



Habib Bank Limited

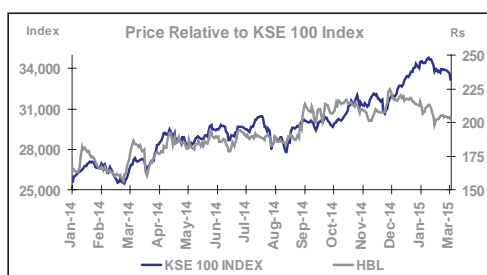
HBL: Giant Getting Ginormous

We endure our liking for Habib Bank Limited with a 'BUY' recommendation for Dec'15 target price of Rs 227/share offering an upside potential of around 25% from current price of Rs 181.32/share with an EPS of Rs 23.40. In addition to capital gain, the company is also offering a dividend yield of 6.9% taking the cumulative return to 32%. The bank is likely to offer average ROE of 19% for the next 3 years (CY15-17). HBL, at the current price of Rs181.32/share, is being traded at PBV of 1.6x and PER of 7.9x based on CY15E book value of Rs 118.6/share and EPS of Rs 23.40. The basis of our recommendation stems from: 1) strong earning growth resulting in a 10% YoY growth during CY15; 2) Increment in average deposit growth up to 6.6% in CY15-17; 3) lower cost of deposit resulting in better spread; 4) growth in investment by 12.9% during CY14 and expected to continue; 5) Bank is expected to gain net interest Income of Rs75.76 billion in CY15 which reflects growth of 12% YoY and 5) reduction in non-performing loans. In addition to that, major risks to our analysis are: 1) political chaos, 2) law & order issues to affect business climate; 3) further decline in interest rates; 4) slowdown in loan growth; and 5) lower capital gains due to under performance of market.

KEY DATA

KATS Code	HBL
Reuters Code	HBL.KA
Current Price (Pkr)	181.32
Year High, Low (Rs)	221.90, 167.48
Market Cap (Rs bn)	277
Market Cap (US\$ bn)	2.74
Shares Outstanding (mn)	1466.85
Free Float (%)	10%

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

HBL Financial Snapshot

	CY14A	CY15F	CY16F	CY17F
Profit after Tax (Rs mn)	31,112	34,384	36,195	37,520
EPS (Rs)	21.21	23.37	24.60	25.50
Book Value (Rs/share)	107.62	118.68	129.73	141.67
DPS (Rs)	12.00	12.75	13.50	13.50
P/E (x)	8.72	7.90	7.49	7.18
P/BV(x)	1.72	1.56	1.43	1.30
Dividend Yield (%)	6.49	6.89	7.30	7.30
Payout (%)	56.6	54.4	54.7	52.8
ROE (%)	19.71	19.75	19.02	18.05
ROA (%)	1.76	1.79	1.78	1.75

Source: Company Reports & WE Research



Valuation: BUY with a Target Price of Rs 227

A combination of valuation methodologies have been used i.e. DDDM (Distributable Dividend Discount Model) and Justified Book Value Method to calculate target price of HBL. Our Dec'15 target price for HBL is Rs 227/share, offering an upside of 25% against current market price of Rs 181.32/ share with an EPS of Rs 23.40. Further support can be achieved through potential dividend yield of 6.9%. Hence we recommend BUY for it.

Distributable Dividend Discount Model

Under the DDDM Model, the total value of the Bank is found by estimating the present value of distributable earnings under a target CAR ratio. Our calculations incorporate a target CAR of 18%, a discount rate of 15.3%, a terminal growth rate of 9%, implying a target price of Dec'15 of Rs 234/share for HBL.

Our Dec'15 target price for HBL is Rs 227/share, offering an upside of 22% against current market price of Rs 185.62/share with an EPS of Rs 23.40. Further support can be achieved through potential dividend yield of 6.9%. Hence we recommend BUY for it.

