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# Inter Market Pulse

## Pakistan Banks

### NBP: Turnaround reflecting in results; upgrade to Buy

- We upgrade NBP from Neutral to Buy with a revised Dec'17 TP of PkR83/sh (Dec'16 TP PkR66/sh earlier), which offers a potential total return of 33%. EPS estimates for CY16/17F have been revised up by 6%/8% to PkR9.71/10.24 on the back of turnaround underway since CY15, which is likely to unlock long awaited earnings potential.
- Since its CY16TD low, the stock has outperformed the IMS Bank Universe by a staggering 26%. We believe this is a function of growing investor confidence on (i) consistent improvement in asset quality and cost efficiencies, and (ii) tremendous potential of non-interest income. The stock trades at CY17F P/B of 0.86x, where narrowing of valuation discount (larger private banks P/B: 1.5x) can unlock upside.
- 2QCY16 earnings of PkR2.84/sh surpassed consensus expectations with support from (i) 10%YoY/31%QoQ rise in NII, (ii) lower loan provisions, (iii) impressive 34%YoY rise in fee income, and (iv) contained 9%YoY increase in admin cost (C/I: 51%). Surprise element in 2H may materialize from unrealized capital gains of PkR45.6bn (on equities: PkR27.8bn)

**NBP upgraded to Buy:** We upgrade National Bank of Pakistan (NBP) from Neutral to Buy with revised Dec'17 TP of PkR83/sh (from previous Dec'16 TP of PkR66/sh), which offers a striking total return of 33%. EPS estimates for CY16/17F have been revised up by 6%/8% to PkR9.71/10.24, supported by visible result turnaround since CY15, which is likely to extend in the medium term, in our view.

**Diminishing asset quality concerns:** Among the positives, NPL ratio has come off by 2.3ppt to 17.8%, backed by recent prudent lending approach (3%YoY loan growth lags behind industry growth of 12%YoY), with coverage of 88% likely to keep credit costs in check going forward. Support can emanate from completion of cleanup exercise on the international front; pre-provision profits from international operations doubled in 1HCY16.

**Unique fee income characteristics could lead to outperformance:** We believe (i) 50% increase in ATM network in CY16F, (ii) introduction of bancassurance in over 600 branches, coupled with debit cards, and (iii) increasing footprint of tax and GoP fee collection beyond the designated 600 branches to over 100,000 agents and ATMs can support robust growth in this area. Other than this, unrealized capital gains backlog of PkR45.6bn (pre-tax; 2.2x CY16F NPAT) has the potential to surprise in 2HCY16.

**Limited cost growth:** Cost efficiencies are coming into play, but C/I of 51% still lags behind peers. We believe (i) possible net retirement of 5000 employees over next few years, (ii) planned measures like changes in medical allowance policies, and (iii) centralization of processes can support the cause.

**Stock price is up and running:** Since its CY16TD low, the stock has muscled through with a run-up of 44%. We believe the market has been quick to appreciate the recent turnaround in the bank, which has long been penalized for having (i) inherent asset quality issues, and (ii) poor cost administration. The stock currently trades at a CY17F P/B of 0.86x, where narrowing valuation discount is likely to unlock further upside. Payout remains a stand-out element, with a 10% dividend yield looking more attractive than traditional IPP plays; sustainability will prevail considering CAR is at over 18%. Any shift from an annual to quarterly dividend policy can further catalyze volumes and stock performance.

**2QCY16 Earnings: Turnaround more visible:** During 2QCY16, NBP posted consolidated NPAT of PkR6.05bn (EPS: PkR2.84), which comfortably surpassed street consensus on the back of (i) 10%YoY/31%QoQ rise in NII, mainly led by 54%YoY increase in investments, (ii) lower loan provisions (PkR879mn vs. PkR3.7bn in 2QCY15), (iii) 34%YoY rise in fee income, and (iv) cost efficiencies clearly coming into play with contained rise in admin costs (up 9%YoY in 2Q). On the balance sheet front, loan growth recovered (up 3%YoY) after posting consecutive declines in the last 4 quarters; but it still remains much lower than peers.

