Alfa Adhi Securities
REN # REP-004

AKSEER RESEARCH
REN # REP-400R

Habib Bank Limited(HBL):
Improving asset quality to support growth

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Prices as of 07 October, 2021

Reiterate ‘BUY’ with a PT of PKR 158/share

- We reiterate our ‘BUY’ call on HBL with June-22 price target (PT) of PKR 158, providing an upside of 45% from current levels along with dividend yield of 9%. We have also revised upward our earnings estimates by 4%/10% for CY21/22 to EPS PKR 23.83/28.65 after incorporating the upbeat 2Q results.
- Our liking for the HBL is based on:
  - Significant improvement in the asset quality over years. The bank’s Gross infection ratio (GIR) has come down to 5.5% in June-21 compared to last 5 year (CY16-20) average of 7.5% despite healthy growth in advances (CAGR of 13%) over the same period.
  - Supported by an ambitious double digit advances growth target (16-18%) mainly led by private sector borrowing, project financing and TERF facility (PKR 35-40bn), HBL will easily be able to increase its ADR to 50% and can avoid the incremental income tax for having ADR below 50%.
  - Rising low cost deposits share through increased focus on the Islamic banking operations. During 1HCY21, HBL added / converted 99 Islamic branches to 161 and further eyeing 100 more branches by the end CY21.
  - Focus on digitalization and increase trade volumes supporting the non-funded income growth, and will maintain NFI's share in total income at 10%.
  - HBL is aggressively spending in technology and compliance segment to gain investors attraction on CPEC related projects. The management might keep the low payout based on capital increase needs as well as keeping the CAR at optimum level.
- The bank is trading at a significant discount of 65% and 36% CY22 P/E and P/B of 3.8x and 0.5x compared to its historical 5 year average P/E and P/B of 10.8x and 0.8x, respectively. We believe, investor’s concerns regarding hefty provisions of PKR 15.5bn in CY19-20 affecting CAR are behind and with bank’s key focus on the Silk Route activities, the stock is worth investing.

Key Data	
PSX Ticker	HBL
Bloomberg	HBL.PA
Reuters	HBL.KA
Target Price (PKR)	158.0
Current Price (PKR)	109.1
Upside/(Downside) (%)	+45%
Dividend Yield (%)	09%
Total Return (%)	+54%
12-month High (PKR)	108.1
12-month Low (PKR)	144.8
Outstanding Shares (mn)	1,466.9
Market Cap (PKR mn)	160,004
Year End	December

Key Ratios	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
EPS	10.45	21.06	23.83	28.65	33.55	38.84
EPS Growth	27%	101%	13%	20%	17%	16%
DPS	5.00	4.25	7.50	10.25	11.75	13.50
PER	10.4	5.2	4.6	3.8	3.3	2.8
Div. Yield	4.6%	3.9%	6.9%	9.4%	10.8%	12.4%
P/B	0.73	0.61	0.57	0.51	0.45	0.40
ROE	7.4%	12.8%	12.9%	14.1%	14.7%	15.2%

