



July 09, 2010

Pakistan Research

Banks | Detailed report

Allied Bank Ltd...

SELL

Initiating coverage...

We initiate our coverage on Allied Bank Limited (ABL) which is Pakistan's fifth largest bank in terms of chunk of deposits of Rs329bn and a total asset base of Rs418bn. ABL is yielding CY10 P/E multiple of 6.4x and P/BV multiple of 1.6x. For valuation purposes, we have used *Justified Price to Book* methodology which yielded multiple of 1.3x, wherein it illustrates target price of Rs 55.7/share.

- For CY10, we expect ABL to show a slight decrease in bottom line. Our financial model spells net earnings of Rs6.9bn with EPS of Rs8.82 as against CY09 net earnings of Rs7.1bn spelling EPS of Rs9.11.
- This illustrates a mere 3% decrease in y-o-y net earnings which is at the pretext of our not so progressive view of Pakistan's economy during CY10 that could spur real corporate or investment banking growth wherein we believe ABL model capsules a main thrust.
- ABL recorded 21.0% and 18.0% increase in its NPLs during CY08 and CY09 respectively. Despite significant surge in NPLs, bank will not require any incremental increase in the provisions against those NPLs as its coverage ratio remained maintained at 77.0% in the last two years or so.
- We expect net interest income (NII) of the bank to show relatively low growth as compared to CY09, during CY10. Bank showed phenomenal growth of 35% in core interest earned during CY09 which we expect not likely to be repeated in CY10 given lack of pace in core financing. That's why we believe, NII to reach at Rs18.6b during CY10 over Rs18.7b in CY09.
- Net interest margin NIM of the bank during the last three years, hovered around 5.0% - 6.0% on the back of high yields on advances portfolio. Interest rates are on the higher side in the economy but slight decline in NII is likely to offset the impact. We believe NIM of the bank is expected to be in the range of 5.7% - 5.9% during CY10.
- Non interest income is expected to grow by 6.0% during CY10. Fee, commission and brokerage income contributes 48% of the total non mark-up income of the bank on average. Its contribution in CY10 is likely to be strengthened further and is likely to reach at Rs3.5b over Rs2.7b in CY09.
- Banking sector balance sheet is under consolidation and hence ABL is not an exception. We have already witnessed 4.34% and 3.38% decline in bank's advances and deposits respectively. We expect advances and deposit of ABL to show 4.0% and 2.0% decline during CY10 respectively.

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ABL Price Data

Closing Price (Rs.)	57.12
12m price range (Rs.)	34.53-66.00
Market Cap (Rs bn)	44.58
Market Cap (USD bn)	0.52
Outstanding Shares (mn)	782.1
52-weeks high	66.00
52-weeks low	34.53
Avg. Daily volume (mn)	0.393
Face Value (Rs.)	10

Based on 02nd, July, 2010 closing

ABL target price	Rs 55.70
CY10 PE multiple	6.61x
CY10 P/BV multiple	1.26x
3-year exp. ROE avg	22%
CY10 NIM	5.7%

KIBOR relationship vis-à-vis Industry Advances

KIBOR has inverse relationship advances growth. As seen in the table below, the historic KIBOR rate in the last six years and the corresponding industry deposits growth.

KIBOR rates started increasing during CY05, since then these rates keep on increasing and hindering the advances growth. KIBOR rates have direct relationship with the benchmark discount rates and since discount rates have increased in the last couple of years due to demand and inflationary pressures in the country's economy.

Year	KIBOR	Industry advances growth	ABL Advances growth
CY04	3.3%	2.6%	40%
CY05	8.2%	2.1%	71%
CY06	9.9%	1.4%	27%
CY07	10.1%	0.8%	18%
CY08	12.8%	1.4%	25%
CY09	13.0%	0.2%	12%

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KIBOR sensitivity analysis

We have done a sensitivity analysis of KIBOR with profitability of ABL. We have taken benchmark 6-month KIBOR rate 12.5% in our model. Based on this, the forecasted earning per share (EPS) for CY10 is Rs8.66.

Though, this working is showing the likely impact on the CY10 forecasted EPS, if any decline occurs in the KIBOR rates. But this sensitivity also helps to determine the impact of downward revision of KIBOR rates on the EPS of CY11 and CY12 as well.

