

BAFL

Offering a total return of 32% owing to high ADR

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We initiate our coverage on Bank Alfalah Limited (BAFL) with a Justified P/B based Dec-20 TP of Rs.55 which provides an upside potential of 23%. A dividend yield of 9%, if incorporated gives a total return of 32%

The deposit base of BAFL bank has grown at a 5-year CAGR of 6% to Rs701bn in CY18. Furthermore, CASA and NIM stand at 71% and 3.27% respectively during the same period

Going forward, we expect the NIM to expand further to 4.2% in CY19, making BAFL one of the largest beneficiaries of the interest rate hike. Furthermore, low proportion of government deposits, high ROA, highest ADR amongst peers, improved CAR and low infection ratio have made the valuation of the company much more attractive

Sector Overview

According to the data updated by State Bank of Pakistan (SBP), total deposits of all banks showed a healthy growth of 10.68% or Rs 1.395 trillion in FY19 to reach an all-time high level of Rs. 14.46 trillion as of June 30, 2019 compared with Rs 13.062 trillion on June 30, 2018. The growth in deposits was mostly fueled in June 2019, mainly due to the amnesty scheme and seasonal targets. On a month-on-month basis, during June 2019, deposits grew by Rs. 998 billion or 7% to Rs 14.458 trillion up from Rs 13.46 trillion in May 2019.

The State Bank of Pakistan's latest data shows the government borrowed Rs1.367 trillion from July 1 to Aug 2 (33 days) as against net debt retirement of Rs20.2bn during the same period last fiscal year. This shift in government's borrowing to the private banks came as a result of SBP's decision to stop lending to the center and finance its cash shortages. Banking money's flow is now directed towards the government papers which is likely to hit the economic growth. However, this scenario is highly favorable for the banking sector of the country.

Banking profitability is set to recover strongly in 2019 on the back of expansion in NIM (net interest margin) coupled with growing deposits and rising interest rate. We expect that the interest rate has come to its peak now at 13.25% after an increase of 750 bps since Dec-17. Keeping the numbers of current account deficit, fiscal deficit and CPI inflation in view, we expect a rate cut of around 25-50 bps before Jun-20. (Dawn, 2019) (Islamabad, 2019) (TheNews, 2018)

NIMs Likely to Expand Further Owing to High ADR

Despite slowdown in economy and industrial growth, the ADR of BAFL stood at 71% in CY18 as compared to its peers' average of 56% due to which it stands out amongst its peers. The bank has always been enjoying high net interest margins as high ADR enables the bank to expand its NIM by earning high yields on corporate loans and allocate the rest of the available funds to the government papers which are also offering double digit returns on account of on-going monetary contractionary phase. Going forward, we expect the bank would be one of the largest beneficiaries of the rate hike as high advances to deposit ratio will result in the expansion of NIM by around 93 bps to 4.2% in CY19.

Low Proportion of Government Deposits

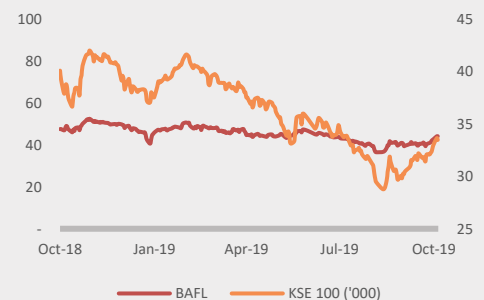
BAFL has a very low proportion of government deposits in its deposit base. By the end of CY18, the bank had only 6.5% of government deposits which makes it one of

Key Statistics

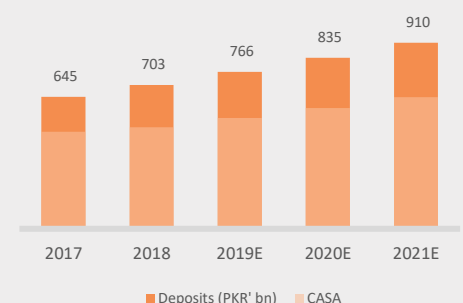
Symbol	BAFL
TP - Dec 20	55.00
LDCP	44.61
Upside	23%
Free Float (mn)	711
Market Cap. (Rs.mn)	79,279

Symbol	P.B
MEBL	2.57
BAHL	1.68
MCB	1.37
ABL	1.12
Peer Average	1.69
BAFL	0.94
Discount	44%

