



# Bank Alfalah

Upbeat earnings and low multiples warrant rerating

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*Prices as of 22<sup>nd</sup> September, 2021*

## Reiterate 'BUY' with a PT of PKR 56/share

- We have revised upward our earnings forecast for Bank Alfalah (BAFL) by 18%/ 11% for CY21/22 post 1HCY21 results to PKR 7.91/8.73 compared to earlier estimates of PKR 6.63/7.83 respectively. We have also rolled forward our PT to June-22 with revised PT of PKR 56, providing an upside of 84% from the current levels including a dividend yield of 14.4%.
- The bank is trading at a CY22F P/B 0.5x, which is at a significant discount of 58%/ 38% to its 10/5 year average P/B of 1.2x/0.8x, respectively. The upbeat earnings outlook coupled with compelling valuations warrant re-rating of the stock.
- We maintain our 'BUY' stance on BAFL and our investment case is supported by i) BAFL successfully maintaining its asset quality in the low single digits despite having one of the highest ADR in the banking industry, ii) Current Accounts %age surging close to 50% will benefit during contractionary monetary cycle and iii) Non-funded income to remain elevated in the near term due to switching to increased digitalization and rise in remittances.
- The bank's asset quality improved during last 5 years, wherein the Gross infection ratio (GIR) of the bank averaged 4.2% over CY16-20 compared to 7.2% during CY11-15. BAFL further improved its GIR to 3.9% with a coverage ratio of ~99% by end of June-21 despite having one of the high ADR amongst our banking universe (June-21 ADR at 62%).
- Above 60% ADR will also safeguard the bank from the new tax framework under the Finance Act 2021, which will penalize banks with low ADRs.
- Due to active mobilization of low cost deposits, the bank is likely to witness limited hike in the credit costs during the interest rate upcycle.
- BAFL's fee based income surged 33% YoY during the 1H, on the back of hefty surge in digital transactions and increased remittances through formal channels. This along with decent share of FX income will keep non-funded income elevated in the near term.
- With earnings expected to grow at a CAGR of 10% over next 5 years, the capital adequacy ratios are likely to remain well above the SBP's regulatory requirement, and BAFL can conveniently maintain its current payout ratio.

Key Data	
PSX Ticker	BAFL
Bloomberg	BAFL.PA
Reuters	BAFL.KA
Target Price (PKR)	56
Current Price (PKR)	32
Upside/(Downside) (%)	+ 70%
Dividend Yield (%)	14.4%
Total Return (%)	+ 84%
12-month High (PKR)	38.5
12-month Low (PKR)	28.5
Outstanding Shares (mn)	1,777.1
Market Cap (PKR mn)	58,522
Year End	December

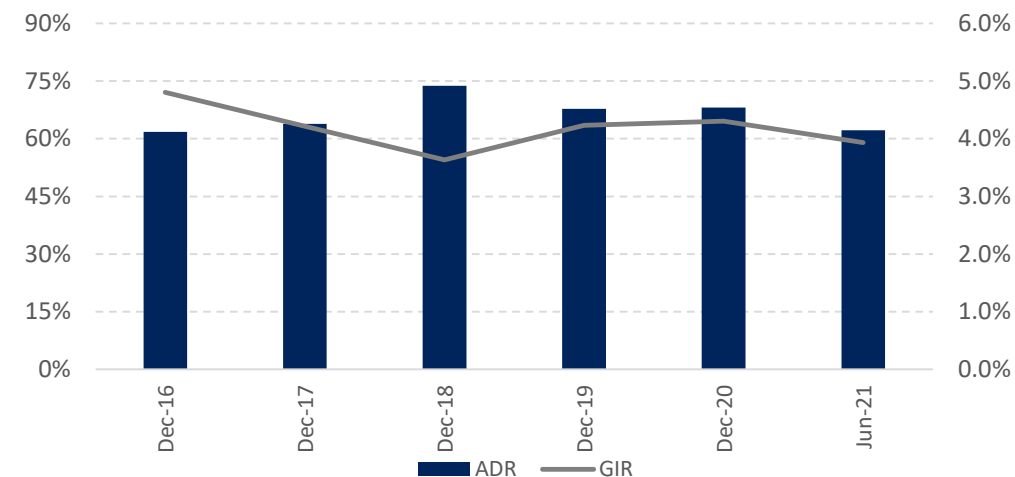
Key Ratios	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
EPS	7.14	5.89	7.91	8.73	9.86	10.74
EPS Growth	19.5%	-17.5%	34.1%	10.4%	12.9%	9.0%
DPS	4.00	4.00	4.25	4.75	5.50	6.00
PER	4.6	5.6	4.2	3.8	3.3	3.1
Div. Yield	12.1%	12.1%	12.9%	14.4%	16.7%	18.2%
P/B	0.66	0.62	0.6	0.52	0.48	0.44
ROE	15.5%	11.5%	14.2%	14.4%	15.0%	15.0%

