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The Vantage Point

Commercial Banks

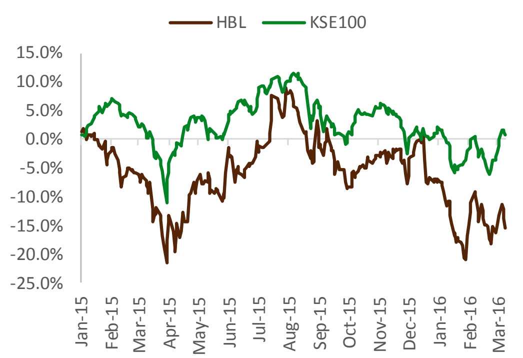
HBL: Lower reinvestment risk but high concerns on credit cost

Habib Bank Ltd

KATS Code	HBL
Bloomberg Code	HBL PA
Price PkR	181.2
Market Cap (PkR mn)	268,316
Market Cap (US$ mn)	2,580
Shares (mn)	1,466.9
52 weeks High	235.53
52 weeks Low	169.40
52 weeks Avg. Trading Volume ('000 sh)	915.12
52 weeks Avg. Trading Value (PkR mn)	182,230.17
Beta 1-Year	0.93

Source: Shajar Research

HBL vs KSE



Source: Bloomberg

Habib Bank Limited - Financial Performance

PkR in Mn*	CY15A	CY16E	CY17F
Net Interest Income	76,761	76,838	84,230
NII after provision	72,426	73,901	80,399
Non-Fund Income	32,265	25,373	28,166
Non-Markup Expense	47,291	51,320	55,700
Profit Before Taxation	57,400	47,954	52,866
Profit After Taxation	35,469	31,170	34,363
Earning Assets Yield	8.82%	7.34%	7.71%
NIMs	4.75%	4.05%	4.00%
Coverage Ratio	92.33%	92.97%	93.66%
EPS	24.18	21.25	23.43
DPS	14.00	15.00	16.00
BVPS	117.16	122.20	130.03

Source: Company Reports, Shajar Research
Note: The projections are on unconsolidated basis
** where applicable*

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- **Post announcement of Habib Bank limited (HBL) CY15 financial results and taking guidance from the conference call, we have incorporated 1) higher loan growth compared to its peers; 2) Lower reinvestment risk (Maturing PIBs/deposit ratio: 5%); 3) higher provisioning costs radiating from overseas advances (20% of total net advances) as evident from the 3ppt rise in infection ratio and, 4) Lower capital gain realization into our projections.**
- **Likewise other banks, HBL would face muted earnings growth in the medium-term, as we exclude PkR3.35/sh gain realized on bond disposal from CY15 EPS. We have not incorporated one-offs such as compensation on tax refunds (EPS Impact: ~PkR2/sh), and realization of accumulated surplus on bonds (PkR7.38/sh) into our calculations.**
- **Our Dec'16 TP of PkR217/sh arrived through Justified P/B methodology offers an upside of 19% and with an expected dividend yield of 8% sets to provide an aggregate return of 25%. We advise investors to remain prudent of the risk emerging from Middle East operations and the result of the inquiry of USA operations.**

Lower reinvestment risk compared to peers'

Against the general consensus of significant headwinds on the earnings of the banking sector due to Jul'16 PIB maturity, the impact on HBL would be limited in our perspective. As per our estimate, PkR81bn PIBs would mature (5% of deposits) which would bring down the investment yield by ~23bps significantly low compared to peers' 150bps on average. To recall, the investment yield churned by 181bps to 8.13% in CY15 as the bank realized a capital gain of PkR7.6bn on disposal of bonds which the management attributes to conservative market risk limits. We highlight that HBL did not realize any gain in the last quarter (4QCY15) which signals that the investments in government securities are well under the market risk limits and thereby, do not expect major capital gain realization during CY16.

Growth in advances and current deposits to compensate

The decline in yield would be compensated through an 8-10% growth in investments and 11-13% loan growth. HBL has positioned itself through locking in funds in shorter tenor papers (39% of deposits) and a strong CAR (15.9%) to take part in CPEC related financing which would gain traction in the 2HCY16 and also looks to expand into consumer financing which has shown significant demand in a low interest rate environment. It has also the option to issue another PkR10bn subordinated debt to further fortify CAR and improve liquidity. Moreover, taking guidance from management's conference call, we expect CA deposits to achieve a CAGR of 13.9% in CY16-20 which would take CA deposit composition to 40%. This asset/liability blend would assist the bank in posting stable NII in a low-interest rate environment while benefiting the bank with repricing mismatch gain in the event of an interest rate hike.

Credit costs; where it would land?

HBL has incurred large credit and administrative cost in the year CY15. We expect provisioning costs to remain on the higher side as 1) loans disbursed in the middle east is ~68% of entire overseas loan portfolio (Unconsolidated Basis) 2) infection ratio of overseas advances has jacked up by 3ppt to 10.73% in CY15 3) NPLs have ascended by ~PkR4.8bn YoY in absolute terms which is equivalent to 3.3% of the gross overseas advances classified as non-performing. While overseas coverage ratio remains strong at 84.2%, the probability of NPLs increasing is high considering that the infection ratio of overseas portfolio touched 18% in CY08-10. However, we recommend "Buy" on the stock with our justified P/B target price of PkR217/sh. HBL is currently trading at one year forward P/B and P/E of 1.49x and 8.56x respectively, which is attractive considering an average ROE of 19% (CY16-20).

Rating System: We uses a 3-tier rating system i.e. Buy, Hold and Sell, based on the level of expected Return. In line with the best international practices.

Benchmark: when total return of a particular stock (capital gain + dividends) exceeds 15%, a Buy rating is assigned. A Sell rating is issued whenever total return is less than -5% and for return in between the 2 ranges, Hold rating is the call. Ratings are frequently updated and can be changed depending upon the assumptions and can be change because of a move in the stock's price, a change in the analyst's estimate of the stock's fair value, a change in the analyst's assessment of a company's business risk, or a combination of any of these factors.

Time Horizon: Time horizon of the Shajar Universe companies is generally the year-end financial reporting period of the company (unless otherwise mentioned).

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Rating Definitions

Buy	=+15% potential
Hold	=-5% to +15% potential
Sell	More than 5% down side

These are few Stock Valuation Techniques we used for valuation

- Dividend discount Model
- Discounted cash flow Model
- Asset based Approach
- FCFF (Free cash flow for the firm)
- FCFE (Free cash flow to equity)
- Comparable Method (P/E, P/Bv, P/S)
- Sum of Parts Valuation