

# HBL

## Emerging from the dark

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We initiate our coverage on Habib Bank Limited (HBL) with a Justified P/B based Dec-22 TP of Rs.160 which provides an upside potential of 31%. A dividend yield of 7%, if incorporated gives a total return of 38%

Earnings are back on track as the bank has emerged successfully from the distress of the New York branch scandal. Going forward, we expect the bank is all set to benefit from the monetary tightening cycle amid strong growth in deposits, normalization of cost, and a low proportion of government & public sector deposits

Furthermore, the bank is expected to garner more interest from the foreign investors now amid reclassification to MSCI FM Index

### Company Overview

HBL is the oldest and the largest bank in Pakistan with operations in 14 countries, and more than 23mn customers. China remains the hub of HBL's international strategy as the bank is the largest executor of CPEC related financing in Pakistan.

### Earnings are Back on Track After Hard Times

In 2017, HBL was rocked by a money-laundering scandal that shook the entire banking sector. The Department of Financial Services of New York State alleged that HBL had committed 53 separate violations between 2007 and 2017. Resultantly, the bank agreed to pay a fine of \$225mn (Rs.24bn) and announced that its president and CEO are bowing out and so is its branch in New York. This settlement brought the financials of the bank into great distress as the bank recorded the EPS for that year at Rs. 4.82 as compared to Rs. 21.69 for 2016. The investors continued to feel the aftershocks of that event in subsequent years as well, as the operating expense to income ratio had abruptly jumped to 76% and 73% in 2018 and 2019 respectively as compared to 52% in 2017, due to several one-offs such as the costs related to New York case, consultancy fees and the impact of rupee devaluation on international expenses. However, the bank has now been able to overcome the distress as the EPS recorded in 2020 was Rs. 21.49 while the expected EPS for 2021 is around Rs. 25. The growth in the earnings is attributed to the normalization of the operating expense ratio to around 56% and the increase in the net interest income at a 5-year CAGR of 10%. Going forward, we expect the bank to continue its growth trajectory in the coming years as well amid strong brand equity (Market Share: 15%), low-cost deposits (CASA: 74%), and a high-interest rate environment.

### Strong Growth in Deposits Likely to Continue

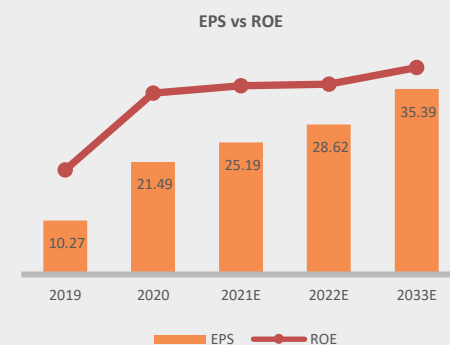
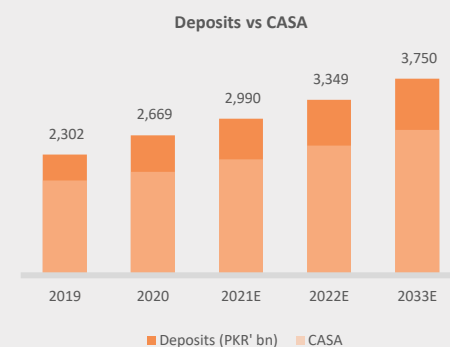
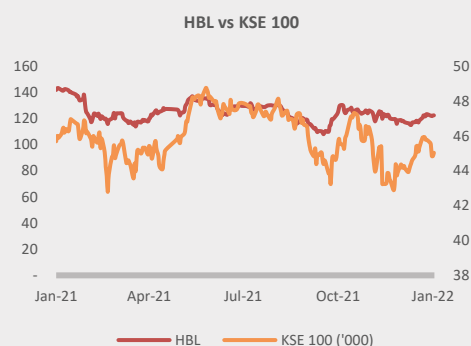
The deposit base of HBL has grown at a 5-year CAGR of 11% to Rs.2.7tn in CY20. The robust growth in deposits has been made possible by the network of around 1,700 branches spread all over the country. Going forward, we expect the deposit base to grow at a 5-year CAGR of 12% to Rs.4.7tn by CY25 on account of the government's efforts to document the economy.