Rs in million	CY15E	CY16F	CY17F
Risk Assets	1,606,547	1,679,708	1,756,528
Increase in RWA	92,728	73,161	76,819
CAR + 2.0%	18%	18%	18%
Additional capital required	15,949	12,584	13,213
Net profit	31,847	33,873	35,294
Available for dividends	15,898	21,289	22,081
PV of cash flows	15,898	18,684	17,007
Terminal Value	378,510		
Discounted Terminal Value	291,544		
Equity Value	343,134		
Shares Outstanding	1,467		
DDDM Target Price Dec'15 (Rs)	234		

Source: WE Estimates

Justified PBV (Price to Book Value)

For Justified Price to Book Value method, a growth rate (g) of 9% based on the assumption that HBL has sustainable ROE of 19.7% and retention ratio of 45.5% at the terminal. The required rate of return of equity is 15.33% based on risk free rate of 10% derived from secondary market rate of 10yr PIB as a proxy and beta of 0.89 and risk premium of 6%, Thus, Justified PBV ratio for HBL stands at 1.7x and multiplying it with its CY16E book value of Rs 129.71/share, the target price of HBL comes to Rs 220/ share.

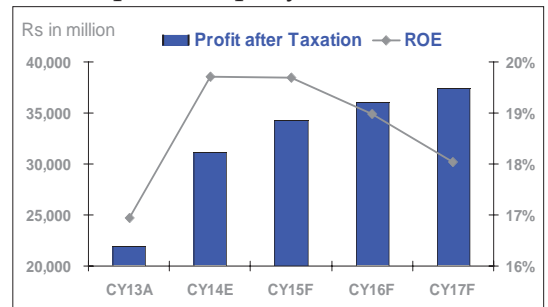
Average Target Price Rs 227/Share



The bank is expected to post a profit after taxation (PAT) of Rs 34,384 million (EPS: Rs 23.4) in CY15 resulting in a 10.5% YoY growth when compared to a PAT of Rs 31,112 million (EPS: Rs 21.21) in CY14. The rise in bottom-line would be on back of surge in net interest income and hike in non-funded income, and relatively stagnant provisions.

Strong Earning growth ahead in CY15

The bank is expected to post a profit after taxation (PAT) of Rs 34,384 million (EPS: Rs 23.4) in CY15 resulting in a 10.5% YoY growth when compared to a PAT of Rs 31,112 million (EPS: Rs 21.21) in CY14. The rise in bottom line would be on back of surge in net interest income and hike in non-funded income, and relatively stagnant provisions. We expect company to announce cash dividend of Rs 12.75/share. The bottom line of the company is expected to fatten in the coming years where it is likely to grow by an average of 7% YoY during (CY15-CY17E) while the ROE of the bank to average 18.9% during (CY15-CY17E).

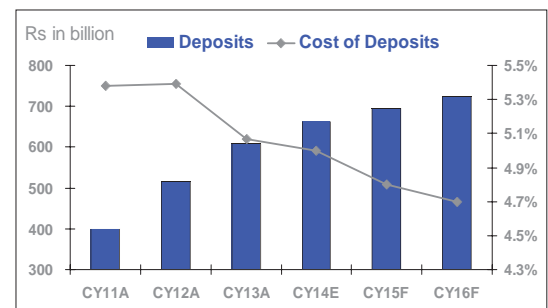


Source: WE Research

Bank's deposit grew at an average rate of 16.7% (CY09-CY14) and expected to grow on average rate of 6.6% (CY15-CY17E) reaching Rs 1,678 billion on the back of growing branch network and higher current account deposits. The CASA ratio of the bank has improved significantly from 75% as of CY13 to 79.5% as of CY14.

