



May 6, 2010

Pakistan Research

Banks | Strategy

KSE100 Closing
10,561.74 (+93.98 points)

Economy to influence banking sector outlook

Broader optimism in FY11 economic outlook *per se* peoples agenda

Current economic slowdown in Pakistan has almost hit every sector. During CY08 – CY10, banking sector profitability has also gone down considerably (24% in CY08 alone) in the wake of high incidence of non – performing loan portfolio (NPL) as well as liquidity crunch albeit central bank's tight monetary stance to check affects of inflation.

The government of Pakistan is expected to pursue pro-people policy from FY11 onwards by spurring growth especially in the ailing private sector hitherto seeing broader political stability drawn from the unanimous passage of 18th amendment. In that context, we may expect economic growth to see signs of recovery in the trajectory of 4% in FY11 mainly due to some base affect change. We believe, present political government would be mindful of the fact that it has already entered into its 3rd year of rule and it would have to put better show as against present abysmal show in order to fastened chances for the next polls in 2013. We expect better development spending that may change investor outlook. As of Jan-Mar'10 our economy remained reckless in terms of real growth, never the less, gained some momentum at the end of March due to spate of net foreign inflows in the banking system (ostensibly due to increased inward remittances of up to USD 6.6 bn from Jul – Mar'10). The figures of Mar'10 has exacerbated to USD 763.7 mn alone showing y-o-y up-tick of 3.3%. Central bank has maintained policy rates at 12.5% given persistent Inflationary trends in the economy (benchmark CPI July – Mar'10: above 11%). Rising fuel prices, increase in the prices of food items and government borrowings for budgetary support simply fuelling inflation in the near future. On the external side, Pakistan's trade deficit narrowed 19% during Jul-Feb FY10 to US\$9.42bn from US\$11.69bn reported in the same period last year.

Since SBP has now allowed 30% benefit of forced sale benefit (FSV) over collaterals, banks profitability is now on the improving side (insinuation of ineffective approach). Due to aforementioned reason alone, combined profitability of the banks (including 23 commercial banks) grew 24% over in 1Q-CY10, as against same period last year.

1QCY10 key takeaways from the banking sector

- Net Interest Income grew 3% y-o-y amounted to Rs64bn
- Non Interest Income grew by 15% y-o-y amounted to Rs22bn
- Decline in provisions against Non performing loans (NPLs) given spate of loan losses in consumer segment during last year
- Average interest rate spreads during Jan-Mar'10 was 7.3% (big five banks bias continues)

Banking sector during 1Q-CY10 posted Rs19.91bn net earnings which was previously reported Rs16.1bn in 1Q-CY09, illustrating 24% increase y-o-y basis. Lending rates have touched a high above 14% with spreads of the big five banks viz. NBP, MCB, UBL, HBL & ABL remained firmed up 5.5% - 7% approx and also according to the data provided by the Central Bank, the average interest rate spreads during Jan-Mar '10 was 7.3%. Furthermore, increase in bottom line is mainly due to decrease in the major chunk of provisions against NPLs during 1QCY10 which is otherwise hiding poor lending activity.

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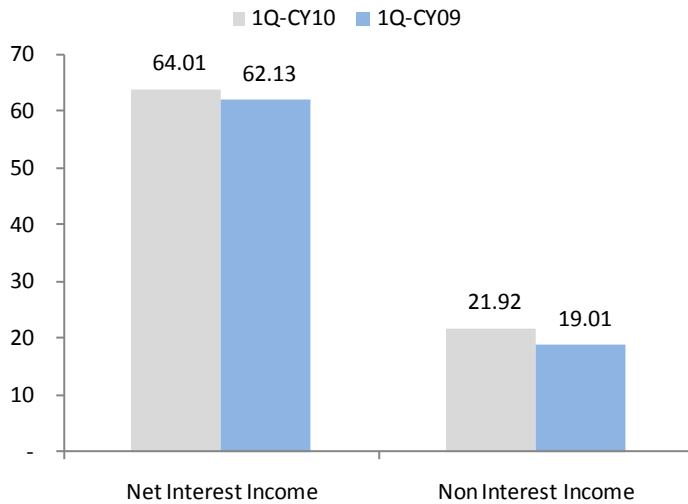
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Market weight

