Alfa Adhi Securities
REN # REP-004

AKSEER RESEARCH
REN # REP-400R

United Bank Limited(UBL):
Robust core earnings to ramp up valuations

November 18, 2021

Saqib Hussain
saqib.hussain@akseerresearch.com

Prices as of November 17, 2021

Alfa Adhi Securities
REN # REP-004

AKSEER RESEARCH
REN # REP-400R

Reiterate 'BUY' with PT of PKR 196/share

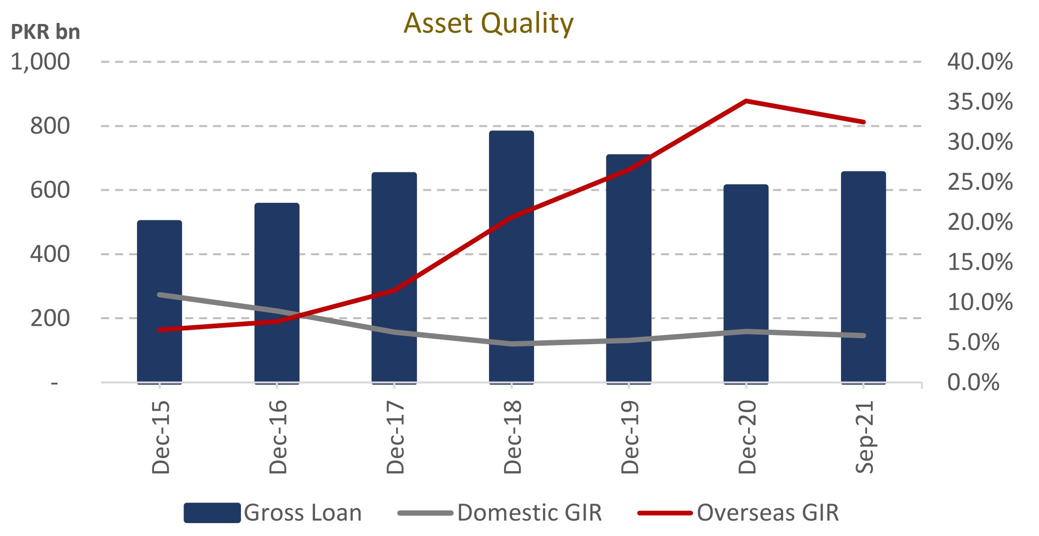
- We revisit our investment case on UBL after robust financial results for 9MCY21. We revise upward our earnings estimates for CY22/CY23 by 21%/10% to PKR 28.7/32.2 compared to our earlier estimates of PKR 23.7/29.2, respectively. We have also adjusted upward, dividend payout estimates on the back of stellar growth in profitability which will lead to higher ROE.
- We maintain 'BUY' call with rolled forward June-22 PT of PKR 196, providing a decent upside of 42% from the current levels. Along with this, UBL is offering one of the highest dividend yield amongst banks in our coverage space with CY22F dividend yield of 13.4%. The stock is currently trading at CY22F P/BV 0.8x, at a discount of 20% from its historic (CY16-20) P/BV 1.0x.
- UBL reported impressive 9MCY21 results with net earnings growing by 41.6% YoY. The growth was mainly supported by lower than expected decline in NII and provisioning reversals. Rebound in the fee and commission income post normalization of business activities and contained operating expenses also drove the profitability during the period.
- UBL's asset quality has improved considerably over time for both overseas and domestic lending. Interestingly, the bank has booked NPL reversal on its domestic book during 9MCY21. While coverage ratio also increased to 96% by the end of Sept-21. We have assumed overall gross infection ratio of 10% in our investment horizon.
- The bank's CASA ratio has also moved to an all time high of 85% (last 5-year average 78%) with current account ratio at 42%. This could have boded well for the bank in containing the cost of funds amidst rising interest rate scenario, however, the recent 1% hike in the CRR requirement by the SBP will potentially raise the deposit mobilization cost.
- The bank has increased its exposure to floaters - both PIBs and T-Bills (71% at end of Sept-21) in order to mitigate the risk of losses amid rising interest rates. Going forward, we expect the share to decline as bank will refocus towards lending activities.
- UBL has gained operational efficiencies over years and has contained admin expenses growth to just 7% YoY during 9MCY21. Cost to income remained stable at 45%. We have assumed the same in our investment horizon.

