Pakistan Banking Sector

Recovering from the lows

Tuesday, August 1, 2023

Report by:

Abdul Rehman Siddiqui

Deputy Head of Research

Abdul.rehman@bmacapital.com

Euromoney Market Leaders Investment Banking (Notable) - 2022

Best Equity Market Consultants Pakistan 2022

Most Innovative Corporate Finance Advisory Firm - Pakistan 2022
Fastest Growing Asset Manager - Pakistan 2022

Best Brokerage House 2017
Best Brokerage House 2016 (Runner-up)
Best Analyst & Trader 2013 (Runner-up)

Sector Coverage of Bank, Insurance, Power, Macroeconomics, Small Caps, Materials
Runner Up

Executive summary

- **Move to digital banking, investment in IT and infrastructure, leaner capital structures, cleaner loan books and improved capitalizations have gone unnoticed for a number of years and we expect that to change with the sector primed for a re-rating.**
- The dramatic last gasp agreement with the IMF has breathed life into the ailing fundamentals and has averted, at least for the time being the much talked about sovereign default. Though, the recovery path will be long and uneasy, it is a cost that Pakistan has long avoided but not anymore.
- With the overall tight monetary/fiscal policy stance at play, we believe defensive stocks, particularly those related to energy sector reforms or those which provide cover against economic slowdown will be in the limelight and to that reason, Banking sector seems to offer the ideal exposure.
- **Our liking for the sector stems from; 1) robust earnings growth (c.60% in CY23E) backed by balance sheet expansion, 2) healthy dividend pay-out capacity (BMA Banking Universe CY23/24E D/Y: 16.5/19.0%) that in some cases even exceeds fixed income returns, 3) strong capitalizations that have improved propensity to absorb economic shocks and 4) undemanding multiples (CY23E P/B, P/E of only 0.7/2.8x).**
- **The Banking Tradable Index (BKTI) has returned a sizable 33% in the month of Jul'23 but we see it as a long due recovery. We do not expect value investors to be put off by the price action in the past month as despite incorporating the same, Banking sector multiples stand considerably cheap at CY23E P/B,P/E of 0.7/2.8x respectively.**
- On the monetary policy front, following yesterday's move, interest rates are expected to be maintained at current levels in the near term but recently agreed IMF reforms and resultantly second round impacts pose potent upside risks. We have not built in any further rate hikes and do not see reversals before 1QCY24.
- **NIMs averaged 5.8% across the BMA Banking universe in 1QCY23 and we see a further 100bps accretion to be incorporated over the next two quarters to 6.8%. However, as we move forward and interest rates revert to longer term averages, we see NIMs receding to 5.2% by CY25.**
- **In terms of numbers, the BMA Banking Universe trades at a CY23E P/B of only 0.7x which translates into a 5/10 year discount of 28%/41% respectively. At the same time, dividend yields for CY23/24 stand at an attractive 16.5%/19.0% respectively, largely in line with the fixed income returns on offer.**
- Ever since questions were raised about external debt sustainability following weakening reserves and drying up forex inflows, attention has been diverted to the possibility of the same for domestic borrowings. Though far-fetched but this has happened in the recent past in developing countries including Sri Lanka, Ghana and Zambia. However, the chances of the same occurring in Pakistan are thin.
- We opine Banks offer an ideal exposure to the Pakistani market and economic recovery and the revival of the IMF program to form the perfect basis for price action. Our top picks are UBL, MCB & BAFL.

Table of contents

Into the spotlight

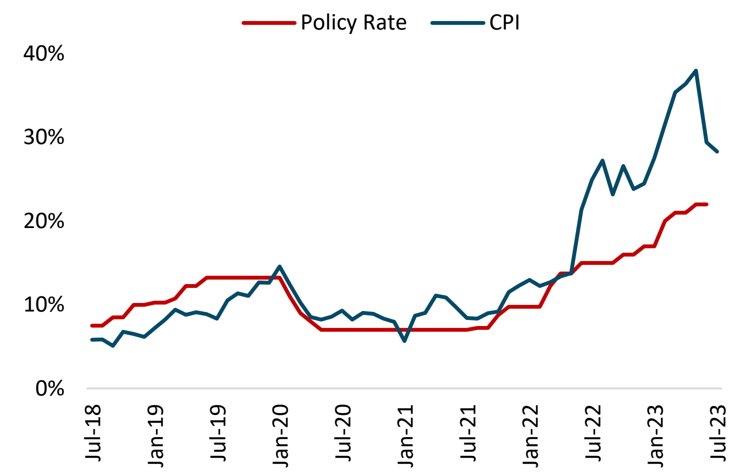
Banking sector has remained a laggard when it comes to market performance for a fair few years despite consistently improving sector fundamentals. Move to digital banking, investment in IT and infrastructure, leaner capital structures, cleaner loan books and improved capitalizations have gone unnoticed for a number of years and we expect that to change with the sector primed for a re-rating. The Banking Tradable Index (BKTI) has returned a sizable 33% in the month of Jul'23 but we see it as a long due recovery. We do not expect value investors to be put off by the price action in the past month as despite incorporating the same, Banking sector multiples stand considerably cheap with a CY23E P/B,P/E of 0.7/2.8x respectively.

Banking sector underperformance to a certain extent can be linked to persistent downsizing by FII's that over the past five years remained net sellers of >USD 500Mn in the banking space alone. This also coincided with the downgrade of Pakistan from emerging to frontier markets by the MSCI. That also weighed-in on market performance to a certain extent given the sector's weight in the KSE-100 (22.4% in Jul'23 vs. 25.7% in Jul'18). We opine the worst has already been incorporated in the pricing and even the slightest of moves towards stability could provide added impetus to our case. We reinitiate coverage on the sector with a strong BUY with our top picks being UBL, MCB & BAFL. We replace MEBL with UBL given the recent price performance of the bank (1 month return of 52.7%).

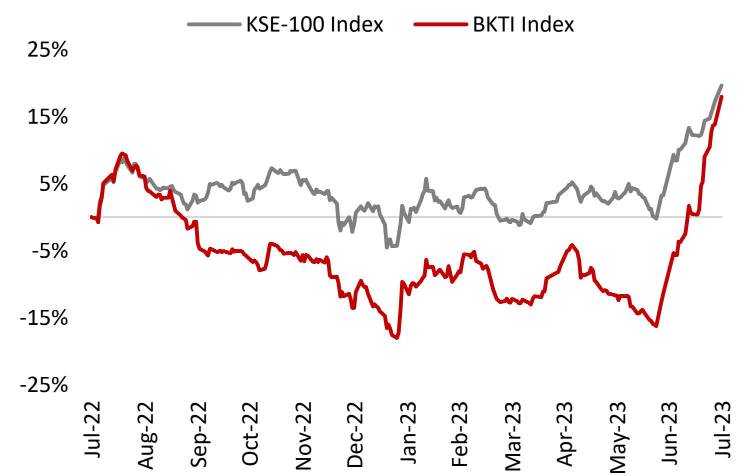
IMF SBA has changed the economic climate altogether: The dramatic last gasp agreement has breathed life into the ailing fundamentals and has averted, at least for the time being the much talked about sovereign default. Though, the recovery path will be long and uneasy, it is a cost that Pakistan has long avoided but not anymore. Be it in the form of energy sector reforms, privatization of cash bleeding state owned enterprises or restricting refinancing schemes, fiscal and monetary discipline is the theme for the foreseeable future as the incoming govt. will likely seek another IMF program right after the conclusion of this temporary arrangement in Apr'24.

With the overall tight monetary/fiscal policy stance at play, we believe defensive stocks, particularly those related to energy sector reforms or those which provide cover against economic slowdown will be in the limelight and to that reason, Banking sector seems to offer the ideal exposure.

Policy Rate vs. CPI (YoY)



KSE-100 Vs. BKTI Index



Source: SBP, BMA Research

Resilience is the key

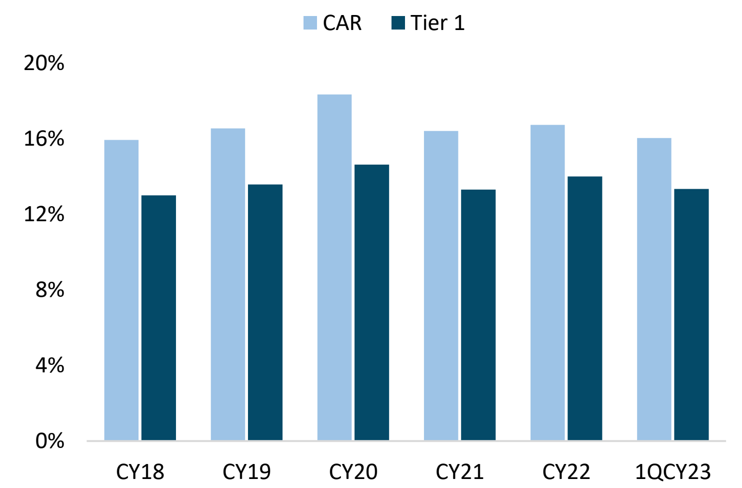
Our liking for the sector stems from; 1) robust earnings growth (c.60% in CY23E) backed by balance sheet expansion, 2) healthy dividend pay-out capacity (BMA Banking Universe CY23/24E D/Y: 16.5/19.0%) that in some cases even exceeds fixed income returns, 3) strong capitalizations that have improved propensity to absorb economic shocks and 4) undemanding multiples (CY23E P/B, P/E of only 0.7/2.8x).

Government has repeatedly turned to banks to bridge the fiscal shortfall: FY23, to little surprise made headlines for all the wrong reasons. All major economic indicators worsened considerably and the decay is not expected to reverse soon. However, the unprecedented crisis has brought a silver lining for the banking sector which has seen profits swell to record levels. This is unlike the phenomena observed across the globe where the banking sector starts to feel the heat as economic indicators weaken. The country's burgeoning fiscal deficit continues to push the government to turn to the banking sector to bridge the shortfall which in turn leads to interest rate hikes with banks' being the primary beneficiaries.

