM. As a consequence, management guided a further 20bps reduction in NIM for 4QCY17.

#### HBL's growing footprint key to maintain non-interest income rise

Similar to bank's PKR 7.8bn treasury income recorded in 9MCY17 (up by +43%), fee income also displayed a healthy growth, positing +14% rise to PKR 15.5bn, driven by expanding remittances market, loan growth and asset management fee. On the outlook, although treasury income is likely to soften up, yet we remain confident on bank's fee income growth, wherein, we project ~11% CAGR over the next 5 years, in-line with management guidance of 9-11% growth.

Exhibit:

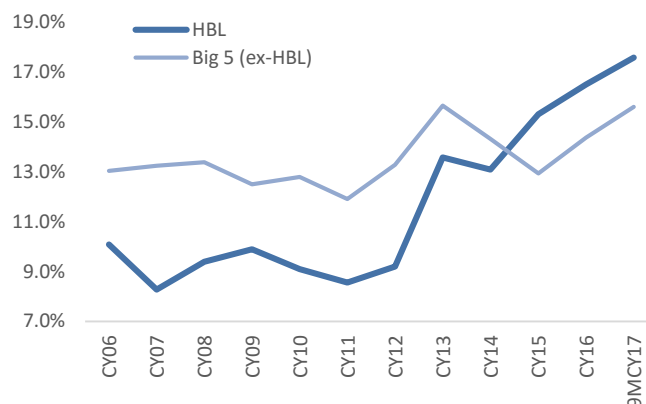
**Fee income growth has been strongest in HBL compared to its peers**



Source: IGI Research, Company Financials, Bloomberg

Exhibit:

**...and now fee income forms a key part of bank's total revenue outpacing its peers in less than 5Years time period**

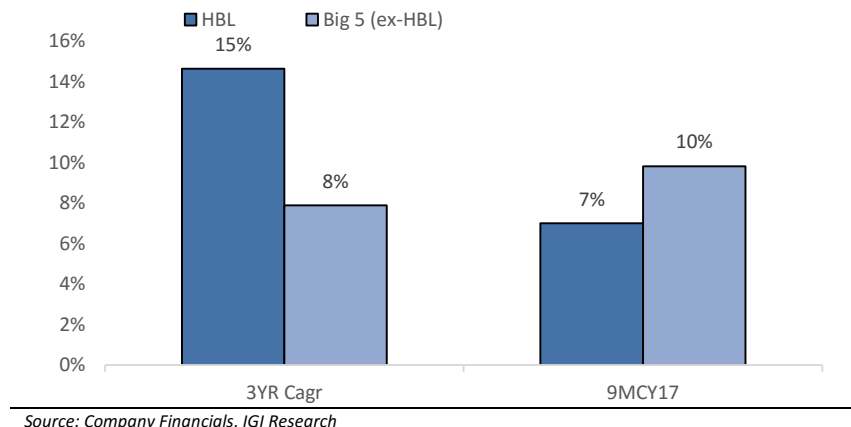


#### Operating cost remain in-line with guidance, excluding consolidation of MFMB and remediation cost of NY branch

HBL management continues to deliver on cost front despite heavy branch and technology expenditure. For the period 9MCY17, operating expense showed a run-off in overall administrative cost, up by +12% to PKR 45.8bn, with major pick-up seen in 3Q. The higher cost during the period, as per the management, ascribes to consolidation impact of First Micro-Finance Bank (FMFB), a subsidiary acquired in CY16, and remediation efforts being carried out in NY branch. The management considers these two costs as one-offs, excluding which operating cost is in-line with management's earlier guidance at 7%. We expect admin cost growth restricted to under ~8% for the next 3 years forward, on average, which under tough revenue environment should help drive EPS growth.

Exhibit:

**Admin cost are finally coming-off, registering +7%YoY growth in 9MCY17 excluding the one-offs**



#### **A combination of capital injection and de-risking to rescue deteriorating capital ratios**

The penalty trimmed off bank's CAR by almost 2%, down to 13.6% by 9MCY17 end. The bank's CET1, as per our estimates, roughly stands at 10.38% inclusive of penalty, well above required ratio of ~8.78%, which rules out the need to raise T1 capital. However, in the management's view, maintaining CAR around ~15% is the utmost priority of the bank. Hence a possible T2 capital injection might be on the cards. We estimate, that for the bank to bring CAR to 15%, it may need to issue additional PKR 20bn worth of T2 capital. However, we see some combination of balance sheet de-risking and T2 capital issue to be a more plausible approach. Nevertheless, in either case, the issue will be earning accretive given low spread on corporate TFC.

#### **Dividend curtailed to restore capital buffer; Payout likely to normalize starting CY18**

While the bank has had a history of maintaining high dividend payout, recent penalty imposition has put a question mark on the bank's on-going payout strategy. Referring to the payout, management's stated priority remains maintaining adequate capital (~15% CAR) for which dividend has been curtailed. Up until 9MCY17, the bank has paid out a cash dividend of PKR 7.0/share, skipping 3QCY17. We expect dividend payout to normalize starting CY18, albeit comprising of a slightly lower payout ratio - 50% compared to historical 60-65%.