Deposits continue to nurture

HBL has maintained its leadership position with market share of deposits stable at around 9.9%. It has been constantly expanding its branches with total of 1614 branches as of Dec'14 with deposit base of Rs 1,570 billion. Bank's deposit grew at an average rate of 16.7% (CY09-CY14) and expected to grow on average rate of 6.6% (CY15-CY17E) reaching Rs 1,678 billion on the back of growing branch network and higher current account deposits. The CASA ratio of the bank has improved significantly from 75% as of CY13 to 79.5% as of CY14. Consequently bank's cost of funds has declined to 4.3% in CY14 versus 4.4% in CY13. We expect further decline to 3.9% in CY15. In CY14 the bank had 34% deposits in current account, 46% in saving account and 20% in fixed deposits. Our expectations for CY15 are 39% in current account, 44% in saving account and 16% in fixed deposits.



Source: WE Research



We expect the advances of the bank to grow at an average of 6.6% YoY in CY15-CY17E. The advances to deposits ratio of the bank would reduce to 41.03% in CY15 versus 42.58% in CY14 accredited to conservative lending approach. Subsequently this led to slight decline in bank's income yields from 8.8% in CY14 to 8.3% in CY15.

The net interest income of the bank is expected to total Rs 75,841 million which reflects growth of 12% for CY15. In CY14 HBL's balance sheet continued to grow Rs 1,769 billion with the deposit base to Rs 1,447 billion. Besides decreasing high cost deposits, the bank increased its domestic deposits to Rs 1.26 trillion. We have assumed 50bps decline in discount rate in May'15 monetary policy.

Advances seeing stability

On the back of improving economic conditions, reducing non-performing loans, and increasing deposits we expect the advances of the bank to grow at an average of 6.6% YoY in CY15-CY17E. The advances to deposits ratio of the bank would reduce to 41.03% in CY15 versus 42.58% in CY14 accredited to conservative lending approach. Subsequently this led to slight decline in bank's income yields from 8.8% in CY14 to 8.3% in CY15. Although the shifting from credit business has hurt bank's yield, but simultaneously the bank managed to strengthen up and improved its asset quality. Firstly, by reducing credit exposure HBL managed to restrict its non-performing loans (NPL) accretion - NPL grew by a meager 9.9% against gross advances in CY14 as compared to 10.5% in CY13. And, secondly it provided enough room to take up a position in lucrative sovereign yields, which helped in keeping bank's Capital Adequacy Ratio (CAR) relatively high. The CAR under Basel III improved from 15.4% to 16.2% as at December 31, 2014, while the Tier 1 CAR improved to 13.3% as a result of strong internal capital generation.

Net interest income on the move

We are expecting net interest income to rise due to HBL's strategic focus to build Current Accounts from its core business. In CY14, HBL had deposits of 34.2% in terms of current account, 43.9% as saving account, 21.9% as fixed deposit account. The net interest income of the bank is expected to total Rs 75,841 million which reflects growth of 12% for CY15. In CY14 HBL's balance sheet continued to grow Rs 1,769 billion with the deposit base to Rs 1,447 billion. Besides decreasing high cost deposits, the bank increased its domestic deposits to Rs 1.26 trillion. We have assumed 50bps decline in discount rate in May'15 monetary policy.

Non funded income grooming

Being the largest private bank, HBL enjoys large pool of investment in diversified businesses. Its continued focus to enhance its Non-Interest Income (NII) has started to produce positive results. On average NII of the bank likely to get a good support by a moderate rise in non-interest income which is expected to total Rs 19,971 million in CY15 against Rs. 19,675 million in CY14, depicting rise by 2%; reflecting bank's adoptive strategy to stream up revenues through alternative distributions channels.



Investments have always been important earning assets to the banks. HBL is keenly focusing towards investment that is witnessed in CY14 where the investment growth increased by 12.9% in CY14 from 2.3% in CY13. The bank was holding PIBs worth Rs 304 billion, Treasury bills worth Rs 450 billion, and other investments worth Rs 143 billion during CY14.

The Cabinet Committee on Privatization (CCOP) has approved a transaction structure under which it will sell 609.3 million shares of the HBL. These shares are divided into two categories: 250 million shares will be sold as base shares through the book-building process; whereas the remaining 359.3 million shares will be available under a Green Shoe Option to be exercised on the basis of investor demand.