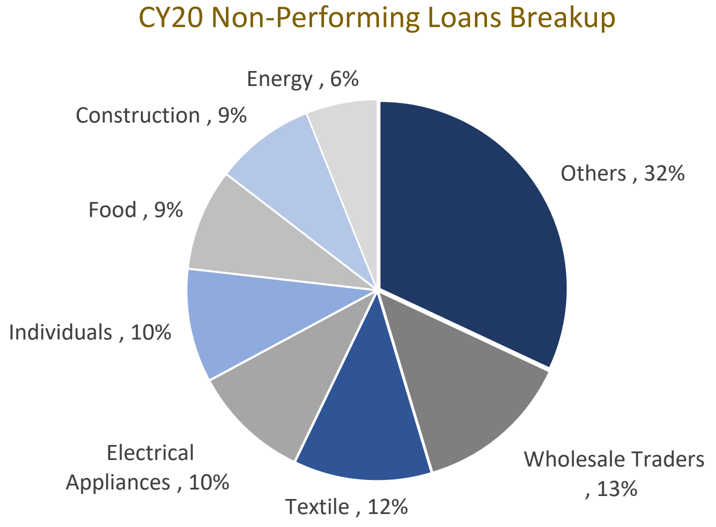
Key Data	
Bloomberg	UBL.PA
Reuters	UBL.KA
PSX Ticker	**UBL**
Target Price (PKR)	196
Current Price (PKR)	138
Upside/(Downside) (%)	+ 42%
Dividend Yield (%)	13.4%
Total Return (%)	+ 56%
12-month High (PKR)	109
12-month Low (PKR)	149
Outstanding Shares (mn)	1,224.2
Market Cap (PKR mn)	168,753
Year End	December

Key Ratios	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
EPS	15.6	17.1	24.7	28.7	32.2	34.1
EPS Growth	-12.6%	9.2%	44.8%	16.0%	12.4%	6.0%
DPS	12.0	12.0	16.0	18.5	21.5	22.5
PER	8.8	8.1	5.6	4.8	4.3	4.04
Div. Yield	8.7%	8.7%	11.6%	13.4%	15.6%	16.3%
P/B	1.0	0.9	0.9	0.8	0.8	0.7
ROE	11.9%	11.8%	16.2%	17.9%	18.8%	18.6%

Asset quality improving gradually; Overseas portfolio infection ratio also declining

- UBL's Non-performing loans (NPLs) accretion has slowed down lately, wherein the overall NPLs increased by meagre 3% CYTD to PKR 86.3bn in 3QCY21. Interestingly, domestic NPLs declined by 4% CYTD to PKR 27.4bn while overseas NPLs grew 7% CYTD to PKR 58.9bn. This resulted in decline in overall Gross Infection Ratio (GIR) to 13.3% in Sept-21 compared to 13.7% in Dec-20. Domestic GIR strengthened by 0.5ppts while overseas GIR improved by 2.6ppts in Sept-21.
- Overseas NPLs of the bank surged at a 5-year (CY16-CY20) CAGR of 37% which deteriorated bank's asset quality, with GIR surging to13.7% in Dec-20 from 8.5% in Dec-16. Around 70% of overseas NPLs came from UAE exposure. Whopping surge in UAE's infected loans was on account of significant decline in global oil prices and crash in property valuations during 2016-2018.
- The bank prudently provisioned against overseas NPLs, which led the coverage ratio improving to 86% in CY20 from 56% in CY16.
- PKR 84bn surge in NPLs during CY20 alone primarily came from pandemic related subjective classification of loans, resulting in hefty provisions. However, with resumption of economic activities and visibility on loans payments, the bank booked reversals up to PKR 514mn during 9MCY21.
- With refocus towards lending we expect the bank to have a provisional charge of PKR 416mn in 4Q, the net reversal standing at PKR 14mn during CY21.
- Despite increased lending going forward, we expect the management to remain prudent and not to compromise on the asset quality and hence the loan accretion to remain slow, with average Gross Infection Ratio to be around 11% in our investment horizon.

