AKD Daily

Monday, Jul 16, 2018

Today's Daily

Pakistan Banks: Adjusting for higher rates

SBP has increased interest rates by a 100bps in Jul'18 MPS resulting in a cumulative bump of 175bps in CY18 so far, citing the following reasons: 1) NFNE core inflation at 7.0%YoY in Jun'18, 2) rising fiscal deficit (FY18E: 6.8% vs. GoP's target of 5.5%), and 3) escalating external imbalance as key determinants. The swift pace of increments has come as a surprise, where we have accordingly revised upwards our average DR assumption to 7.50 % in CY18F (previously at 7.0%).This remains particularly positive for banks, with net interest margins likely improving on the back of higher asset yields. Accordingly, our earnings estimates for the Big-6 banks have increased by an avg. 3.5-7.0% for CY18F. While banks will continue to struggle in CY18F (earnings to decelerate on the back of one-off exogenous charges during the year), recovery thereon should be swift (CY19F earnings growth of average 24%) making a strong long-term investment case. In addition to, the attractive forward valuation set at hand (CY19F PB/PER at 1.1/7.4x) post a sharp reduction in prices (AKD Banking Universe lost 7% CYTD) furthers our investment thesis. We advise building position in We advice building position in undervalued names like HBL, UBL, MCB and BAFL.

KSE100 - Index

Current	40,271.00
Previous	39,875.12
Chg.	0.99%

Mkt Cap. (PkRbn/US$bn)

Current	8,317 / 68.43
Previous	8,227 / 67.69
Chg.	1.09%

Daily Turnover (mn)

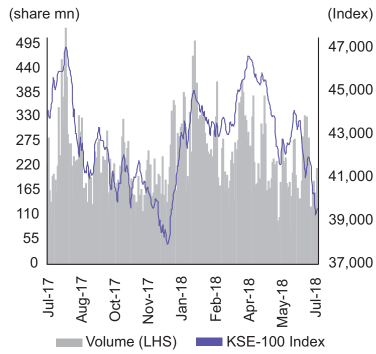
Current	124.75
Previous	108.90
Chg.	14.6%

Value Traded (PkRmn/US$mn)

Current	5,743 / 47.25
Previous	4,826 / 39.71
Chg.	19.0%

News and Views

- While speaking at the PSX, the interim FM Shamshad Akhtar said that Pakistan might have to approach IMF post elections. However it was not necessarily a bad thing to ensure stability. Pakistan has the capability to negotiate with IMF and has the right experts.
- As stocks of furnace oil pile up, state-run oil marketing company Pakistan State Oil (PSO) is reluctant to import more fuel in the absence of firm demand from power producers. A senior government official revealed that independent power producers were not consuming furnace oil in line with the demand they had floated at the time of imports.
- The Federal Board of Revenue (FBR) has allowed sales tax adjustment paid at customs clearance stage by steel melters on import of raw materials including various categories of remeltable iron and steel scrap.



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Policy rate up by 100bps: In a preemptive move, SBP raised benchmark rate by 100bps with TR/DR ending at 7.5%/8.0%. This marks the third round of interest rate hike in CY18 (cumulative 175bps) in order to curb buildup of inflationary pressures (core inflation NFNE standing at 7.0%YoY in Jun'18 vs. 5.5%YoY in Jun'17). Additional catalyst for the hawkish stance included rising fiscal deficit (FY18E: 6.8% vs. GoP's target of 5.5%), rupee devaluation and escalating external imbalance. Going forward, inflation is expected to continue to mount in light of currency depreciation and rising oil prices along with sustained external imbalance, subsequently leading to continued upward trajectory of interest rate profile. In this regard, we expect cumulative 75bps hike in interest rate during the ongoing year with TR/DR ending at 8.25%/8.75% by Dec'18.

Upward adjustment in DR: In light of the recent uptick in interest rates, we have upward revised our macro assumptions for DR where we now see a cumulative 250bps hike in CY18F (vs. 125bps earlier). Adjusting for the same, our earnings estimates go up by 3.5-7% in CY18F for our banking universe. That said, earnings rebound will become more noticeable from CY19F (earnings growth of an average 24%) particularly in the absence of one-off charges while improvement in NIMs in the backdrop of higher asset yields should further aid recovery.

Investment Perspective: In the backdrop of an increasing interest rate scenario, we believe banks having: 1) a higher proportion of low cost C/A deposits, 2) prudent asset quality credentials, 3) lower PIB/investment ratio and 4) an adequate CAR buffer should be preferred. We advise building position in undervalued names like HBL, UBL, MCB and BAFL.

B-6: Earnings & TP revision on 50bps increase

	EPS(PkR)	CY18F	TP-Dec'19
HBL	New	19.89	237.60
	Old	18.71	228.40
	Change	6.3%	4.0%
MCB	New	19.10	253.80
	Old	18.05	242.60
	Change	5.8%	4.6%
UBL	New	16.92	253.30
	Old	16.30	246.50
	Change	3.8%	2.8%
ABL	New	12.57	100.20
	Old	11.95	96.10
	Change	5.2%	4.3%
BAFL	New	6.47	55.20
	Old	6.12	52.90
	Change	5.7%	4.3%
NBP	New	9.86	71.50
	Old	9.45	68.90
	Change	4.3%	3.8%

Source: Co. Reports & AKD Research

B-6: Key factors at play in an increasing interest rate scenario

Mar'18	CA/deposits	PIB/inv	NPL	coverage
HBL	38%	41%	8%	86%
MCB	38%	29%	9%	91%
ubl	39%	54%	8%	79%
BAFL	44%	32%	4%	89%
ABL	37%	35%	4%	97%
NBP	47%	30%	15%	88%

Source: Co. Reports & AKD Research

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