Sensitivity	KIBOR			
	12.50%	12.00%	11.50%	11.00%
CY10				
EPS (Rs.)	8.66	8.05	7.43	6.82
NIM	5.7%	5.4%	5.2%	5.0%

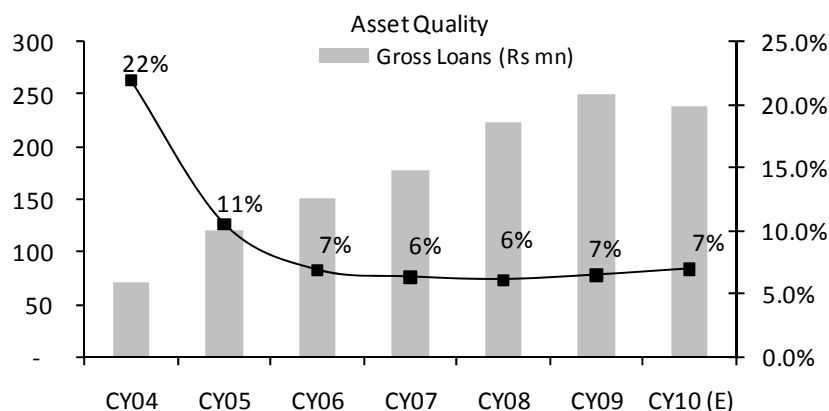
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The reason for which we did this sensitivity analysis is the possibility of downward revision in the discount rates. Since discount rate has direct relation with the KIBOR rates, we can see decline in these rates also. For the last three years, interest rates are very high in our economy. Persistent inflationary and demand pressures were the major reasons behind high interest rates.

High interest rates have been hindering the industry growth tremendously. GDP growth recorded at its low level of 2.0% in last FY09. If the government gets any success in controlling the inflation, then interest rates will come down. Decline in the interest rates and KIBOR will have positive impact on the banking sector credit growth. Currently SME sector, private sector and industries can not afford to borrow money at high rates because of increasing cost of doing business. If interest rates going down, then it will boost economic activity.

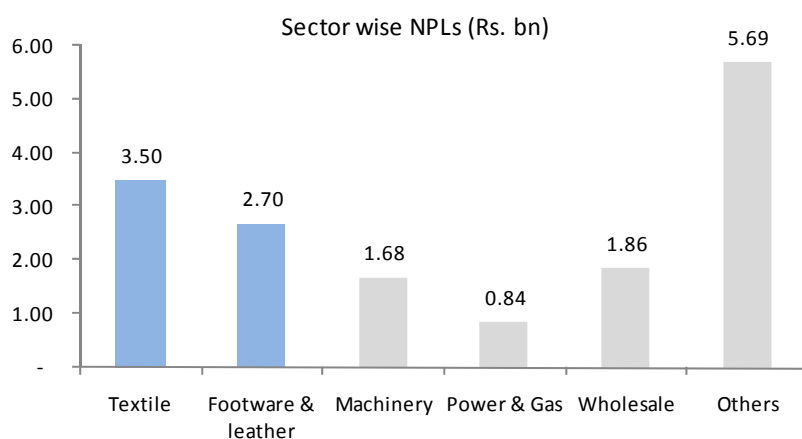
Asset Quality...

Major concern for banking sector is the balance sheet, which has been hit badly by increase in the Non Performing Loans. ABL's loan book has also witnessed an upsurge in its NPLs which has increased to Rs16.28bn in CY09 as against Rs13.77bn in CY08, thus showing a net increase of Rs2.50bn. But considering the size of the loan book of the bank, and the infection ratio of 6.5% in CY09 was slightly above over 6.2% of the previous year; whereas coverage ratio remained at previous year's level of 77%. No benefit of FSV has been taken while determining the provision against NPLs during CY09.



Segment wise NPLs...

Segment wise data shows the textile sector and footwear and leather garments are the major contributor to the NPLs of the bank in CY09. But the point to be noted here is that bank has already provided enough provisioning against these bad loans to protect the bank incremental provisioning in the coming years.



Earnings Outlook...

Our full year earnings forecast for ABL is Rs.6.77bn (EPS: Rs8.66) in CY10, decline of 5.0% expected over the corresponding CY09 earnings of Rs.7.1bn (EPS: Rs.9.11). Shrinking spreads and relatively less growth in the core interest income is expected during CY10 over CY09, which will be one of the main reasons behind the anticipated decline in the bottom line.