Source: Company Accounts & Akseer Research

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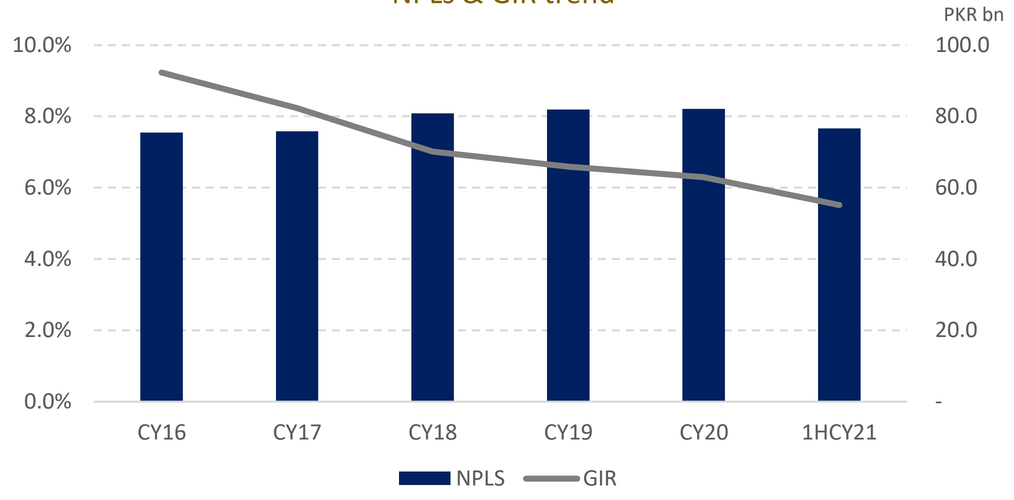
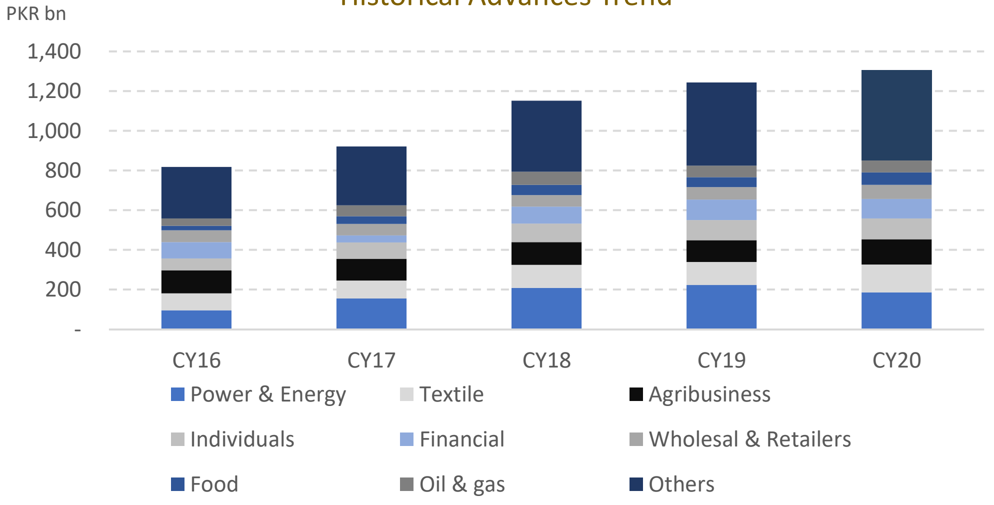
Asset quality improving despite aggressive lending growth

- **NPLs ratio has come down to all time low of 5.5%**
  - HBL has significantly improved its assets quality in last 5 years, the gross infection ratio declining to all time low of 5.5% by end of June-21, compared to 5-year average of 7.5%.
  - During CY20 major incremental NPLs of PKR 2.9bn (mainly HASCOL) came from oil & gas sector, whereas overall NPLs increased by only PKR 0.2bn. This was due to considerable decline of PKR 1.9bn and PKR 1.8bn in NPLs from textile and agribusiness respectively during CY20 despite growth of 21% YoY and 15% YoY in lending to these sectors correspondingly.
  - The bank has also gradually improved its coverage ratio over the time period, standing at 100% in CY20, rising to 103% end of June-21.
- **Lending in focus; ADR to remain above 50%**
  - HBL advances also rose in tandem with industry trend during 1H, up 6% CYTD to PKR 1.39tn and market share maintained at 15.4%. With the rising credit demand, HBL is targeting a double digit growth in advances during 2HCY21. We have assumed around 16% credit growth during CY22-25.
  - The management highlighted achieving this target on the back of consistent financing demand, besides additional borrowing from dairy, livestock and cement sectors.
  - Islamic assets have grown at an accelerated pace, (advances up at a CAGR of 3.4x over last 5 years), providing further impetus to the aggressive lending growth.
  - HBL's presence in China's capital, provides a new potential for loan growth besides increased trade activities.
  - HBL's ADR stood at 44.6% at end of June-21. HBL posted higher effective tax rate of 43% due to additional tax charge on lower ADR. With aggressive lending approach the bank is eyeing to increase its ADR to 50% in the medium term, which will also benefit in terms of no additional income tax.
  - We have assumed an ADR of around 52% in our forecast whereas the NPLs ratio expected to be around 5.0% with coverage ratio of 97%.