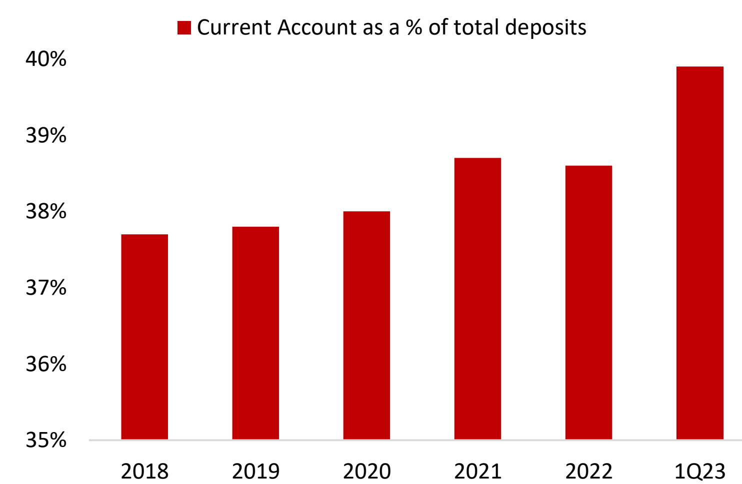
Fundamentals remain strong: All major banking sector indicators have improved compared to the previous year though PKR depreciation has impacted a few. The loan book has grown by 13.5% YoY despite the economic pressures with corporates finding it increasingly difficult to bridge working capital financing needs as inflation made historic highs (FY23 avg. inflation: 29%). As a result, we see the numbers receding to mid single digits in the ongoing calendar year before undergoing a gradual recovery. On the bad loans front, NPL accretion has remained in check and largely resilient courtesy limited exposure in riskier segments (consumer, retail, SME).

On the deposits side, growth has remained robust at 16.9% YoY largely in line with the mid-teens observed over the last few years. The inflows have been supplemented by high inflation readings and resultantly interest rates which have made saving deposits (↑15.1% YoY) an attractive avenue. Investments, on the other hand have been the go-to option for the sector as excess liquidity has consistently been parked in federal government securities which offer in excess of 20% return on the shorter tenor paper. IDR's as a result have increased to multi-year highs of 79.5% and could build up further if rate hikes persist and the economic slowdown keeps demand for lending at bay.

Capitalization ratios stand strong



Current account buildup is cushioning NIMs



Source: SBP, BMA Research

Make hay while the sun shines

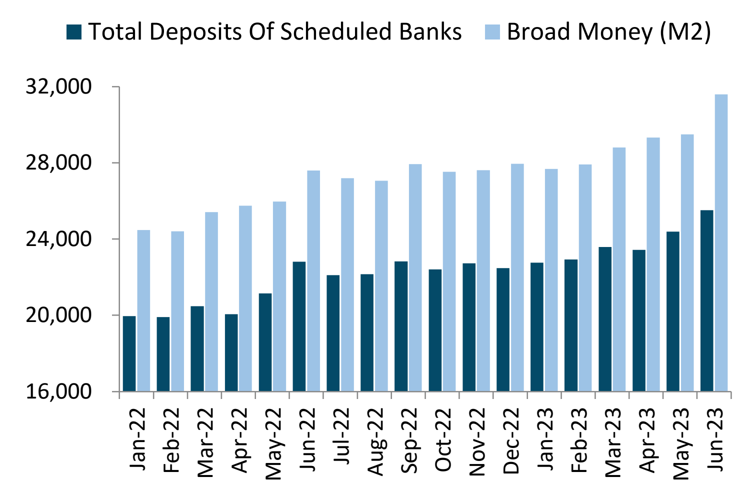
Interest rates and NIMs: From the lows of 7% observed during the pandemic era, both Pakistan and the interest rates have come a long way. Record fiscal shortfalls, nosediving currency and skyrocketing inflation readings meant a swift shift from accommodative monetary policy to a restrictive one. Ever since, interest rates have trebled (policy rate currently stands at 22%) and it is still unclear if they have topped out. The primary culprit being inflation readings which averaged ~29% in the outgoing fiscal year thus highlighting a massive ~700bps shortfall in real terms. Even if we take directive from the MPC which states that it uses a 12-18 months horizon to determine policy decision, current interest rates might match average inflation (FY24E CPI: 21.8%) or maybe even turn positive but that to a large extent depends on how the IMF agreed upon reforms play out.

On the monetary policy front, following yesterday's move, interest rates are expected to be maintained at current levels in the near term but recently agreed IMF reforms and resultantly second round impacts pose potent upside risks. We have not built in any further rate hikes and do not see reversals before 1QCY24. Though, positive surprises from international oil prices, improved crop output following devastating floods last year and settling PKR (supplemented by easing import restrictions) could soften the readings and allow for a more accommodative stance going forward.

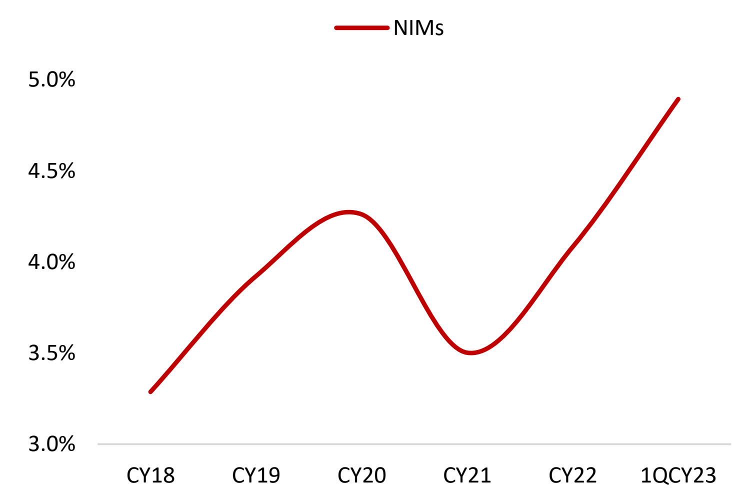
NIMs; time to shine: Given the persistent rate increases over the past 6 quarters, NIMs are yet to fully reflect the same due to lagged asset pricing. Given greater exposure in short term paper and floating rate bonds, investment books have been more flexible in quickly accounting for the hikes compared to the loan portfolios which generally tend to take 1-2 quarters. NIMs averaged 5.8% across the BMA Banking universe in the quarter ended Mar'23 and we see a further 100bps accretion to be incorporated over the next two quarters to 6.8%. However, as we move forward and interest rates revert to longer term averages, we see NIMs receding to 5.2% by CY25.

M2 and deposit growth: Over the past 20 calendar years, deposit growth has perfectly imitated M2 accretion as evident by the CAGR which clocks-in at 14.4% for deposits against 14.3% for M2. However, the increases recorded in the two over CY22 were slightly different at 7.1% and 9.9% for banking sector deposits and M2 respectively. We opine this to do a lot

Total Deposits & M2 (PKR Bn)



Undergoing a V-shaped recovery



Source: Company Accounts, SBP, BMA Research

Non-core income under the microscope

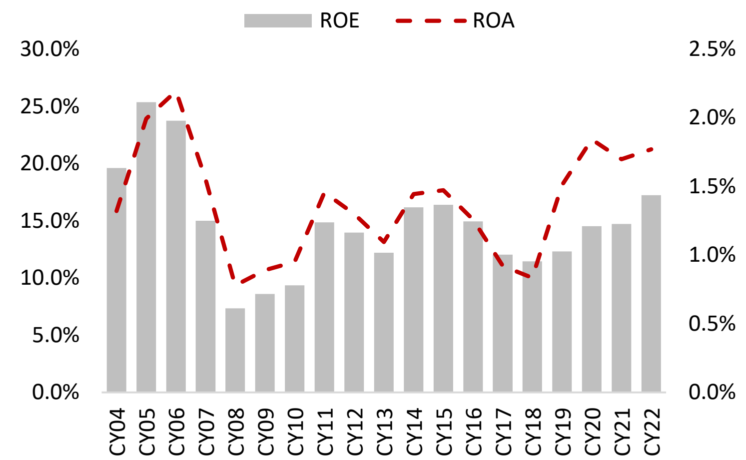
with the Advances related taxation adopted in the previous Federal Budget which to a certain extent hampered deposit mobilization.

Furthermore, with interest rates consistently on the rise, an industry wide phenomena of adding low cost deposits was observed in order to keep the balance sheets leaner. Going forward, we expect the visible difference between the two noted in CY22 to be bridged and revert to long term average mid-teen levels. Our thesis is based on two primary reasons; 1) roll back of ADR related taxation which will enable FI's to increase the deposit base without the need for additional lending and 2) softer inflation readings could translate into higher savings.

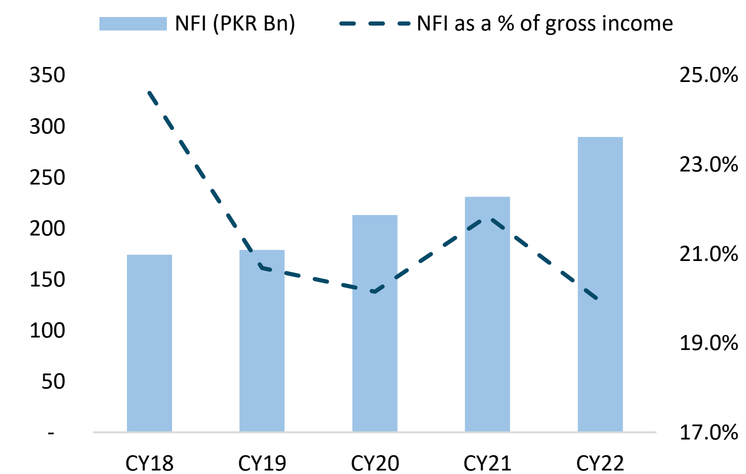
Non-core income: The Banking sector enjoyed a fruitful CY22 on the back of strong showing in fee and forex income segments. Fee income underwent a healthy 21% YoY accretion aided primarily by increased branch banking fee, card related income and trade commissions. Forex income, on the flip side underwent a sharp 130% YoY increase on the back of immense exchange rate volatility and higher transactional volumes. Going forward, we expect fee income growth to remain robust in the near term as hefty investments in digital infrastructure continue to bear fruit and reduce the onus on branch banking. However, forex income is expected to take a hit and decline to normalized levels before returning to long term growth.

It is worth mentioning here that the SBP did caution commercial banks' from making use of the limited forex availability and generating exuberant returns however, the same is yet to reflect in the reported numbers. Given the earlier roll back of ADR related taxes, effective tax rate for banks stands at 49% (39% Corporate Tax + 10% Super Tax) for CY23, slightly lower compared to 52.4% booked by the sector in the previous year. Plus taking into account the record profitability that banks' have generated over the past year, we opine the risk of another one-off tax like the one imposed in the recent budget to shore up fiscal revenues cannot be ruled out that could prove to be a major setback for the sector.