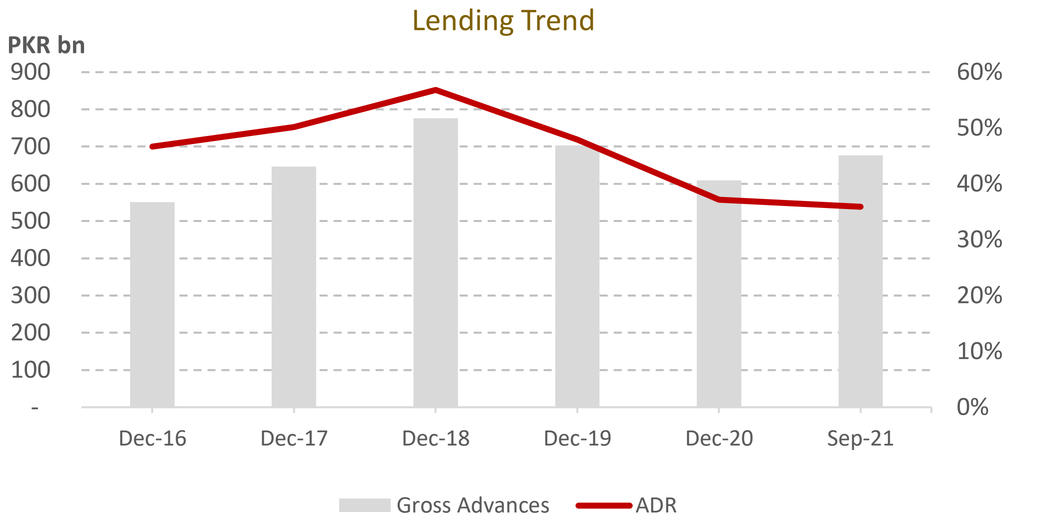


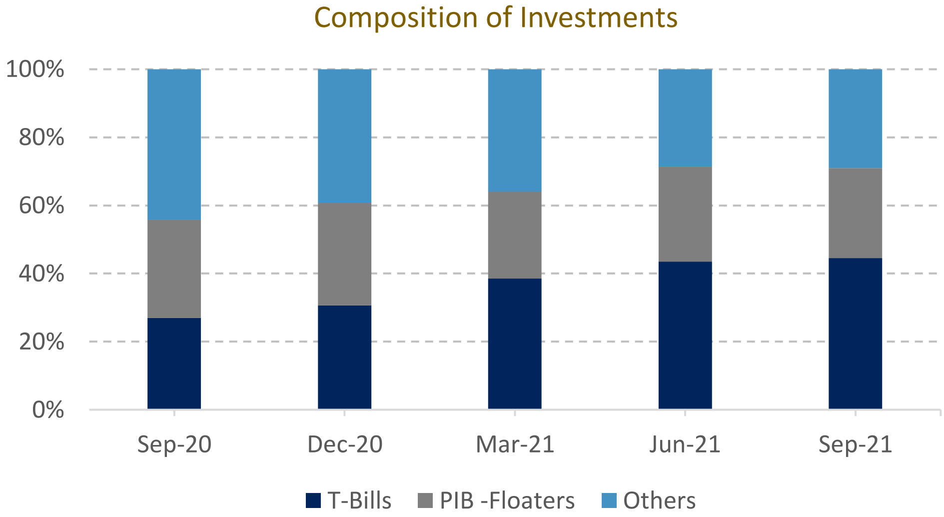


Source: Company Accounts & Akseer Research

The management not to aggressively grow the loan book, ADR to remain below regulatory requirement

- **ADR expected to grow to 40% by CY23**
  - UBL's gross advances have witnessed a low CAGR of 3% over last five years given the management has not aggressively grown its loan book due to hefty delinquencies coming from international financing. The ADR, resultantly came down to 36% in Sept-21 after peaking to 57% in CY18.
  - The govt. in order to encourage private sector lending has levied extra income tax on the banks with ADR below 50%, and hence requires banks to utilize more funds towards financing. UBL management, nevertheless, does not intends to either shed its deposit growth or to lend aggressively so not to compromise on its asset quality.
  - The bank's domestic NPL ratio came down to 5.9% end of Sept-21, improving from 6.3% in Dec-20 and the bank plans to maintain the same.
  - Taking cue from management guidance, we have assumed gradual increase in UBL ADR to reach 50% by CY27 from current level of 36%.
- **Investments tilted towards the shorter tenor bills/ floaters**
  - UBL's investment is well placed to reap the benefits from anticipated interest rates hike. In this regard, the bank has increased its floating rate based PIBs and T-bills mix to 71% end of Sept-21 vs. 61% by end of Dec-20.
  - UBL's IDR hovers around 87% compared to its last 5 - year average of 67%. We have assumed IDR of 70% in our investment horizon (CY22-27) due to bank's gradual shift towards lending.