NPLs & GIR trend



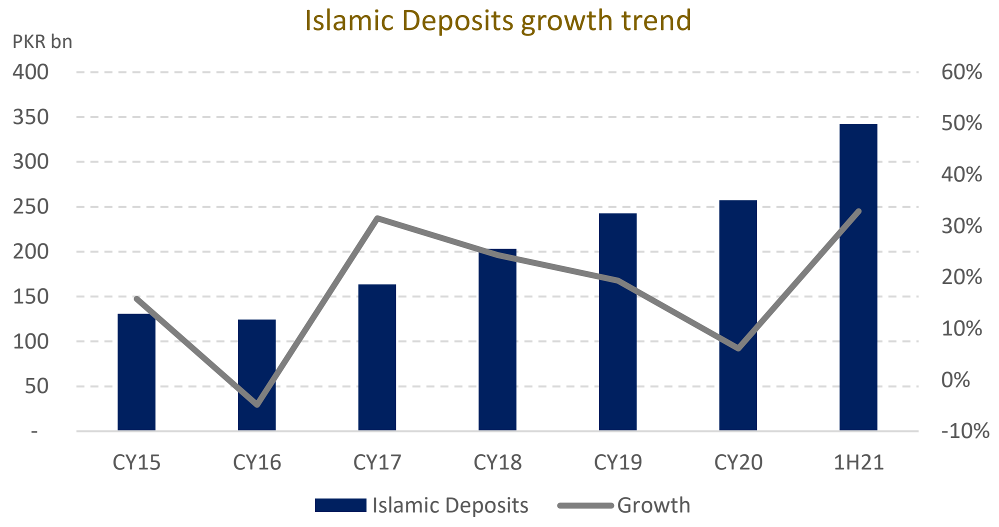
Historical Advances Trend

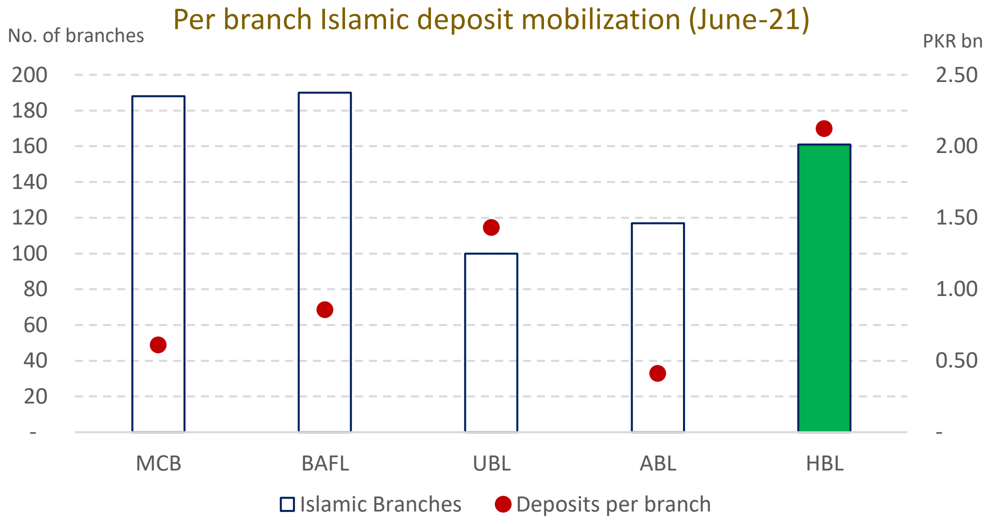


Source: Company Accounts & Akseer Research

Islamic banking deposits to keep overall cost of funds low

- Increasing footprint in Islamic banking has bore fruits for HBL. The bank's Islamic deposits grew 33% CYTD to PKR 342bn in June-21, surpassing conventional banks Islamic branches based and Islamic banks' deposits growth of 20% and 13% CYTD, respectively.
- HBL is aggressively expanding the Islamic branches network and opened 99 new Islamic branches during 1HCY21, compared to negligible increase by its peers. BAFL and MCB opened 5 and 1 branches, respectively while UBL and ABL did not add any new Islamic branches.
- This also brought HBL to top of the conventional banks with Islamic banking branches, given per branch deposit mobilization remained highest at PKR 2.1bn for HBL versus the peers, and gaining 2pps market share to 21% as of June-21. The market share in total Islamic banking deposits also increased by 1.4pps to 8.9%.