Source: Company Accounts & Akseer Research

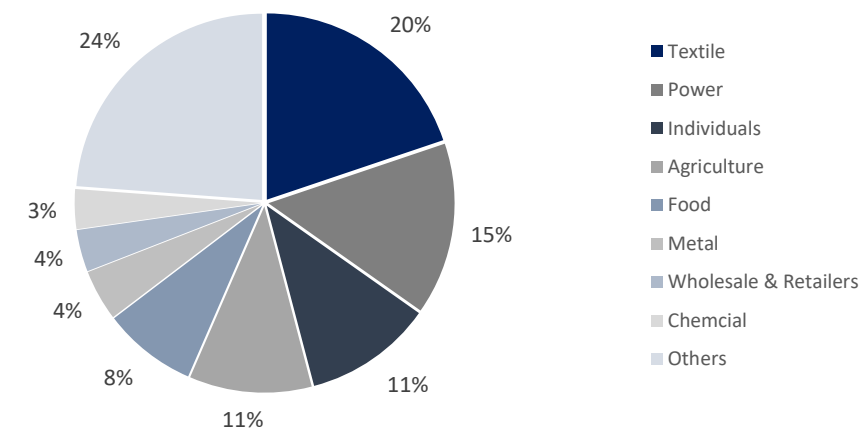
## Asset quality improved despite aggressive lending policy

- BAFL witnessed double digit growth of 13% YoY in its loan book to PKR 601bn during CY20. key concentration of financing remained towards textiles (+ PKR 26bn), agriculture (+ PKR 25bn) and consumer (+ PKR 11bn), accounting for 42% of the total loan book. Growth momentum continued into CY21 wherein advances grew 6.2% CYTD to PKR 638bn.
- Due to bank's aggressive lending policy, BAFL's ADR stood at 68% in CY20, however, declined to 62% by end of June-21 as deposits growth (+16% CYTD) outpaced the advances (+6% CYTD) surge during 1H. To highlight, BAFL has maintained its ADR ratio above 50% during the last 15 years.
- Keeping the ADR above 50% has benefitted the bank from not being penalized with the additional income tax, levied by the government through Finance Act 2021. To recall, the government announced imposition of additional income tax on the banks in June-21 with ADRs below 50%. If ADR ranges between 40-50% (2.5% tax will be levied) and if the ADR is below 40%, banks will pay additional tax of 5%.
- Despite aggressive lending policy, BAFL's management kept the NPLs accretion low, with only 10bps to 4.3% in the Gross Infection Ratio (GIR) during CY20. GIR further came down to 3.9% end of June. The bank has also gradually improved its coverage ratio over the years, standing at 91% in CY20 and 99% in 1HCY21.
- NPLs surged by PKR 3.4bn during CY20 out of which PKR 1.8bn came from HASCOL Petroleum, which has been 100% provided by the bank. Going forward, we do not see any major stress on the asset quality of the bank.
- We have assumed an ADR of around 68% in our forecast whereas the NPLs ratio expected to be around 4.0% with coverage ratio of 100%.