### National Bank of Pakistan

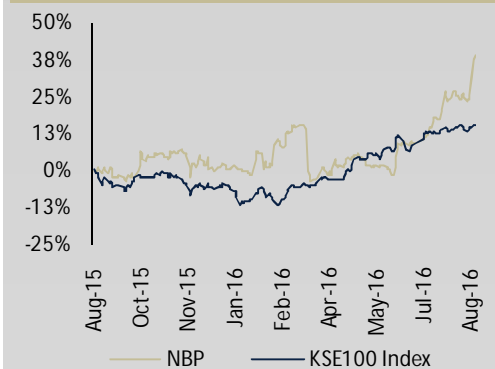
Price (PkR/sh)	73.7
TP (PkR/sh)	83.0
Stance	Buy
Upside	12.7%
Fwd D/Y*	20.7%
Total Return	33.4%
Bloomberg / Reuters	NBP PA / NBPK.KA
Mkt Cap (US\$m)	1,496.4
52wk Hi-Low (PkR/sh)	73.65-51.15
3m Avg. Daily Vol ('000 shrs)	1,733
3m Avg. Traded Val (US\$m)	1.07

\*Expected dividend of CY16F+CY17F

	CY16F	CY17F	CY18F
Revised	9.71	10.24	10.90
Previous	9.13	9.53	9.68
Change	6.4%	7.5%	12.6%

Source: IMS Research

### NBP vs. KSE100 Index



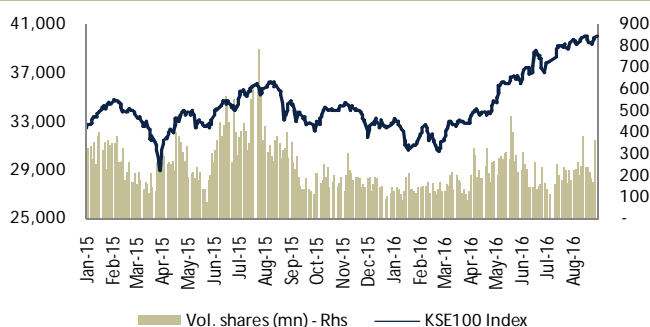
Source: IMS Research

Analyst certification and required disclosures begin on page 3 & 4

To find our Research on Bloomberg, please type - *IMKP <GO>*

**Morning News**

- **Bank payment agreement to be signed between SBP and Iranian Central Bank:** SBP has shared a draft agreement with GoP for the much awaited BPA with Bank Markazi Jamhuri Iran. According to the draft, both central banks will issue Letter of Comfort to the commercial banks on both sides on individual requests. This will help smooth and expand the bilateral trade between the two countries as absence of banking channel was the key hurdle in payment mechanism for bilateral trade.
- **Shell to add 15 more outlets to its portfolio:** Shell Pakistan has decided to revamp its network of 780 outlets and launch a Shell Select Program, which entails setting up convenience stores and other services on the outlets. Moreover the company is planning to add another 15 outlets to the existing portfolio.
- **Centre and Sindh to reach settlement on power bills soon:** Federal and Sindh government are set to resolve the long outstanding power dues of PKR72bn. According to GoP, Sukkur Electric and Power Company (SEPCO) and Hyderabad Electric Supply Company (HESCO) owe the sum to which Sindh government does not agree. The development will help ease the pressure on the massive circular debt in the country.
- **The Abraaj Group considering divesting stake in K-Electric:** The company announced that its majority shareholder was evaluating the possibility of divesting its stake (of up to 66.4%) in the company to Shanghai Electric Power Company Limited.