- HBL is eyeing to further increase its Islamic banking footprint, taking its total number of Islamic branches to 300 by Dec-21 (161 as of June-21).
- HBL's total deposit base crossed PKR 3tn, up 10% CYTD in June-21, with CASA ratio at 81%.
- Going forward we expect total deposits to grow at a 3-year (CY22-25) CAGR of 10% with CASA ratio being around 81%.
- We believe, with CASA maintaining above 80% and incremental Islamic deposits, the cost of funds is expected to remain contained despite rising interest rates going forward. We have assumed interest expense to grow at a 3-year (CY22-25) CAGR of 9% while cost of deposits settling around 5.0%.





Source: Company Accounts & Akseer Research

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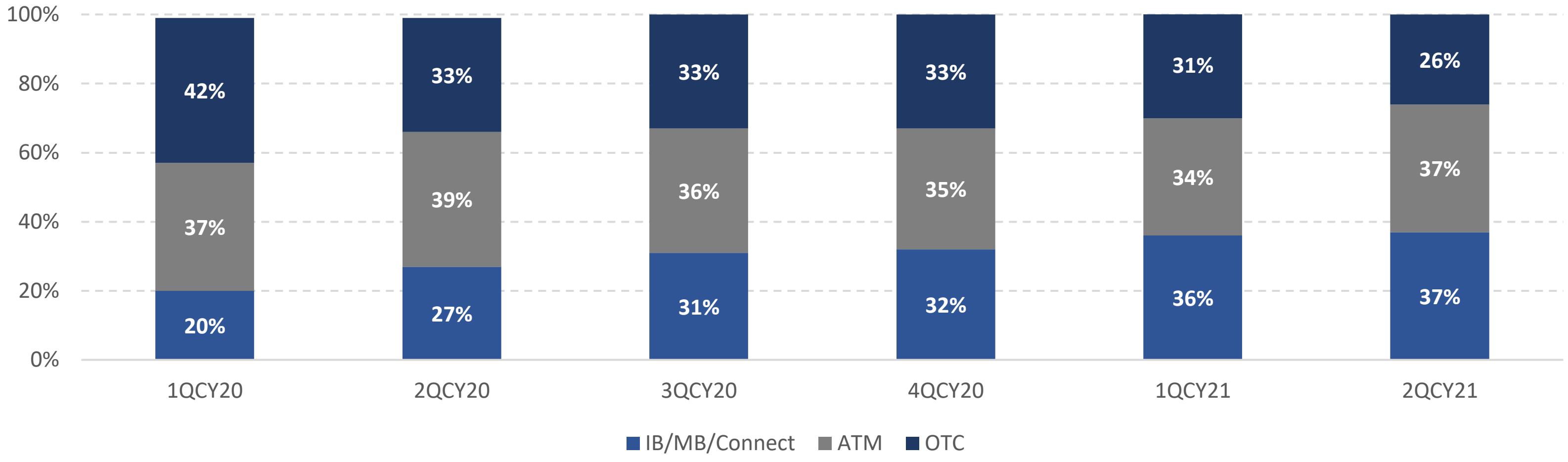
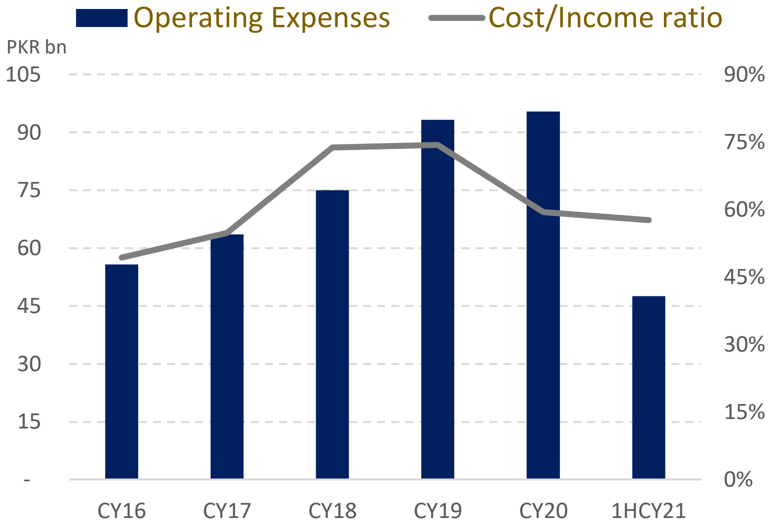
Digitalization to keep NFI elevated; C/I receding to normal levels

