Bank AL Habib (BAHL)

Trading at 1.8x P/E; Re-valuation warranted given strong fundamentals

Wednesday, April 24, 2024

We initiate coverage on Bank AL Habib (BAHL) with a price target of PkR 130/share. Our investment thesis is based on: 1) years of above-average balance sheet growth means BAHL is no longer a mid-sized bank and deserves a higher multiple, 2) excellent track record with 0.5% credit charge, 20% deposit growth and 23% ROE for over two decades, 3) limited NPL risk given all-time high IDR of 77% and prudent lending history, 4) focus on the Islamic banking space; currently 13% of deposits and growing at 30 – 40% YoY and 5) structural tailwinds for the banking sector, driving equity market performance.

Historical mid-sized bank PB discount no longer applies: Historically, mid-sized banks used to trade at a 20 – 40% discount to the largest banks, given the former's lower ROEs and the latter's premier brand image and entrenchment as the sector's largest banks. The competitive landscape has changed over the past decade as mid-sized banks have upped their game. By virtue of their sustained high deposit growth, superior management and higher ROEs, the categorization of "mid-sized" and the valuation discount attached to it needs thorough revision.

P/B discount between "mid-sized" banks (BAHL, BAFL, HMB, FABL) and the Top 3 (HBL, UBL, NBP) have converged

Source: BMA Research

BAHL Financial Highlight	
Target (PkR/sh)	130.0
Upside (%)	43.3%
Yield (%)	22.0%
Total Return (%)	**65.3%**

Financial Overview	Dec23	Dec24E	Dec25E
EPS (PkR)	31.8	50.5	63.3
DPS (PkR)	14.0	20.0	24.0
PE (x)	2.9	1.8	1.5
Yield (%)	15.4%	22.0%	26.4%
BVPS (PkR)	113.9	140.6	179.0
PB (x)	0.8	0.6	0.5
ROE (%)	31.8%	40.5%	39.0%

Source: Company Accounts, BMA Research

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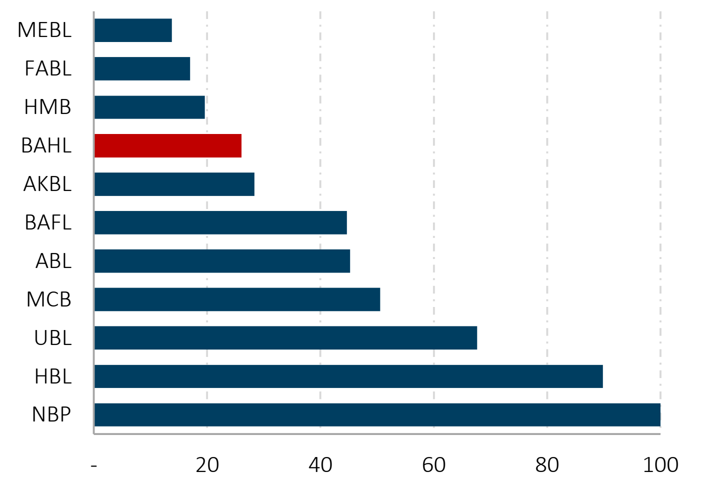
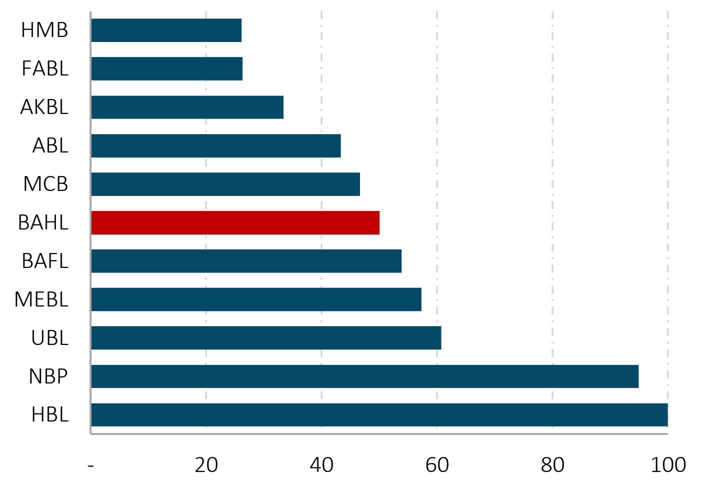
Tracking banking sectors rankings and looking to the next decade: We rank banks across three decades by deposit size below. BAHL has risen from the 8th largest bank to the 6th largest bank (5th in 2022) over the past decade. Notably, while BAHL's deposits were only 26% of the largest bank in 2009, it currently stands at 50%. We forecast what the next decade might look like if these banks maintain future growth at the average growth rate of the past three years. Meezan is expected to be the largest bank followed by BAFL, HBL and BAHL. Growth can be attributed to BAHL's consistent 11% branch growth over the past decade whilst other banks such as MCB, UBL and BAFL have consolidated their branch network.