ROE's and ROA's on the road to recovery



Robust NII growth has diluted the impact of NFI in gross income



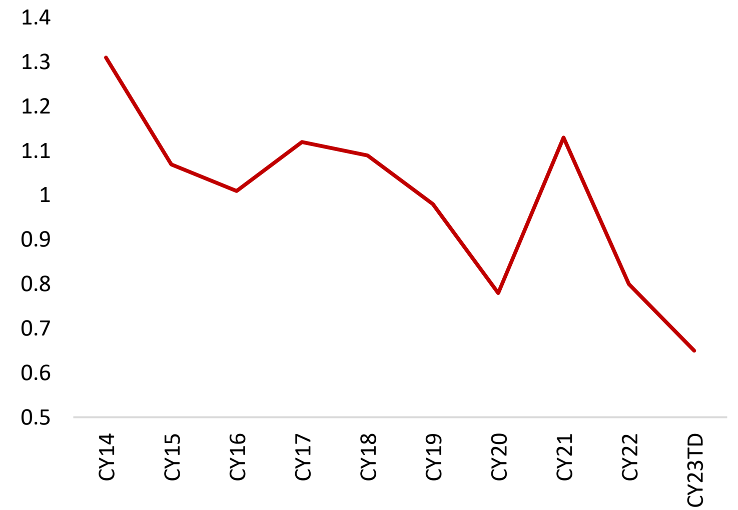
Too low for too long

Trading discounts and dividend yields: Trading multiples for banks' have receded to multi-year lows despite robust profitability and healthy pay-outs and the discount has widened over the last few years. This has, to a large part to do with persistent foreign outflows that have only escalated in the recent past due to economic challenges and PKR devaluation. Banks' being the largest sector in terms of weightage have resultantly felt the heat. Plus the imposition of one-off taxes on an already heavily taxed and regulated sector have not helped build the investor sentiment. On the domestic front, recent allocations and the slight shift towards equity from fixed income has translated into some market performance though re-rating will be a product of new allocations and foreign inflows which in turn rely upon PKR stability and business confidence. In terms of numbers, the BMA Banking Universe trades at a CY23E P/B of only 0.7x which translates into a 5/10 year discount of 28%/41% respectively. At the same time, dividend yields for CY23/24 stand at an attractive 16.5%/19.0% respectively, largely in line with the fixed income returns on offer.

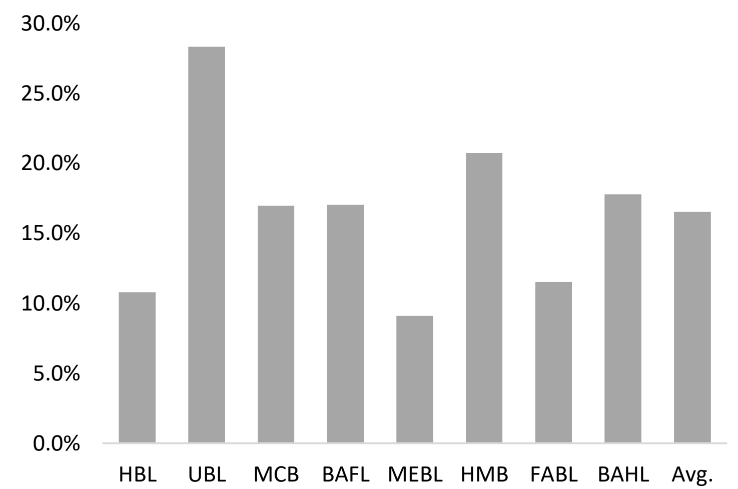
Keeping these in mind plus the balance sheet resilience to counter any short term economic headwinds, we opine Banks offer an ideal exposure to the Pakistani market and economic recovery and the revival of the IMF program to form the perfect basis for price action. Our top picks are UBL, MCB & BAFL.

Adoption of IFRS-9: The long awaited adoption of IFRS-9 is expected to come into effect from 2024 having been delayed by 12 months by the SBP. Just to recall, banks have been preparing pro-forma accounts since CY22 and sharing the same with the SBP to ensure financial soundness. With the first impact expected to flow through the equity and not the P&L, capitalization ratios of the sector could be affected. Though, broader current capitalization remains robust, we can expect buildup of general provisioning buffers to ease the one time hit on equity. As a result, we might see a more prudent provisioning stance in the remaining half of the year particularly in those banks that have thin capitalization buffers or those with greater exposure towards riskier assets. Once this one time hit is taken into account, adoption of an expected credit loss model going forward would reduce income statement volatility thus improving earnings quality.

Discount (P/B basis) has widened over the years



Attractive dividend yields on offer (CY23E)



Source: PSX, BMA Research

Domestic debt restructuring is a foregone conclusion

Domestic debt restructuring: Ever since questions were raised about external debt sustainability following weakening reserves and drying up forex inflows, attention has been diverted to the possibility of the same for domestic borrowings. Though far-fetched but this has happened in the recent past in developing countries including Sri Lanka, Ghana and Zambia. However, the chances of this occurring in Pakistan are thin. Our thesis is based on the following premise:

1) Lower public debt levels which stand at ~80% of GDP as at Dec'22 compared to 128/144/94% for Sri Lanka/Zambia/Ghana respectively.

2) Less than 20% of the total domestic debt has a short term maturity while about 2/3rd is parked in longer term bonds.

3) Haircuts in domestic debt could hamper capitalization ratios for local banks which could have implications on the financial sector and the future of the IMF program.

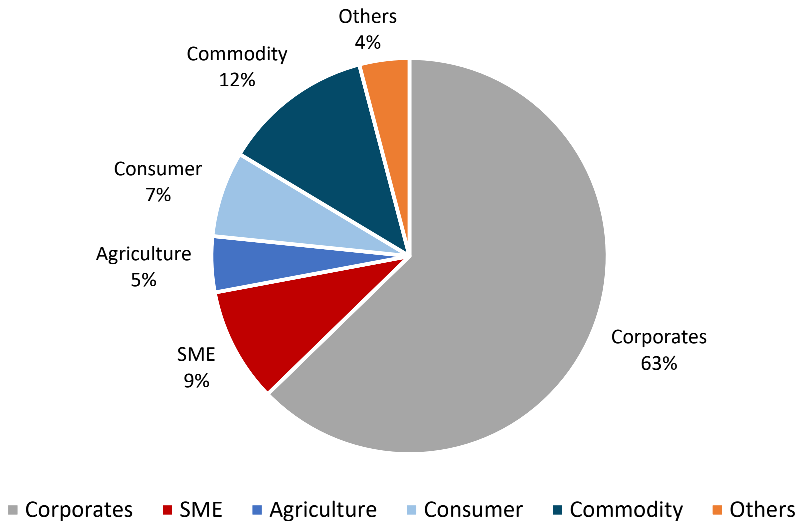
Domestic debt has already re-profiled by the lengthening of bank's investments books as evident in the table below:

Maturity profile of banks' investments (PKR Bn)	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Upto 1 year	5,816	4,993	5,920	6,308	7,027
Over 1 year but upto 3 years	997	1,791	2,100	3,423	4,993
Over 3 year but upto 5 years	414	593	1,514	2,337	3,940
Over 5 years	687	1,563	2,401	2,487	2,440
	7,914	8,939	11,935	14,554	18,400

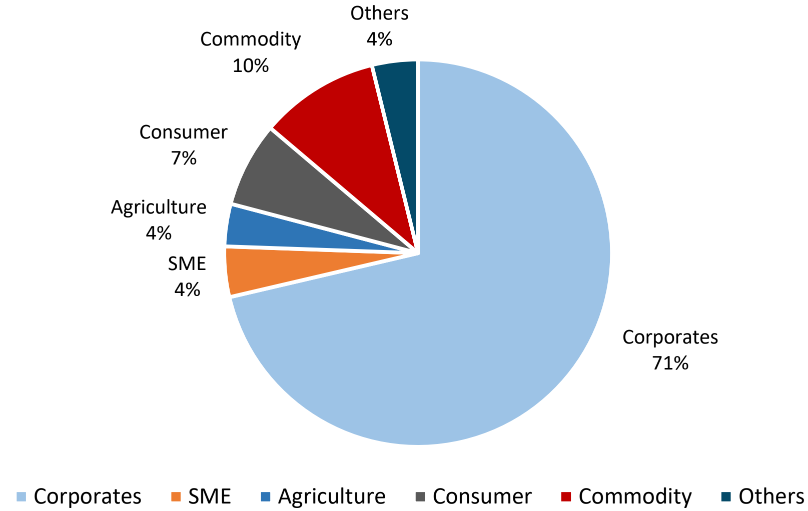
Source: SBP, BMA Research

Learning from mistakes

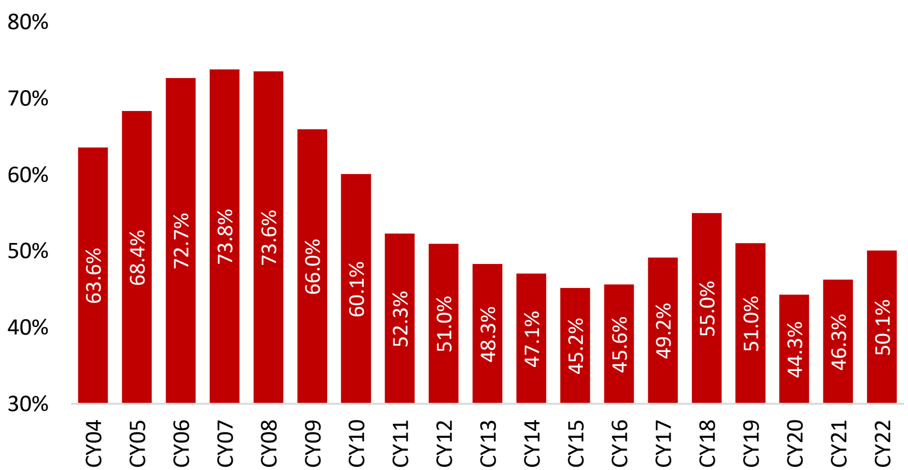
Composition of loan book (CY10)



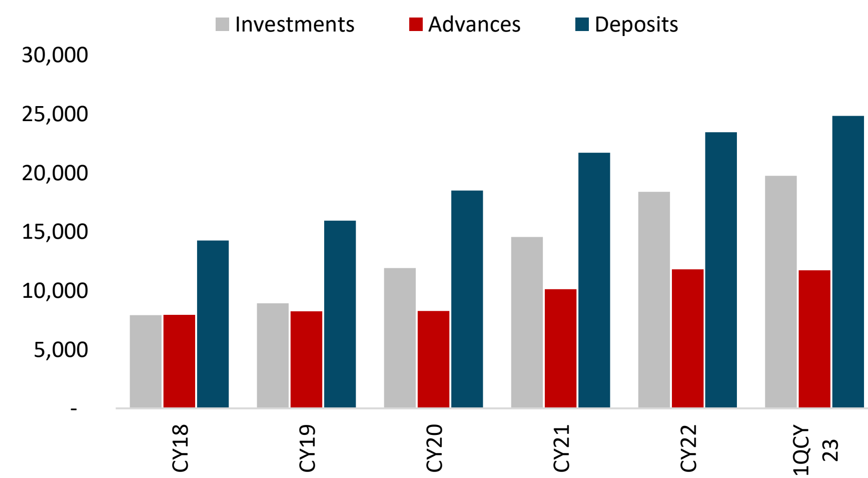
Composition of loan book (CY22)