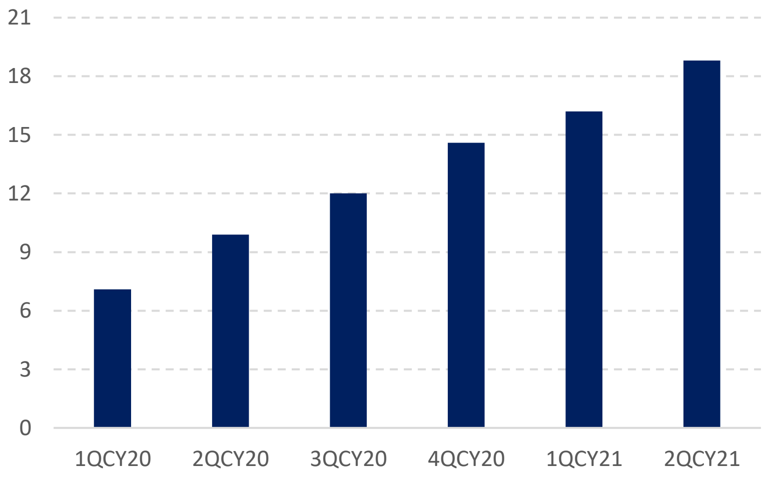
- **Increased digital channels usage to support NFI growth**
  - Key focus on digitalization of operations coupled with consumer conversion to digital channels resulted in fee & commission income growing by 32% YoY to PKR 11.8bn in 1HCY21. This was supported by strong growth in card (+46% YoY) and consumer finance related fee (+25% YoY). Fee on trade related activities also posted double digit growth of 32% YoY to PKR 1.96bn in 1HCY21.
  - HBL is the first Pakistani bank to open its branches in China to reap the benefits of CPEC related projects As per new reports, HBL has handled around USD 6bn worth of transactions under CPEC in different modes, supporting trade income growth.
  - We expect the bank to post a CAGR of 11% in NFI on the back of higher fee and commission income which is expected to grow by 13% over CY22-25.
- **Higher spending towards digitalization & IT**
  - HBL's operating expenses grew by only 2% YoY in CY20 vs last 5 year average growth of 17%, mainly due to absence of any major legal/ consultancy charges related to New York branch. During CY20, Cost to Income (C/I) ratio settled at 59% compared to 74% in 2019 and further down to 56% in June-21.
  - We expect operating expenses to grow at a 5-year CAGR of 5% on the back of higher expenditure in digital and technology infrastructure along with opening of new Islamic branches.
  - However, the expenditure materializing into high income growth will keep the C/I below 60%. We have assumed average C/I ratio of 58% in our investment horizon.

Digital Transactions – Since COVID-19 spread IB/MB transactions share is growing





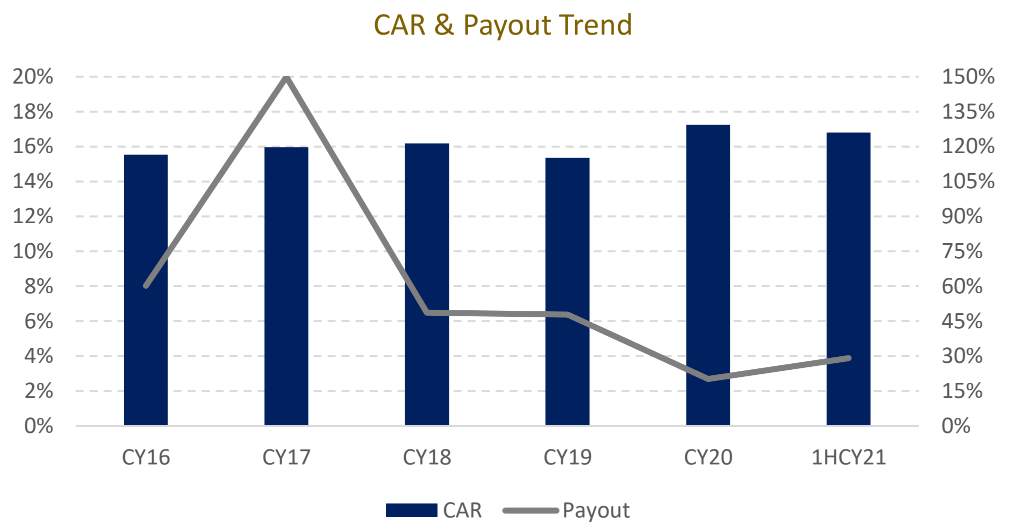
Transactions Count (mn)