### Low Proportion of Government Deposits

HBL has almost the lowest proportion of government and public sector deposits in its deposit base. By the end of CY20, the bank had only 5.8% of government deposits and 5.1% of public sector deposits which makes it the least affected bank in the case of the formation of treasury single account (TSA).

### Key Statistics

Symbol	BAHL
TP - Dec 22	160.00
HBL	122.15
Upside	31%
Free Float (mn)	733
Market Cap. (Rs.mn)	179,176



Sources: ACPL Research, Company Financials, PSX

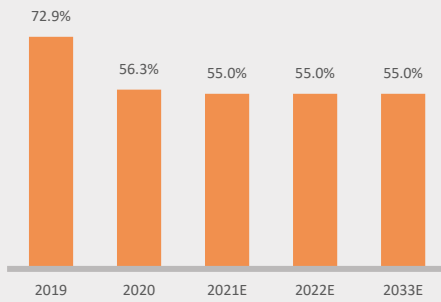
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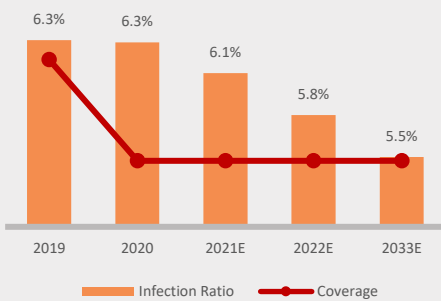
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## Key Statistics

Operating Cost to Income



Infection Ratio vs Coverage



Sources: ACPL Research, Company Financials, PSX

## MSCI Reclassification to FM is a Key Positive

To recall, Morgan Stanley Capital International (MSCI) reclassified the MSCI Pakistan Index from its Emerging Market Index (EMI) to Frontier Markets Index (FMI) on 30<sup>th</sup> November 2021. HBL was one of the three securities included in the standard index. Therefore, we expect the bank to garner more interest from the foreign investors now amid the increased weight of the Pakistan index (1.9%) in the MSCI FM index as compared to 0.02% in the MSCI EM index.

## Valuation

HBL is offering CY22E ROE of 13.6% and is currently trading at CY22E PE of 4.27x. Furthermore, the scrip is trading at a CY22E P/B of 0.58x which offers a discount of 24% relative to its historical 3-year average of 0.76x. We have a **BUY** stance on the scrip with a Justified P/B based Dec-22 TP of Rs.160 which provides an upside potential of 31%. Furthermore, it also offers a dividend yield of 7% which makes the total return of 38%.

## Key Risks to Valuation

- More than expected rise in NPLs
- Less than expected growth in deposits

## Financial Projections

Rupees' millions	2019	2020	2021E	2022E	2023E	2024E	2025E
Mark-up / Return / Interest earned	246,425	257,777	269,305	344,964	407,435	452,860	505,617
Mark-up / Return / Interest expensed	-151,799	-135,725	-140,017	-214,039	-244,328	-273,379	-305,916
<b>Net Mark-up / Interest Income</b>	<b>94,626</b>	<b>122,052</b>	<b>129,288</b>	<b>130,924</b>	<b>163,107</b>	<b>179,482</b>	<b>199,701</b>
Fee and commission income	18,197	16,353	19,624	21,586	23,745	26,119	28,731
Dividend income	1,311	1,668	1,823	1,997	2,191	2,409	2,654
Foreign exchange income	176	-422	-341	-341	-341	-341	-341
(Loss) / gain from derivatives	-186	1,078	42	42	42	42	42
(Loss) / gain on securities	-1,566	7,027	3,981	4,435	4,944	5,514	6,152
Other income	827	38	2	0	0	0	0
<b>Total non-markup / interest income</b>	<b>18,759</b>	<b>25,743</b>	<b>25,130</b>	<b>27,719</b>	<b>30,581</b>	<b>33,743</b>	<b>37,238</b>
<b>Non-mark-up/interest expenses</b>							
Operating expenses	-82,709	-83,152	-84,930	-87,254	-106,528	-117,274	-130,316
Workers' Welfare Fund	-567	-1,104	-1,187	-1,219	-1,489	-1,639	-1,821
Other charges	-480	-321	-335	-429	-507	-564	-629
<b>Profit Before Provisions</b>	<b>29,628</b>	<b>63,218</b>	<b>67,966</b>	<b>69,741</b>	<b>85,164</b>	<b>93,749</b>	<b>104,172</b>
Provisions / (reversal of provisions)	-2,530	-10,224	-5,844	-5,164	-5,304	-5,404	-5,451
<b>Profit before income tax</b>	<b>27,099</b>	<b>52,994</b>	<b>62,122</b>	<b>64,577</b>	<b>79,860</b>	<b>88,345</b>	<b>98,721</b>
Income tax expense	-12,035	-21,471	-25,169	-22,602	-27,951	-30,921	-34,552
<b>Profit for the year</b>	<b>15,064</b>	<b>31,524</b>	<b>36,953</b>	<b>41,975</b>	<b>51,909</b>	<b>57,424</b>	<b>64,168</b>
<b>EPS</b>	<b>10.27</b>	<b>21.49</b>	<b>25.19</b>	<b>28.62</b>	<b>35.39</b>	<b>39.15</b>	<b>43.75</b>