ADR and NPLs Trend



CY20 Advances Breakup

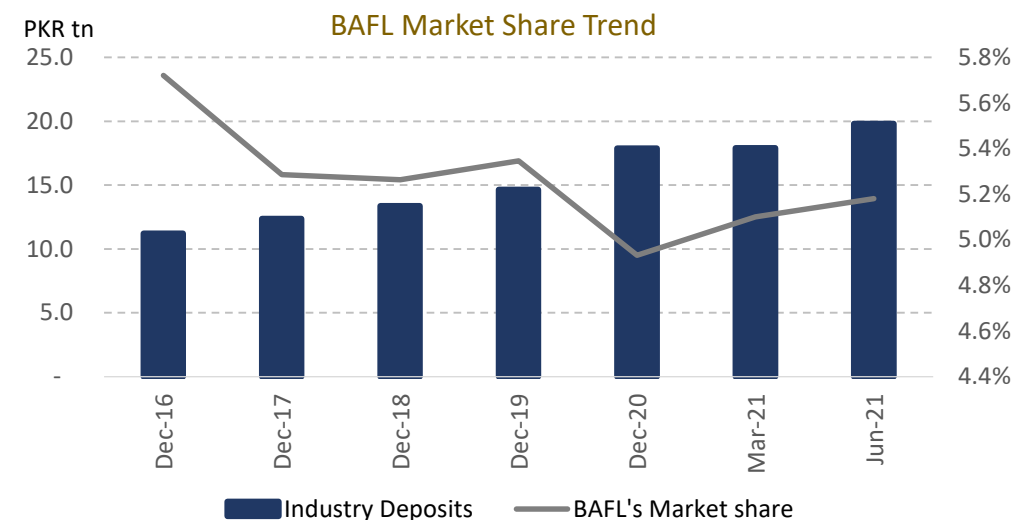


Source: Company Accounts & Akseer Research

## Focus on zero cost deposit mobilization led to regaining deposit market share and NIMs accretion

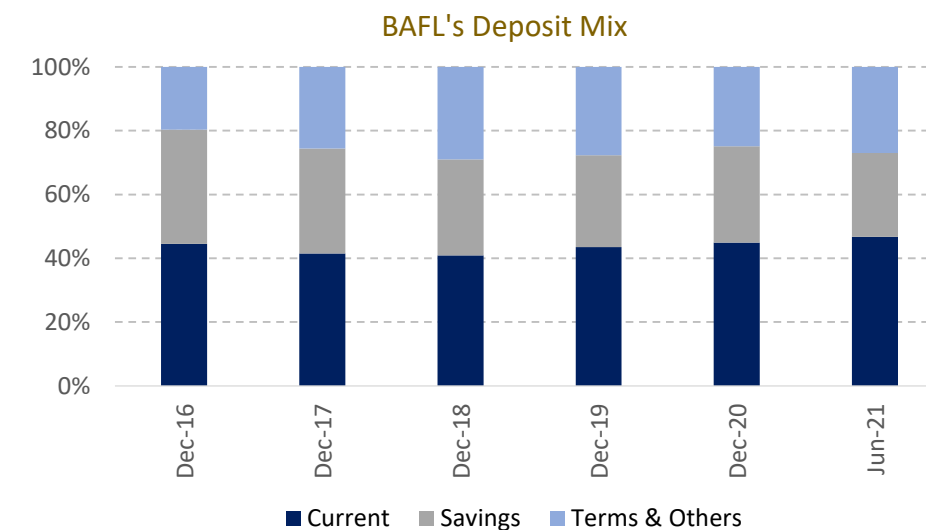
### ■ Deposit market share rose above 5%

- With low cost deposit mobilization strategy in place, the bank's fixed deposits grew at a lower rate of 13% YoY in CY20 as against Savings Accounts and Current Accounts growth of 18% YoY and 17% YoY respectively. BAFL's total deposits grew at 13% YoY vs industry growth of 22% YoY, which led to bank's deposit market share shrank to 4.9% in CY20 compared to 5.3% in CY19.
- Nevertheless, during 1HCY21 BAFL's deposits surged 16% CYTD, surpassing industry growth of 11% CYTD, with BAFL regaining its market share to 5.2%. In absolute terms, the bank's deposit base crossed one trillion mark for the first ever time to PKR 1.03tn by June-21.
- Going forward we expect the bank to maintain its share above 5% with a CAGR of 11% over next five years.



### ■ NIMs accretion also resumed from 2Q

- Contrary to sector trend, BAFL's net interest margins (NIMs) jumped 6bps to 3.5% in 2QCY21. Yield on interest earning assets increased by 29bps while increase in credit cost was at a lesser pace of 23bps on the back of 17% YoY surge in zero cost deposits.
- On CYTD basis, NIMs are still lower by 80bps due to lagged impact of steep cut in interest rates (625bps) on lending.
- BAFL's NIMs averaged 4.2% over CY16-20 and are highly sensitive to the interest rate upcycle as it has the highest ADR ratio of 62% in our banks' universe.
- We expect NIMs to rebound and stabilized around 4.6% going forward.



