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REP-091

HABIB BANK LIMITED

Profitability to Recover from CY19 Onwards



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KATS Symbol	HBL
Reuters Symbol	HBL.KA
Target Price (Dec-19)	Rs172
LDCP	Rs131.35
Outstanding Shares (Mn)	1,466.85
Free Float (Mn)	733.43
Market Cap (Mn Rs)	192,670
52 Week High	218.99
52 Week Low	131.35

Highlights

- HBL stock price declined from a high of Rs218.99/share CYTD to recently Rs131.35/share (down by 40%) as current year profitability was adversely affected by losses and higher admin/compliance costs

- HBL posted 1HCY18 profit after tax of Rs7.9bn (EPS:Rs5.42) as compared to profit after tax of Rs15.49bn (EPS:Rs10.56) in SPLY, down by 49%. The decline in earnings is mainly due to FX loss (Rs2.5bn), pension charge (Rs1.9bn) and compliance cost (Rs1.4bn)

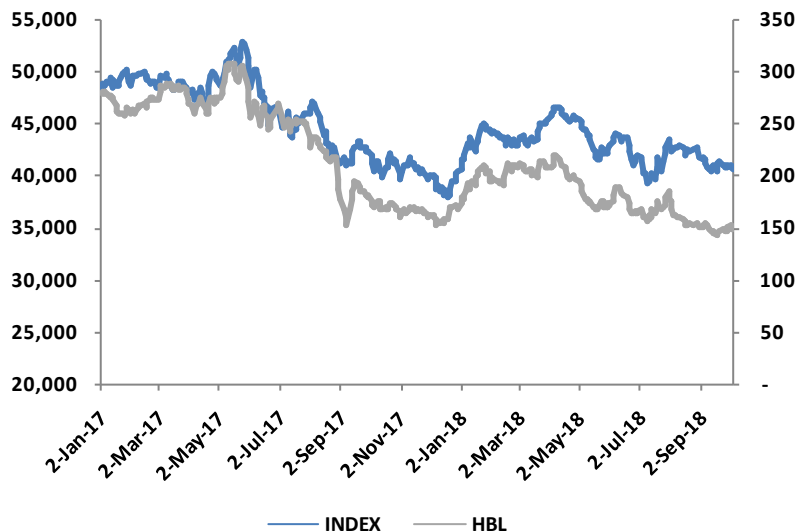
- In 2HCY18 we expect bank's earning to remain under pressure due to concern on international business and further exchange loss in 3Q on foreign borrowing. However we expect HBL's earning to start recovering from CY19

- HBL's overall advances grew by 12% in 1HCY18 and 5 year CGAR of 13.55% with improved asset quality (infection ratio declined by 67bps to 7.57%). However concerns on international loan book continue to persist

- Curtailment of dividend along with contraction in international advances has improved CAR which stands at 17.1% in 2QCY18 as compared to 15.96% in CY17 while CET-1 stands at 12.8% which is well above the regulatory requirement after implementation of D-SIB

- HBL is currently trading at CY18E and CY19E P/B of 0.95x and 0.88x and P/E of 10.78x and 5.94x respectively. We have a BUY stance on HBL with Dec 19 TP of Rs172 based on Justified P/B

Fig.1 KSE 100 Index vs HBL



Source: PSX, ASL Research

Lower Non Interest Income and Higher Admin Cost Drag 1HCY18 Earnings

- HBL posted 1HCY18 consolidated PAT of Rs8.12bn translating into EPS of Rs5.42/share (down by 49% YoY) due to loss on foreign currency borrowing of Rs2.5bn resulting from an 10% devaluation of PKR against USD; one off pension cost of Rs1.9bn, and legal and regulatory cost related to NY branch of Rs1.4bn.
- Net interest income declined by 3% which is mainly due to maturity of high yield PIBs in last year and lagged impact of rising interest rate on investment where cost was repriced immediately
- Lower capital gain (down by 83%) and FX losses (mentioned above) resulted in overall non interest income declining by 35%
- Operating expense increased by 27%. As mentioned above, the increase is mainly due to one off impact of pension charge and legal and compliance related costs related to New York business. Excluding the impact of these expenses admin cost has increased by 7.4% YoY in 1HCY18