Source: Company Accounts & Akseer Research

Higher spending, maintaining optimum capital level to keep payout low for medium term

- HBL is aggressively spending towards digital banking initiatives and technology infrastructure upgrades to capture Chinese investment under CPEC as well as local market share.
- Besides, implementation of IFRS-9 from CY22 onwards will likely have negative impact of 40-45bps on bank's capital adequacy.
- In order to cover the above mentioned costs and to keep the CAR above the central bank's minimum requirement of 13.5%, the management has hinted towards the retention of dividends. This is also evident from the recent payout which has come down to below 30% in 2QCY21.
- We expect HBL payout to average around 35% during CY22-24 while we have maintained CAR at 17% over the medium term.



Source: Company Accounts & Akseer Research

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Risk - Return Profile

- **Valuation Basis**
  - Our PT for HBL has been computed on the dividend discounting method using Justified P/B for the calculation of terminal value. We have used sustainable ROE of 14% to calculate exit P/B, along with a risk-free rate of 11%, a beta of 1.0 and a market risk premium of 6% to arrive at a cost of equity of 17%.
- **Investment Thesis**
  - Our investment case on HBL is based on:

1) Asset quality improving over years
2) Strong advances growth and well paced investments to benefit from interest rate cycle
3) Largest deposit base in the industry.

- **Risks**
  - Key risks to our investment thesis are

1) Cost to income ratio remaining elevated longer than anticipated.
2) Lower than anticipated growth in advances.
3) More than expected rise in NPLs.

Relative price performance

Source: PSX & Akseer Research

Comparative Ratios - CY21	HBL	BAFL	UBL	MCB	BAHL	MEBL
EPS	23.8	7.9	20.8	23.2	17.1	19.1
EPS Growth	13.0%	34.1%	21.8%	-5.1%	6.0%	21.7%
DPS	7.50	4.25	16.0	19.5	6.75	7.25
PER	4.6	4.2	5.9	6.4	4.0	7.3
Div. Yield	6.9%	12.9%	13.0%	13.1%	9.9%	5.2%
P/B	0.6	0.6	0.8	1.0	0.8	1.5
ROE	12.9%	14.2%	13.9%	14.9%	22.0%	37.4%