Source: Company Accounts & Akseer Research

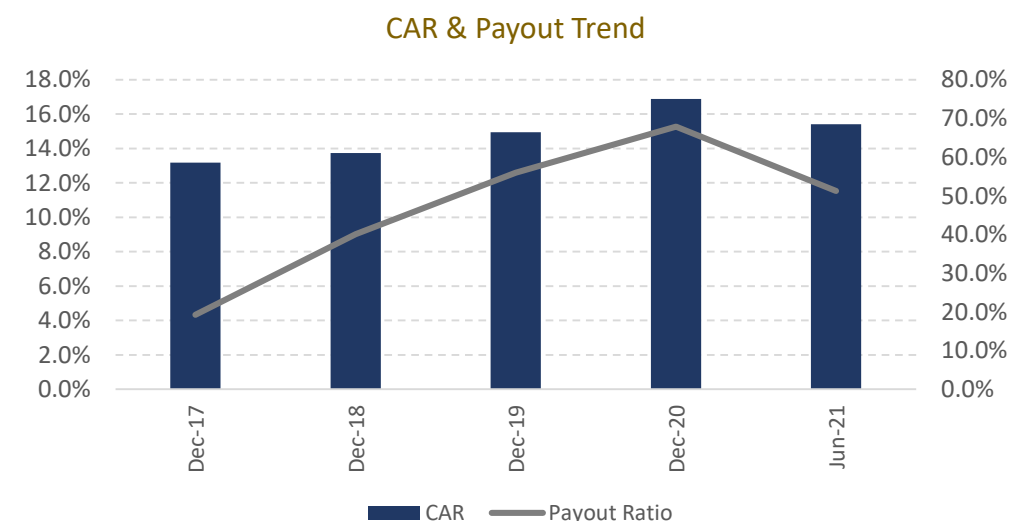
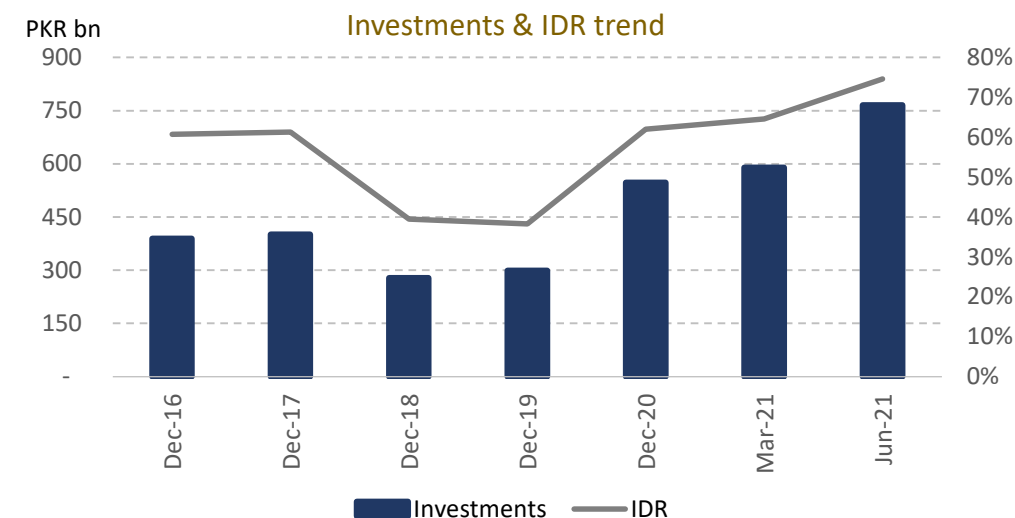
## Significant surge in the IDR led the CAR to comfortable levels; dividends' stream to continue

### ■ IDR at all time high of 75%

- Anticipating the interest rate hike, the bank increased its T-bills and PIBs (mainly floaters) concentration in total investments to 51% and 28% respectively in June-21 over Dec-20.
- Significant hike in government based bonds took IDR of the bank to all time high of 75% in June-21 versus 5-year average of 53%.
- We expect the IDR to normalize to below 70% levels going forward and have assumed average IDR of 67% in our investment horizon (CY22-27).