Financial Highlights

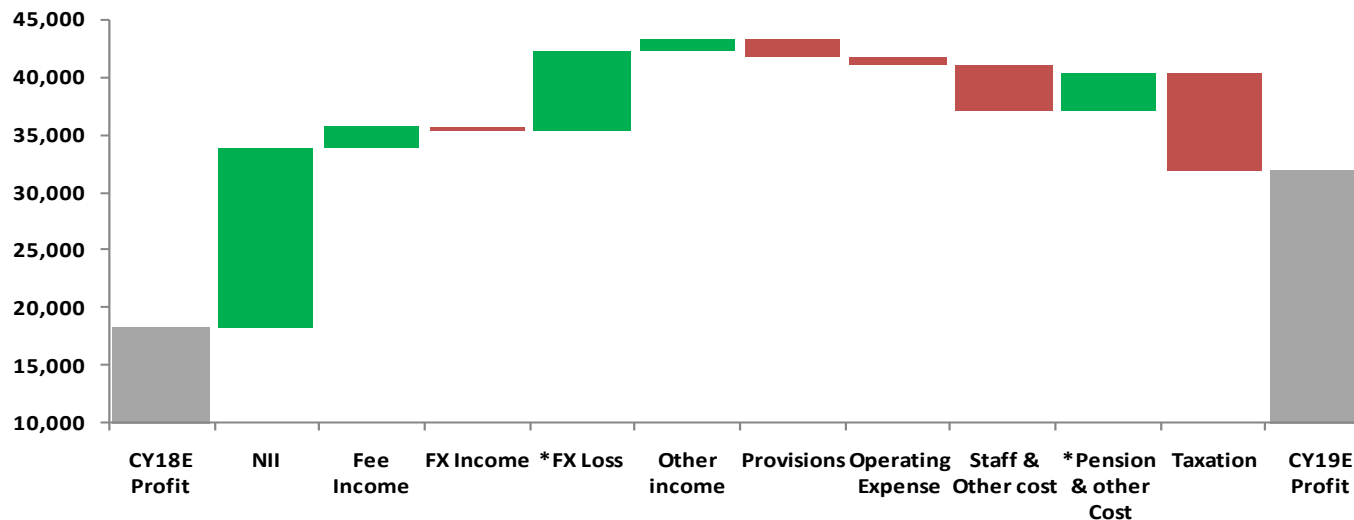
Rs '000 (except where indicated)	1HCY18	1HCY17	% Δ	Q2CY18	Q2CY17	% Δ
Net Interest Income	40,282,586	41,401,430	-3%	20,319,083	20,126,011	1%
Provision	(21,293)	(1,161,348)	-98%	(226,384)	(321,502)	-30%
Non Interest income	10,742,671	16,433,728	-35%	5,578,146	8,313,373	-33%
Operating Expense	(36,875,386)	(28,956,634)	27%	(18,911,923)	(14,065,296)	34%
Profit before taxation	14,128,578	27,717,176	-49%	6,758,922	14,052,586	-52%
Taxation	(6,000,506)	(12,040,056)	-50%	(3,318,491)	(4,972,865)	-33%
Profit after taxation	8,128,072	15,677,120	-48%	3,440,431	9,079,721	-62%
EPS	5.42	10.56	-49%	2.29	6.16	-63%

Source: Co. Financials, ASL Research

CY18 Earnings Expected to Remain Depressed but Recover in CY19

- In 2HCY18 we expect bank’s earning to remain under pressure due to concern on international business, continuation of legal and transformation cost on foreign business, lagged impact of increase in interest rate on investment, absence of any significant capital gain and expected exchange loss on foreign borrowing of ~Rs986mn expected in 3QCY18
- We expect HBL earnings to recover in CY19 on back of increase in domestic asset base, absence of one-off cost (pension cost and other admin cost), higher interest rate and improved non interest income. On foreign loan, any further devaluation of PKR against USD may result in exchange loss in CY19