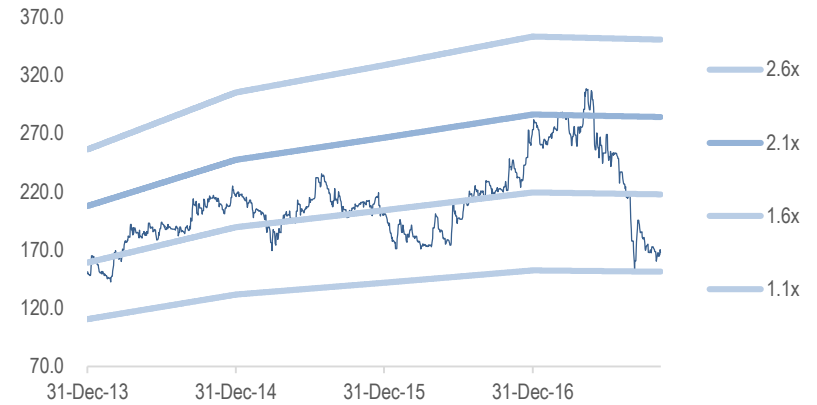
#### **Inexpensive valuation; trading at FY17E P/B of 1.3x**

While making provision for 3QCY17 tax, the bank has not considered penalty amount as tax deductible despite believing it to be so, after consultation with its advisors (per share impact of PKR 5.7). Accordingly, we have not incorporated this in our valuation. The sell-off in wake of imposed penalty has made the scrip attractive with HBL trading at a CY 17E/18F P/B of 1.3x/1.2x, lower than 1.7x/1.7x CY17E/18F P/B of MCB and 1.4x/1.3x CY17E/18F P/B of

UBL. With fundamentals and growth factors intact, we see the bank grossly undervalued at its current price level and hence maintain our **“BUY”** stance. Thus, with our Dec-17 target price of 225.8/share, we see +34.4% upside from its last close.

Exhibit:

**HBL trading at the lowest P/B band in last 3 Years**



Source: Company Financials, IGI Research

## Habib Bank Limited (HBL)

Current Price (PKR):	168					Target Price (PKR):	226					Upside	34					Recommendation	BUY
Period end (DEC) - PKRbn	CY15A	CY16A	CY17E	CY18F	CY19F	Period end (DEC)	CY15A	CY16A	CY17E	CY18F	CY19F								
Income Items						Valuation													
Net Interest Income	75.0	82.0	80.9	85.6	96.4	P/E (X)	7.7	7.2	27.6	6.7	5.9								
Fee Income	17.1	18.7	20.8	23.6	26.9	P/B (X)	1.3	1.3	1.3	1.2	1.1								
Non Interest Income	36.6	31.1	34.6	34.8	38.5	Div. Yld (%)	8.3	8.3	4.2	7.1	10.1								
Total Op. Revenues	111.6	113.0	115.5	120.5	134.9	Payout	64.2	60.0	115.0	50.0	60.0								
Operating Exp.	50.0	55.8	60.3	64.3	68.8	Bonus (%)	-	-	-	-	-								
Pre-Prov. Profits	61.7	57.2	55.2	56.1	66.1	ROE	18.2	18.1	4.6	17.9	18.6								
Provisions	4.5	0.7	1.5	(0.1)	2.3	ROE (tier 1)	20.9	20.9	5.3	20.7	21.3								
Pre-tax Profits	57.2	56.5	53.7	56.2	63.8	Asset Quality													
Tax	25.2	22.3	21.1	19.7	22.3	NIMs	4.2	4.0	3.5	3.3	3.2								
Post-tax Profits	32.0	34.2	8.9	36.6	41.5	IEA / Total Assets	88.7	86.7	87.3	87.6	87.8								
Balance Sheet Items						Cost of Deposit	3.0	2.3	2.5	2.6	2.6								
Gross Advances	702.6	817.3	915.3	1,043.5	1,189.5	IDR	77.7	71.3	71.1	70.9	70.8								
NPLs	76.8	75.4	76.3	77.3	79.1	ADR	39.0	39.7	40.8	40.8	40.6								
Net Advances	637.4	748.5	846.2	975.0	1,119.3	Infection Ratio	10.9	9.2	8.3	7.4	6.7								
Invetments	1,270.8	1,344.4	1,474.3	1,696.5	1,952.2	Coverage Ratio	85.8	86.4	86.1	86.1	86.1								
IEA	1,967.1	2,172.9	2,408.5	2,772.9	3,188.4	Growth Rates													
Non-IEA	251.4	334.3	349.5	392.7	441.8	Advances	6.2	16.3	12.0	14.0	14.0								
Total Assets	2,218.4	2,507.2	2,758.0	3,165.6	3,630.1	NPL Growth	(3.4)	(1.8)	1.2	1.3	2.3								
Deposits	1,634.9	1,886.0	2,073.9	2,391.4	2,756.6	IEA	21.1	10.5	10.8	15.1	15.0								
CASA	1,344.2	1,544.9	1,699.5	1,987.9	2,304.3	Deposits	7.2	15.4	10.0	15.3	15.3								
IBL	1,977.3	2,250.0	2,500.7	2,887.0	3,332.3	NII	8.6	9.2	(1.3)	5.8	12.5								
Total Liabilities	2,035.8	2,310.9	2,563.4	2,951.5	3,398.8	Non Interest Incor	55.6	(15.1)	11.3	0.7	10.7								
Share Capital	14.7	14.7	14.7	14.7	14.7	Operating Exp.	17.3	11.6	8.1	6.7	6.9								
Total Equity	182.6	196.3	194.6	214.1	231.3	Profits	0.5	7.0	(73.9)	309.6	13.5								
Cashflow Items						Equity	7.7	7.5	(0.9)	10.1	8.0								
Net Income Adj. Or Dep/Amor.	-	37.7	12.8	40.6	45.8	Du-Pont Analysis													
Changes In Working Capital	-	(25.0)	(7.9)	(11.4)	(12.7)	NIMs	4.2%	4.0%	3.5%	3.3%	3.2%								
Operating Cashflow	-	12.7	4.9	29.3	33.0	Non-II / Rev.	32.8%	27.5%	29.9%	28.9%	28.6%								
Investing Cashflow	-	60.5	(43.6)	(37.6)	(39.0)	Cost / Income	44.8%	49.3%	52.2%	53.4%	51.0%								
Financing Cashflow	-	0.2	49.1	46.5	49.8	Cost / Asset.	2.3%	2.2%	2.2%	2.0%	1.9%								
Closing Cash	167.3	238.4	248.9	287.0	330.8	Pre-prov/ ROA	3.0%	2.4%	2.1%	1.9%	1.9%								
Per Share Data						Prov. / ROA	0.2%	0.0%	0.1%	0.0%	0.1%								
EPS (diluted)	21.8	23.3	6.1	24.9	28.3	Tax Rate	44.1%	39.5%	39.2%	35.0%	35.0%								
DPS	14.0	14.0	7.0	12.0	17.0	ROA	1.6%	1.4%	1.2%	1.2%	1.2%								
BVPS	124.5	133.8	132.6	146.0	157.7	Asset / Equity	11.6	12.5	13.5	14.5	15.3								
Capital						ROE	18.2%	18.1%	16.7%	17.9%	18.6%								
CAR %	17.0	15.3	13.2	14.2	13.7	Non-Financial													
RORWA	5.1	3.1	0.7	2.4	2.5	Branches	1,663	1,677	1,697	1,717	1,737								

SOURCE: IGI Research, Company accounts

UPDATED: 14-Nov-17

## Important Disclaimer and Disclosures

**Research Analyst(s) Certification:** The Research Analyst(s) hereby certify that the views about the company/companies and the security/securities discussed in this report accurately reflect his or her or their personal views and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst(s) is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

**Disclaimer:** The information and opinions contained herein are prepared by IGI Finex Securities Limited and is for information purposes only. Whilst every effort has been made to ensure that all the information (including any recommendations or opinions expressed) contained in this document (the information) is not misleading or unreliable, IGI Finex Securities Limited makes no representation as to the accuracy or completeness of the information. Neither, IGI Finex Securities Limited nor any director, officer or employee of IGI Finex Securities Limited shall in any manner be liable or responsible for any loss that may be occasioned as consequence of a party relying on the information. This document takes no account of the investment objectives, financial situation and particular needs of investors, who shall seek further professional advice before making any investment decision. This document and the information may not be reproduced, distributed or published by any recipient for any purpose. This report is not directed or intended for distribution to, or use by any person or entity not a client of IGI Finex Securities Limited, else directed for distribution.

**Rating system:** IGI Finex Securities employs three tier ratings system, depending upon expected total return (return is defined as capital gain exclusive of tax) of the security in stated time period, as follows:

Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

**Risk:** Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security(ies)/company(ies) in the report will be achieved.

**Basic Definitions and Terminologies used:** **Target Price:** A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment. **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E:** Price to Earnings ratio of a company's share price to its per-share earnings. **P/B:** Price to Book ratio used to compare a stock's market value to its book value. **DY:** The dividend yield is dividend per share, divided by the price per share.

IGI Finex Securities Limited

**Research Analyst(s)**

Research Identity Number: BRP009

© Copyright 2017 IGI Finex Securities Limited

## 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: 973	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

#### Faisalabad Office

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

#### Multan Office

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

#### Peshawar Office

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

#### 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

#### 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

#### Abbottabad Office

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

#### Sialkot Office

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