BAFL vs KSE 100



Deposits vs CASA



Sources: ACPL Research, Company Financials, PSX

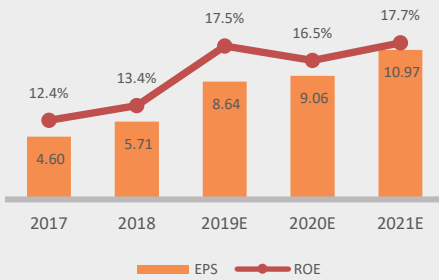
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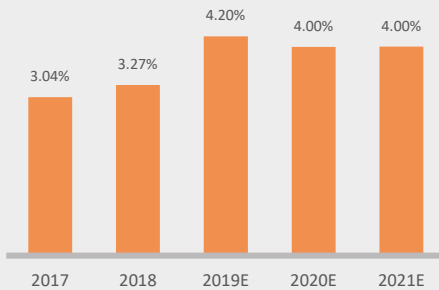
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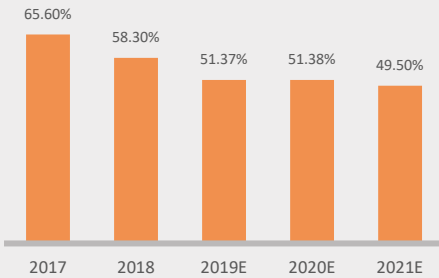
EPS vs ROE



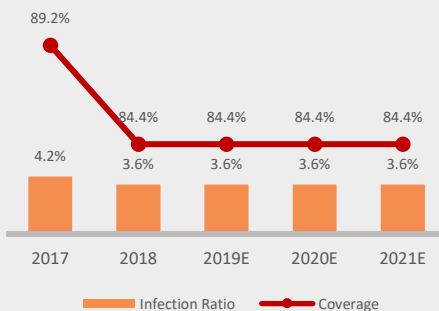
Net Interest Margin (NIM)



Operating Cost to Income



Infection Ratio vs Coverage



Sources: ACPL Research, Company Financials, PSX

the least affected banks in case of the formation of treasury single account (TSA) in the future.

Low Infection Ratio Amongst Peers

Despite BAFL is one of the aggressive banks in Pakistan which have larger proportion of SME and consumer loans in their portfolio along with high ADR, the bank has effectively been able to restrict its infection ratio to 3.63% in CY18. Going forward, we expect the ratio to remain under control in future as well even in the rising interest rate regime. However, we expect the significant provision of around Rs1.5bn in CY19 on account of lower coverage (84%) in CY18 as compared to its peers' average of 88%.

Improved Capital Adequacy Ratio

Due to the regulatory constraints with respect to CAR, the bank didn't announce any dividend in CY16 in order to meet the CAR requirement. However, the bank has shown a significant improvement with respect to CAR in subsequent years. A TFC was issued to support the growth but gradually the bank is enriching the Tier 1 capital while ensuring regular dividend to shareholders. BAFL posted the CAR of 14.95% in CY18 with an increment of 156 bps since CY17 and as per the result of half year 2019, the CAR of the bank stands at 16.8%. Going forward, we expect the bank to maintain the payout ratio of 40-45% in coming years.

Valuation

BAFL is offering CY20E ROE of 16.5% and is currently trading at CY20E PE of 4.92x. Furthermore, the script is trading at a CY20E P/B of 0.81x which offers a massive discount of 41% relative to its historical 5-year average of 1.37x. We have a **BUY** stance on the script with a Justified P/B based Dec-20 TP of Rs.55 which provides an upside potential of 23%. Furthermore, it also offers an attractive dividend yield of 9% which makes the total return of 32%.