ADR's have also come down sharply



Investments are the go-to option



Source: SBP, BMA Research

Valuation metrics

	EPS		DPS		Price	Target Price	Upside	Rating	Div. Yield		P/E		P/B	
	CY23E	CY24E	CY23E	CY24E					CY23E	CY24E	CY23E	CY24E	CY23E	CY24E
HBL	38.7	45.9	10.5	13.5	97.3	135.0	38.8%	BUY	10.8%	13.9%	2.5	2.1	0.4	0.4
UBL	43.6	46.3	43.0	43.0	151.9	206.0	35.7%	BUY	28.3%	28.3%	3.5	3.2	0.9	0.8
MCB	42.2	46.6	25.0	28.0	147.4	201.0	36.4%	BUY	17.0%	19.0%	3.5	3.2	0.8	0.8
MEBL	41.0	43.8	12.0	17.0	131.9	158.0	19.8%	BUY	9.1%	12.9%	3.2	3.0	1.4	1.1
BAFL	20.9	23.2	7.0	8.0	41.1	54.0	31.4%	BUY	17.0%	19.5%	2.0	1.8	0.5	0.4
BAHL	29.2	28.1	10.0	10.0	56.2	93.0	65.5%	BUY	17.8%	17.8%	1.9	2.0	0.6	0.4
FABL	10.1	11.4	3.0	4.5	26.1	40.0	53.6%	BUY	11.5%	17.3%	2.6	2.4	0.5	0.4
HMB	18.3	20.3	7.5	8.5	36.2	59.0	63.0%	BUY	20.7%	23.5%	1.8	1.7	0.5	0.4

Source: PSX, BMA Research

Prices are as at July 31th,2023

Habib Bank: Digitizing the way forward

HBL's focus long moved from brick and mortar and towards non-branch channels and the same is set to prove crucial as financial inclusion increases, in our view. In addition to its strong presence in the domestic business, HBL was one of the early movers when it came to the adoption of digitization and that has helped in cementing its top spot in the sector further. With limited international exposures and strengthening domestic franchise, we opine external overhangs have subsided considerably and have in fact been overplayed in context of price performance. The bank's P/B multiples have receded to only 0.5x currently compared to average 5/10-year P/B of ~0.7/1.2x, implying a discount of ~32/59% respectively. With profitability expected to clock-in at record levels this year, we believe current multiples are unjustified and could form the basis of price action going forward. We remain Overweight with a Dec-23 TP of 135/sh.

Ideally placed investments book: At the conclusion of CY22, ~50% of the investments book had a maturity of less than one year which we opine bodes particularly well for the bank in the context of the current economic situation. Over the next year, at least, we expect financing from international sources to be particularly limited and the government will need to resort to domestic borrowings to bridge the fiscal shortfall. Given this scenario and the absence of advances related tax, HBL seems well positioned to capitalize on the record policy

Habib Bank Limited — (PSX: HBL, Bloomberg: HBL.PA): Earnings Snapshot

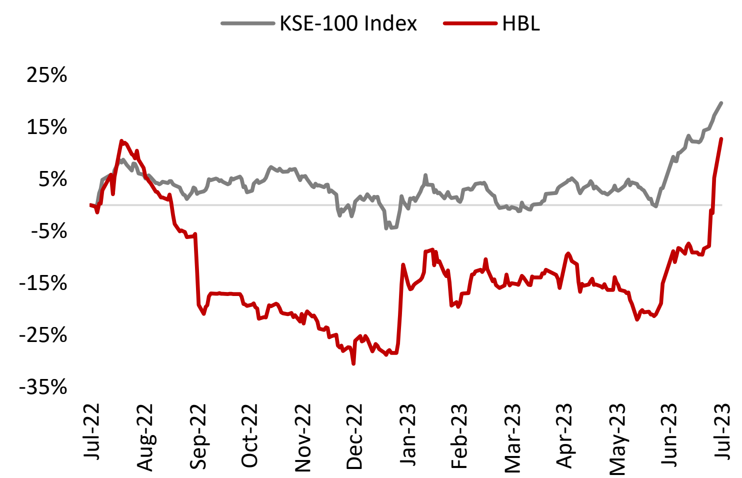
(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	130,104	131,419	165,653	236,563	284,993
Non-interest income	30,595	35,671	43,703	46,852	61,129
Fee income	18,796	25,433	31,510	40,103	46,119
FX income	(162)	5,381	11,947	6,123	6,307
Gain on securities	7,055	842	866	(725)	518
Operating expenses	95,449	97,614	126,783	163,493	196,235
Provisions – net	12,220	8,087	8,482	9,702	7,371
Profit before taxation	53,031	61,388	74,001	110,221	142,516
Profit after taxation	30,913	34,867	31,370	56,816	67,368
EPS	**21.1**	**23.8**	**21.4**	**38.7**	**45.9**
DPS	**4.3**	**7.5**	**6.8**	**10.5**	**13.5**

Source: Company Financials, BMA Research

Stock Information

PSX Code	HBL
Bloomberg Code	HBL PA
Target Price (PKR)	**135.0**
Last Closing (PKR)	97.3
Potential Gain (%)	**38.8%**
52 Weeks Range	101.4/59.3
12M Avg. Vol (Mn)	0.32
12M AVT (USD Mn)	0.08
Mkt Cap (USD Mn)	497.7
Shares Outstanding (Mn)	1,467
Free Float	45%

Performance Chart



Source: PSX, BMA Research

rate and build on its investments book. That said, we do not see IDR's of the bank receding in the foreseeable future and could well be maintained at over 50%. This would also help in maintain NIMs at 6.2/6.7% over CY23/24 respectively.

Investment in IT bearing fruit: As financial inclusion is gaining traction, HBL is fully leveraging its presence by utilizing its multi-faced digital product line. This is evident by the rising scale of digital transactions which now stand at 86% of total transactions compared to only 63% in CY19. Going forward, we expect this to improve further and prove to be imperative in bringing down operating costs.

Focus continues on Islamic banking: Despite being a conventional bank, HBL offers one of the country's largest Islamic banking windows. The Islamic segment now constitutes of ~300 branches and we expect the same trend to persist in the future with branches either being converted to Islamic or closed down altogether to make the structure leaner. Although, overall growth numbers for Islamic banking are decent, greater penetration in the same alongside digital transformation could prove to be game changers for the bank in the future.

Thin capitalization buffers mean dividend pay-outs will be limited: Owing to the bank's DSIB status, HBL has to maintain an additional 150bps over the base requirement of 9.0/10.5/11.5% for CET1/Tier-1/CAR respectively. As at QEJun23, CAR buffers stand at 219bps over revised requirement while the buffer for Tier-1 is lower at 138bps (currently standing at 11.9% against requirement of 10.5%). Keeping that in mind and the management's guideline to build adequate buffers (~200bps), we opine dividend pay-outs to remain limited with the pay-out ratio expected at around 20%. However, stability in the PKR could provide some respite and enhance the buffers by ~1% thus enhancing the pay-out capacity.

United Bank: Re-rating in play

UBL's international deleveraging exercise continues as the bank closed down its Switzerland & Tanzania operations last year. As a result, international operations now make up only 8% of the bank's assets compared to ~20% in CY16. With the balance sheet more lean and enhanced focus on the robust domestic franchise, we believe the overhang of external pressures such as PKR devaluation and NPL pile-up will ease off for the bank going forward. On the domestic front, operations remain strong and given the recent improved performance of non-core income and greater digital outreach, we believe UBL will be one of the prime beneficiaries as financial inclusion takes center stage. UBL is one of our favored sectoral plays and we maintain a BUY with a Dec-23 TP of 206/sh, implying an upside of 35.7%.

Provisioning fears have eased considerably: After a fair few torrid years of battling consistent NPL build up from the GCC, the tide has turned as the bank booked a net reversal in CY22 and no charge thus far in CY23. With oil prices sustaining at over USD 75/bbl and all service sectors back to routine levels, we believe the worst is behind us and the risk of any spike in bad loans from the GCC remains restricted. On the domestic front, there seems to be little risk as the bank has majorly lent to corporates and the composition of consumer, SME or retail are fairly low. However, some risk could emanate from the foreign bonds portfolio as noted late last year with outlook for Sri Lanka and Turkey still looking murky.

United Bank Limited — (PSX: UBL, Bloomberg: UBL.PA): Earnings Snapshot

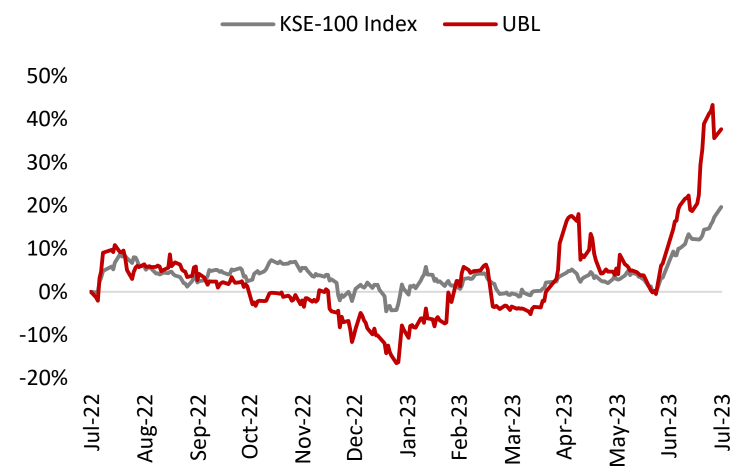
(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	74,959	71,759	103,209	131,003	153,339
Non-interest income	17,094	23,379	34,443	38,843	42,215
Fee income	11,097	13,064	15,871	17,567	19,443
FX income	3,685	3,992	8,414	12,191	12,557
Gain on securities	411	3,758	466	(377)	388
Operating expenses	41,093	43,966	53,673	65,325	78,991
Provisions – net	16,768	(955)	15,669	(58)	3,055
Profit before taxation	34,192	52,127	68,310	104,579	111,240
Profit after taxation	20,899	30,882	32,063	53,331	56,733
EPS	**17.1**	**25.2**	**26.2**	**43.6**	**46.3**
DPS	**12.0**	**18.0**	**22.0**	**43.0**	**43.0**

Source: Company Financials, BMA Research

Stock Information

PSX Code	UBL
Bloomberg Code	UBL PA
Target Price (PKR)	**206.0**
Last Closing (PKR)	151.9
Potential Gain (%)	**35.7%**
52 Weeks Range	159.6/91.5
12M Avg. Vol (Mn)	0.14
12M AVT (USD Mn)	0.06
Mkt Cap (USD Mn)	648.6
Shares Outstanding (Mn)	1,224
Free Float	40%

Performance Chart



Source: PSX, BMA Research

United Bank Limited (UBL)

Well positioned investments book to keep NIMs robust: Following a strong end to CY22 as we saw a spurt in lending, the trend reversed swiftly as the management highlighted limited demand for private sector credit and earlier pay-back of loans by corporates to be the primary reasons. On the investments side, things look favorably placed for the bank. The bank has total PIB exposure of ~1.0Trn (60% of investments book) of which almost 50% are floaters while the bank holds T-bills of around PKR 400Bn. Given the short duration of ~50% of the book (Floaters+T-bills), we expect NII accretion to persist and NIMs to remain strong in the near term.

