October 8, 2021

PAKISTAN
BANKS

REP-019
MARKET
VISTA

Banks poised to make a decent rally

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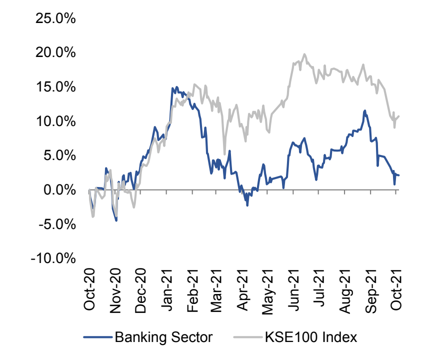
- **Since SBP raised DR by 25bps in the last MPS, yields on various on the run T-bills have gone up by 25bps—28bps pointing to the burgeoning expectations of another DR hike before CY21.**
- **The expectations of further hikes in interest rates have built up at a time when average book growth for local banks has been reported at 22%, one of the strongest in history.**
- **With headline growth in GDP likely to touch 5% mark in FY22, there is no immediate risk over buildup in NPLs in the short to medium term. Also, with average coverage ratio of our banking universe close to 98%, the provisioning costs are forecasted to remain low in the medium run.**
- **GoP lately made an amendment in the Finance Act, penalizing banks with lower ADR by levying higher tax rates on their income. While this is expected to push banks into growing their loan books, it could also potentially slow down deposit growth with greater emphasis put on cheap deposits.**
- **Despite a robust growth in profitability (AKD banking universe profitability up by 17%) and healthy dividend payouts, banking sector has underperformed the index by 2%CYTD. As a result of this underperformance, the valuations have opened up further and the average P/B of the sector is standing at 0.55x. Our top picks from banking universe are MEBL and MCB, offering total returns of 44% and 60% respectively.**

Banking Sector vs. KSE100 Index 100



Source: PSX & AKD Research

Interest rates rebound—more hikes likely before CY21 end: Since SBP raised DR by 25bps in the last MPS, yields on various on the run T-bills have gone up by 25bps—28bps. This points to the burgeoning expectations of another DR hike before CY21 end which bodes well for AKD banking universe where the risk of short term compression in NIMs amid timing mismatch in asset and liability repricing will be mitigated by i) higher concentration of floating rate PIBs and ii) higher representation of current accounts in the deposit mix (41.7% currently vs 39.8% in CY18).

Book growth has been highest in the recent years: AKD Banking universe reported a book growth of ~22%YoY during 1HCY21 as against the last ten year average growth of only 10%. This growth in book size is driven by growth in deposit size where the deposit base has swollen by a whopping 25% over the same period. However we expect growth to slow down going forward as the banks look to address their ADR concerns amid amendments in the finance act which penalize overly conservative ADR ratios. This will put additional emphasis over the quality over quantity of deposits where banks under our active coverage have already increased their CA mix to ~41.7%.

Prudent lending policies have largely kept asset quality concerns at bay: Prudent lending policies have allowed the local banking industry to wither the storm of economic slowdown and come out of it relatively unscathed. To this end, most banks in our coverage universe built up discretionary general provisions during CY20 and 1HCY21. With country coming out of COVID-19 induced lockdown and the broader economic outlook looking far more satisfactory, we expect the provisioning expenses to remain muted going forward.

Investment perspective: Our AKD Banking Universe trades at a ~33% discount to its 5yr average P/B— Ex-MEBL, this discount increases to 49% . Despite a robust growth in profitability (AKD banking universe profitability up by 17%YoY) and healthy dividend payouts, banking sector has underperformed the index by 2%CYTD. As a result of this underperformance, the valuations have opened up significantly and the average P/B of the sector is standing at 0.55x. Our top picks from banking universe are MEBL and MCB, offering total returns of 44% and 60% respectively.

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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.)

New Rating Definitions	
Buy	**> 14.5% expected total return (Rf: 8.5% + Rp: 6%)**
Neutral	**> 8.5% to < 14.5% expected total return**
Sell	**< 8.5% expected total return (Rf: 8.5%)**

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