## Horizontal Analysis

Horizontal Analysis	2019	2020	2021E	2022E	2023E	2024E	2025E
Mark-up / Return / Interest earned	56.8%	4.6%	4.5%	28.1%	18.1%	11.1%	11.6%
Mark-up / Return / Interest expensed	87.1%	-10.6%	3.2%	52.9%	14.2%	11.9%	11.9%
<b>Net Mark-up / Interest Income</b>	<b>24.5%</b>	<b>29.0%</b>	<b>5.9%</b>	<b>1.3%</b>	<b>24.6%</b>	<b>10.0%</b>	<b>11.3%</b>
Fee and commission income	13.1%	-10.1%	20.0%	10.0%	10.0%	10.0%	10.0%
Dividend income	-19.4%	27.2%	9.3%	9.5%	9.8%	10.0%	10.1%
Foreign exchange income	-105.3%	-339.4%	-19.1%	0.0%	0.0%	0.0%	0.0%
(Loss) / gain on securities	-161.5%	-548.7%	-43.4%	11.4%	11.5%	11.5%	11.6%
Other income	109.4%	-95.4%	-95.4%	-95.4%	-95.4%	-95.4%	-95.4%
<b>Total non-markup / interest income</b>	<b>14.1%</b>	<b>37.2%</b>	<b>-2.4%</b>	<b>10.3%</b>	<b>10.3%</b>	<b>10.3%</b>	<b>10.4%</b>
<b>Non-mark-up/interest expenses</b>							
Operating expenses	17.6%	0.5%	2.1%	2.7%	22.1%	10.1%	11.1%
Workers' Welfare Fund	-119.9%	94.7%	7.5%	2.7%	22.1%	10.1%	11.1%
Other charges	-3.2%	-33.2%	4.5%	28.1%	18.1%	11.1%	11.6%
<b>Profit Before Provisions</b>	<b>21.0%</b>	<b>113.4%</b>	<b>7.5%</b>	<b>2.6%</b>	<b>22.1%</b>	<b>10.1%</b>	<b>11.1%</b>
Provisions / (reversal of provisions)	-45.5%	304.1%	-42.8%	-11.6%	2.7%	1.9%	0.9%
<b>Profit before income tax</b>	<b>36.5%</b>	<b>95.6%</b>	<b>17.2%</b>	<b>4.0%</b>	<b>23.7%</b>	<b>10.6%</b>	<b>11.7%</b>
Income tax expense	49.3%	78.4%	17.2%	-10.2%	23.7%	10.6%	11.7%
<b>Profit for the year</b>	<b>27.8%</b>	<b>109.3%</b>	<b>17.2%</b>	<b>13.6%</b>	<b>23.7%</b>	<b>10.6%</b>	<b>11.7%</b>
<b>EPS</b>	<b>27.8%</b>	<b>109.3%</b>	<b>17.2%</b>	<b>13.6%</b>	<b>23.7%</b>	<b>10.6%</b>	<b>11.7%</b>

