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Mar’21 spreads clocked in at 4.31%

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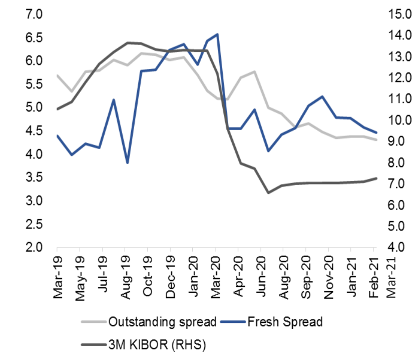
- **Banking sector spreads for Mar’21 stood at 4.31%, recording a marginal dip over Feb’21 of 4.38%, taking 1QCY21 avg. spread to 4.35% as against 5.42% in the same period last year and 4.50% in the previous quarter. Fresh spreads continue to diminish for the fourth consecutive month with the latest reading exhibiting a dip of 10bps MoM taking 1QCY21 cumulative decline to 32bps from Dec’20.**
- **1QCY21 earnings of our banking universe registered a growth of 36.5%YoY/27.0%QoQ to stand at PkR54.0bn while sequential growth is primarily driven by jump in Non Funded Income and steep decline in provisioning expense. Core income of the sector registered a decline of 3.7%QoQ with lower spreads and normalization in investment yield pulling down gross yields to 49.2% vis-à-vis 51.3% in the previous quarter.**
- **The banking sector has underperformed the market with CY21TD negative performance of 6.6% compared to KSE-100’s +3.5% with market participants looking for value elsewhere amid broad market expectation of stable interest rates. We expect the sector to regain interest as COVID third wave dilutes and authorities mount on the normal course of policy making.**
- **On valuations, we have preference for larger plays compared to mid tiers where we like HBL (earnings recovery, high exposure to economic activity — Dec’21TP: PkR174.6), UBL (CY21F dividend yield of 9.6% - Dec’21TP: PkR142.5/sh), and MCB (PIB book, recoveries from NIB portfolio supporting earnings — Dec’21TP: PkR223.4/sh).**

Banking sector spreads stand at 4.31% in Mar’21: Banking sector spreads for Mar’21 stood at 4.31% recording a marginal dip over Feb’21 of 4.38%, taking 1QCY21 avg. spread to 4.35% as against 5.42% in the same period last year and 4.50% in the previous quarter. Fresh spreads continues to diminish for the fourth consecutive month with the latest reading exhibiting a dip of 10bps MoM taking 1QCY21 cumulative decline to 32bps from Dec’20. A similar trend has been witnessed in credit spreads which has recorded a downtick to 45bps in Mar’21 compared to 105bps in Dec’20 (Avg. 1QCY21 credit spreads stood at 60bps vis-à-vis 102bps in 4QCY21). We attribute these trends to competitive pricing to push financing growth as well as subsidized financing schemes of the Central Bank. To highlight, advances have registered a growth of 1.2% QoQ in the 1QCY21 over 5.0%QoQ already registered in 4QCY20 (attributable to seasonal financing offtakes particularly by agriculture sector) — an indication of robust business outlook in the medium run which should also help the banking sector containing credit risks with the relief period expired in Mar’21.

Capital gains holding up 1QCY21 earnings of the banking sector: 1QCY21 earnings of our banking universe registered a growth of 36.5%YoY/27.0%QoQ to stand at PkR54.0bn while sequential growth is primarily driven by jump in Non Funded Income and steep decline in provisioning expense. On the former, NFI registered an uptick of 15.0%QoQ with the push coming from capital gains (1QCY21: PkR8.8bn vs. PkR1.7bn in the previous quarter) and FX income (1QCY21: PkR6.0bn vs. PkR5.2bn in 4QCY21), while fee income surprising remained flat vs. historical trend of decline in 1Qs (certain year-end adjustments have kept 4Q fee income elevated in the past). Provisioning expense stood at PkR7.6bn in 1QCY21 compared to PkR27.3bn in the previous quarter where across the board declines were witnessed giving an indication of asset quality panning out in the near term. Core income of the sector registered a decline of 3.7%QoQ with lower spreads and normalization in investment yield pulling down gross yields to 49.2% vis-à-vis 51.3% in the previous quarter.

Investment Perspective: The banking sector has underperformed the market with CY21TD negative performance of 6.6% compared to KSE-100 index’s +3.5% with market participants looking for value elsewhere amid broad market expectation of stable interest rates. We believe the sector to regain interest as uncertainty regarding COVID third wave evades and the Central Bank mounts its normal course of policy making. On valuations, we have preference for larger plays compared to mid tiers where we like HBL (earnings recovery, high exposure to economic activity — Dec’21TP: PkR174.6), UBL (CY21F dividend yield of 9.6% - Dec’21TP: PkR142.5/sh), and MCB (PIB book, recoveries from NIB portfolio supporting earnings — Dec’21TP: PkR223.4/sh).

Spreads and borrowing rate



Source: SBP, Bloomberg & AKD Research

AKD Banking Sector Earnings Review

(PkRbn)	1QCY21	1QCY20	YoY	4QCY20	QoQ
Markup Earned	308	394	-21.9%	307	0.4%
Markup Expensed	156	251	-37.8%	149	4.7%
Net Interest Income	152	143	6.1%	157	-3.7%
Non-Interest Income	49	39	25.1%	42	14.9%
Non-Mark-up Expenses	104	99	5.1%	103	1.2%
Pre-Provision Profit	96	83	16.1%	97	-0.7%
Provisions	8	16	-51.5%	27	-72.3%
PBT	89	67	31.8%	70	27.5%
Taxation	35	28	25.1%	27	28.5%
PAT	54	40	36.5%	43	26.9%

Source: Company reports, PSX & AKD Research

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