

PAKISTAN BANKS

HMB: Payout a limiting factor!

Coverage Initiation

- We initiate coverage on Habib Metropolitan Bank (HMB) with a 'Neutral' stance and a Dec'19TP of PkR43.8/sh. We believe lower dividend payout (CY18: 34.0% vs. CY17: 55.0%) due to pressure on CAR from unrealized losses on PIB holdings to overshadow otherwise strong fundamentals of the bank (avg. CY19-21F ROE of 17.1%) in the medium run.
- NIMs are likely to avg. at 3.4% (CY19-21F) vs. 2.8% (CY16-18) driven by, i) accumulation of higher yielding PIBs (3y CAGR assumed at 22.0%), and ii) advances growth of 19.3% (avg. CY16-18) enhancing interest rate sensitivity of the bank.
- We expect cost of provisioning to avg. at 0.8% (CY19-21F), significantly lower than compared to avg. 2.1% (CY09-13). Our expectation is based upon better industry dynamics for the textile sector (38.0% of advances in CY18 but significantly lower than 53.3% in CY09) and overall coverage ratio comfortable at 93.7% vs. 72.1% (CY09-13).
- The bank carries higher load of fixed deposits (41.3% of deposits as of Dec'18) however, viewed with highest deposits/branch (PkR1.6bn per branch), HMB stands at a better position to peers with total expense of deposits (total cost + administration expense) standing at 6.1% vs. avg. 6.5% of other mid-tiers.

Improvement in NIMs to drive ROE: NIMs are likely to avg. at 3.4% (CY19-21F) vs. 2.8% (CY16-18) driven by, i) accumulation of higher yielding PIBs (3y CAGR assumed at 22.0%) - PIB yield spread is assumed at ~2.2% on a 3y PIB vs. ~0.1% lending yield spread earned by the bank in CY18, and ii) advances growth of 19.3% (avg. CY16-18) enhancing interest rate sensitivity. Lower CAR buffer (1.2% as of Dec'18) could be reflected on the bank's advances growth that is expected to fall to CY19-21F avg. of 3.8%, with textile sector potentially drawing higher financing share. Additionally, continuous improvement in deposit mix (HMB reduced its fixed deposits by 2ppt in CY18 to 41.3%, still the highest in our universe) would materially be positive for NIMs. That said, the bank negates the impact of higher fixed deposits through effectively leveraging branch network for deposit growth (deposit/branch highest amongst mid-tiers at PkR1.6bn). This puts the bank at a better position to peers with total expense of deposits (average cost of deposits + administration expense) standing at 6.1% vs. avg. 6.5% of other mid-tiers.

... But not without contained provisioning costs and NFI support: We expect cost of provisioning to avg. at 0.8% (CY19-21F), significantly lower than compared to avg. 2.1% (CY09-13). Our expectation is based upon better industry dynamics for the textile sector and overall coverage ratio comfortable at 93.7% vs. 72.1% (CY09-13). Further, exposure to textile sector occupies 38.0% of total advances significantly lower than 53.3% in CY09. Lower provisioning costs together with robust Non Funded Income (NFI) base is likely to support earnings growth of the bank. Non Funded Income (NFI) contribution to total income is likely to remain stable at CY18 level (26.8%) driven by core-NFI. An important element of NFI for HMB is its FX income (contribution of 6.4% is the highest in the recurring revenues of any bank in our universe). We expect FX income share in total NFI base to cross 25% mark in the medium term, as seen in times of uncertainty (CY09-12) vs. 15.8% in CY13-17. Fee income franchise is expected to beat historical 5y CAGR of 11.2%, benefitting from currency devaluation (trade related fees) and branch network expansion (22.4% branches added in the past 2y).