Fig.2 Earning Bridge CY18E and CY19E



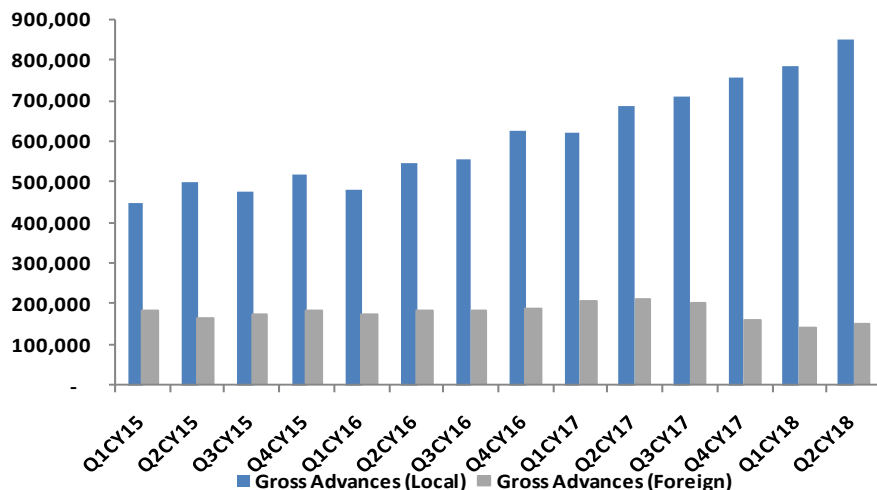
Source: Co Financials, ASL Research

■ Up ■ Down

Growth in Domestic Advances but Concern on International Book

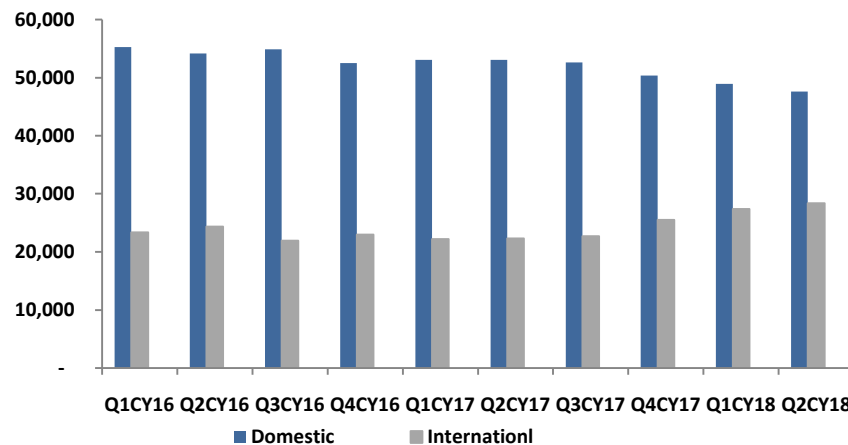
- HBL overall advances grew by 9.04% in 1HCY18 with improvement in quality of domestic assets. Domestic advances grew by 12.27% in 1HCY18 whilst coverage and infection ratios improve to 90.7% and 5.57% respectively
- On international advances bank faces contraction in its business. Overall loan book declined by 35% and quality of advances declines as infection ratio on international book reached 19% in 2QCY18 with coverage ratio of 82%. We see further risk of provisioning on foreign loan book as coverage improves
- With improved CAR and CET-1 ratio we expect HBL is in a position to increase its advance book exposure on domestic side

Fig.3 Gross Advances and Growth (Rs in Mn)



Source: Co Financials, ASL Research

Fig.4 Non Performing Loans (Rs in Mn)



