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Sector Update

Banking Sector

Result Review CY15: Bottom line Surge by 16% Y/Y

Mar 17, 2016

In a year marked with harsh policy measures, multi decade low interest rates, banking sector fared relatively well with profitability witnessing a spike of 16% Y/Y in CY15 (excluding Bank of Punjab, Bankislami and Meezan Bank Ltd). On a sequential basis, earnings contracted by 33% Y/Y as banks adopt to low yield environment and forgoing one time gains. Tapering of earnings in 4QCY15 was underpinned by 1) NII income shrinking by 10% Y/Y due to laggard asset re-pricing and lower weighted yield on investments, 2) Significant blip in equity portfolio impairment, and 3) Non-core income declining by 8% Y/Y owing to low forex trading and portfolio gains. In spite imposition of 0.3% WHT on banking transactions, deposits of the industry grew by a healthy 11.54% Y/Y as advances swell by 7.26% Y/Y. Investments, on the other hand, ratcheted up by an astounding 31.66% Y/Y, keeping private credit off take limited.

Earnings Drivers in CY15

- Braving the storm of policies targeting the sectors margins through out the year, banks through foresight managed to post robust increment of 19% Y/Y in NII by investing in high yielding PIBs/T-bills, and strategic re-profiling of deposit mix. JSBL and BAFL remained at the top witnessing jump of 45% Y/Y and 31% Y/Y in NII
- Playing it safe, banks revved up their provisioning coverage against bad loans along with booking pre-emptive provisioning against some advances, driving net provisioning expense to rise by 2.5x Y/Y. With the commodity rout playing havoc with equities prices, ABL, UBL and MCB were the big ticket banks to book substantial impairments on their portfolios (Cumulative: PKR3.4bn)
- Non-mark up income continues to lend support to core operations as it recorded a gain of 20% Y/Y with fee based income and dividend income being the main drivers in addition to one off gains on investments. Liquidating its position in government securities, SBL's non-core income spiked by 3.7x Y/Y followed by 61% Y/Y increase booked by HMB on their PIB portfolio
- Tax incident for the industry blew up by 54% Y/Y with the imposition of one time super tax of 4% on CY14 profits coupled with uniform rate of 35% on all sources of income, taking effective tax rate to 40%. Small tier banks faced the brunt of this harsh measure with SMBL effective tax rate of 67% followed by 47% for SBL

Banking Sector: Earnings Snapshot

PKR mn	CY15	CY14	YoY	4QCY15	4QCY14	YoY
Mark-up Return	833,162	782,740	6%	211,335	242,554	-13%
Mark-up Expense	410,981	428,899	-4%	98,328	116,423	-16%
Net Provisioning	35,899	24,494	147%	13,065	17,569	-26%
Net Mark-up income	386,282	329,347	17%	99,942	108,561	-8%
Non-Mark-up income	181,831	151,720	20%	39,307	42,761	-8%
Expenses	282,199	259,036	9%	75,590	70,456	7%
Profit Before Taxation	285,914	222,031	29%	63,914	81,347	-21%
Taxation	115,262	74,738	54%	23,406	20,925	12%
Profit after Taxation	170,653	147,293	16%	40,508	60,421	-33%

Source: Company Reports & HMFS Research

Profitability of Top 10 - Banks

PKR(bn)	CY15	CY14	Y/Y growth
JSBL	2.03	1.06	91%
SBL	0.43	0.23	90%
FABL	4.22	2.48	71%
HMB	7.66	4.93	55%
SNBL	2.21	1.58	40%
BOK	1.79	1.31	37%
BAFL	7.52	5.64	33%
NBP	19.22	15.03	28%
AKBL	5.04	4.01	26%
BAHL	7.40	6.35	17%

Source: Company Reports & HMFS Research

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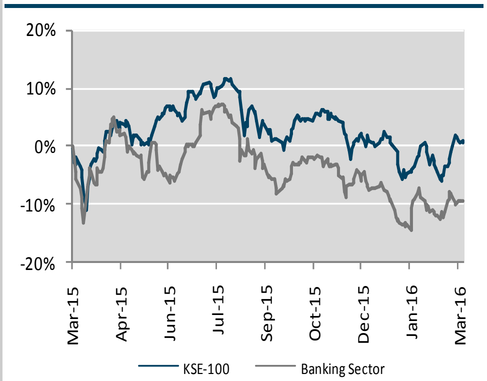
KSE 100 Index Vs Banking Sector



Source: HMFS Research

Profitability of Top 5 Banks

Earnings of the top tier banks (HBL, MCB, UBL, ABL and NBP) in CY15 clocked in at PKR122bn, depicting a robust growth of 11% Y/Y. Taking everyone by surprise, NBP came out the clear winner, witnessing stout increment of 28% Y/Y underpinned by sagacious deposit re-profiling as cost of deposits trickled down by 14% Y/Y. NBP deposits and investments surpassed the industry growth pace, posting surge of 16% Y/Y and 47% Y/Y respectively. Posting robust growth of 12% Y/Y, UBL's bottom line ballooned by 12% Y/Y with 43% of deposits parked in PIB's bearing fruit for the bank as mark-up income swelled by 14% Y/Y. Provisioning expenses jumped by 2.9x Y/Y as provisioning against Yemen exposure as per SBP directives was built up along with bulking general provisioning. HBL witnessed healthy growth of 10% Y/Y in the period under review as investment book grew by 35% Y/Y coupled with 6% Y/Y uptick in advances. Non-core income propelled profitability further as HBL recorded gains on its investments. underpinned by increased investment in government bonds (41% of deposits,↑ 6% Q/Q). MCB's bottom line grew by a nominal 5% Y/Y, as deposit erosion in 2HCY15 plagued the bank however, reversals on NPLs supported earnings expansion. ABL was the laggard in the group, as earnings remained flattish with 1% Y/Y increase as the bank followed stable growth strategy forgoing gains on its PIB book. Bottom-line was hit by PKR1.8bn impairment in 4QCY15 on ABL oil heavy equity book in-line with international commodity slump.

Investment Perspective

Subdued inflation pickup has postponed a reversal in interest rates to CY17, keeping margins for the industry under pressure as sword of reinvestment risk in light of humungous upcoming PIB maturity in Jul'16 looms. China Pakistan Economic Corridor (CPEC) driven credit off take is likely to pickup later than expected, keeping outlook for advances growth in CY16 bleak. Using Justified P/B methodology, our top picks in the sector are HBL with our Dec'16 target price of PKR268/share offering an upside of 27%, along with ABL which offers 34% upside to our Dec'16 provisional target price objective PKR135/share followed by UBL with Dec'16 provisional T/P of PKR212/share.

Rating Definition	Recommendation	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
	Expected Return	> 15.0%	> 5.0% to <15.0%	> -5.0% to <5.0%	> -15.0% to <-5.0%	>-15.0%

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