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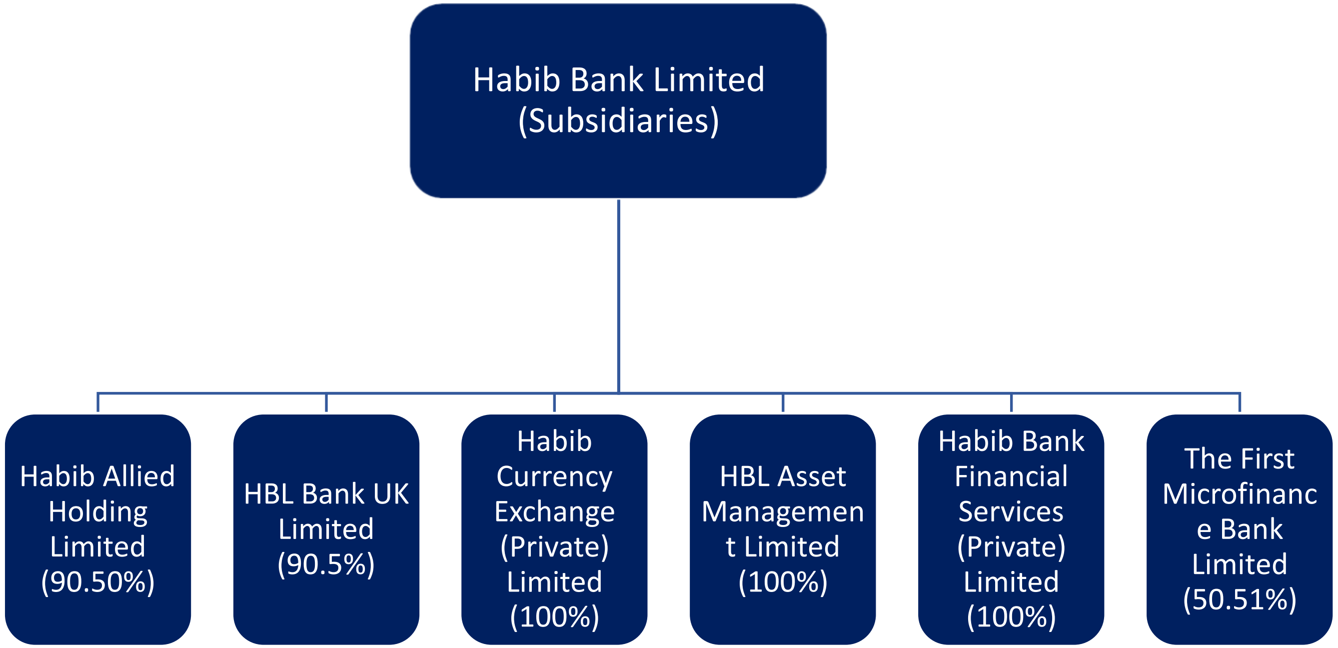
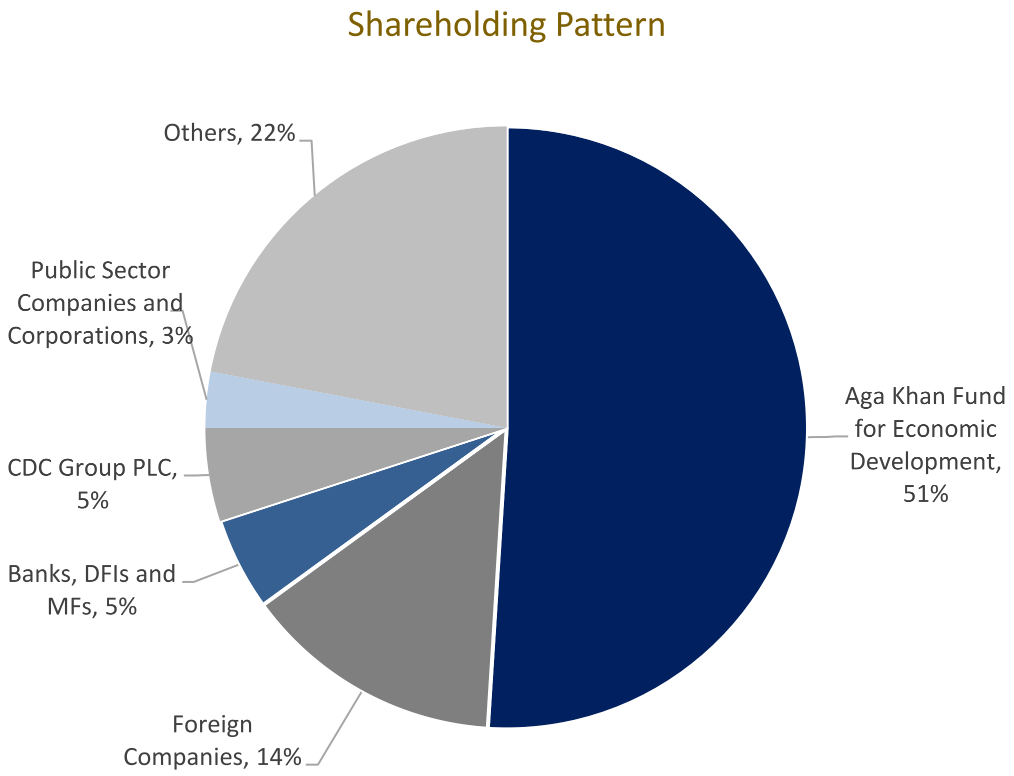
Brief Overview

- Habib Bank Limited, founded in 1947 and privatized in 2004 and is the largest bank in the country engaged in commercial banking services in Pakistan and overseas. The bank operates through an extensive network of 1,637 branches, including 161 Islamic banking branches, and 38 branches outside Pakistan. End of June-21, HBL's assets stood at PKR 4.1tn, and the deposit base reach PKR 3.1tn end of June-21. The Aga Khan Fund for Economic Development S.A. (AKFED) is the majority shareholder in the bank.