Bank Rankings by Deposit Size as of 2009 - other banks' deposit % of largest bank (NBP)



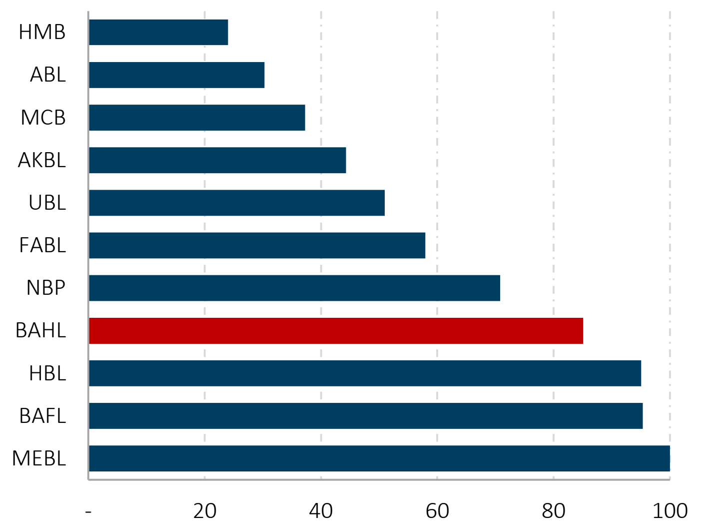
Source: BMA Research, Company Financials

Bank Rankings by Deposit Size as of 2023 - other banks' deposit % of largest bank (HBL)



Source: BMA Research, Company Financials

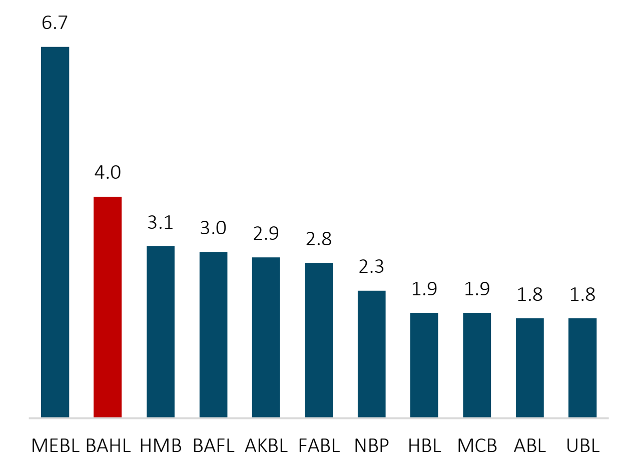
Bank Rankings by Deposit Size as of 2034 - other banks' deposit % of largest bank (MEBL)