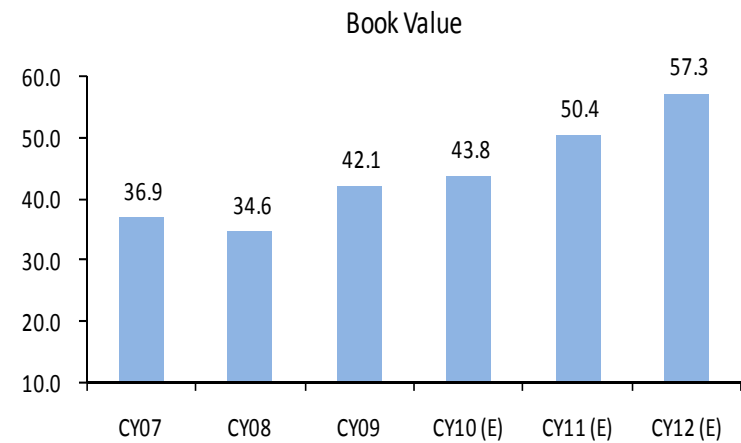
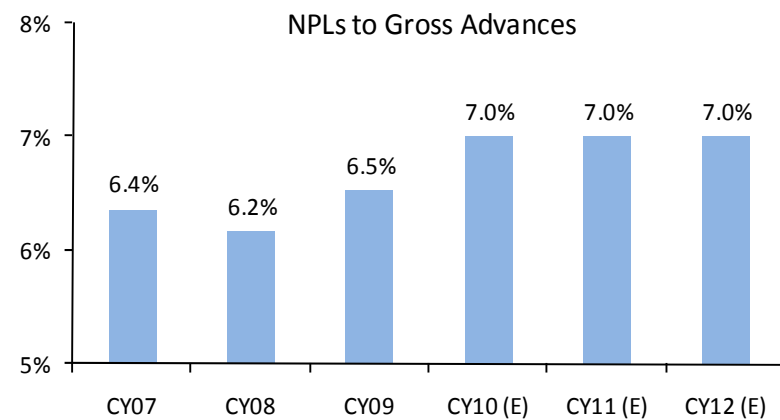
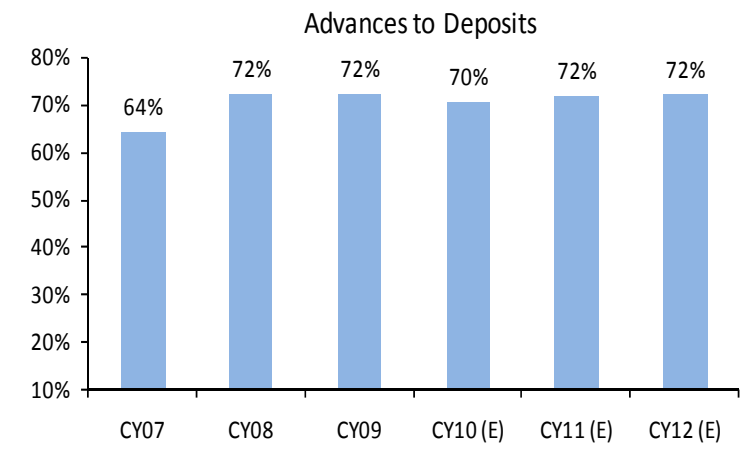
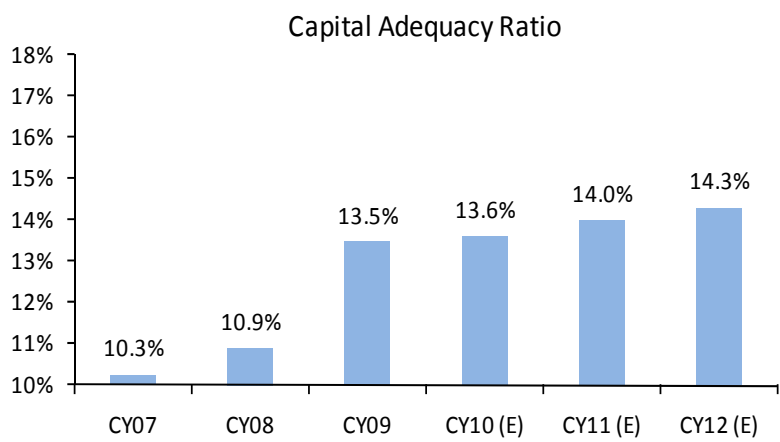
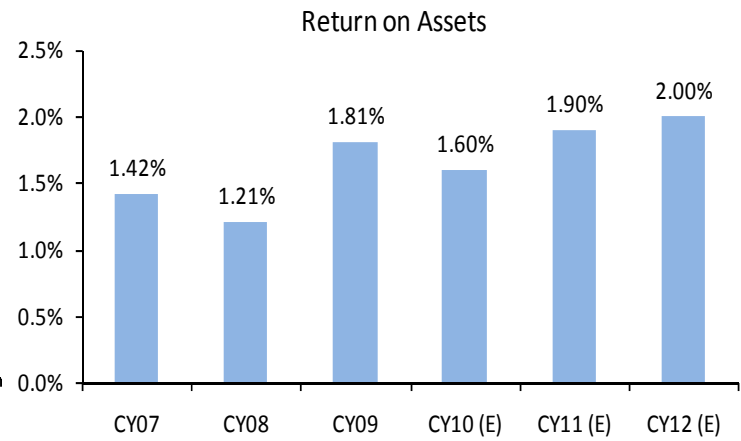
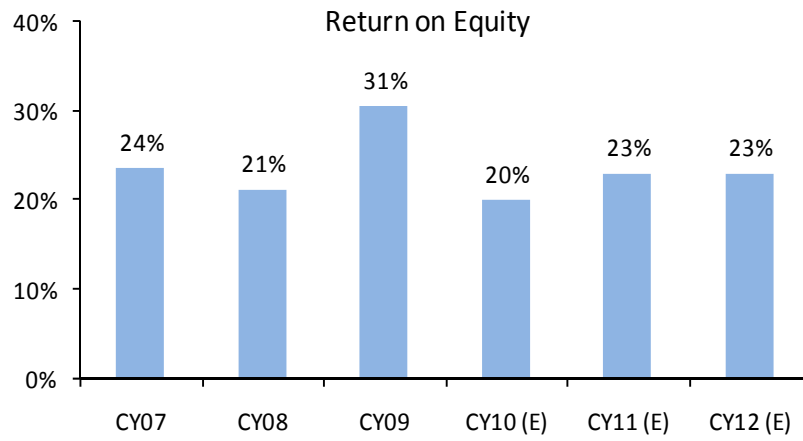
Fundamental Valuation...