### ■ Consistent payout to continue

- BAFL has maintained above threshold capital adequacy ratios which will create flexibility to maintain the current dividend payout in the medium term, in our view.
- Capital Adequacy ratio (CAR) of the bank stood at 15.4%, comfortably above the central bank's capital requirement of 11.5%.
- In absolute terms, dividend for CY22 and CY23 is expected at PKR 4.75/share and PKR 5.25/share, leading to an attractive dividend yield of 14.4% and 16.7%, respectively.



Source: Company Accounts & Akseer Research

## BAFL has one of the highest NFI to total income Ratio; C/I ratio is also a cause of concern

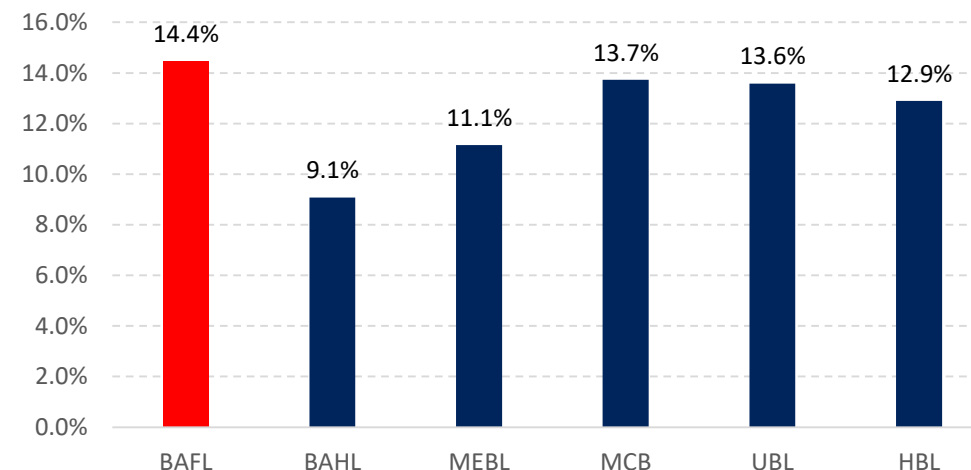
### ■ NFI to total income ratio highest amongst our banking universe...

- BAFL, being more skewed towards trade and consumer financing products, has one of the highest ratio of non-funded based income (NFI) to total income in our banking universe, clocking in at 14.4% compared to the top-tier banks ratio of 13.7% (MCB), 13.6% (UBL) and (12.9%) HBL.
- NFI surge is supported by remittances income (BAFL's market share 14.5%) and increased digital transactions.
- FX income has also contributed positively, having share of 25% in non-funded income in the last 3 years.
- We foresee the trend to continue with NFI contributing on average 10% to total income.

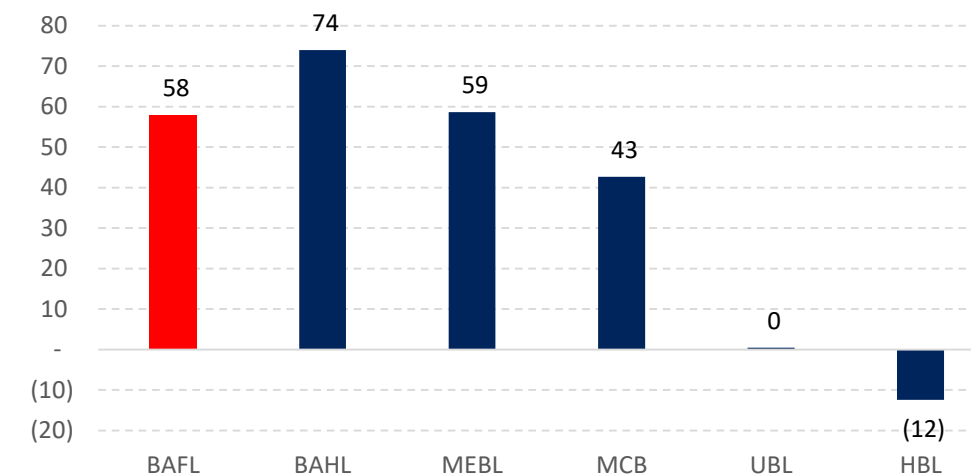
### ■ ...however, C/I ratio is also on top

- BAFL along with other banks aggressively expanded its branch network, by adding 58 new branches on average during the last 5 years. The management plans to add further 70 branches in the ongoing financial year (we do not expect the same level of addition to network due to pandemic related uncertainty and till June only 7 branches have been added)
- This coupled with increased digital spending led BAFL's cost to income (C/I) ratio to touch 58.1% in 1HCY21.
- Going forward, we expect the cost to income to remain elevated, averaging around 58% over CY22-27.