Lower dividend payouts to keep a check on stock performance: HMB has corrected 11.3% CY19TD on account of lower expected payout given pressure on CAR (CY18 CAR: 13.1% vs. 17.4% in CY17) from unrealized losses on PIB holdings (PkR8.8bn as of Dec'18). The dividend payout is expected to remain at current levels (CY18: 34%) citing potential accretion in unrealized losses, with maturity of current PIB holding extending 2-3y and interest rate hikes continuing in CY19, dragging CAR of the bank. We believe lower dividend payouts to overshadow otherwise strong fundamentals of the bank (avg. CY19-21F ROE of 17.1%) in the medium run. We have a 'Neutral' stance on the stock with a Dec'19TP of PkR43.8/sh, offering an upside of 10.0% from last close (Total return: 16.3%). To highlight, the bank is currently trading at a discount of 22.1% to our universe based on ROE per unit of P/B vs. historical discount of 12.7% (HMB's CY19F P/B: 0.9x).

REP-019

MARKET VISTA

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NEUTRAL

| | |
|--------------------|-------------------|
| TARGET PRICE (PkR) | SHARE PRICE (PkR) |
| 43.8 | 39.8 |
| UPSIDE/DOWNSIDE | DIV. YIELD |
| 10.0% | 6.3% |

HMB: Valuations stats

| | CY18 | CY19F | CY20F |
|-----------|------|-------|-------|
| EPS (PkR) | 5.9 | 6.9 | 8.3 |
| DY (%) | 5.0 | 6.3 | 7.5 |
| BVPS | 38.6 | 43.0 | 50.7 |
| P/B (x) | 1.0 | 0.9 | 0.8 |
| P/E (x) | 6.7 | 5.8 | 4.8 |
| ROE (%) | 15.2 | 17.0 | 17.8 |
| ROA (%) | 1.0 | 0.9 | 1.0 |

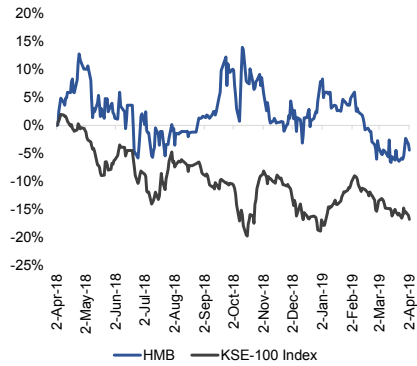
Source: Company Report & AKD Research

| | |
|-----------------------------|---------------|
| KATS Code | HMB |
| Bloomberg Code | HMB.PA |
| Price PkR | 39.8 |
| Market Cap (PkRmn) | 41,670.60 |
| Market Cap (US\$m) | 297.64 |
| Shares (mn) | 1,047.83 |
| Free Float Share (mn) | 471.52 |
| 3M High (PkR) | 46.00 |
| 3M Low (PkR) | 39.64 |
| 1Yr High (PkR) | 48.41 |
| 1Yr Low (PkR) | 39.64 |
| 3M Avg Turnover '000 | 201.09 |
| 1Yr Avg Turnover '000 | 316.85 |
| 3M Avg DT Value (PkR'000) | 10,090.55 |
| 3M Avg DT Value (US\$'000) | 72.08 |
| 1Yr Avg DT Value (PkR'000) | 13,664.09 |
| 1Yr Avg DT Value (US\$'000) | 97.60 |



AKD Securities Limited

HMB vs. KSE100 Index



Source: PSX & AKD Research

HMB -Annual Financial Databank

Valuation Multiples

| (Year End Dec-31) | CY16A | CY17A | CY18A | CY19F | CY20F |
|-----------------------------|--------|-------|-------|-------|-------|
| EPS | 5.8 | 5.4 | 5.9 | 6.9 | 8.3 |
| EPS Growth | -20.1% | -4.3% | 9.5% | 12.9% | 20.6% |
| DPS | 3.0 | 3.0 | 2.0 | 2.5 | 3.0 |
| Payout Ratio | 51.0% | 55.0% | 34.0% | 36.0% | 36.0% |
| BVPS | 37.9 | 41.9 | 38.6 | 43.0 | 50.7 |
| P/E (x) | 6.9 | 7.4 | 6.7 | 5.8 | 4.8 |
| P/BV (x) | 1.0 | 0.9 | 1.0 | 0.9 | 0.8 |
| ROA | 1.2% | 0.9% | 1.0% | 0.9% | 1.0% |
| ROE | 16.0% | 14.0% | 15.2% | 17.0% | 17.8% |
| Dividend Yield | 7.5% | 7.5% | 5.0% | 6.3% | 7.5% |
| Market Cap/ Deposits | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Investment-to-Deposit Ratio | 73.0% | 76.4% | 62.9% | 69.1% | 71.7% |
| Loan-to-Deposit Ratio | 33.2% | 35.1% | 43.5% | 32.9% | 31.3% |
| Infection Ratio | 12.4% | 9.3% | 7.0% | 8.8% | 9.1% |
| Coverage Ratio | 85.2% | 88.7% | 93.7% | 88.1% | 88.1% |
| Net Interest Margins | 2.8% | 2.8% | 2.9% | 3.2% | 3.4% |
| Cost of provisioning | 0.5% | -0.2% | 0.2% | 0.6% | 0.8% |