Strong CAR to facilitate robust pay-outs: UBL has announced back to back dividends of PKR 11/sh in the previous quarter equating to a pay-out of 100%. These pay-outs have been enabled by the robust capitalization buffers of the bank which stand at a comfortable >550bps over set requirements. As a result of these higher than expected pay-outs, we have increased the bank's payout ratio to 100/90% for CY23/24 respectively. We have assumed a pay-out of PKR 43/sh apiece for CY23/24.

Building on its digital platforms: Given the higher focus on the domestic franchise and the bank's consistent investment in IT infrastructure, we believe the bank is favorably placed to benefit from increased usage of digital platforms. This is evident by the higher digital throughput (PKR 1.0Trn) and greater transactional volumes on mobile/internet. Total digital transactions now make up ~70% of total bank transactions compared to 57% a year ago. Going forward, we opine this to be a key area of focus for the bank and one that could support C/I ratios (1HCY23-37.6%).

MCB Bank: Best in class

Given one of the industry's best deposit mix, strong NPL recovery stream and stable dividend pay-outs aided by robust capitalization, MCB stands to be one of our favored picks in the BMA Banking space. We would like to particularly highlight the superior earnings quality and pay-out policy of the bank that have remained consistent and stable despite major headwinds faced by the sector be it in terms of NPL accretion, interest rate changes or strengthening capital base. Though, we agree that the bank has not been at the forefront of initiatives currently being taken up by industry peers, the bank's superior loan book quality, strong CASA, robust NPL recovery stream and stable pay-outs make up for the shortfall. MCB is our sectoral pick and we remain OW with a Dec-23 TP of PKR 201/sh.

Top notch CASA to continue to support NIMs: The bank's CASA stood at 96.9% in the Mar'23 quarter, one of the best in the industry courtesy an envious 54% contribution from Current Accounts. This is a stark contrast to the other 3 large banks (HBL, UBL & MEBL) which on average have a CASA of ~85%. As a result, NIMs accretion in MCB is relatively swifter compared to the likes to HBL & UBL which have an average funding cost of 8.9% (as at QEMar23) compared to only 7.7% for MCB. Though, it is still higher than the 7.0% observed in MEBL primarily due to the absence of a floor rate for deposits in Islamic banks. Going forward, NIMs are expected to improve further as the bank follows a strict no-cost deposit

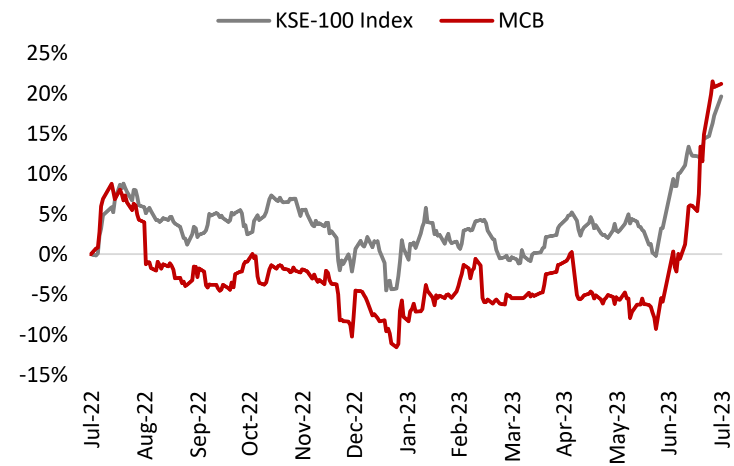
MCB Bank Limited — (PSX: MCB, Bloomberg: MCB.PA): Earnings Snapshot

(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	71,334	63,987	87,156	141,623	164,561
Non-interest income	18,136	20,074	24,614	27,781	29,344
Fee income	10,936	12,440	14,182	15,298	15,604
FX income	2,525	3,734	9,159	9,726	10,698
Gain on securities	3,332	811	(2,782)	216	242
Operating expenses	33,908	36,894	43,186	51,786	60,993
Provisions – net	7,313	(4,823)	(2,782)	2,638	3,881
Profit before taxation	48,249	51,989	71,365	112,337	129,032
Profit after taxation	29,037	30,811	32,741	50,011	55,217
EPS	**24.5**	**26.0**	**27.6**	**42.2**	**46.6**
DPS	**20.0**	**19.0**	**20.0**	**25.0**	**28.0**

Source: Company Financials, BMA Research

Stock Information	
PSX Code	MCB
Bloomberg Code	MCB PA
Target Price (PKR)	**201.0**
Last Closing (PKR)	147.4
Potential Gain (%)	**36.4%**
52 Weeks Range	150.6/107.0
12M Avg. Vol (Mn)	0.09
12M AVT (USD Mn)	0.04
Mkt Cap (USD Mn)	609.4
Shares Outstanding (Mn)	1,185
Free Float	35%

Performance Chart



Source: PSX, BMA Research

accumulation strategy without chasing target market shares. We see NIMs undergoing a further 120bps accretion to 7.9% (6.7% in 1Q) in CY23 as re-pricing continues to play out.

Bad loan recoveries like no other: MCB bank has a long history of having the best bad loan recovery stream and that continues to be the case. For the purpose of comparison, we have calculated a reversals to NPL's ratio for large banks over the last 10 years, which clearly shows that MCB stands heads and shoulders above the rest. The bank has recovered on average 11.5% of its bad loans over the last 10 years, while ABL comes in at a distant second at only 9.7%. The management expects recovery stream to remain strong in the near term particularly from the legacy portfolio of NIB of which the bank has reversed ~30% (PKR 8.7Bn) to date out of PKR 29.6Bn inherited. Although the recoveries have slowed down in the recent years, we opine this to pick up pace as the economic activity reverts to normalized levels.

ADR to revert to longer term means: After shooting to ~PKR 800Bn at the close of CY22, lending book of the bank declined sharply to PKR 700Bn in Mar'23. The spurt is attributable to the Advance related tax in place to penalize banks with low lending levels. However, given that the restriction is no more in place, we see ADR's being maintained at around 45% against the 58% seen at year end. Given the economic situation, private sector credit demand is expected to remain subdued and the bank which has previously been cautious on the lending front, will continue to maintain a conservative stance.

Meezan Bank: Premier for a reason

Meezan Bank offers the best exposure to Pakistan's banking sector, in our view. Being a mix of growth and value, we opine MEBL to be one of the prime beneficiaries of the interest rates up-cycle, digitization and changing consumer preferences. Supernormal deposit mobilization (5-year CAGR of 20% vs. 13% for industry), above average ROE generation (5-year avg.: 34%) and strong earnings growth stand out for MEBL. Though risk of implementation of MDR has put off some investors, we believe chances of the same being adopted are low. Recent price performance has narrowed valuation discounts but we still believe there remains room for price action as the bank trades at a CY23/24 P/B, P/E multiples of only 1.4/1.1x (10-year avg.: 2.0x) while generating an ROE of 52/42% in CY23/24 respectively. We also believe the bank is now in a position to increase its pay-out ratio thanks to sizable capitalization buffers and easing branch related expenditure. We remain Overweight with a Dec-23 TP of PKR 158/sh.

NIMs to surpass 8% in CY23: Despite the massive addition of branches over the years, the bank has not compromised on quantity over quality and has consistently improved its deposit mix. CASA of the bank has improved from 75% in 2016 to 88% however, it is the CA ratio that particularly stands out. The bank's excellent CA ratio of 51% (as at QEMar23) alongside the absence of MDR have kept funding costs considerably lower compared to

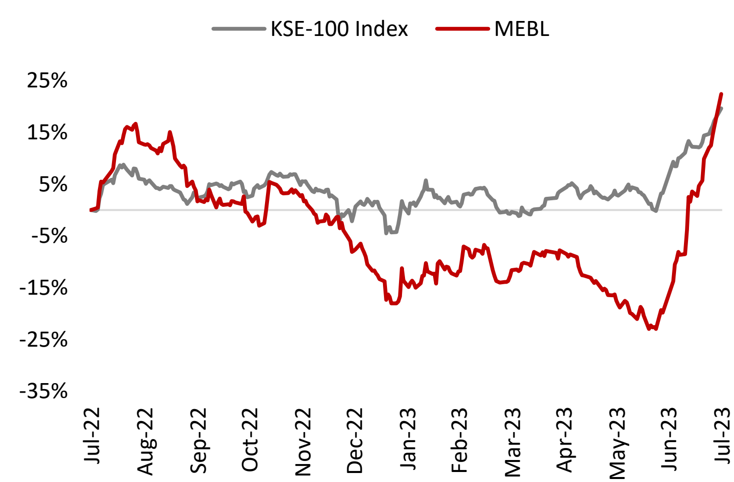
Meezan Bank Limited — (PSX: MEBL, Bloomberg: MEBL.PA): Earnings Snapshot

(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	64,849	68,921	121,704	197,375	220,150
Non-interest income	10,072	14,892	19,103	20,995	24,893
Fee income	5,914	9,353	13,316	16,027	19,232
FX income	2,154	3,158	3,617	1,963	2,002
Gain on securities	683	349	(55)	600	1,066
Operating expenses	29,775	35,324	48,245	69,183	85,907
Provisions – net	8,210	993	4,177	4,603	5,293
Profit before taxation	36,936	47,496	88,385	144,584	153,842
Profit after taxation	22,166	28,355	45,007	73,291	78,460
EPS	**12.4**	**15.8**	**25.1**	**41.0**	**43.8**
DPS	**6.0**	**6.0**	**8.5**	**12.0**	**17.0**

Source: Company Financials, BMA Research

Stock Information	
PSX Code	MEBL
Bloomberg Code	MEBL PA
Target Price (PKR)	**158.0**
Last Closing (PKR)	131.9
Potential Gain (%)	**19.8%**
52 Weeks Range	138.9/82.4
12M Avg. Vol (Mn)	0.13
12M AVT (USD Mn)	0.05
Mkt Cap (USD Mn)	823.3
Shares Outstanding (Mn)	1,790
Free Float	25%

Performance Chart



Source: PSX, BMA Research

peers and will continue to facilitate healthy NIMs accretion where we expect margins to surpass 8.0% in CY23 and remaining stable around the same level in CY24. This is turn pulls our earnings estimates to 41.0/43.8 for CY23/24 respectively.