Non-Funded Income to Total Income (June-21)



Avg. branches added in last 5 years



Source: Company Accounts & Akseer Research



## Risk - Return Profile

### Valuation Basis

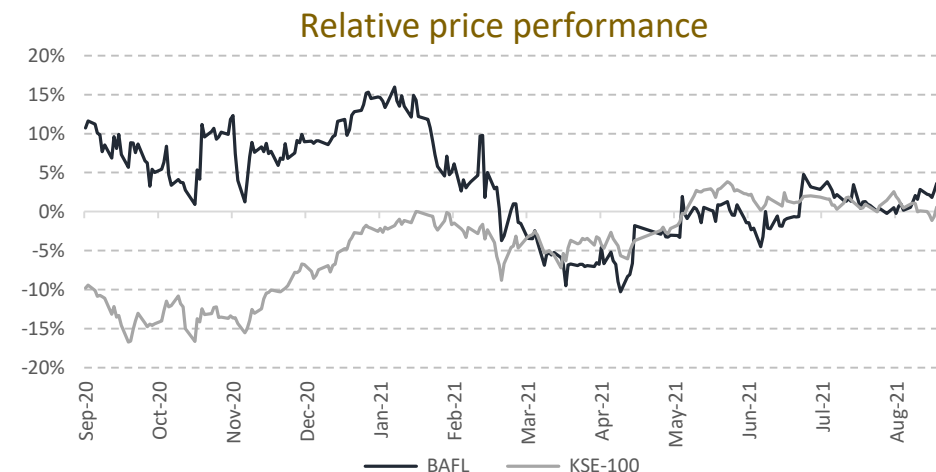
- Our PT for Bank Alfalah Limited (BAFL) has been computed on dividend discounting method using Justified P/B for the calculation of terminal value. We have used sustainable ROE of 16.0% to calculate exit P/B, along with a risk free rate of 11%, beta of 1.0 and market risk premium of 6% to arrive at cost of equity of 17%.

### Investment Thesis

- Our investment case on BAFL is based on:
  - NIMs expansion to support core earnings.
  - One of the highest ADR in the industry.
  - Balance sheet ideally positioned to benefit from the rising interest rate scenario.

### Risks

- Key risks to our investment thesis are
  - Lower than anticipated hike in interest rates.
  - Lower than anticipated growth in advances and deposits,
  - Higher than forecasted NPLs provisioning, and
  - Higher than anticipated non-interest expenses (C/I ratio)