Source: Co Financials, ASL Research

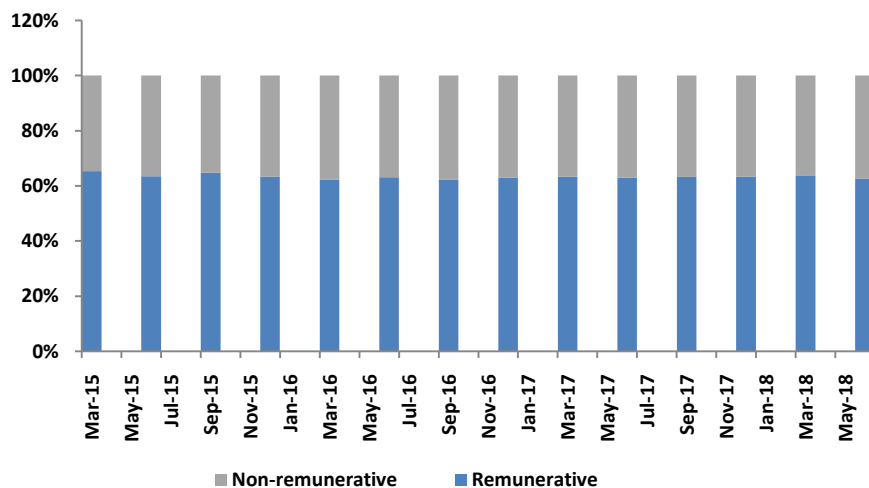
Additional Cost on Deposit Protection

- Deposit protection mechanism introduced by SBP requires banks to pay an insurance premium of 0.16% per year on eligible deposits. According to our calculation HBL could have to pay around RS1.6bn annually (after tax EPS impact of Rs0.71) in order to meet the above regulation

Investments and Deposit Base Well Positioned in Rising Interest Rate Environment

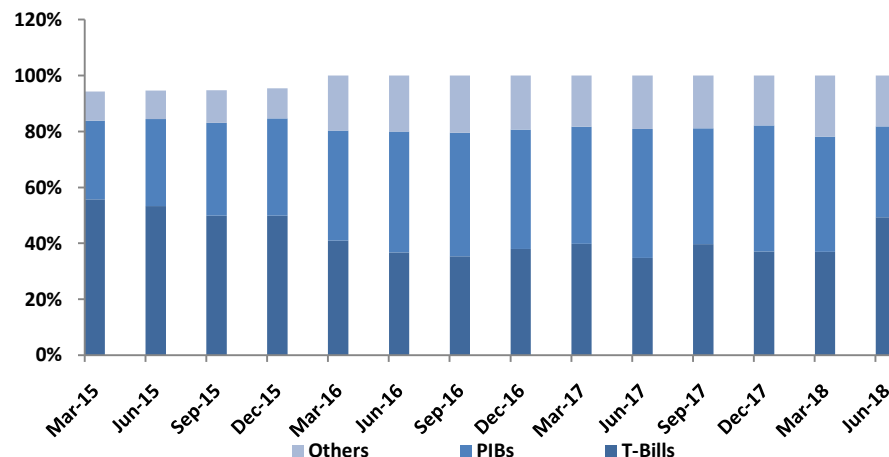
- T-bills now comprise 49% of total investment (2QCY17: 35%) changing investment mix in favor of T-bills would create room for HBL to benefit from rising interest rates
- 37% of HBL’s deposits are non remunerative which would contribute towards higher net interest margins as interest rate rise. We expect every 100bps increase in interest rate would add ~Rs2.28/share in the EPS

Fig.5 Remunerative and Non Remunerative Deposits (% of total)



Source: Co Financials, ASL Research

Fig.6 Investment Mix (% of total)



Source: Co Financials, ASL Research

Capital Ratios at Satisfactory Level

- Last year’s penalty of Rs23.7bn on HBL’s NY branch affected HBL’s capital adequacy ratio. Since the imposition of the fine, curtailment of dividend along with contraction in international advances has improved CAR which stands at 17.1% in 2QCY18 as compared to 15.96% at the end of CY17. CET-1 stand at 12.8% which is well above the regulatory requirement after implementation of D-SIB. To recall HBL has to maintain 2% additional CET-1 ratio above the required level as per D-SIB requirement
- We expect HBL to start paying regular dividend from 4QCY18 however any additional penalty and cost related to foreign operations may impact the dividend paying capacity of HBL

Fig.7 Capital Adequacy Ratio (CAR)