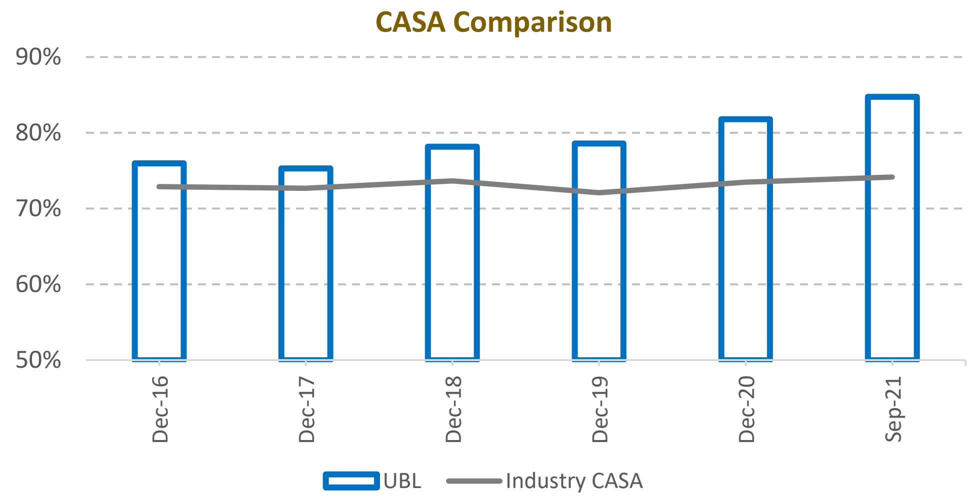


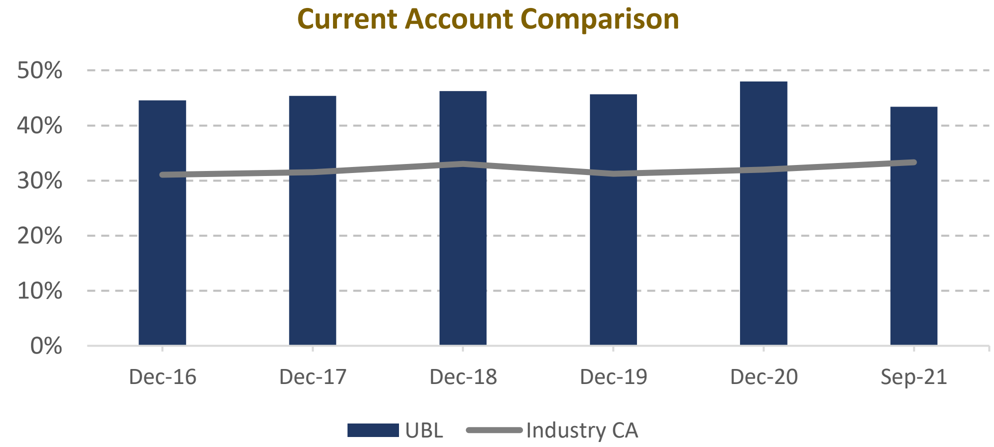
Source: Company Accounts & Akseer Research

Alfa Adhi Securities
REN # REP-004
AKSEER RESEARCH
REN # REP-400R

CASA touches all time high of 85%; 1% hike in CRR to curtail the CASA growth

- Active mobilization of low cost funds has raised UBL's CASA ratio to 85% in Sept-21 versus 76% in CY16, 2nd highest after MCB (92%) in our banking universe. The industry average CASA ratio stood at 73% in last 5 years (CY16-20).
- UBL posted double digit growth in Current Account deposits, at a 5-year CAGR of 12% during CY16-20 compared to saving account CAGR of 9%. Resultantly, share of Current Accounts stands at 43% end of Sept-21.
- However, as per the recent notification of the SBP, the average Cash Reserve Requirement (CRR) for scheduled banks has been increased from 5% to 6% while the daily minimum CRR has also been revised upward by 100bps to 4%. We believe, this development will have a negative impact on UBL's CASA ratio and overall cost of fund as the bank will increase its time liabilities with more than one year maturity requiring higher deposit rates.
- This coupled with rising interest rates will lead to cost of funds averaging 5.2% over CY22-27 versus 4.4% during CY17-21.
- We have maintained bank's deposits growth at 5-year CAGR of 10% during CY22-27.