Source: ACPL Research, Company Financials

## Key Ratios

Profitability Ratios		2019	2020	2021E	2022E	2023E	2024E	2025E
Yield on Earning Assets	%	8.81	7.59	6.93	8.02	8.52	8.45	8.42
Interest Cost	%	5.55	4.14	3.82	5.21	5.32	5.31	5.31
Net Interest Margin	%	3.26	3.45	3.11	2.81	3.21	3.14	3.11
Operating Cost to Income	%	73.87	57.23	55.99	56.04	56.03	56.03	56.03
Return on Equity	%	7.48	12.99	13.51	13.62	14.81	14.44	14.25
Return on Assets	%	0.49	0.87	0.89	0.91	1.01	1.00	1.00
<b>Balance Sheet Analysis</b>		<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
Deposits Growth	%	13.95	15.97	12.00	12.00	12.00	12.00	12.00
CASA to Deposits	%	78.57	74.03	74.03	74.03	74.03	74.03	74.03
Advances to Deposits	%	46.61	41.86	47.47	47.31	47.16	47.02	46.87
Investments to Deposits	%	58.73	71.63	69.81	68.27	66.90	65.68	64.58
PIBs to Investments	%	47.32	55.04	55.04	55.04	55.04	55.04	55.04
T Bills to Investments	%	46.04	33.26	33.26	33.26	33.26	33.26	33.26
Gross Infection Ratio	%	6.34	6.32	6.10	5.80	5.50	5.20	4.90
Provisioning Coverage	%	91.78	88.89	88.89	88.89	88.89	88.89	88.89
Net Infection Ratio	%	0.55	0.75	0.64	0.61	0.58	0.55	0.52
Capital Adequacy Ratio	%	15.35	17.24	17.09	17.36	17.72	17.93	18.11
Leverage Ratio	%	4.42	4.25	4.21	4.28	4.39	4.49	4.58
<b>Operational Analysis</b>		<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
Market Share - Deposits	%	15.73	14.93	14.80	14.67	14.54	14.41	14.28
Market Share - Advances	%	14.01	14.05	13.93	13.80	13.68	13.56	13.44
Market Share - Investments	%	15.35	16.47	15.93	15.44	15.00	14.59	14.22
No. of Branches		1712	1697	1697	1697	1697	1697	1697
<b>Investment Ratios</b>		<b>2019</b>	<b>2020</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
Dividend Per Share		5.00	4.25	7.00	8.00	10.00	11.00	12.25
Dividend Yield	%	4.09	3.48	5.73	6.55	8.19	9.01	10.03
Dividend Cover	x	2.05	5.06	3.60	3.58	3.54	3.56	3.57
Retention Ratio	%	51.31	80.22	72.00	72.00	72.00	72.00	72.00
Payout Ratio	%	48.69	19.78	28.00	28.00	28.00	28.00	28.00
No. of Shares	('m)	1467	1467	1467	1467	1467	1467	1467
Earnings Per Share		10.27	21.49	25.19	28.62	35.39	39.15	43.75
Book Value Per Share		137.32	165.47	186.43	210.14	239.00	271.03	306.88
Price to Earnings	x	11.89	5.68	4.85	4.27	3.45	3.12	2.79
Price to Book Value	x	0.89	0.74	0.66	0.58	0.51	0.45	0.40

Source: ACPL Research, Company Financials

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<b>TP</b>	Target Price	<b>CAGR</b>	Compound Annual Growth Rate	<b>FCF</b>	Free Cash Flows
<b>FCFE</b>	Free Cash Flows to Equity	<b>FCFF</b>	Free Cash Flows to Firm	<b>DCF</b>	Discounted Cash Flows
<b>PE</b>	Price to Earnings Ratio	<b>PB</b>	Price to Book Ratio	<b>BVPS</b>	Book Value Per Share
<b>EPS</b>	Earnings Per Share	<b>DPS</b>	Dividend Per Share	<b>ROE</b>	Return of Equity
<b>ROA</b>	Return on Assets	<b>SOTP</b>	Sum of the Parts	<b>LDCP</b>	Last Day Closing Price

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To arrive at our Target Price, Abbasi & Company (Private) Limited uses different valuation methods which include:

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- II. Dividend Discount Model
- III. Relative Valuation Model
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SELL	Less than and equal to -5%

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Market Weight	Neutral
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