We initiate our coverage on Allied Bank Limited (ABL). In terms of price, ABL is currently yielding at CY10 P/E of 6.61x and P/BV of 1.26x. For valuation purpose, we used Justified P/BV multiple approach, which gives 1.2 x, wherein our target price for CY10 is 55.7/share.

We recommend SELL at current levels

CAPM assumptions	
Beta	1.12
Risk free rate	12.70%
Risk Premium	7.00%
Terminal growth	5.00%
ROA	2.00%
ROE	19.00%
BVS Rs/sh	45.4
P/BV (x)	1.26
P/E (x)	6.61
RRR	21.00%

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See ABL financial projections on the next page

Income Statement Rs mn	CY07	CY08	CY09	CY10F	CY11F	CY12F
Interest earned	21,201	30,571	41,122	44,063	48,652	50,628
Interest expensed	10,093	17,273	22,422	25,450	26,316	25,524
Net interest income	11,108	13,298	18,700	18,614	22,336	25,103
Provisions	2,713	1,372	3,163	2,372	3,230	3,526
Net income after provisions	8,394	10,142	14,202	14,988	18,131	20,452
Non interest income	3,920	4,897	5,958	6,296	7,801	8,633
Fee, commission	2,063	2,307	2,708	3,520	4,224	5,069
Div income/gain on sale of investment	147	1,420	1,375	1,444	1,516	1,592
Income from dealing in FCY	195	959	762	838	880	924
Other income	77	59	36	40	44	48
Total income	12,314	15,039	20,160	21,284	25,932	29,086
Non-interest expenses	6,361	8,918	9,624	10,864	12,265	13,845
Profit before tax	5,953	6,121	10,536	10,420	13,667	15,241
Profit after tax	4,076	4,157	7,122	6,773	8,883	9,907
EPS (Rs)	5.21	5.31	9.11	8.66	11.36	12.67

Balance Sheet Rs mn	CY08	CY09	CY10F	CY11F	CY12F	CY12F
Assets						
Cash and balances with treasury banks	29,740	23,654	26,436	32,343	32,658	33,379
Balances with other banks	668	2,097	1,280	3,234	3,919	3,338
Lendings to financial Institutions	18,419	15,793	28,123	22,466	22,650	24,959
Investments	83,958	82,647	94,789	96,665	98,900	102,590
Advances	168,407	212,972	237,344	227,316	230,837	235,454
Other assets	10,705	17,370	17,955	16,553	17,871	17,858
Operating Fixed assets	7,549	11,134	12,447	14,554	15,349	15,688
	320,110	366,696	418,374	413,132	422,183	433,266
Liabilities						
Bills payable	3,494	2,952	3,162	3,234	3,266	3,338
Borrowings from financial institutions	22,934	27,778	39,819	33,460	36,089	36,807
Deposits and other accounts	263,972	297,475	328,875	323,433	326,576	333,790
Sub-ordinated loans	2,499	2,498	5,497	5,497	5,497	5,497
Other liabilities	7332	13636	11,059	12,010	12,511	11,306
Deferred liabilities	-	-	1,871	0	0	
	300,231	344,340	388,414	377,635	383,939	390,739
Net assets	19,878	22,356	29,960	35,497	38,244	42,527
Capital						
Share Capital	5,386	6,464	7,110	7,821	7,821	7,821
Reserves	6,051	5,805	6,583	5,325	6,985	7,015
Unappropriated profit/losses	6,971	8,537	12,199	14,558	19,236	24,886
	18,408	20,805	25,891	27,704	34,042	39,722
Surplus on revaluation of assets	1,470	1,550	4,069	7,793	4,202	2,804
	19,878	22,356	29,960	35,497	38,244	42,527