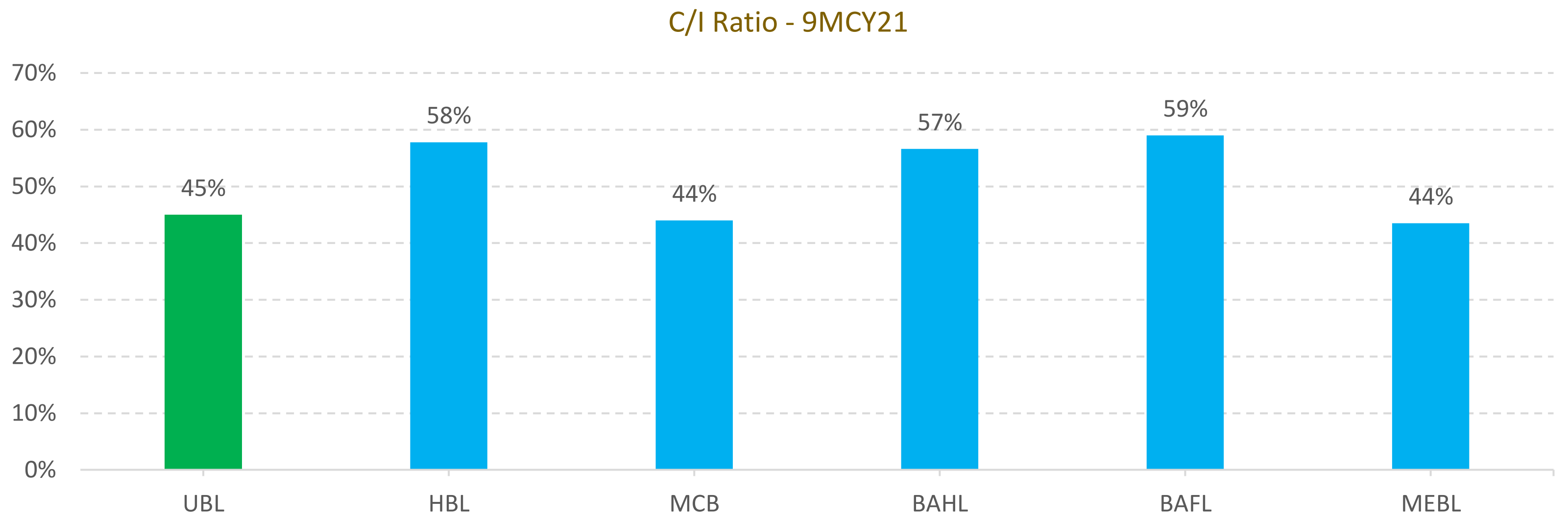


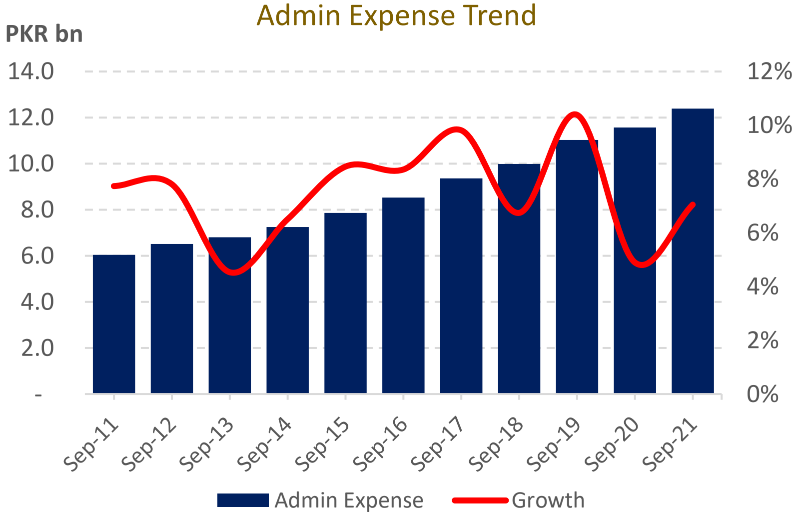
**Sept-21 industry CASA & CA numbers are based on Universe average*
Source: Company Accounts & Akseer Research

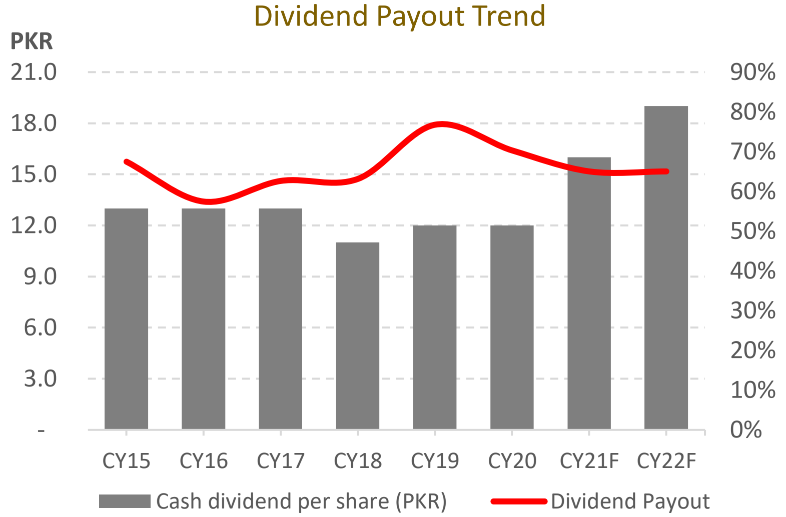
Alfa Adhi Securities REN # REP-004
AKSEER RESEARCH REN # REP-400R

C/I ratio one of the lowest in our banking universe, expected to be maintained around 45%

- UBL, admin expenses grew by a modest 7% YoY in 9MCY21 compared to its last 10-year average of 8% primarily due to consolidation going on in UBL's branch operations. That has helped in containing Cost to Income (C/I) ratio at 45% during 9MCY21, one of the lowest in our banking universe.
- UBL branch network declined to 1,344 in Sept-21 compared to 1,356 in Dec-20, lowering overall operating cost. On the other hand, bank's digital spending continues to grow wherein the IT expenses grew at 3-year (CY17-20) CAGR of 20%.
- We have assumed a stable C/I ratio of 45% in our investment horizon (CY22-27).