Income Statement

| (PkRmn) | CY16A | CY17A | CY18A | CY19F | CY20F |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Interest Income | 11,774 | 14,252 | 16,654 | 20,432 | 24,716 |
| Fee Income | 3,084 | 3,489 | 3,847 | 4,660 | 5,230 |
| FX Income | 1,036 | 1,172 | 1,498 | 2,248 | 2,023 |
| Dividend Income | 122 | 430 | 103 | 23 | 33 |
| Total Recurring Revenues | 16,016 | 19,343 | 22,103 | 27,363 | 32,001 |
| Capital Gains | 4,325 | 423 | 85 | 52 | 77 |
| Other Income | 322 | 389 | 567 | 595 | 625 |
| Total Income | 20,663 | 20,155 | 22,754 | 28,011 | 32,703 |
| Administration Expenses | 9,408 | 10,535 | 11,798 | 13,705 | 16,077 |
| Other Expenses | 62 | 35 | 188 | 234 | 272 |
| Profit before provisions | 11,193 | 9,585 | 10,769 | 14,072 | 16,355 |
| Provisions | 845 | 74 | 424 | 1,569 | 2,032 |
| Profit before taxes | 10,348 | 9,511 | 10,345 | 12,503 | 14,323 |
| Net Income | 6,129 | 5,865 | 6,421 | 7,246 | 8,737 |

Balance Sheet

| (PkRmn) | CY16A | CY17A | CY18A | CY19F | CY20F |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Investments | 314,133 | 395,266 | 341,284 | 454,181 | 528,927 |
| Gross Advances | 159,882 | 198,217 | 252,674 | 234,462 | 251,113 |
| Less: Provisions | 16,931 | 16,426 | 16,561 | 18,130 | 20,162 |
| Advances | 142,951 | 181,790 | 236,113 | 216,333 | 230,952 |
| Total Assets | 526,443 | 651,126 | 664,410 | 769,753 | 872,455 |
| Borrowing | 37,205 | 67,323 | 53,009 | 30,402 | 40,174 |
| Deposits | 430,444 | 517,685 | 542,839 | 657,638 | 737,990 |
| Current Deposits | 120,721 | 132,885 | 143,954 | 184,215 | 221,253 |
| Saving Deposits | 114,969 | 138,445 | 148,144 | 194,307 | 213,796 |
| Total Liabilities | 486,705 | 607,263 | 623,958 | 724,724 | 819,331 |
| Shareholder's Equity Inc. MI | 37,209 | 42,929 | 46,014 | 51,165 | 57,366 |
| Total Equity | 39,738 | 43,862 | 40,452 | 45,029 | 53,124 |

Shareholding Pattern

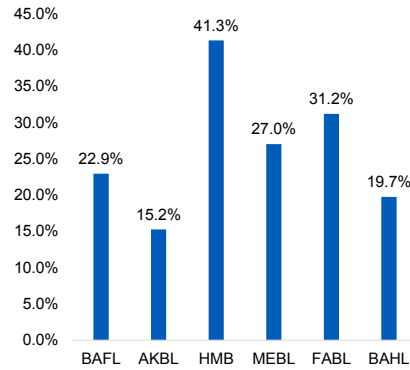
*As of Dec-2018 Annual Report

| Category | (%) |
|--|-------|
| Directors | 2.35 |
| Associated Companies | 51.26 |
| Executives | 0.06 |
| Public Sector Companies and Corporations | 1.06 |
| Banks, DFI, NBFC, Ins, Takaful & Modarabas | 6.39 |
| Mutual Funds | 4.15 |
| General Public | |
| Local | 16.01 |
| Foreign | 0.29 |
| Foreign Companies | 10.29 |
| Others | 8.12 |

