

## National Bank of Pakistan Grappling for Glory

## Commercial Banks

### Buy

Target Price	78.4
Last Closing	61.9
Upside (%)	26.8
PSX Code	NBP
Bloomberg Code	NBP PA

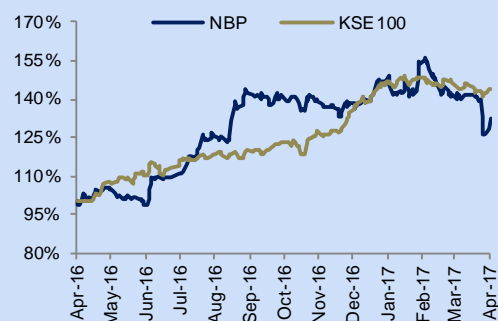
#### Shares

Market Cap (USD m)	1,253.2
Outstanding Shares (m)	2,127.5
Free Float (%)	23.8
12M Avg. Daily Turnover (m)	2.1
12M High   Low (PKR)	74.00   47.00
Major Shareholders	State Bank of Pakistan

#### Key Metrics

	CY16A	CY17E	CY18F
Adj. PAT (PKR bn)	23.0	21.8	21.6
EPS (PKR)	10.8	10.3	10.1
P/E (x)	5.71	6.02	6.10
P/B (x)	0.73	0.73	0.72
DPS (PKR)	7.5	7.0	7.0
Div Yield (%)	12.1	11.3	11.3
ROE (Tier II)	13.1	12.1	11.9

#### Stock Performance



Source: Bloomberg

#### Analyst

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#### Shadowed Valuation

Pursuant to the analyst briefing held yesterday, we revise our investment case on National Bank of Pakistan (NBP) with a target price of PKR 78.4/share (down 11%) largely emanating from an expected decline in earnings of 5% YoY for CY17. Our reservations remain on lower spreads (Loan book) and yields (investments), higher cost to income ratio and lower capital gains going forward. Positives arise from renewed focus on Non-Funded income through a range of new initiatives targeting fee income, similar trend on the provisioning front (however we have a reserved stance) and lower expected cost of funds. The scrip currently trades at an attractive P/B (x) of 0.73 offering 26.8% to our Justified Price to book multiple of 0.92x.

#### Focus on Fee Income growth

CY16 saw a resurgence in Fee income growth of 18% YoY from a relative lower 2yr average of 4.4% (CY14-15). The management eyes the head as a major growth area which is also evident from the range of initiatives, new products, agreement's with insurance and telecom companies and up gradation of internal systems.

#### Coverage Rising

The improving asset quality of the bank is evident as gross advances grew by 12.8% YoY while the infection ratio declined to 15.4% from a high of 18.5% since CY12. The telling sign here is the 6% decline in classified loans resulting in an improved coverage ratio which is up to 91.4% compared to the industry ratio of 81.2%. This bodes well as historically there is significant risk assigned to the bank however the trend is on amends.

#### Provisions Held

	2012	2013	2014	2015	2016	%
<b>Textiles</b>	<b>25,868</b>	<b>27,694</b>	<b>26,431</b>	<b>30,783</b>	<b>29,837</b>	<b>27.07</b>
Metal Products	527	4,277	9,122	14,694	15,959	14.48
General Traders	4631	10,285	12,080	10,347	9,855	8.94
Energy	4051	7,488	7,889	5,299	3,937	3.57
Hotel and Services	733	882	3,291	4,247	3,422	3.10
Chemical and Pharma's	3104	3,166	2,041	4,097	2,279	2.07
<b>Sugar</b>	<b>3535</b>	<b>2,624</b>	<b>3,463</b>	<b>3,763</b>	<b>3,447</b>	<b>3.13</b>
<b>Agriculture</b>	<b>1271</b>	<b>1,874</b>	<b>2,036</b>	<b>2,286</b>	<b>2,795</b>	<b>2.54</b>
Others	28,667	31,714	32,196	35,810	38,708	35.11
	<b>72,387</b>	<b>90,004</b>	<b>98,549</b>	<b>111,327</b>	<b>110,240</b>	

Infection Ratio	12.6%	16.3%	16.6%	18.5%	15.4%
Coverage Ratio	78.4%	77.6%	81.2%	86.8%	91.4%

Source: Company Financials, AHL Research

#### Cost of Funds

The prevalent low interest environment has been beneficial for NBP on a large scale given the high concentration in Fixed and Saving accounts. Despite a declining CASA (CY15 76.9%; CY16 73.5%) the cost of deposits has declined by 6.1% YoY keeping interest expense stable. With renewed focus to take advantage of the low interest rates, the bank has set targets for the sales teams with incentives inclined towards around current accounts. The results of the new strategy are expected to be seen progressively through the current year. Going forward we can see the cost of funds hover around the 3% in the next two years mark compared to the 5% range recorded through CY09-14.

### Capital Gain Theorem

Over the past two years NBP has in total realized PKR 20,740mn of capital gains constituting 48% of the PAT recorded over the same period. Although true to the industry; we still believe that this is a major driver for the scrip. The declining trend can be seen in both capital gains percentage realized over total surplus (CY15 24% declining to CY16 15%) and percentage realized over AFS surplus (CY15 42% declining to 26%). Going forward we feel the percentage will decline further impacting non funded income.

#### Exhibit: Revaluation Surplus and Capital Gains

	2012	2013	2014	2015	2016
<b>Surplus on Revaluation</b>					
AFS	18,540	33,164	45,564	29,563	33,118
Fixed Assets	17,412	22,133	22,288	22,168	23,181
	<b>35,952</b>	<b>55,297</b>	<b>67,853</b>	<b>51,731</b>	<b>56,299</b>
<b>Capital Gains Realized</b>					
<b>Federal Govt Securities:</b>					
MTBs	353	250	24	189	154
PIBs	162	233	823	6,633	3,084
GoP Ijarah Sukuks	34	7	35	2	1
	<b>548</b>	<b>490</b>	<b>882</b>	<b>6,825</b>	<b>3,239</b>
NIT Units	45	332	1,052	-	-
Shares and Mutual Funds	2050	1,419	6,089	4,923	5,231
Foreign Govt/Debt Securities	163	440	14	25	1
Associates - Mutual Funds	414	1,207	623	511	54
	<b>2,672</b>	<b>3,397</b>	<b>7,778</b>	<b>5,458</b>	<b>5,287</b>
<b>Total</b>	<b>3,220</b>	<b>3,887</b>	<b>8,660</b>	<b>12,283</b>	<b>8,525</b>
% Realised over Total Surplus	9%	7%	13%	24%	15%
% Realised over AFS Surplus	17%	12%	19%	42%	26%

Source: Company Financials, AHL Research

### The Pension Case

Much hype has been advocated to the pension case which according to the auditors would amount to PKR 47.7bn translating into a per share impact of PKR 22.42 in a worst case scenario. The matter has been put forward to the Supreme Court who earlier has passed a judgment in favor of the State Bank of Pakistan in an identical case.

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as December 2017 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +10% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -10% from last closing of market price(s)

\* Upside for Power Generation Companies (Ex. KEL) is upside plus dividend yield.

### Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discount Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserved Base Valuation (RBV)**

### Risks

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**

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