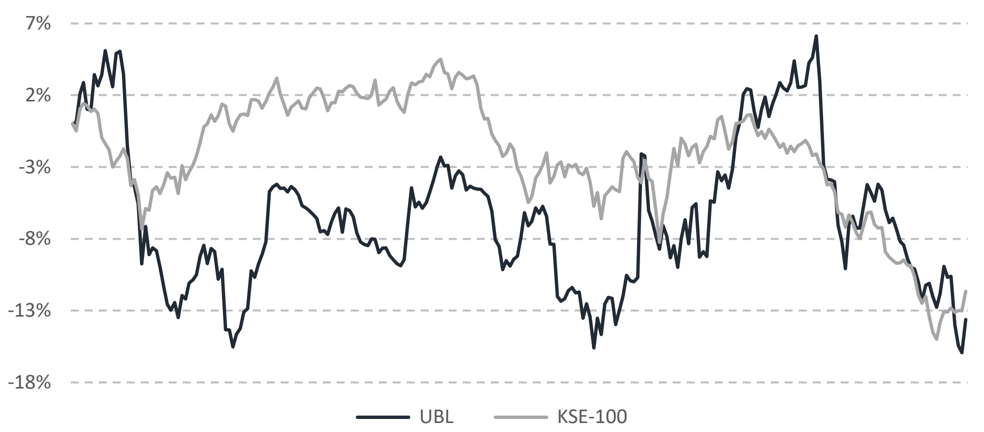


Alfa Adhi Securities
REN # REP-004
AKSEER RESEARCH
REN # REP-400R

Risk - Return Profile

- **Valuation Basis**
  - Our PT for United Bank Limited (UBL) has been computed on dividend discounting method using Justified P/B for the calculation of terminal value. We have used sustainable ROE of 18.2% 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 UBL is based on:
    1) NIMs expansion on the back of strong balance sheet growth.
    2) Improving asset quality.
    3) Balance sheet ideally positioned to benefit from the rising interest rate scenario.
- **Risks**
  - Key risks to our investment thesis are
    1) Lower than expected interest rates hike.
    2) Lower than anticipated growth in advances and deposits,
    3) Higher than forecasted NPLs and provisioning, and
    4) Higher than anticipated non-interest expenses (C/I ratio)