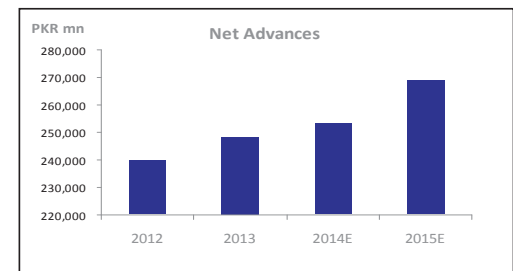
Investments remained Focus

Investments have always been important earning assets to the banks. HBL is keenly focusing towards investment that is witnessed in CY14 where the investment growth increased by 12.9% in CY14 from 2.3% in CY13. The bank was holding PIBs worth Rs 304 billion, Treasury bills worth Rs 450 billion, and other investments worth Rs 143 billion during CY14. Among these, Rs 223 billion worth of PIBs were secured for available for sale, Rs 76 billion worth were hold till maturity, and Rs 5 billion were held for trading. Treasury bills worth Rs 407 billion were available for sale whereas Rs 42 billion T-Bills were hold for trading. We are expecting the same aggressiveness to continue with the investment of 1 trillion in CY15. Investment to deposit ratio considered is 60.8% for CY15.

HBL is currently trading at a CY15E Price to Book value of 1.6x, Price to Earning ratio of 7.9x and Dividend Yield of 6.31%. Within the backdrop of a rebounding economy, we remain bullish on the banking sector in general and the larger banks in particular which do not need to raise further capital in order to fund future growth. Further upside potential can be witnessed with an increase in free float as the Government of Pakistan looks to divest 41.5% of its stake over the upcoming months comprising of more than six hundred million shares.

Government to offload its shares

Government of Pakistan, under privatization program, plans to offload its shareholding of more than six hundred million shares (41.5%) of HBL through a Capital Market transaction to foreign and Domestic investors. The Cabinet Committee on Privatization (CCOP) has approved a transaction structure under which it will sell 609.3 million shares of the HBL. These shares are divided into two categories: 250 million shares will be sold as base shares through the book-building process; whereas the remaining 359.3 million shares will be available under a Green Shoe Option to be exercised on the basis of investor demand.



Source: Company Reports & WE Research



Key Risks

Political, law & order issues to affect business climate

Targeted raids by rangers and police to arrest criminals linked with political parties creating uneasiness. Any clash in result would badly affect equity market.

Slowdown in loan growth

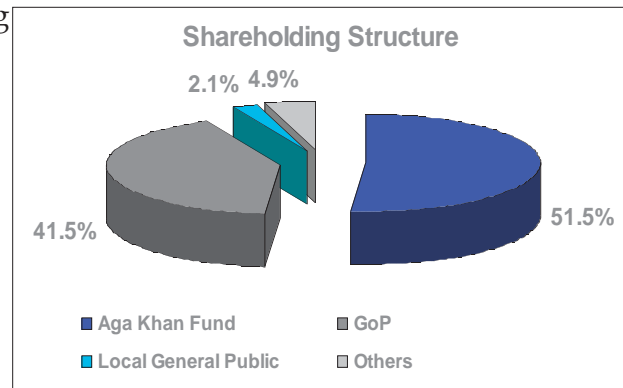
We expect the net advances of the bank to grow by around 6% in CY15 therefore lower rise in advances could reduce our CY15 estimates for the bank.

Lower capital gains would restrict growth

Stock market is poised for new targets in CY15 on back of P/E re-rating, earnings growth, and positive foreign inflows. However market can turn bad on multiple triggers and huge correction can result in lower gains/provisions on HBL non funded income.