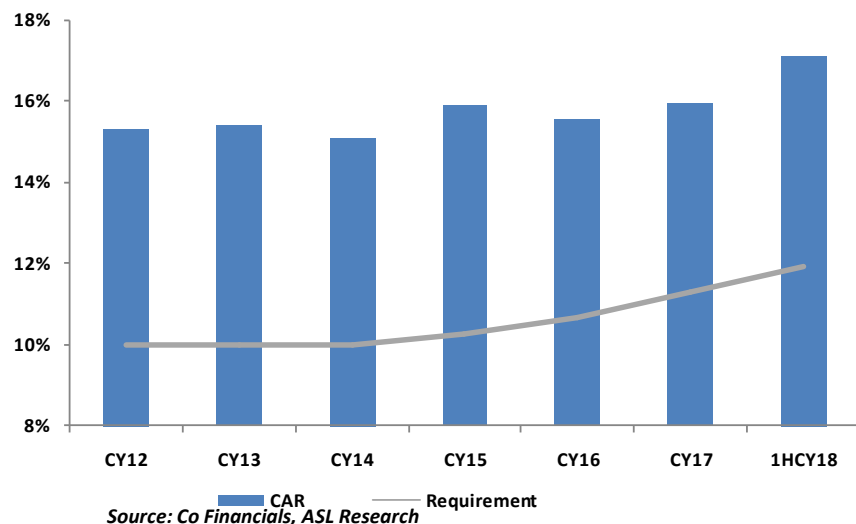
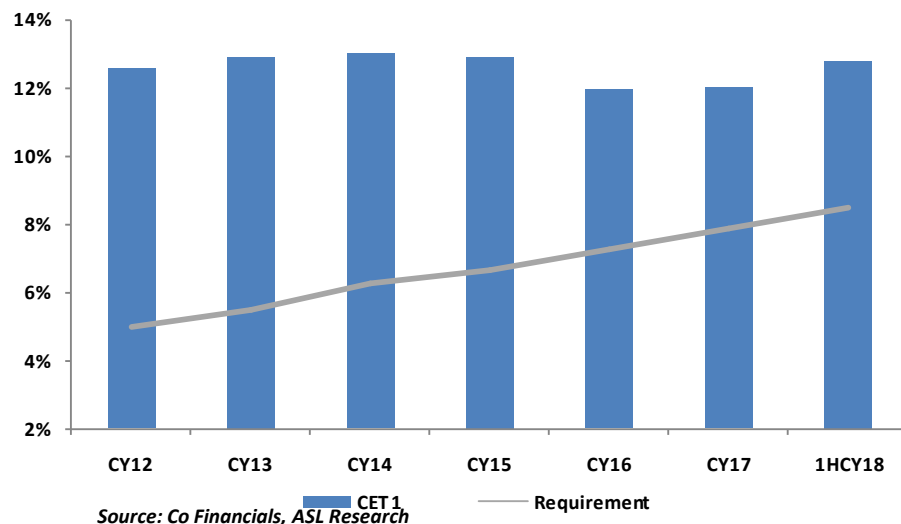


Fig. 8 Common Equity Tier 1 Ratio (CET-1)



Valuation

- We believe HBL's price has already incorporated all the negatives as price has decline by 40%. We estimate CY18E and CY19E EPS to be Rs12.19 and Rs22.11 respectively.
- HBL is currently trading at CY18E and CY19E P/B of 0.95x and 0.88x respectively. We have a BUY stance on HBL with Dec 19 TP of Rs172 based on Justified P/B

Earning Estimates

	CY17A	CY18E	CY19E	CY20E
EPS (Rs)	5.34	12.19	22.11	27.72
P/E (x)	24.61	10.78	5.94	4.74
DPS (Rs)	8.00	6.00	12.00	14.00
D/Y	6.09%	4.57%	9.14%	10.66%
BVPS (Rs)	128.72	138.43	148.54	162.26
P/B (x)	1.02	0.95	0.88	0.81

Source: Co. Financials, ASL Research

Key Risks

- Lower than estimated increase in interest rates
- Increase in non performing loans
- Further penalty and increase in legal cost on international business
- Exchange loss on foreign borrowing
- Changes in regulatory and reporting requirement

Disclaimer

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

- Comparable Method (P/E, P/B etc.)
- Discounted Cash flow Method
- Sum of the parts {SOTP}
- Equity and Asset based valuation

Rating

- BUY Total return more than 20% from last closing of market price
- HOLD Total return is in between 10% and 20% from last closing of market price
- REDUCE Total return is less than 10% from last closing market price



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