Relative price performance



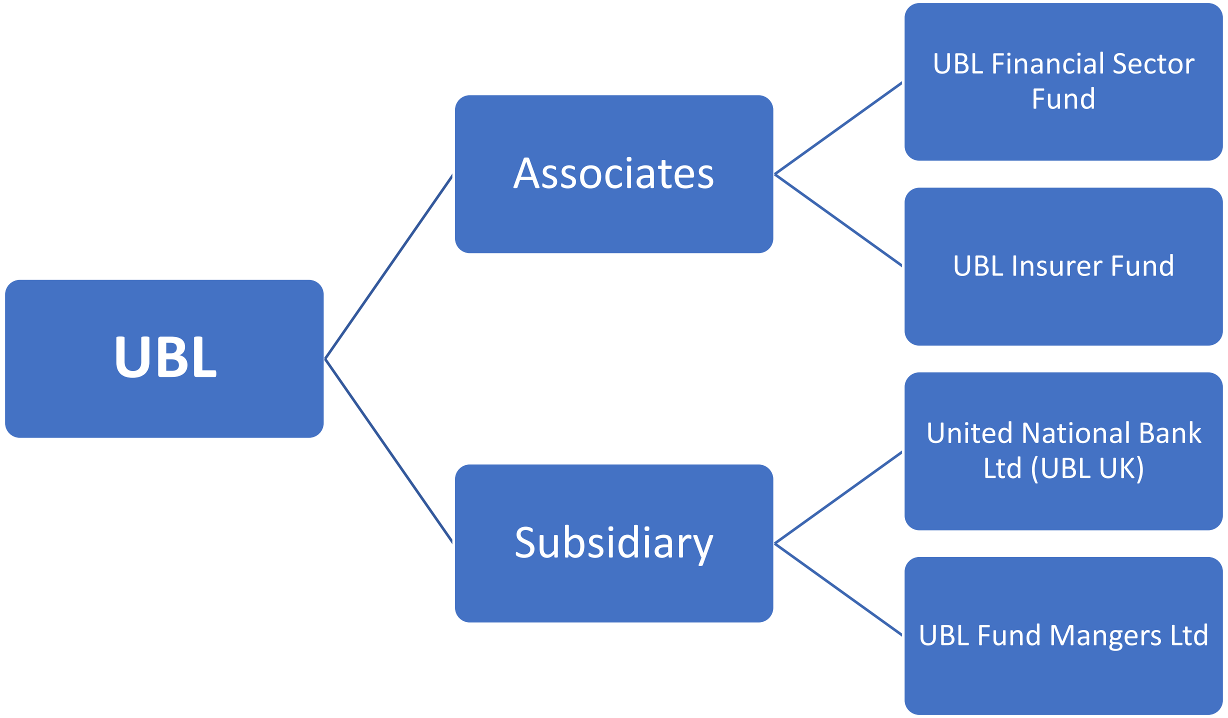
Source: PSX & Akseer Research

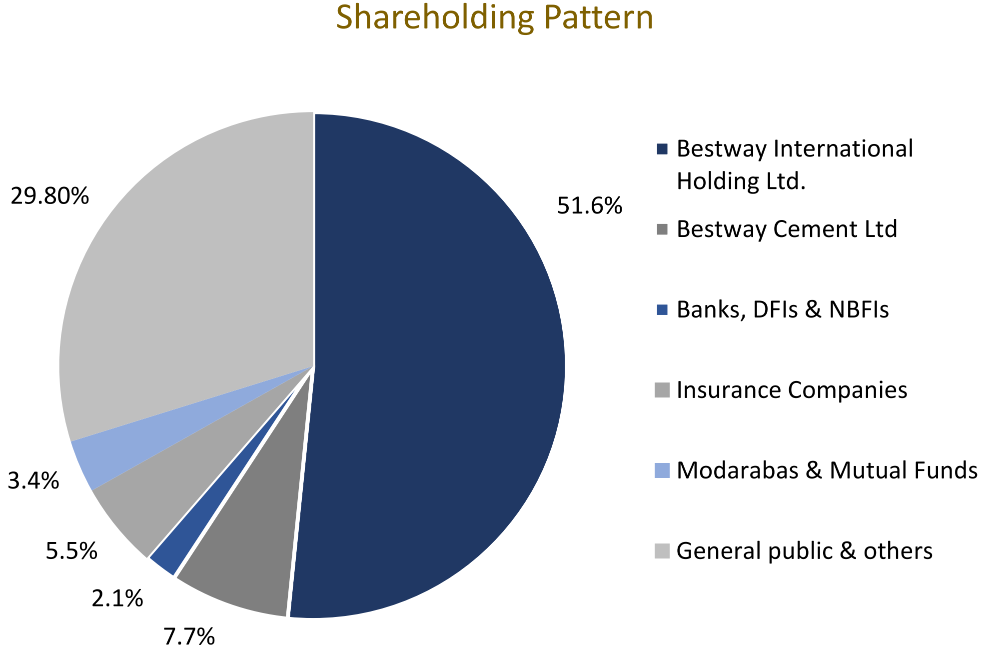
Comparative Ratios - CY21	UBL	HBL	BAFL	MCB	BAHL	MEBL
EPS	24.7	24.5	7.9	24.0	16.4	16.1
EPS Growth	44.8%	16%	33.2%	-1.9%	2%	2.6%
DPS	16.0	7.0	4.25	19.0	6.5	6.0
PER	5.6	5.1	4.5	6.5	4.4	8.9
Div. Yield	11.6%	5.6%	12.1%	12.2%	9.0%	4.2%
P/B	0.9	0.7	0.6	1.0	0.9	1.5
ROE	16.2%	13.2%	14.2%	15.3%	21.3%	36.4%

Brief Overview

- United Bank Limited is the third largest bank in Pakistan's banking industry in terms of its asset book, which stood at PKR 2.5tn end of Sept-21. The bank was founded in 1959 and is headquartered in Karachi, Pakistan. United Bank Limited is a subsidiary of Bestway international Holdings Limited with main concentration of assets in Pakistan (92.5%), followed by (7.5%) in GCC region. End of Sept-21, UBL operated through 1,344 branches in Pakistan, including 114 Islamic banking branches; and 2 branches in Export Processing Zone, as well as 11 branches internationally.

- **Group Structure**





Source: Company Accounts & Akseer Research

Financial Highlights

Income Statement (PKR mn)	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
Mark-up/interest earned	153,676	152,003	152,622	195,476	225,623	243,987
Mark-up/interest expensed	91,902	77,044	78,630	101,687	117,219	124,746
Net interest income	**61,774**	**74,959**	**73,993**	**93,789**	**108,404**	**119,241**
Non-funded income	**21,676**	**17,094**	**22,341**	**19,690**	**20,751**	**21,803**
Provision charged	8,220	16,768	2	3,776	5,193	6,010
Operating expenses	40,989	41,093	43,707	48,642	55,386	62,392
Profit after tax	**19,134**	**20,898**	**30,264**	**35,099**	**39,442**	**41,805**
Ratios						
EPS	15.6	17.1	24.7	28.7	32.2	34.1
DPS	12.0	12.0	16.0	18.5	21.5	22.5
PER	8.8	8.1	5.6	4.8	4.3	4.0
Dividend yield	8.7%	8.7%	11.6%	13.4%	15.6%	16.3%
NIMs	4.9%	4.9%	3.6%	3.9%	4.2%	4.2%
Cost/Income Ratio	49%	45%	45%	43%	43%	44%