Company Introduction

Habib Bank Limited incorporated in Pakistan, is a scheduled Bank, engaged in commercial banking and related services. It is enjoying a very strong backing in terms of 51% shareholding by Aga Khan Fund for Economic Development (AKFED), followed by 41.5% by Government of Pakistan and the rest 7.5% among institutions and retail investors. The Bank is listed on all stock exchanges in Pakistan. The Bank operates a total of 2100 branches in Pakistan as well as 27 other countries. Currently it holds over 8 million customers worldwide. Over \$ 3 billion of remittances were channeled through HBL and its partnering financial institutions network, primarily in Gulf, Saudi Arabia, UK and USA during CY14.



Source: Company Report



HBL - Financial Highlights

Key Ratio Analysis

	CY14A	CY15F	CY16F	CY17F
EPS (Rs)	21.21	23.37	24.60	25.50
DPS (Rs)	12.00	12.75	13.50	13.50
Book Value (Rs/share)	107.62	118.68	129.73	141.67
Dividend Yield	6.49	6.89	7.30	7.30
Dividend Payout	56.6	54.4	54.7	52.8
ROE (%)	19.71	19.75	19.02	18.05
ROA (%)	1.76	1.79	1.78	1.75
ADR (%)	42.58	41.19	40.48	40.13
IDR (%)	62.02	61.08	59.60	58.68
PAT Growth (%)	42.0%	10.5%	5.3%	3.7%
NII Growth (%)	25.3%	12.5%	7.9%	5.9%
Non int. exp. Growth (%)	16.9%	6.8%	6.8%	6.9%
Deposits Growth (%)	9.9%	8.6%	6.8%	5.9%
Net Advances Growth (%)	6.0%	5.0%	5.0%	5.0%
Investments Growth (%)	12.9%	6.9%	4.3%	4.3%
NPLs / Gross Advances (%)	9.9%	9.9%	9.9%	9.9%

Source: Company Reports & WE Research

Income Statement

Rs in million	CY14A	CY15F	CY16F	CY17F
Interest Earned	135,929	141,171	149,620	155,341
Interest Expensed	68,498	65,330	67,801	68,721
Interest Income	67,430	75,841	81,819	86,620
Provisions	734	1,909	2,291	2,749
Interest Income after Provisions	66,696	73,932	79,528	83,871
Non Interest Income	19,675	19,971	20,401	21,157
Non Interest Expenses	39,496	42,198	45,088	48,180
Profit before Taxation	46,875	51,705	54,841	56,848
Taxation	15,762	17,321	18,646	19,328
Profit after Taxation	31,112	34,384	36,195	37,520

Source: Company Reports & WE Research



Balance Sheet

Rs in million	CY14A	CY15F	CY16F	CY17F
Cash & Bank balances	122,271	170,991	223,017	264,554
Balances with other banks	53,026	55,677	58,461	61,384
Lending to financial institutions	34,314	36,029	37,831	39,722
Investments	897,574	959,490	1,000,298	1,043,147
Advances	555,395	583,164	612,322	642,939
Operating Fixed Assets	24,874	26,118	27,424	28,795
Other assets	81,743	85,830	90,122	94,628
Total Assets	1,769,196	1,917,300	2,049,475	2,175,169
Bills Payable	21,956	23,053	24,206	25,416
Borrowings	99,631	104,612	109,843	115,335
Deposits	1,447,215	1,570,997	1,678,463	1,777,694
Deferred tax liabilities	1,850	1,943	2,040	2,142
Other liabilities	40,677	42,710	44,846	47,088
Total Liabilities	1,611,329	1,743,316	1,859,398	1,967,675
Share Capital	14,669	14,669	14,669	14,669
Reserves	40,705	43,817	46,930	50,042
Un-appropriated Profit	81,708	94,711	107,692	121,996
Total Tier I Equity	137,081	153,197	169,290	186,707
Surplus on Revaluation of Assets	20,786	20,786	20,786	20,786
Total Shareholder Equity	157,868	173,984	190,077	207,493

Source: Company Reports & WE Research



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