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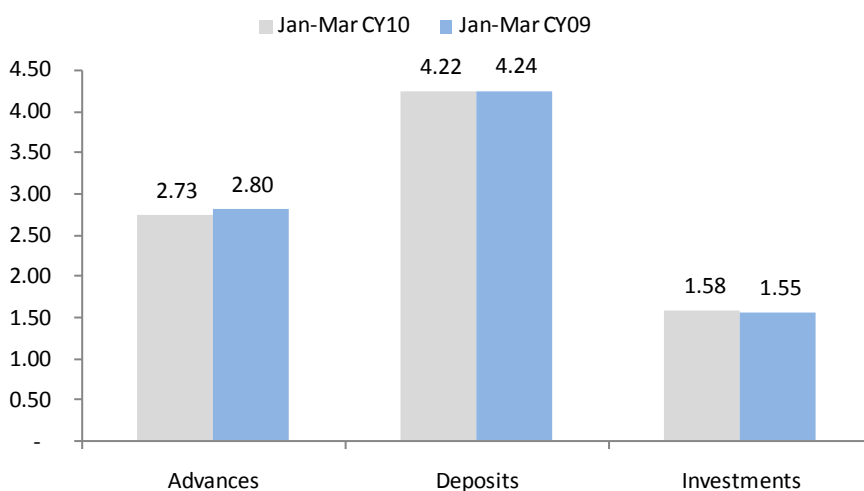
| | |
|---------------------|-----|
| KSE volume mn | 121 |
| Market Cap US \$ bn | 35 |

Net Interest Income (NII) of the banking sector during the said quarter remained flat and grew just 3% to reach at Rs64.01bn over Rs62.13bn in the corresponding quarter of 1Q-CY09. Banking sector is still witnessing poor advance led growth due to peculiar issues wherein total loan book resulted in a decline during Jan-Mar'10. *Non interest income* on the other hand registered an impressive growth of 15% with the gains of the stock market perhaps (KSE 100 increased by 8% in annualized terms; wherein few value stocks have shown 25% - 50% increase). The total non – core income reported Rs21.92bn as compared to Rs19.01bn in the same quarter last year.



As discussed earlier, there was a significant decline in the provisions against NPLs of the banks. Most of the banks are maintaining their coverage ratio at near 70% and adopted a prudent approach towards loan disbursement to minimize their NPLs. Total provisions made by the banks in the first quarter is Rs12bn declined by 24% from Rs15.89bn.

We see looming consolidation phase with regards to advances growth. Removal of long term and bad loans from loan book causing total advance of the banks to narrowing down by 2% during Jan-Mar'10 and reached at the level of Rs2.73tr. Deposits on the other hand remained at the level of Rs4.2tr level. Banks are now trying to increase their CASA in order to cut down the cost of deposits in the future. Total Investments also showed a flat growth of 2% during the period and reached at Rs1.58tr.



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Banking Sector Profitability 1Q-CY10