Source: Company Accounts & Akseer Research

Alfa Adhi Securities
REN # REP-004
AKSEER RESEARCH
REN # REP-400R

Financial Highlights

Balance Sheet (PKR mn)	CY19A	CY20A	CY21E	CY22F	CY23F	CY24F
Cash & Treasury Balances	235,862	250,838	232,079	257,606	283,366	311,703
Investments	840,448	1,128,674	1,458,144	1,542,645	1,657,489	1,768,747
Advances	636,220	530,279	557,116	687,715	797,075	931,763
Operating Fixed Assets	54,348	53,037	52,732	49,222	45,945	42,783
Other Assets	126,817	86,754	90,147	100,062	110,068	121,075
Total Assets	**1,893,695**	**2,049,583**	**2,390,217**	**2,637,250**	**2,893,944**	**3,176,071**
Borrowings from FIs	154,484	128,987	238,373	257,103	282,814	311,095
Deposits	1,467,063	1,640,212	1,853,013	2,056,826	2,262,509	2,488,760
Other Liabilities	103,078	96,310	109,980	120,977	132,075	144,282
Total Liabilities	**1,724,626**	**1,865,510**	**2,201,366**	**2,434,907**	**2,677,397**	**2,944,137**
Equity	169,069	184,073	188,852	202,343	216,547	231,934
Total Liabilities & Equity	**1,893,695**	**2,049,583**	**2,390,217**	**2,637,250**	**2,893,944**	**3,176,071**
Ratios						
P/BV	1.0	0.9	0.9	0.8	0.8	0.7
BVPS	138	150	154	165	177	189
ROE	11.9%	11.8%	16.2%	17.9%	18.8%	18.6%
ROA	1.0%	1.1%	1.4%	1.4%	1.4%	1.4%
ADR	47.9%	37.1%	36%	38%	40%	42%
IDR	57.3%	68.8%	78.7%	75.0%	73.3%	71.1%
NPL/Gross Loan	10.9%	13.7%	13.6%	12.1%	11.3%	10.5%
Deposit Growth	7.4%	11.8%	13.0%	11.0%	10.0%	10.0%
Loan Growth	-11.1%	-16.7%	5.1%	23.4%	15.9%	16.9%

Source: Company Accounts & Akseer Research

Disclosures and Disclaimer

This report has been prepared and marketed jointly by Akseer Research (Pvt) Limited and Alfa Adhi Securities (Pvt) Limited, hereinafter referred jointly as “JV” and is provided for information purposes only. Under no circumstances this is to be used or considered as an offer to sell or solicitation of any offer to buy. While reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. From time to time, the JV and/or any of their officers or directors may, as permitted by applicable laws, have a position, or otherwise be interested in any transaction, in any securities directly or indirectly subject of this report. This report is provided only for the information of professionals who are expected to make their own investment decisions without undue reliance on this report. Investments in capital markets are subject to market risk and the JV accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors, who should seek further professional advice or rely upon their own judgment and acumen before making any investment. The views expressed in this report are those of the JV’s Research Department and do not necessarily reflect those of the JV or its directors. Akseer Research and Alfa Adhi Securities as firms may have business relationships, including investment--banking relationships, with the companies referred to in this report. The JV or any of their officers, directors, principals, employees, associates, close relatives may act as a market maker in the securities of the companies mentioned in this report, may have a financial interest in the securities of these companies to an amount exceeding 1% of the value of the securities of these companies, may serve or may have served in the past as a director or officer of these companies, may have received compensation from these companies for corporate advisory services, brokerage services or underwriting services or may expect to receive or intend to seek compensation from these companies for the aforesaid services, may have managed or co-managed a public offering, take-over, buyback, delisting offer of securities or various other functions for the companies mentioned in this report.

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.

Ratings Criteria

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.

Research Dissemination Policy

The JV endeavours to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as email, fax mail etc.

Analyst Certification

The research analyst, denoted by ‘AC’ on the cover of this report, has also been involved in the preparation of this report, and is a member of the JV’s Equity Research Team. The analyst certifies that (1) the views expressed in this report accurately reflect his/her personal views and (2) no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Contact Details

Akseer Research (Pvt) Limited
1st Floor, Shaheen Chambers, KCHS block 7 & 8, off. Shahrah-e-Faisal
T: +92-21-34320359-60
E: info@akseerresearch.com

Alfa Adhi Securities (Pvt) Limited
3rd Floor, Shaheen Chambers, A-4 Central Commercial Area, KCH Society, Block 7 & 8, Near Virtual University, Karachi
T: +92-21-38694242
E: info@alfaadhi.net