Pakistan Banking Sector

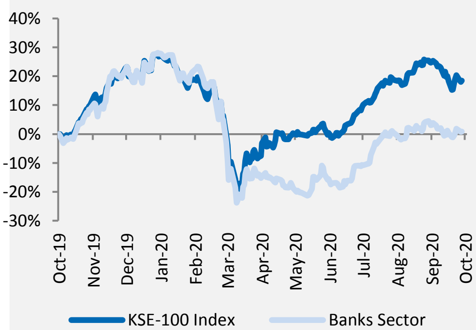
Bloated provisioning may contain earnings growth during 3QCY20

15-Oct-20

Sector Performance

	1M	3M	12M
Absolute %	(2.8)	13.6	3.7
Relative to KSE %	2.4	4.1	(17.2)

Banking Sector vs. KSE100



EPS Forecasts

Bank	9MCY20F	YoY	3QCY20F	QoQ
HBL	15.2	158%	4.9	-35%
UBL	12.1	4%	3.2	-37%
MCB	16.1	18%	4.9	-13%
ABL	10.3	22%	2.9	-27%
BAFL	4.4	-20%	1.2	-29%
BAHL	8.9	42%	2.4	-39%

Source: Company Reports, BIPLS Research

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- **BIPL Banking Sector's profitability is expected to decline by ~30%QoQ as the margin compression and higher cost of provisioning is expected to weigh in on the earnings. As for the 9MCY20, total profitability is expected to increase by ~31%YoY amid one-offs realized during 9MCY19.**
- **Exposure to higher yielding long term bond and improving deposit mix are expected to provide some support to the NIMs.**
- **Further support is also expected to come from higher trading and fee based income which had bore the brunt of lockdowns in the previous quarter.**
- **Administrative expenses are also expected to remain high owing to higher than anticipated cost pressures during the quarter.**
- **Finally, no payout is expected in this quarter, in line with SBP's statutory directives. Banks have underperformed the market during CY20 by 13% but may be primed for a good price rally as expectations of DR reversal build amid higher inflationary pressures.**

Lower interest rates to start reflecting on NIMs: With SBP easing interest rates by 625bps since Mar'20, we expect NIMs to start reflecting sharp monetary easing. Some support to NIMs however is expected to come from i) asset-liability re-pricing mismatch, ii) improved liability mix amid improvements in deposit mix of BIPL Banking Universe and iii) positive impact of looking in high yielding PIBs. Owing to the said reasons, despite lower interest rates, NIMs are expected to largely remain flat.

Robust balance sheet growth to support profitability: Deposit size of scheduled banks has posted a robust growth of ~20%YoY during 9MCY20 as opposed to a realized growth of about 12% in the entire CY19. Amid higher deposit base, the deposit mix of BIPL Banking Universe has also improved in each of the last four quarters where the average CASA has reached ~89% as of 2QCY20. We expect the increased focus on raising cheap deposits to support profitability going forward amid 625bps cut in benchmark interest rates.

NFI to pick up significantly amid easing lockdown and easing DR: The Non Funded Income (NFI) of our banking universe is expected to pick up as Fee Income is likely to report a sequential recovery. To note, 2QCY20 was particularly bad for banks as the lockdown restrictions resulted in a decline in fee based income whereas the trading income also remained muted. However, with DR easing and PSX posting a secular rally, we expect the trading income to pick up significantly which will further support the earnings during 3QCY20.

Provisioning costs to be a key concern: Despite prudent lending practices of the industry and various incentives given by SBP to contain build up of toxic assets, we expect our universe banks to book additional loan losses on account of fresh subjective classifications and general provisioning in order to beef-up coverage going forward. Banks at higher risk of build-up in infection ratio are BAFL (higher exposure to SME lending) and UBL (risks related to foreign loan book).

Investment perspective: Banks have underperformed the market during CY20 by 13% but may be primed for a good price rally as expectations of DR reversal build amid higher inflationary pressures. We highlight MCB and BAHL as potential outperformers going forward amid prudent lending policies and favorable investment mix.

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* Total stock return = capital gains + dividend yield

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