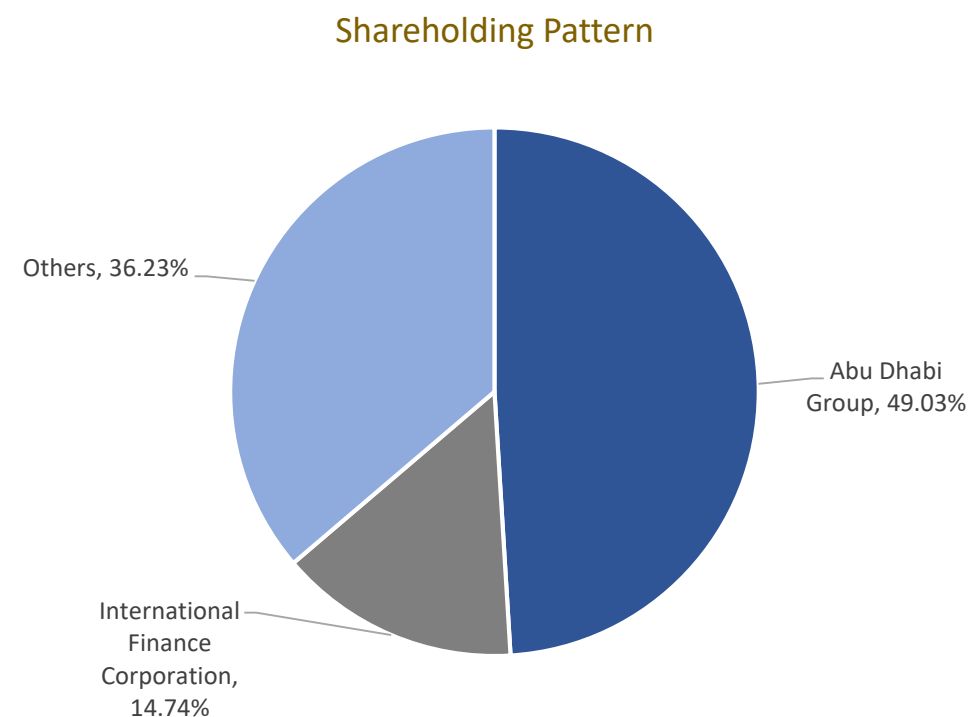
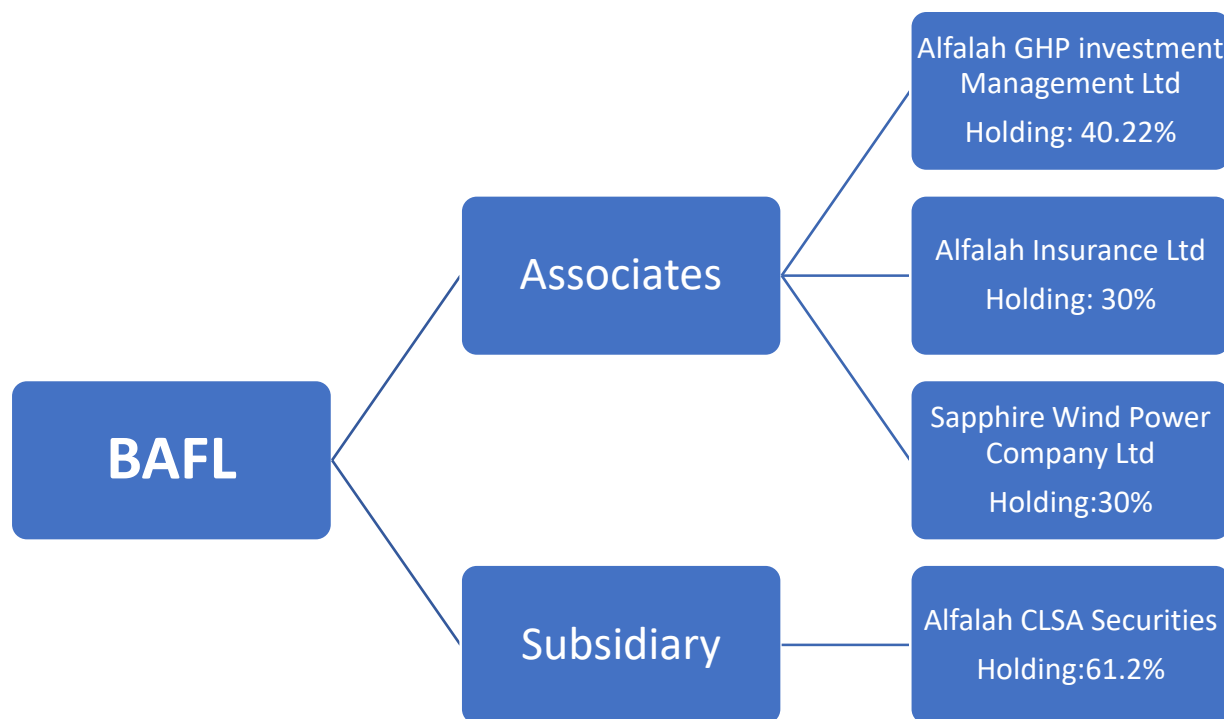
Source: PSX & Akseer Research

Comparative Ratios - CY21	BAFL	HBL	UBL	MCB	BAHL	MEBL
EPS	7.9	22.9	20.8	22.9	17.1	19.1
EPS Growth	34.1%	9%	21.8%	-6.6%	6%	21.7%
DPS	4.25	9.00	16.0	19.5	6.75	7.25
PER	4.2	5.0	5.8	7.1	4.1	7.0
Div. Yield	12.9%	7.8%	13.2%	12.0%	9.7%	5.4%
P/B	0.7	0.6	0.8	1.1	0.8	1.4
ROE	14.2%	12.7%	13.9%	14.7%	22.0%	37.4%

## Brief Overview

- Bank Alfalah Limited commenced its banking operations in November 1992 and got listed on the Pakistan Stock Exchange in 2004. The Bank is engaged in banking services, with key focus towards the consumer financing with a network of 736 branches across more than 200 cities in the country, and international presence in Afghanistan, Bangladesh, Bahrain and the UAE.