**KSE100 Index & Volume**

Source: PSX

**World Indices**

	Close	DoD Δ	DoD Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Pakistan	39,991.8	-31.2	-0.1%	21.87%	5.84%
China	3,074.7	4.7	0.2%	-13.12%	4.85%
Hong Kong	23,016.1	194.8	0.9%	5.03%	10.68%
India	28,343.0	440.3	1.6%	8.52%	4.41%
Indonesia	5,362.3	-8.4	-0.2%	-12.10%	6.89%
Malaysia	1,681.6	0.0	0.0%	-0.64%	2.15%
Japan	16,725.4	-12.1	-0.1%	-12.13%	6.65%
Singapore	2,828.4	-1.0	0.0%	-1.89%	-0.63%
Korea	2,039.7	7.4	0.4%	4.00%	2.64%
Taiwan	9,110.6	0.4	0.0%	9.26%	4.26%
Bangladesh	4,534.0	0.0	0.0%	-2.06%	0.59%
Sri Lanka	6,540.2	0.0	0.0%	-5.14%	4.09%
Philippines	7,794.9	-50.6	-0.6%	12.12%	-0.45%
Thailand	1,546.1	2.0	0.1%	20.04%	7.00%
Vietnam	672.7	3.2	0.5%	16.17%	5.06%
USA	2,176.1	-4.3	-0.2%	6.47%	3.48%
UK	6,820.8	-17.3	-0.3%	9.27%	3.69%
Germany	10,657.6	113.2	1.07%	-0.79%	9.02%

Source: Bloomberg

**Forex & Money Market**

	Close	DoD Δ	YoY Δ bps	CYTD Δ bps	FYTD Δ bps
6m Tbill yield (%)	5.88	0.00	-1.07	-0.51	-0.01
10Y PIB yield (%)	7.78	0.00	-1.60	-1.55	0.19
6m Kibor (%)	5.78	-0.01	-1.04	-0.48	-0.03

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
PkR/US\$	104.82	-0.009	-0.01%	0.8%	0.1%	0.0%
PkR/EUR	117.12	-0.178	-0.15%	-0.2%	2.4%	0.3%
PkR/JPY	1.024	-0.002	-0.20%	19.0%	17.7%	0.4%

Source: Bloomberg

**Commodity Prices**

	Close	DoD Δ	DoD Δ (%)	YoY Δ (%)	CYTD Δ (%)	FYTD Δ (%)
Gold - US\$/oz	1,311.11	-12.39	-0.9%	15.7%	23.5%	-0.8%
Oil (WTI)- US\$/bbl	46.35	-0.63	-1.3%	2.5%	25.1%	-4.1%
Cotton US\$/lb	65.97	-0.72	-1.1%	3.5%	4.3%	5.0%
Coal - US\$/MT	66.25	0.15	0.2%	22.5%	36.7%	13.2%
CRY Index	182.82	-1.61	-0.9%	-7.2%	3.8%	-5.1%

Source: Bloomberg

**Portfolio Flows**

(US\$m)	Current	WTD	MTD	12M	CYTD	FYTD
Total FIPI	(0.04)	0.03	0.03	(20.21)	(177.35)	(37.89)
Individuals	4.35	0.36	3.26	56.88	32.26	(43.41)
Companies	(2.79)	(5.39)	5.04	(135.95)	(140.37)	8.47
Banks / DFI	(2.07)	(4.93)	(6.11)	(60.81)	(70.60)	(44.33)
NBFC	0.07	(0.40)	7.50	183.14	141.95	17.60
Mutual Funds	2.52	15.75	15.87	95.04	67.37	71.50
Other Organization	(0.30)	(1.41)	(2.42)	48.96	24.78	(3.56)
Broker Trading	(1.74)	(4.00)	(2.93)	(9.91)	(17.49)	(9.32)

Source: NCCPL

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Ratings Guide*	Total Return
Buy	More than 15%
Neutral	Between 0% - 15%
Sell	Below 0%

\*Based on 12 month horizon unless stated otherwise in the report. Total Return is sum of any Upside/Downside (percentage difference between the Target Price and Market Price) and Dividend Yield.

**Valuation Methodology:** We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

**Risks:** (i) Greater than expected growth in NPLs, (ii) extension of lackluster loan growth trend, and (iii) continuation of high cost-to-income.

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