Rs in Bn

| Banks | PAT | | EPS | | Chg % |
|-------------------------|--------------|--------------|---------|---------|------------|
| | 1Q-CY10 | 1Q-CY09 | 1Q-CY10 | 1Q-CY09 | |
| Allied Bank | 1.78 | 1.45 | 2.27 | 1.85 | 23% |
| Arif Habib Bank | (0.21) | (0.14) | (0.43) | (0.28) | 54% |
| Askari Bank | 0.33 | 0.32 | 0.51 | 0.49 | 3% |
| Atlas Bank | (0.37) | (0.45) | (0.74) | (0.90) | -18% |
| Bank Alfalah | 0.59 | 0.45 | 0.43 | 0.33 | 31% |
| Bank AlHabib | 0.88 | 0.68 | 1.20 | 0.93 | 30% |
| BankIslami | 0.05 | (0.85) | 0.09 | (1.60) | -106% |
| Bank of Khyber | 0.11 | (0.15) | 0.21 | (0.30) | NM |
| Faysal Bank | 1.69 | 0.26 | 2.77 | 0.42 | 560% |
| Habib Bank | 3.60 | 3.48 | 3.60 | 3.47 | 3% |
| Habib Metropolitan | 0.87 | 0.93 | 1.00 | 1.06 | -6% |
| JS Bank | (0.19) | (0.35) | (0.31) | (0.57) | -46% |
| KASB Bank | (0.36) | (0.18) | (0.38) | (0.19) | NM |
| MCB Bank | 4.14 | 4.13 | 5.45 | 5.44 | 0% |
| Meezan Bank | 0.36 | 0.28 | 0.52 | 0.41 | 29% |
| Mybank | (0.02) | (0.79) | (0.04) | (1.49) | -98% |
| National Bank | 4.22 | 4.21 | 3.13 | 3.13 | 0% |
| NIB Bank | 0.02 | 0.40 | 0.01 | 0.10 | -94% |
| RBS | (1.14) | (0.26) | (0.67) | (0.15) | 345% |
| Samba Bank | (0.06) | (0.17) | (0.07) | (0.19) | -61% |
| Standard Chartered Bank | 0.81 | 0.03 | 0.21 | 0.01 | NM |
| Soneri Bank | 0.04 | 0.27 | 0.07 | 0.44 | -85% |
| United Bank | 2.78 | 2.54 | 2.27 | 2.07 | 10% |
| Total PAT | 19.91 | 16.10 | | | 24% |

Outlook weak – grim reality if government does not pursue growth strategy

The outlook of the banking sector is related to government of Pakistan's initiative related to energy sector. If government bails out present energy sector's circular debt of more than let say Rs150bn than it would be banks who would have to take that as 'parked investments' which banks are compelled to so to bail government out. If that case lingers on since Pakistan's electricity tariffs would continue to be mitigated through subsidies, we will see banks to be somewhat long term beneficial owners of energy distribution chain companies.

Secondly, we expect better textile flows in the wake of value added chain prices are increasing. A new phenomenon has emerged wherein China will lessen its cotton production and import yarn from the rest of the world which is pushing cotton and value added chain prices on the higher side. This we feel is good news for banking sectors trade finance business. However, chronic power shortage in Punjab province is a threat to that argument. However, we do not see any major policy shift towards growth from the government given fiscal constraints (fiscal deficit is more than 5% thus breaching IMF covenants) and government is not likely to put lot of disbursements under PSDP as against actual announcements of Rs500bn odd grant in coming FY11 finance bill.

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However, big five banks to muster high lending rates of 14% at least up to 3QCY10. Some of the banks such as MCB is already banking on low cost deposit strategy, however, second tier banks will see a tough ask to not only increase paid ups but also deposit base. Tight monetary stance and liquidity crunch expected to remain in the system. Increase in the worker remittance and foreign inflows will help in easing pressure on rupee for some time.