Source: BMA Research, Company Financials

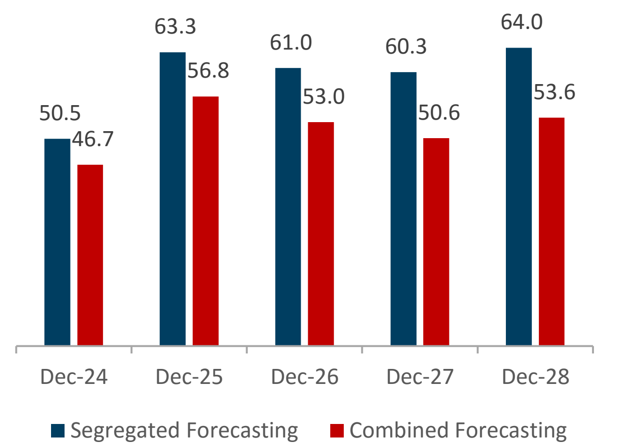
BAHL has the highest deposit growth after Meezan Bank: We've rank banks across three decades by deposit size below. BAHL has risen from the 8th largest bank to the 6th largest bank (5th in 2022) over the past decade. More tellingly, while BAHL was only 26% of the size of the largest bank in 2009, today it stands at 50%. We forecast what the next decade might look like if these banks maintain future growth at the average growth rate of the past three years. Meezan is expected to be the largest banks followed by BAFL, HBL and BAHL. Growth can be attributed to BAHL's consistent 11% branch growth over the past decade whilst other banks such as MCB, UBL, ABL etc. have consolidated branches at one point or another.

Deposit Base Growth (2013-2023)



Source: BMA Research, Company Financials

Jump in EPS due to separate forecasting of Islamic deposits (40% deposit growth, 2% lower deposit cost)



Source: BMA Research, Company Financials

Islamic Deposits growing at 40% Y/Y since 2021: Since 2020, Islamic deposits' share has risen from 8% to 13%. We forecast this to reach 18% in three years, growing to PKR 650bn by 2026.

Additionally, based on the Declaration of Profit disclosures, BAHL offers PLS rates of 11 – 17%, with an average of 15%. This is 5.5% lower than the MDR and results in a 2% differential between the total deposit cost for Islamic vs. conventional deposits.

In order to capture the impact of the high Islamic banking deposit growth and lower deposit cost, we have segregated the businesses in our model and forecasted both separately.

Since Islamic deposits are growing twice as quickly as conventional deposits, the contribution of Islamic deposits to BAHL's profitability is magnified over time. Previously Islamic deposits were less than 10% of total and the policy rate averaged 10% between 2015 – 2023. Going forward, with higher interest rates and higher proportion of Islamic deposits, the contribution to EPS can not be ignored.

Investment book is primed for re-pricing: Based on interest rate sensitivity disclosures, after excluding treasury bills and floating rate PIBs (which fall within the 1 year category based on interest rate sensitivity), BAHL has PkR 654bn maturities within 1 year, followed by small maturities over the remaining time horizons.

Out of a total of PkR 754bn of these maturities, PkR 518bn are fixed rate PIBs. Therefore, we can be fairly certain that BAHL's PIB book will undergo major re-pricing over the coming 12 months.

The management could choose to focus on near term investment yields by opting for floating rate PIBs or re-purchase fixed rate PIBs. The former would immediately boost earnings while the latter would lead to accruing AFS surpluses, which can later be realized as interest rates decline.

BAHL's Projected PIB Maturities (PkR bn)

Tenor	Outstanding		
1M	273		
1-3M	241		
3-6M	836	Maturies within 1Y	
6-12M	39	<1Y	1,389
1-2Y	16	Less: Floating Instruments	735
2-3Y	3	Fixed PIBs and Others	654
3-5Y	69	1-2Y	16
5-10Y	14	2-3Y	3
>10Y	0	3-5Y	69
Not Exposed	14	5-10Y	14

Source: Company Accounts, BMA Research

Historically, credit costs have been limited: Between 2005 and 2023, BAHL's credit charges have averaged 0.6%, considerably lower than the industry's average charge of 1.0%. Even within these numbers, BAHL's credit charges are inflated as it has averaged a general provision to NPL ratio of 60% since 2009. Currently the general provision stands at 35% of non-performing loans.

While the General Provision remains large, given the shift to IFRS 9, and the conservative history of the bank, we've assumed PkR ~7.0bn provisioning charge per year for the next 3 years as it builds up buffers.

Banking sector has structural tailwinds: Pakistan's difficult economic scenario is a boon for banks as they primarily act as financiers of the government deficit. Even as double digit interest rates pull the brakes on the economy, the government's worsened Debt-to-GDP ratio and high fiscal borrowing almost guarantee an investment avenue for the banking sector. As banks move to IFRS 9, given the unpredictability of the expected credit loss methodology, investment in government paper may continue to remain the favoured option.

