Pakistan Banks

Research Entity Notification Number: REP-005

What to look forward to in CY16 results

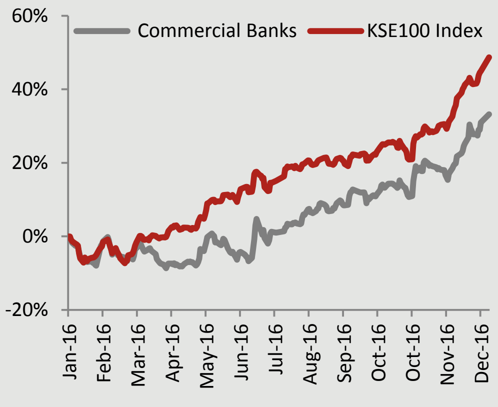
Monday January 09, 2017

Banking Sector Performance

	1M	3M	12M
Absolute %	12%	17%	33%
Relative to KSE %	0%	-2%	-15%

Source: PSX, BMA Research

Relative Chart KSE100 vs Banks



Source: PSX, BMA Research

- **The banking sector is expected to report squeezed NIMs in the upcoming 4QCY16 results following the retirement of high yielding PIBs.**
- **Deposit base has reported a growth of ~20%YoY as of Dec'16 which is significantly higher than our expectation, as a result of higher M2 growth and increased penetration.**
- **Advances also posted a robust growth of ~17% over the same period as the record low interest rates and improved confidence drove the demand of private sector credit.**
- **PSX has posted decent returns during CY16 but we expect banks to refrain from realizing substantial capital gains during 4QCY16, preventing high base effect for CY17.**
- **The market has been quick to price in the positives hence the banking scrips are largely trading close to our TP. However, BAHL and ABL, still offer total returns of 25% and 16%, respectively on the last closing.**

NIMs likely to take a hit in 4QCY16: Pakistan's banking sector is likely to report a declining trend in NIMs during 4QCY16 following the retirement of high yielding PIBs. This in confluence with a lagged impact of asset re-pricing post DR cut in May'16 will likely put a downward pressure on NIMs. Resultantly, we expect the BMA Banking Universe to report 30bpsQoQ – 50bpsQoQ lower NIMs during the upcoming 4QCY16. In the short term, a reversal in DR will result in further depression in NIMs before exhibiting a sequential recovery. This will be as a result of mismatch in asset and liability re-pricing where the liabilities get re-priced immediately while the assets are laggards.

Deposit base to report a robust growth: As per the latest numbers reported by SBP, deposit base has reported a growth of ~20%YoY as of Dec'16 which is higher than our expectation. The growth in deposits is a function of i) robust M2 growth and ii) increased penetration of banking industry in the economy. In this regard, we expect BAHL, HBL and UBL to report the highest deposit growth in our coverage universe on the back of i) aggressive growth strategy and ii) already significant branch network. MCB and BAFL, on the other hand, are likely to underperform in this matrix as a result of heavy focus on raising low cost deposits only.

Credit off-take picking up the pace: Advances posted a growth of ~17% over the same period as the record low interest rates and improved confidence drove the demand of private sector credit. Latest SBP report on credit off-take gives encouraging signals as the private sector demand for fixed capital investment has picked significantly which is likely due to growth in machinery imports under CPEC umbrella.

Phenomenal PSX performance; a trigger on its own: PSX was amongst the best performing equity market during CY16 which is why banks will likely have significant unrealized capital gains. With the market performance expected to remain upbeat in the months leading upto eventual MSCI classification, we expect the gains will likely be seen during 1HCY17, rather than 4QCY16. This will allow the banks to avoid high base effect during CY17 and hence report a sequential growth.

Investment Perspective: The market has been quick to price in the positives such as i) expected reversal in DR, ii) MSCI re-rating and iii) broad based improvement in asset quality and hence the banking scrips are largely trading close to our TP. Value can still be found in BAHL and ABL, each offering total return of 25% and 16% respectively on the last closing.

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Rating definitions	
Overweight	Total stock return > expected market return + 2%
Market-weight	Expected market return ± 2%
Underweight	Total stock return < expected market return - 2%

*Total stock return = capital gain + dividend yield

Old rating system (discarded effective Feb 29'16)

Buy	>20% upside potential
Accumulate	>=5% to <=20% upside potential
Hold	<5% to >5% potential
Reduce	<=-5% to >=-20% downside potential
Sell	<-20% downside potential

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)