Key Risks to Valuation

- Earlier than expected cut in interest rate
- More than expected rise in NPLs

Key Ratios

Profitability Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Yield on Earning Assets	%	8.00	7.25	6.62	6.13	6.44	9.29	10.50	9.99	9.26	8.41
Interest Cost	%	4.91	3.94	3.39	3.10	3.17	5.09	6.50	5.99	5.44	4.89
Net Interest Margin	%	3.09	3.31	3.24	3.04	3.27	4.20	4.00	4.00	3.82	3.52
Operating Cost to Income	%	66.22	59.45	62.55	65.60	58.30	51.37	51.38	49.50	49.49	50.90
Return on Equity	%	12.59	14.10	13.14	12.41	13.42	17.50	16.50	17.71	16.66	14.91
Return on Assets	%	0.76	0.83	0.86	0.82	1.01	1.40	1.35	1.49	1.44	1.30
Balance Sheet Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Deposits Growth	%	15.31	5.65	0.12	0.63	8.98	8.98	8.98	8.98	8.98	8.98
CASA to Deposits	%	67.93	70.06	79.99	73.51	70.62	70.62	70.62	70.62	70.62	70.62
Advances to Deposits	%	49.06	52.20	59.09	62.12	71.37	76.12	76.12	76.11	76.10	76.09
Investments to Deposits	%	53.52	66.09	60.71	62.13	39.50	38.87	37.84	36.90	36.04	35.25
PIBs to Investments	%	58.58	55.64	64.25	35.64	19.90	19.90	19.90	19.90	19.90	19.90
T Bills to Investments	%	19.59	22.73	14.71	47.73	59.28	59.28	59.28	59.28	59.28	59.28
Gross Infection Ratio	%	6.37	5.27	4.80	4.21	3.63	3.63	3.63	3.63	3.63	3.63
Provisioning Coverage	%	70.07	83.73	86.06	89.22	84.39	84.39	84.39	84.39	84.39	84.39
Net Infection Ratio	%	1.95	0.90	0.70	0.47	0.59	0.55	0.55	0.55	0.55	0.55
Capital Adequacy Ratio	%	12.75	13.27	13.18	13.39	14.95	15.42	15.74	16.24	16.59	16.77
Leverage Ratio	%	0.00	3.41	3.46	4.06	5.64	5.76	5.93	6.19	6.38	6.49
Operational Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Market Share - Deposits	%	7.26	6.88	5.72	5.22	5.26	5.21	5.17	5.12	5.07	5.02
Market Share - Advances	%	6.84	7.33	7.10	6.39	6.57	6.51	6.45	6.39	6.33	6.27
Market Share - Investments	%	6.35	6.23	5.27	4.66	3.68	3.54	3.42	3.30	3.20	3.10
No. of Branches		648	653	639	638	649	660	672	683	695	707
Investment Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Dividend Per Share		2.00	1.00	0.00	1.50	2.50	3.50	4.00	4.50	5.00	5.00
Dividend Yield	%	4.48	2.24	0.00	3.36	5.60	7.85	8.97	10.09	11.21	11.21
Dividend Cover	x	1.59	4.23	0.00	3.06	2.28	2.47	2.27	2.44	2.30	2.26
Retention Ratio	%	36.99	76.38	100.00	67.36	56.23	59.49	55.85	58.96	56.49	55.83
Payout Ratio	%	63.01	23.62	0.00	32.64	43.77	40.51	44.15	41.04	43.51	44.17
No. of Shares	('m)	1777	1777	1777	1777	1777	1777	1777	1777	1777	1777
Earnings Per Share		3.17	4.23	4.45	4.60	5.71	8.64	9.06	10.97	11.49	11.32
Book Value Per Share		25.22	30.02	33.83	37.03	42.57	49.38	54.92	61.92	68.98	75.93
Price to Earnings	x	14.05	10.54	10.04	9.71	7.81	5.16	4.92	4.07	3.88	3.94
Price to Book Value	x	1.77	1.49	1.32	1.20	1.05	0.90	0.81	0.72	0.65	0.59

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	55,378	61,438	57,245	56,176	59,318	93,378	115,091	119,650	121,096	119,955
Mark-up / Return / Interest expensed	-33,505	-32,811	-28,474	-27,199	-27,727	-48,481	-67,353	-67,558	-66,834	-65,469
Net Mark-up / Interest Income	21,873	28,627	28,770	28,976	31,591	44,897	47,739	52,092	54,262	54,486
Fee and commission income	3,120	4,384	4,668	6,013	6,292	7,047	7,751	8,526	9,379	10,317
Dividend income	492	514	585	460	576	335	356	378	402	429
Foreign exchange income	2,043	1,379	1,121	1,443	2,169	2,277	1,504	1,580	1,658	1,741
(Loss) / gain on securities	1,218	1,836	1,682	1,134	993	62	67	73	79	86
Other income	2,163	748	813	85	192	249	262	275	289	303
Total non-markup / interest income	9,036	8,862	8,868	9,076	10,200	9,970	9,940	10,832	11,807	12,876
Non mark-up / interest expenses										
Operating expenses	-20,261	-21,956	-23,423	-24,672	-23,967	-27,562	-28,940	-30,387	-31,906	-33,502
Workers' Welfare Fund	-206	-330	-118	-259	-392	-410	-431	-488	-512	-508
Other charges	0	0	0	-33	-6	-215	-265	-275	-279	-276
Profit Before Provisions	10,442	15,203	14,097	13,089	17,426	26,681	28,044	31,774	33,372	33,077
Provisions / (reversal of provisions)	-1,929	-2,599	-1,073	616	-588	-1,511	-1,646	-1,794	-1,955	-2,131
Profit before income tax	8,514	12,604	13,023	13,705	16,838	25,171	26,397	29,980	31,417	30,946
Income tax expense	-2,873	-5,081	-5,123	-5,539	-6,687	-9,817	-10,295	-10,493	-10,996	-10,831
Profit for the year	5,641	7,523	7,900	8,166	10,150	15,354	16,102	19,487	20,421	20,115
EPS	3.17	4.23	4.45	4.60	5.71	8.64	9.06	10.97	11.49	11.32