1QCY10 Updated PBV and PER snapshot

| Reported banks | Tracker | PBV* | PER** | Comments |
|--|---------|------|-------|-----------------------------|
| Mybank Limited | MYBL | 0.39 | NE | Under performers |
| JS Bank Ltd. | JSBL | 0.4 | NE | Under performers |
| Soneri Bank Limited | SNBL | 0.56 | 30.65 | Acquisition & merger target |
| Bankislami Pak | BIPL | 0.56 | 139.5 | Under performers |
| Atlas Bank Ltd. | ATBL | 0.63 | NE | Under performers |
| Standard Chartered Bank Pakistan Limited | SCBPL | 0.64 | 9.65 | NC |
| Arif Habib Bank | AHBL | 0.67 | NE | NC |
| Askari Bank Limited | AKBL | 0.74 | 8.88 | NC |
| Habib Metropolitan Bank Limited | HMB | 1.13 | 7.59 | NC |
| Meezan Bank Ltd. | MEBL | 1.2 | 7.92 | Growing bank |
| United Bank Ltd. | UBL | 1.22 | 6.66 | HOLD |
| Habib Bank Limited | HBL | 1.28 | 6.9 | BUY |
| Bank AL-Habib Limited | BAHL | 1.75 | 6.84 | NC |
| MCB Bank Limited | MCB | 2.28 | 9.9 | BUY |

Standard Capital Securities Research / www.scstrade.com stock screening search engine

*PBV is updated to 1QCY10

**PER estimated by search engine

NE = negative earnings

NC = Not covered

*Please note that some other banks quarterly a/cs have yet to come

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www.scstrade.com Stock Screening search engine update

| Best expected P/E stocks | (x) | Best stocks based on low historical P/E | (x) |
|---|-------------|---|-----------|
| J.D.W.Sugar Ltd | 1.27 | Fecto Cement | 1.31 |
| Gadoon Textile Mills | 1.36 | Packages Ltd | 2.70 |
| Dadabhoy Cement | 1.42 | D.G.Khan Cement | 3.23 |
| Faysal Bank | 1.57 | Pace Pakistan | 3.50 |
| Southern Electric Power Co | 1.76 | | |
| Overvalued stocks based on expected P/E | (x) | Overvalued stocks based on historical P/E | (x) |
| Soneri Bank | 29.36 | Kohat Cement | 29.10 |
| Dawood Lawrencepur Ltd | 29.31 | Pak Suzuki Motor Co | 28.53 |
| Jahangir Siddiqui and Co | 27.03 | Singer Pakistan | 27.72 |
| Unilever Pakistan | 26.00 | Nishat(Chunian) Ltd | 25.82 |
| BOC Pakistan | 23.53 | Sazgar Engineering Ltd | 24.55 |
| 1-month outperformers vs KSE 100 | (%) | Best stocks based on P/BV | (x) |
| KSE Gain (loss) | 1.09 | D.G.Khan Cement | 0.32 |
| TRG Pakistan | 28.67 | Attock Refinery Ltd | 0.80 |
| Azgard Nine Ltd | 27.02 | Arif Habib Securities | 0.95 |
| Pakistan Services Ltd | 22.35 | Al-Abbas Cement | 0.98 |
| Unilever Pakistan | 22.10 | BYCO Petroleum Ltd | 1.80 |
| 1-month underperformers vs KSE 100 | (%) | Trading Signals | |
| KSE Gain (loss) | 1.09 | Clariant Pakistan | Sell |
| New Jubilee Insurance Co. Ltd | -26.74 | EFU General Insurance | Buy |
| EFU Life Assurance Limited | -25.15 | Fauji Fertilizer Co | Buy |
| Lafarge Pakistan Cement Limited | -23.79 | Habib Metropolitan Bank Ltd | Buy |
| EFU General Insurance | -22.94 | Jahangir Siddiqui and Company Ltd | Buy |
| FIPI update* | (USD mn) | Key Financial markets update | |
| Gross buy | 14.99 | Inflation CPI % (Jul09-Mar10) | 11.29% |
| Gross sell | -3.48 | Forex Reserves (23-April-10) (bn) | \$14.98 |
| Net buy (sell) | 11.50 | Trade Balance (Jul09-Mar10) (bn) | (\$10.92) |
| *source NCCPL website | | 6-Month KIBOR | 12.28% |
| Total foreign portfolio update** | 2,340 | USD - PKR parity | 84.10 |
| **source SBP website | | KSE Market Capitalization (bn) | USD 35.45 |

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