- **Group Structure**





Source: Company Accounts & Akseer Research

Financial Highlights

Income Statement (PKR mn)	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
Mark-up/interest earned	258,114	271,237	267,596	340,706	386,755	428,473
Mark-up/interest expensed	156,791	141,133	141,408	195,268	220,346	237,379
Net interest income	**101,323**	**130,104**	**126,189**	**145,438**	**166,409**	**191,094**
Non-funded income	**24,162**	**30,595**	**35,084**	**35,709**	**39,469**	**43,692**
Provision charged	3,314	12,220	5,578	6,519	7,064	9,313
Operating expenses	93,290	95,449	94,636	103,522	115,550	129,081
Profit after tax	**15,333**	**30,892**	**34,954**	**42,024**	**49,209**	**56,968**
Ratios						
EPS	10.45	21.06	23.83	28.65	33.55	38.84
DPS	5.00	4.25	7.50	10.25	11.75	13.50
PER	10.4	5.2	4.6	3.8	3.3	2.8
Dividend yield	4.6%	3.9%	6.9%	9.4%	10.8%	12.4%
NIMs	3.1%	3.6%	3.1%	3.3%	3.4%	3.5%
Cost/Income Ratio	74%	59%	59%	57%	56%	55%

Source: Company Accounts & Akseer Research

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Financial Highlights

Balance Sheet (PKR mn)	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
Cash & Treasury Balances	367,594	375,280	430,517	464,387	509,603	563,017
Investments	1,379,607	1,948,577	2,145,060	2,123,030	2,303,534	2,513,426
Advances	1,166,957	1,223,510	1,355,470	1,658,340	1,873,238	2,095,356
Operating Fixed Assets	89,552	99,603	118,035	125,718	127,907	130,095
Other Assets	223,423	202,093	233,432	253,928	275,713	307,425
Total Assets	**3,227,132**	**3,849,063**	**4,282,514**	**4,625,404**	**5,089,995**	**5,609,320**
Borrowings from FIs	382,206	544,108	528,549	570,131	625,643	691,220
Deposits	2,437,597	2,830,371	3,246,938	3,502,383	3,843,396	4,246,244
Other Liabilities	182,577	209,088	219,768	232,244	261,612	267,471
Total Liabilities	**3,002,381**	**3,583,568**	**3,995,255**	**4,304,758**	**4,730,651**	**5,204,935**
Equity	224,752	265,495	287,260	320,646	359,344	404,385
Total Liabilities & Equity	**3,227,132**	**3,849,063**	**4,282,514**	**4,625,404**	**5,089,995**	**5,609,320**
Ratios						
P/BV	0.73	0.61	0.57	0.51	0.45	0.40
BVPS	150.22	177.89	192.28	214.60	240.48	270.62
ROE	7.4%	12.8%	12.9%	14.1%	14.7%	15.2%
ROA	0.5%	0.9%	0.9%	1.0%	1.0%	1.1%
ADR	51%	46%	44.2%	50.0%	51.5%	52.2%
IDR	57%	69%	66.1%	60.6%	59.9%	59.2%
NPL/Gross Loan	6.6%	6.3%	5.4%	5.1%	5.1%	5.0%
Deposit Growth	14.1%	16.1%	14.7%	7.9%	9.7%	10.5%
Loan Growth	8.0%	4.8%	10.8%	22.3%	13.0%	11.9%

Source: Company Accounts & Akseer Research

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Valuation Methodology

To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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JV employs a three-tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

Ratings are updated to account for any development impacting the economy/sector/company, changes in analysts' assumptions or a combination of these factors.

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