Dividend pay-outs to increase as branch expansion slows down: With the branch network of the bank reaching ~1k branches, we expect the management to mildly slowdown branch expansion going forward. Note that branch network expansion has been the primary reason for the bank's high C/I ratio (~50% over CY16-22) over the years and scaling back of the same plus the sizable earnings growth will pull it down to 34/37% in CY23/24 respectively, in our view. This could significantly increase the bank's capacity to scale up its pay-outs which currently stand at considerably lower (30%) than other peer conventional banks at ~50%. We have assumed pay-outs of PKR 12/17 per share in CY23/24 equating to ~35%.

Increased govt. borrowing works in favor of the bank: Limited fixed income investment options have been a persistent concern for Islamic banking industry over the years as evident by the significant differences in issuance sizes and IDR's (60% for Islamic banks vs. 80% for conventional banks). However, the current economic challenges mean that the govt. will need to resort to domestic borrowings to bridge the fiscal shortfall in the absence of international financing. This was reflective in the last year as well as the bank was able to raise IDR from 44% in CY21 to 59% in CY22 courtesy greater Sukuk issuances. Given the floating nature of Islamic investments and a bigger auction pool, we believe MEBL has on its hands an attractive deployment option amid limited demand for private sector credit.

Bank Alfalah: Aiming for the big league

We iterate BAFL as one of our favored picks in the Banking space on the back of the bank's excellent deposit growth, robust branch expansion plans, envious CA ratio and attractive dividend yield. The past year has been a fruitful one for the bank as it has enhanced its branch network, strengthened its non-core income areas particularly remittances and government backed BISP program. Deposit mobilization has led robust balance sheet expansion while also enabling optimization. Taking cue from this and the cheap CY23E P/B multiples of only 0.5x, we opine current price levels offer an attractive entry point. We have a BUY stance on the scrip with a Dec-23 TP of PKR 54/sh.

Top notch CA ratio to provide respite to NIMs: The bank underwent a deposit growth of ~32% YoY in 1QCY23, far beating industry surge of 13.5%. What is even better than the upwelling growth is the fact that CA ratio stands at a healthy 44% which will keep NIMs accretion ticking in the near term. We expect NIMs to average 6.0% over CY23-24 as re-pricing continues to filter through to the bottom-line before easing off to 5.2% in CY25.

Branch network expansion to continue: Ever since CY19, the bank has adopted a branch expansion strategy that still remains intact. Fast forward to CY23, the strategy remains very much in place which the branch network having been expanded to over 900 branches till 1QCY23. The management however, remains bullish on this end and expect to close the year with an addition of 100 new branches taking the tally to almost 1k.

Bank Alfalah Limited — (PSX: BAFL, Bloomberg: BAFL.PA): Earnings Snapshot

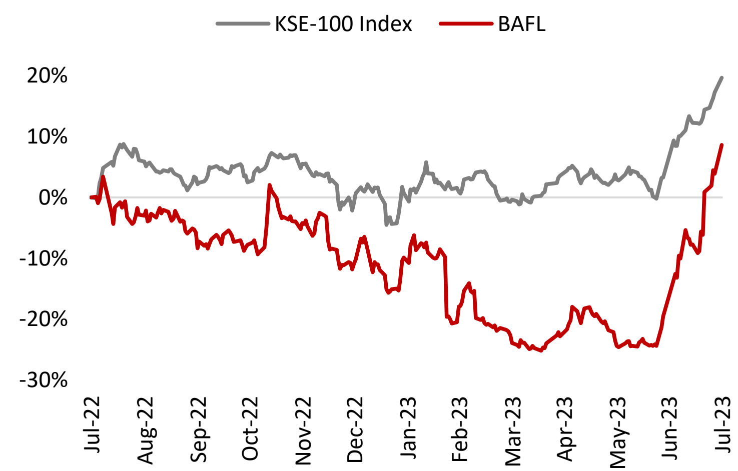
(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	44,705	46,048	77,340	118,924	141,126
Non-interest income	12,795	16,474	21,786	24,305	26,888
Fee income	6,559	8,221	10,842	12,510	13,761
FX income	3,398	4,128	9,219	10,334	10,644
Gain on securities	2,285	3,142	332	(147)	278
Operating expenses	32,032	36,840	50,497	71,703	89,422
Provisions – net	7,589	2,312	12,468	6,688	6,972
Profit before taxation	17,879	23,370	36,160	64,838	71,620
Profit after taxation	10,475	14,217	18,206	32,995	36,526
EPS	**6.6**	**9.0**	**11.5**	**20.9**	**23.2**
DPS	**4.0**	**4.0**	**5.0**	**7.0**	**8.0**

Source: Company Financials, BMA Research

Stock Information

PSX Code	BAFL
Bloomberg Code	BAFL PA
Target Price (PKR)	**54.0**
Last Closing (PKR)	41.1
Potential Gain (%)	**31.4%**
52 Weeks Range	42.2/27.6
12M Avg. Vol (Mn)	0.34
12M AVT (USD Mn)	0.04
Mkt Cap (USD Mn)	226.1
Shares Outstanding (Mn)	1,577
Free Float	40%

Performance Chart



Source: PSX, BMA Research

Bank Alfalah Limited (BAFL)

Though that will likely keep the admin costs on the higher side in the short term however, the profit contribution will flow through in 12-18 months as the gestation period for the branches is completed.

Strengthening its non-core income streams: Apart from the rigorous effort of the management to shore up its domestic footprint, the bank has also been successful in diversifying its income stream and divulging into non-core income areas. To be specific, fee income, alternate delivery channels and trade/remittances segments have spearheaded this growth for the bank. The bank now boasts a healthy 8% share in the trade business while the remittances market share has swelled to ~15%. Similarly, the bank's digital footprint has grown as the digital touchpoints have grown from 55k in Mar'22 to over 73k in Mar'23. Moving forward, we expect income stream from this end to become more profound as current investments in the digital space bear fruit.

Interest moving away from lending to investments: Lending has long been the forte for BAFL particularly when it comes to the riskier segments be it consumer, SME or retail. However, the focus has moved over the past year due to three primary reasons; 1) economic slowdown that has reduced the demand for lending and earlier repayments from customer base, 2) removal of ADR thresholds and 3) high interest rates which have made investments an attractive avenue to generate essentially risk free return. Resultantly, ADR has slid to only 45% in Mar'23 from over 58% in the SPLY while IDR has risen to ~83% from 77% over the same period. However, we expect this to be a short-term move and ADR to move closer to the 55-60% levels the bank has long maintained as interest rates top out and the tide turns.

One of the best yield plays: Though numbers suggest a growth story, healthy dividend pay-outs make the bank an attractive yield play. Balance sheet growth has enabled the bank to maintain a ~50% pay-out in the past two years but we expect the trend to slow down to ~35% this year with annual pay-out expected at PKR 7/sh which equates to a dividend yield of ~17%. It is pertinent to note here that recent buy-back and cancellation of 200Mn shares by the bank will also facilitate improved earnings and higher pay-outs going forward.

Bank Al-Habib: Into the fast lane

BAHL has undergone a significant change in fortunes as the management adopted a more proactive approach in terms of amplified branch outreach and digital transformation. The bank has now cemented its place as a robust mid-sized bank courtesy double digit deposit growth aided by rigorous branch expansion, strengthening investments portfolio, clean loan book and leveraged balance sheet generating above average ROE's consistently. The lean balance sheet structure and growing deposit base have enabled the bank to optimize its asset base while strengthening its capitalization ratios. Incorporating the same in our valuations, we reinitiate coverage on BAHL with a BUY rating with a Dec-23 TP of PKR 93/sh, offering an upside of 65%. We opine the stellar performance of the bank over the past couple of years is yet to be reflected in the stock price and current levels (CY23/24 P/B of 0.6x/0.4x) are enticing.

Branch network doubles in 5 years: BAHL's rigorous branch expansion theme continued to be the core area of focus for the management as 123 new branches were opened in CY22 to surpass 1k branches. Note that the bank has doubled its branch network over the past seven years and the management expects to close the close the year with a tally of 1200. The same strategy seems to be bearing fruit as the company's deposits have undergone a 5-year CAGR of 19.2% compared to 13.4% for the industry. As a result of which, deposits to equity ratio of

Bank Al Habib Limited — (PSX: BAHL, Bloomberg: BAHL.PA): Earnings Snapshot

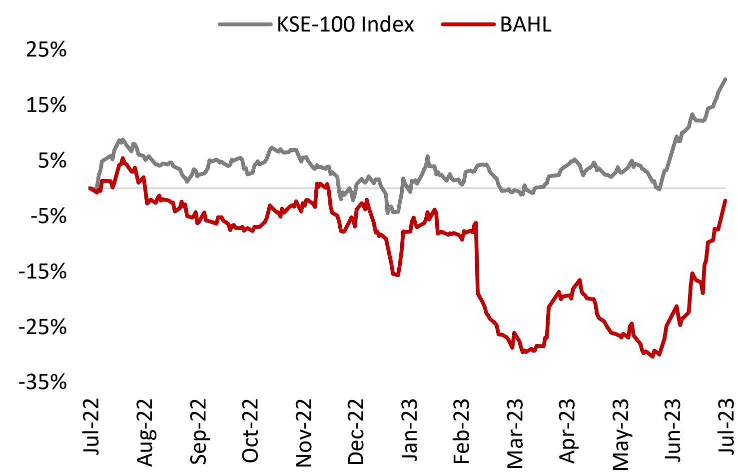
(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	57,620	55,609	77,319	104,660	110,782
Non-interest income	10,273	14,027	21,196	24,806	27,013
Fee income	6,678	9,305	11,595	12,590	13,670
FX income	2,143	2,970	7,241	10,020	11,022
Gain on securities	186	(41)	183	99	102
Operating expenses	34,748	39,410	52,761	64,544	70,880
Provisions – net	4,543	(47)	12,871	3,477	5,764
Profit before taxation	28,581	30,273	32,884	61,445	61,150
Profit after taxation	17,811	18,702	16,570	32,439	31,187
EPS	**16.0**	**16.8**	**14.9**	**29.2**	**28.1**
DPS	**4.5**	**7.0**	**7.0**	**10.0**	**10.0**

Source: Company Financials, BMA Research

Stock Information

PSX Code	BAHL
Bloomberg Code	BAHL PA
Target Price (PKR)	**93.0**
Last Closing (PKR)	56.2
Potential Gain (%)	**65.5%**
52 Weeks Range	61.5/40.0
12M Avg. Vol (Mn)	0.06
12M AVT (USD Mn)	0.01
Mkt Cap (USD Mn)	218.0
Shares Outstanding (Mn)	1,111
Free Float	65%

Performance Chart



Source: PSX, BMA Research

the bank has swelled to 19.3x, one the highest in the industry that have aided the bank in generating consistently robust ROE's (CY18-22 avg. ROE: 21%). With continued deposit mobilization amid record interest rate levels, we expect ROE's to inch up further and see them averaging 25% over CY23-25.