Horizontal Analysis

	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	25.97%	10.94%	-6.83%	-1.87%	5.59%	57.42%	23.25%	3.96%	1.21%	-0.94%
Mark-up / Return / Interest expensed	23.79%	-2.07%	-13.22%	-4.48%	1.94%	74.85%	38.93%	0.31%	-1.07%	-2.04%
Net Mark-up / Interest Income	29.47%	30.88%	0.50%	0.72%	9.02%	42.12%	6.33%	9.12%	4.17%	0.41%
Total non-markup / interest income	9.15%	-1.94%	0.07%	2.35%	12.39%	-2.26%	-0.30%	8.97%	9.01%	9.05%
Non mark-up / interest expenses										
Operating expenses	17.19%	8.37%	6.68%	5.33%	-2.86%	15.00%	5.00%	5.00%	5.00%	5.00%
Workers' Welfare Fund	11.91%	59.81%	-64.10%	118.65%	51.46%	4.46%	5.25%	13.21%	5.00%	-0.89%
Other charges	0.00%	0.00%	0.00%	0.00%	-80.35%	3240.12%	23.25%	3.96%	1.21%	-0.94%
Profit Before Provisions	35.61%	45.59%	-7.28%	-7.15%	33.14%	53.11%	5.11%	13.30%	5.03%	-0.88%
Provisions / (reversal of provisions)	116.0%	34.7%	-58.7%	-157.4%	-195.5%	156.7%	9.0%	9.0%	9.0%	9.0%
Profit before income tax	25.07%	48.05%	3.33%	5.24%	22.86%	49.49%	4.87%	13.57%	4.79%	-1.50%
Income tax expense	34.79%	76.88%	0.83%	8.11%	20.74%	46.79%	4.87%	1.92%	4.79%	-1.50%
Profit for the year	20.64%	33.36%	5.01%	3.37%	24.30%	51.27%	4.87%	21.02%	4.79%	-1.50%
EPS	20.64%	33.36%	5.01%	3.37%	24.30%	51.27%	4.87%	21.02%	4.79%	-1.50%

Source: ACPL Research, Company Financials

Advances Analysis

For the Year 2018	Gross Advances	Infection Ratio	NPLs Coverage
Textile	18.1%	3.9%	99.6%
Power (electricity), Gas, Water, Sanitary	15.4%	1.4%	25.0%
Agriculture, Forestry, Hunting and Fishing	10.1%	0.5%	52.6%
Individuals	9.3%	1.6%	68.5%
Food & Allied Products	9.1%	5.0%	90.6%
Others	6.9%	3.1%	78.9%
Chemical and Pharmaceuticals	4.2%	3.8%	100.0%
Wholesale & Retail Trade	3.5%	10.4%	97.3%
Metal & Allied industries	3.3%	3.7%	100.0%
Oil and Allied	2.9%	0.0%	0.0%
Cement	2.5%	0.0%	0.0%
Sugar	2.2%	7.2%	44.2%
Electronics and electrical appliances	2.1%	1.2%	100.0%
Automobile and transportation equipment	2.0%	9.6%	37.6%
Financial	1.9%	9.6%	100.0%
Exports / Imports	1.6%	8.5%	90.5%
Construction	1.5%	6.5%	100.0%
Services	1.3%	1.4%	87.5%
Transport, Storage and Communication	1.3%	27.2%	100.0%
Mining and Quarrying	0.4%	0.0%	0.0%
Footwear and Leather garments	0.4%	9.9%	90.4%
Insurance	0.0%	0.0%	0.0%
Total	100.0%	3.6%	84.4%

Source: ACPL Research, Company Financials

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DEFINITION OF TERMS

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

VALUATION METHODOLOGY

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

- I. Discounted Cash Flow Model
- II. Dividend Discount Model
- III. Relative Valuation Model
- IV. Sum of Parts Valuation

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Stock Rating	Expected Total Return
BUY	Greater than 15%
HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

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