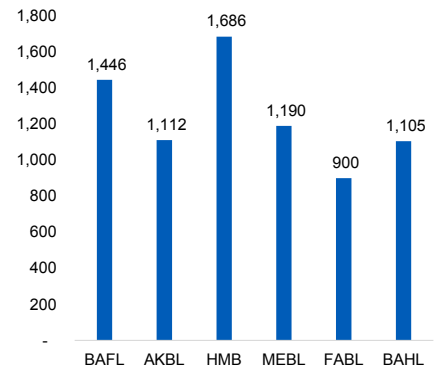
Source: Company Report & AKD Research

Chart bank

Deposit mix carries load of high cost of deposits

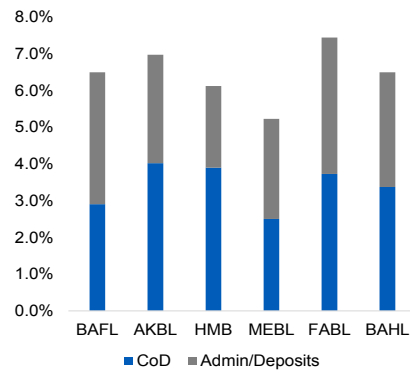


..... But highest deposit / branch amongst mid-tiers negate impact

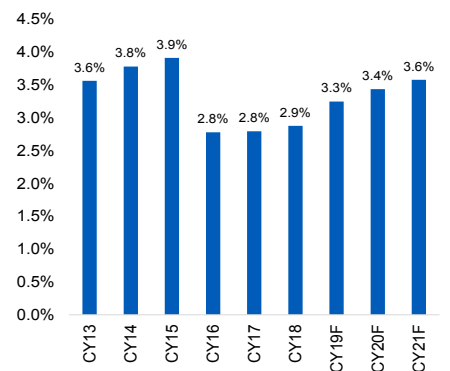


Source: Company Report & AKD Research

— Evidenced by total expense on deposits comparable to peer banks

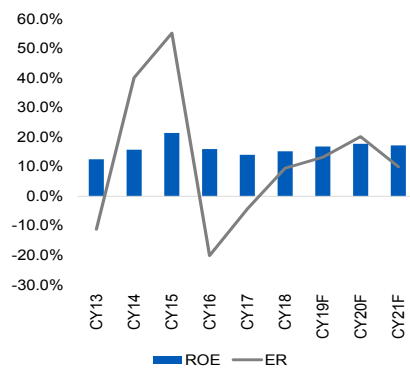


NIMs reaching historic levels

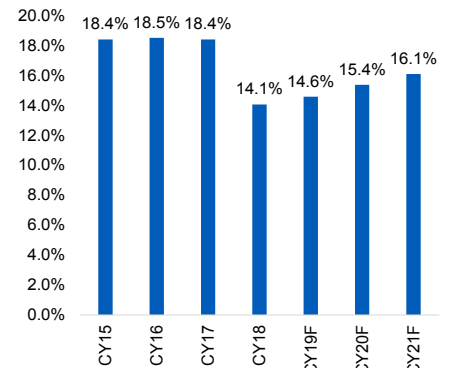


Source: Company Report & AKD Research

..... Would carry ROE north of 15% amid earnings growth of +10%



..... Though recovery of CAR could be a medium term phenomena



Source: Company Report & AKD Research

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New Rating Definitions

| | |
|---------|--|
| Buy | > 19% expected total return (Rf: 13% + Rp: 6%) |
| Neutral | > 13% to < 19% expected total return |
| Sell | < 13% expected total return (Rf: 13%) |

Old Rating Definitions (Discontinued)

| | |
|------------|---|
| Buy | > 20% upside potential |
| Accumulate | > 5% to < 20% upside potential |
| Neutral | < 5% to > -5% potential |
| Reduce | < -5% to > -20% downside potential |
| Sell | < -20% downside potential |
| Not Rated | No investment opinion or recommendation |

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

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

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