At the same time, the Islamic banking business model is starting to drive conventional bank earnings as these banks expand their Islamic banking operations to meaningfully large sizes.

We expect the fiscal deficit to average 5 – 6% for the foreseeable future unless significant revenue measures are implemented. Large deficits will continue to drive double digit M2 growth and banks may continue to re-cycle deposits into government securities to earn relatively risk free profits. Given this, we believe, the banking sector continues to remain one of the most attractive and low risk forms of investment on the PSX.

Valuation – Target of PkR 130/sh: We have used Dividend Discount Methodology assuming a 14.5% Risk Free Rate and 24.1% Cost of Equity after using the appropriate beta and an 8% risk premium. We have used an 8% rather than a 6% risk premium given Pakistan's elevated macro-economic risk.

This leads us to a DDM based December 2024 TP of 160/share. This results in 77% capital upside in addition to a 21% dividend yield. Note that, at the current price, the dividend yield alone nearly offsets the cost of equity.

Based on current fair value (discounting further by 24%), we believe BAHL is worth PKR 130/share, for a current upside of 44% in addition to a 21% dividend yield.

BAHL Financial Statement						
PkR mn	**Dec-21**	**Dec-22**	**Dec-23**	**Dec-24**	**Dec-25**	**Dec-26**
Net Interest Income	55,609	77,319	124,148	182,962	227,602	245,723
Non Interest Income	14,027	21,196	23,227	26,188	30,113	34,811
Total Revenues	**69,636**	**98,515**	**147,375**	**209,150**	**257,715**	**280,534**
Provisions	(47)	12,871	4,200	6,585	5,733	7,492
Operating Expenses	38,754	51,787	70,274	92,433	114,049	140,163
PBT	30,273	32,884	71,128	110,132	137,933	132,879
PAT	18,702	16,570	35,319	53,965	67,587	65,111
EPS (PkR)	**16.8**	**14.9**	**31.8**	**50.5**	**63.3**	**61.0**
DPS (PkR)	**7.0**	**7.0**	**14.0**	**20.0**	**26.0**	**24.0**

BAHL Key Financial Ratios						
PkR mn	**Dec-21**	**Dec-22**	**Dec-23**	**Dec-24**	**Dec-25**	**Dec-26**
BVPS (Tangible)	75.2	84.9	100.7	127.1	169.1	205.0
BVPS	81.0	85.7	113.9	139.3	180.3	215.4
ROA	1.1%	0.8%	1.4%	1.9%	2.1%	1.7%
ROE	22.0%	17.9%	31.8%	39.9%	39.6%	30.8%
NII Growth	-3.5%	39.0%	60.6%	47.4%	24.4%	8.0%
PAT Growth	5.0%	-11.4%	113.1%	59.0%	25.2%	-3.7%
Payout Ratio	28.1%	41.6%	47.0%	44.1%	39.6%	41.1%
Deposits Growth	19.1%	19.7%	23.3%	22.6%	23.0%	21.7%
Advances Growth	43.8%	10.9%	6.9%	1.4%	9.7%	9.6%
ADR	56.0%	51.9%	45.0%	37.2%	33.2%	29.9%
IDR	63.1%	73.9%	77.8%	71.8%	75.0%	77.2%
Cost of deposits	3.6%	6.2%	10.7%	11.6%	8.9%	7.2%
Yield on investments	8.7%	11.9%	17.6%	20.7%	17.6%	15.0%
Yield on advances	6.3%	10.3%	16.2%	18.6%	16.8%	13.7%
NII/Deposits	4.6%	5.4%	7.1%	8.5%	8.6%	7.6%
NPLs / Gross Loans	1.0%	1.8%	2.8%	3.4%	3.8%	4.2%
Provisions / NPLs	169.0%	121.0%	105.5%	100.2%	95.0%	93.2%
Net NPLs / Net Advances	-0.7%	-0.4%	-0.2%	0.0%	0.2%	0.3%
Credit Charges	0.0%	1.7%	0.5%	0.8%	0.6%	0.7%
Admin Cost / Income	55.7%	52.6%	47.7%	43.0%	43.0%	48.9%
Admin Cost / Deposits	3.2%	3.6%	4.0%	4.2%	4.2%	4.2%

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Old rating system

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)