- Group Structure**



Source: Company Accounts & Akseer Research



## Financial Highlights

Income Statement (PKR mn)	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
Mark-up/interest earned	92,481	92,616	100,374	126,705	151,098	167,312
Mark-up/interest expensed	47,623	47,911	53,929	70,661	85,277	94,542
<b>Net interest income</b>	<b>44,857</b>	<b>44,705</b>	<b>46,445</b>	<b>56,044</b>	<b>65,821</b>	<b>72,770</b>
<b>Non-funded income</b>	<b>10,396</b>	<b>12,795</b>	<b>13,921</b>	<b>12,840</b>	<b>13,443</b>	<b>14,131</b>
Provision charged	3029	7589	1,666	3,095	3,726	4,374
Operating expenses	29,843	32,032	35,505	39,848	46,333	50,663
<b>Profit after tax</b>	<b>12,696</b>	<b>10,475</b>	<b>14,050</b>	<b>15,514</b>	<b>17,518</b>	<b>19,086</b>
Ratios						
EPS	7.14	5.89	7.91	8.73	9.86	10.74
DPS	4.00	4.00	4.25	4.75	5.50	6.00
PER	4.6	5.6	4.2	3.8	3.3	3.1
Dividend yield	12.1%	12.1%	12.9%	14.4%	16.7%	18.2%
NIMs	5.3%	4.3%	3.6%	4.3%	4.6%	4.5%
Cost/Income Ratio	54%	56%	59%	58%	59%	59%

Source: Company Accounts & Akseer Research

## Financial Highlights

Balance Sheet (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Cash & Treasury Balances	100,732	99,348	99,722	103,923	114,835	127,467
Investments	299,098	547,090	706,201	758,004	816,134	972,986
Advances	511,236	577,316	689,122	764,468	847,836	922,538
Operating Fixed Assets	30,344	32,261	32,653	33,374	34,252	35,279
Other Assets	123,262	128,859	131,256	162,849	199,080	171,428
<b>Total Assets</b>	<b>1,064,672</b>	<b>1,384,874</b>	<b>1,658,953</b>	<b>1,822,619</b>	<b>2,012,137</b>	<b>2,229,699</b>
Borrowings from FIs	102,842	314,960	415,578	457,136	505,135	560,700
Deposits	782,284	881,767	1,049,303	1,154,233	1,275,428	1,415,725
Other Liabilities	91,518	97,129	90,302	99,149	109,516	121,395
<b>Total Liabilities</b>	<b>976,645</b>	<b>1,293,856</b>	<b>1,555,183</b>	<b>1,710,519</b>	<b>1,890,079</b>	<b>2,097,820</b>
Equity	88,028	93,977	103,770	112,100	122,058	131,879
<b>Total Liabilities &amp; Equity</b>	<b>1,064,672</b>	<b>1,387,833</b>	<b>1,658,953</b>	<b>1,822,619</b>	<b>2,012,137</b>	<b>2,229,699</b>
<b>Ratios</b>						
P/BV	0.7	0.6	0.6	0.5	0.5	0.4
BVPS	49.5	52.9	58.4	63.1	68.7	74.2
ROE	15.5%	11.7%	14.8%	15.0%	15.6%	15.7%
ROA	1.2%	0.9%	0.9%	0.9%	0.9%	0.9%
ADR	67.7%	68.1%	68.1%	68.8%	69.1%	67.8%
IDR	38.2%	62.0%	66.6%	65.0%	63.4%	68.2%
NPL/Gross Loan	4.2%	4.3%	3.7%	3.7%	3.8%	4.0%
Deposit Growth	11.3%	12.7%	19.0%	10.0%	10.5%	11.0%
Loan Growth	2.2%	13.4%	19.0%	11.0%	11.0%	9.0%

Source: Company Accounts & Akseer Research

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