Building its loan book: Previously, the bank had a conservative stance towards lending however, with a more proactive approach, the lending book has also been scaled up. Majority increase has been noted in the textiles and food sectors while the bank also seems to be repositioning itself in the consumer segment. The bank's loan book has increased at an impressive 5-year CAGR of over 20% while industry has only managed to grow by 11.7% over the same period. However, the same has not been done at the cost of bad loan pile-up. The bank still maintains a clean loan book and we opine there is little probability of spike in bad loans evident by a coverage ratio of over 120% and an infection ratio of only 1.8%.

Robust investment income to keep NII ticking: Recent repositioning of the asset books following the sharp increase in interest rates have yielded results so far as the bank posted record profits in the past quarter (PKR 10.6Bn/9.5 per share). Moving forward, we expect NII accretion on the back of upwelling investment income to continue and to keep NIMs strong in the near term. Note that the bank has around 75% (PKR 865Bn as at YEDec22) of the total investments parked in longer term PIBs which we opine to be a huge support to earnings (and also capital gains) as the interest rate cycle reverses. On the international bond portfolio, we opine the one-off charge (PKR 10Bn) booked by the bank to sufficiently provide for the international rating downgrades particularly pertaining to its exposure to Sri Lanka. Therefore, chances of further value erosion from that end are limited.

Faysal Bank: Cashing in on the novelty factor

FABL has added the novelty factor to itself following full conversion into an Islamic bank. We believe timely conversion to work in favor of the bank in the light of 1) high interest rates which will support top-line growth, 2) absence of MDR which will amplify NIMs accretion, 3) improved availability of fixed income instruments for Islamic banks and 4) changing consumer preferences as Islamic banking gains more traction. Broader bank metrics stand strong with above average deposit growth (5-year CAGR of 15.9% vs. 12.7% for industry), robust ADR's, firm capitalization footing and healthy ROE generation (17% in CY22) to name a few. With completion of the conversion exercise, we opine the bank is ready to embark on a growth oriented journey and provides ideal exposure to the Islamic banking space. We reinitiate coverage with a BUY and Dec-23 TP of 40/sh (54% upside).

Trading discounts could narrow if FABL follows in MEBL's footsteps: Following full conversion to Islamic, we believe the bank is now in a position of embarking on a growth journey. The balance sheet footing is strong with a 16.7% CAR and ~14% Tier-1 and will likely strengthen further as profitability is expected to mark record levels this year. If the strategy is adopted, we opine the discount on the bank's trading multiples (CY23E P/B of 0.5x) will converge as it trades at a sizable 67% discount to MEBL (CY23E P/B of 1.4x). If not the case then the bank's pay-out could increase considerably from the 20-25% (barring the one-off PKR 5.5/sh pay-out in 3QCY22) FABL has maintained over the last couple of years.

Faysal Bank Limited — (PSX: FABL, Bloomberg: FABL.PA): Earnings Snapshot

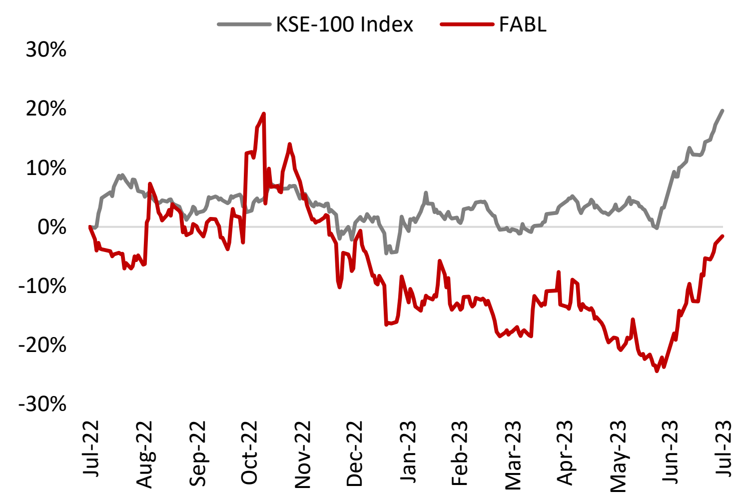
(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	24,534	25,834	39,988	60,215	70,692
Non-interest income	8,231	8,509	8,959	11,143	13,148
Fee income	3,861	5,094	6,628	7,596	8,355
FX income	2,093	2,379	2,848	3,739	3,926
Gain on securities	1,697	310	(1,560)	(850)	70
Operating expenses	19,740	20,887	27,494	36,501	43,010
Provisions – net	2,254	48	(940)	4,045	6,889
Profit before taxation	10,770	13,409	22,393	30,812	33,942
Profit after taxation	6,511	8,153	11,160	15,370	17,311
EPS	**4.3**	**5.4**	**7.4**	**10.1**	**11.4**
DPS	**0.0**	**1.5**	**7.0**	**3.0**	**4.5**

Source: Company Financials, BMA Research

Stock Information

PSX Code	FABL
Bloomberg Code	FABL PA
Target Price (PKR)	**40.0**
Last Closing (PKR)	26.1
Potential Gain (%)	**53.6%**
52 Weeks Range	31.9/19.8
12M Avg. Vol (Mn)	0.16
12M AVT (USD Mn)	0.01
Mkt Cap (USD Mn)	137.9
Shares Outstanding (Mn)	1,518
Free Float	25%

Performance Chart



Source: PSX, BMA Research

Faysal Bank Limited (FABL)

NIMs to inch up as the absence of MDR comes into play: Though it is still early to say and the real impact is yet to fully materialize, funding costs of the bank have started to moderate despite only being one quarter into full conversion. Note that, cost of deposits (ex-CA) moderated to 10.8% in 1Q against 11.2% in the previous quarter in spite of the 400bps hike in policy rate in 1Q from 16% to 20%. This serves as a good indication of how NIMs can rapidly increase as re-pricing continues. We expect NIMs to rise to 6.6/7.0% in CY23/24 respectively as the re-pricing impact flows through and the absence of MDR becomes more profound.

Balance sheet expansion has remained robust despite conversion: FABL has consistently surpassed industry growth trends which is evident by the higher than industry deposit (CY18-22 CAGR of 15.9% against 12.7% for the industry) and advances growth (CY18-22 CAGR of 14.4% against 12.8% for the industry). Furthermore, the deposit mobilization was not at the expense of higher cost deposits as CASA jumped from only 72% in CY17 to ~86% in the past quarter (Mar'23). It is worth highlighting that this growth was achieved when the bank was in the phase of being converted into a full-fledged Islamic bank which further cements our view that it can sizably scale up its deposits franchise and assets books going forward with the addition of Islamic banking novelty factor.

Habib Metropolitan: Undergoing a style drift

BMA CAPITAL

The move from sticky fixed deposits, robust capitalization ratios, strong non-core income and well positioned investments book are key factors that premise our liking for HMB. The bank's investments are ideally placed to make the most of multi decade high interest rates with ~57% of the book maturing in 12 months, hence the element of re-pricing will be considerably higher in HMB than peers. It is also worthy to note the healthy increase in non-core income particularly fee income that has expanded at an expressive 5-year CAGR of 19% while lower composition of fixed cost deposits will support NIMs accretion, in our view. The bank trades at CY23/24 P/B of only 0.5/0.4x respectively which indicates a 14% discount (at current levels) to other mid-sized banks which we opine is unjustified given the consistently strengthening balance sheet footing and robust ROE's. We reinitiate with a BUY and a Dec'23 TP of 59/sh (upside: 63%; DY: 21%).

Ideally positioned investments book: As at the end of CY22, 57% of HMB's investments portfolio (>PKR 400Bn) were due to mature in 12 months. This ratio is the highest in our BMA Banking sector coverage and enables the bank to make the most of the high interest rates. Of the said 57%, 11%/PKR 77Bn have already re-priced at the conclusion of Mar'23 quarter and this persistent re-pricing will cushion NIMs going forward. Note that, the bank already has an IDR of 86% (>PKR 800Bn) which will help in pulling NIMs by around 90/30bps in CY23/24 respectively.

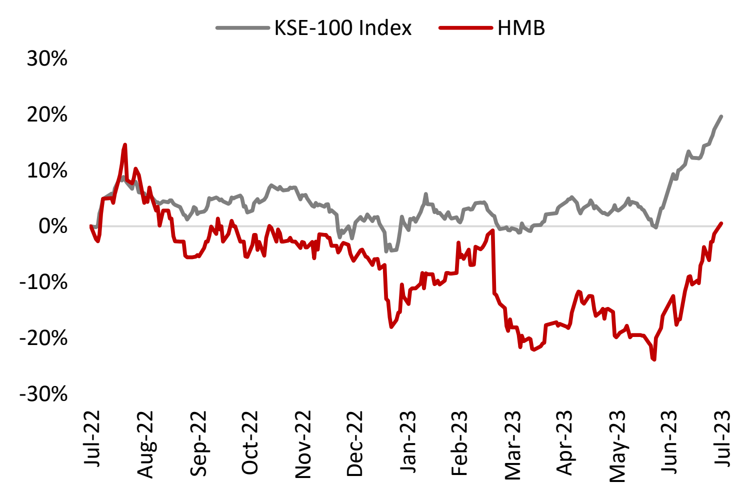
Habib Metropolitan Bank — (PSX: HMB, Bloomberg: HMB.PA): Earnings Snapshot

(PKR Mn)	CY20A	CY21A	CY22A	CY23E	CY24F
Net interest income	28,763	29,497	40,611	57,928	65,820
Non-interest income	9,650	11,140	13,216	14,869	15,890
Fee income	5,376	6,906	7,931	9,025	9,927
FX income	4,087	3,707	5,094	5,650	5,763
Gain on securities	(44)	102	(217)	(114)	100
Operating expenses	14,875	17,087	22,677	31,156	37,347
Provisions – net	3,502	2,009	3,531	3,995	2,563
Profit before taxation	20,037	21,541	27,618	37,646	41,800
Profit after taxation	12,008	13,459	14,261	19,187	21,318
EPS	**11.5**	**12.8**	**13.6**	**18.3**	**20.3**
DPS	**4.5**	**5.0**	**5.3**	**7.5**	**8.5**

Source: Company Financials, BMA Research

Stock Information	
PSX Code	HMB
Bloomberg Code	HBL PA
Target Price (PKR)	**59.0**
Last Closing (PKR)	36.2
Potential Gain (%)	**63.0%**
52 Weeks Range	41.4/27.3
12M Avg. Vol (Mn)	0.03
12M AVT (USD Mn)	0.00
Mkt Cap (USD Mn)	132.3
Shares Outstanding (Mn)	1,048
Free Float	45%

Performance Chart



Source: PSX, BMA Research

Habib Metropolitan Bank Limited (HMB)

Healthy fee income growth to continue to support earnings: Fee income has expanded at an impressive 19% over CY17-22 with primary impetus coming from commission on trade (30%) and card related fee (28%) respectively. This is in spite of softening trade related commission income to 5% YoY in CY22 on the back of administered imports. However, this could undergo a sharp increase as international flows are generated and trade activity reverts to normalized levels. Similarly, with the 500 branches milestone achieved in the outgoing year, we opine other income segments to also strengthen the non-core income stream going forward.

Lower fixed deposits are supporting the bottom-line: Previously, the impact of interest rate hikes was not particularly visible for the bank due to its huge fixed deposit base as they made ~45% of the bank deposits until CY18. However, following a strategic shift in CY19 and increased deposit mobilization, the bank has significantly shed these high cost deposits and they now make up only 30% of the deposit base. Hence, the impact of recent rate hikes will be particularly amplified compared to what we have observed in the past.

Robust capitalization can facilitate higher pay-outs: With profitability expected to hit record levels this year and major investment in the brick and mortar model done, we opine dividend pay-outs of the bank can improve going forward. Sound capitalization only cements our view as the bank's Tier-1 and CAR stand comfortable at 13.2% and 14.0% respectively. Pay-out ratio over the past couple of years slid to 25% however, we see that reverting to longer term averages of 40-50% in the upcoming years.

Key risks

- **Higher than expected provisioning:** Though prudent lending policies and limited exposure to riskier sectors have kept NPL accretion under wraps, further weakening of the economic landscape could trigger delinquencies.

- **Higher admin costs:** Inflation has hit the sector hard and administrative expenses have increased by over 30% YoY. Continuation of the same trend post Jun'24 could revise down our earnings estimates.

- **Interest rate reversals:** We have built in interest rate reversals of 400bps in CY24. Higher than expected rate cuts or timing of the same could derail our earnings estimates.

- **One-off taxation charges/windfall levies:** In the recent budget, the govt. announced a one-off charge of additional 10% for income exceeding PKR 500Mn on an annualized basis. Accounting for this, our effective tax rate for CY23 is 49% and we have extended the same to CY24 citing the continuation of a tight fiscal policy. Any upwards revision in the same like the Advances related tax imposed last year or windfall levy on exuberant forex income could hurt earnings estimates.

- **Capital losses on investments book:** We have broadly assumed nominal capital gains but unexpected rate hikes could lead to mark to market losses.

- **Import curbs:** Import curbs could reduce banks' commission/trade/fee income and impact profitability estimates.

- **Devaluation:** Further devaluation of PKR could weaken capitalization ratios and impact dividend paying capacities.

Disclaimer

This research report is for information purposes only and does not constitute nor is it intended as an offer or solicitation for the purchase or sale of securities or other financial instruments. Neither the information contained in this research report, nor any future information made available with the subject matter contained herein will form the basis of any contract. Information and opinions contained herein have been compiled or arrived at by BMA Capital Management Limited from publicly available information and sources that BMA Capital Management Limited believed to be reliable. Whilst every care has been taken in preparing this research report, no research analyst, director, officer, employee, agent or adviser of any member of BMA Capital Management Limited gives or makes any representation, warranty or undertaking, whether express or implied, and accepts no responsibility or liability as to the reliability, accuracy or completeness of the information set out in this research report. Any responsibility or liability for any information contained herein is expressly disclaimed. All information contained herein is subject to change at any time without notice. No member of BMA Capital Management Limited has an obligation to update, modify or amend this research report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn. Furthermore, past performance is not indicative of future results.

The investments and strategies discussed herein may not be suitable for all investors or any particular class of investor. Investors should make their own investment decisions using their own independent advisors as they believe necessary and based upon their specific financial situations and investment objectives when investing. Investors should consult their independent advisors if they have any doubts as to the applicability to their business or investment objectives of the information and the strategies discussed herein. This research report is being furnished to certain persons as permitted by applicable law, and accordingly may not be reproduced or circulated to any other person without the prior written consent of a member of BMA Capital Management Limited. This research report may not be relied upon by any retail customers or person to whom this research report may not be provided by law. Unauthorized use or disclosure of this research report is strictly prohibited. Members of BMA Capital Management and/or their respective principals, directors, officers and employees may own, have positions or effect transactions in the securities or financial instruments referred herein or in the investments of any issuers discussed herein, may engage in securities transactions in a manner inconsistent with the research contained in this research report and with respect to securities or financial instruments covered by this research report, may sell to or buy from customers on a principal basis and may serve or act as director, placement agent, advisor or lender, or make a market in, or may have been a manager or a co-manager of the most recent public offering in respect of any investments or issuers of such securities or financial instruments referenced in this research report or may perform any other investment banking or other services for, or solicit investment banking or other business from any company mentioned in this research report. Investing in Pakistan involves a high degree of risk and many persons, physical and legal, may be restricted from dealing in the securities market of Pakistan. Investors should perform their own due diligence before investing. No part of the compensation of the authors of this research report was, is or will be directly or indirectly related to the specific recommendations or views contained in the research report. By accepting this research report, you agree to be bound by the foregoing limitations.

BMA Capital Management Limited and / or any of its affiliates, which operate outside Pakistan, do and seek to do business with the company(s) covered in this research document. Investors should consider this research report as only a single factor in making their investment decision. BMA Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer/company prior to the publication of a research report containing such rating, recommendation or investment thesis.

Stock Rating

Investors should carefully read the definitions of all rating used within every research reports. In addition, research reports carry an analyst's independent view and investors should ensure careful reading of the entire research reports and not infer its contents from the rating ascribed by the analyst. Ratings should not be used or relied upon as investment advice. An investor's decision to buy, hold or sell a stock should depend on said individual's circumstances and other considerations. BMA Capital Limited uses a three-tier rating system: i) Buy, ii) Neutral and iii) Underperform (new rating system effective Jan 1'18) with our rating being based on total stock returns versus BMA's index target return for the year. A table presenting BMA's rating definitions is given below:

Old rating system

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.)

BMA Branches

BMA CAPITAL MANAGEMENT LIMITED
TREC HOLDER AT PAKISTAN STOCK EXCHANGE LIMITED

HEAD OFFICE:
Level 8, Unitower, I.I. Chundrigar Road, Karachi - 74000, Pakistan
Tel: +92 21 111 262 111 | Fax: +92 21 3243 0748 | www.bmacapital.com | info@bmacapital.com

Stock Exchange Branch:
Room 141, Pakistan Stock Exchange,
Stock Exchange Road, Karachi.
Tel: (021) 32410617

Bahadurabad Branch:
Office # 3, Mezzanine Floor,
Akber Manzil, Main Bahadurabad
Roundabout, Karachi.
Tel: (021) 3486 0393-98
Fax: (021) 3493 1396

Gulshan-e-Iqbal Branch:
Commercial Office premises bearing,
B-29 Mezzanine Floor 13/A, Main University
Road, Gulshan-e-Iqbal Karachi.
Tel: (021) 34825023

North Nazimabad Branch:
D-14 Office No 02, 2nd Floor Block H,
MCB Building, Near 5 Star Round About,
North Nazimabad Karachi.
Tel: (021) 36672301-00.

Awami Markaz Branch:
G13, Ground floor, Awami Markaz,
Shahrah-e-Faisal, Karachi.
Tel: (021) 34300578

Lahore Cavalry Branch:
Office No. 74, 2nd Floor, Commercial Area,
Main Cavalry Ground, Lahore Cantt, Lahore.
Tel: (042) 3667 6614-20
Fax: (042) 3661 9912

Lahore Gulberg Branch:
Commercial Office No. 402, 7th Floor,
Mega Tower 63-B, Main Boulevard,
Gulberg II, Lahore.
Tel: (042) 35762953-57

Lahore LSE Branch:
1st Floor Room# 110-111, LSE Building,
19- Khayaban-e-Aiwan-e-Iqbal, Lahore.
Tel: (042) 36280931-34

Islamabad Branch:
104, 1st Floor, 82-East,
Muhammad Gulistan Khan House,
Fazel e Haq, Blue Area, Islamabad.
Tel: (051) 280 2354-5
Fax: (051) 280 2356

Sialkot Branch:
2nd Floor, Sialkot Business & Commerce
Centre, Paris Road, Sialkot, Adjacent to
Sialkot Chamber of Commerce.
Tel: (052) 4260091-94

Multan Branch:
Office No. 607/A, 6th Floor,
The United Mall, Plot No. 74,
Abdali Road, Multan.
Tel: (061) 457 6611-15
Fax: (061) 457 6615

Sargodha Branch:
Ground floor, Shan Plaza, Block No 16,
Main Khushab Road, Near Allied Bank
Limited, Sargodha.
Tel: (048) 3767 817-18

Faisalabad Branch:
Mezzanine Floor, State Life Building #2,
Plot No. 833 Liaquat Road, Faisalabad.
Tel: (041) 2612261-5.

Gujranwala Branch:
51-H Block, Near Standard Chartered Bank,
Trust Plaza, GT Road, Gujranwala.
Tel: (055) 3848501-05

Chakwal Branch:
Office No. 12, 1st Floor, Ejaz Plaza,
Talagang Road, Chakwal.
Tel: (0543) 553850, 0543-543720,0543-543721.

Jhelum:
2nd Floor, Khalid Plaza, Plot#7/89,
Kazim Kamal Road, Jhelum.
Tel: (054) 4620594-97

Peshawar Branch:
Shop No.F1 & F2, 1st Floor Mall Tower 35,
The Mall Peshawar Cantt.
Tel: (091) 5274770-72

Abbottabad Branch:
Gohar Son's Arcade, 1st Floor, Office# 4,
Supply Bazar, Sikandarabad, Abbottabad.
Tel: (0992) 400346-47

Gujar Khan Branch:
1st Floor, Office# 101 & 102, Akbar Kayani
Plaza, GT Road, GujarKhan.
Tel: (051) 3762083

Bahawalpur Branch:
Plot # 13-A, 1st Floor, Office # 2,
Model Town B, Bahawalpur.
Tel: (062) 2883158, 2884158