

BOP

A script with better prospects offering a total return of 41%

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We initiate our coverage on The Bank of Punjab (BOP) with a Justified P/B based Dec-20 TP of Rs.13 which provides an upside potential of 33%. A dividend yield of 8%, if incorporated gives a total return of 41%

The deposit base of BOP has grown at a 5-year CAGR of 14% to Rs596bn in CY18. Furthermore, CASA and NIM stand at 63% and 2.87% respectively during the same period

Going forward, strong deposits' growth, high ROE, low operating cost, one of the highest ADR amongst peers, and highest proportion of T-bills in Investments last year have made the valuation of the company much more attractive

However, low CASA to deposits (63.45%), high infection ratio (11.6%), having one of the highest proportion of government deposits (56.3%) along with the CAR of less than 13% to remain the key risks for the bank

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)

Strong Growth in Deposits Likely to Continue

The deposit base of BOP bank has grown at a 5-year CAGR of 14% to Rs596bn in CY18. The robust growth in deposits has been made possible by the network of 576 countrywide branches, which have been increasing with a 5-year average growth rate of 12%. Going forward, we expect the deposit base to grow at a 5-year CAGR of 10% to Rs959bn by CY23 on account of strong brand equity, and the government's efforts to document the economy.

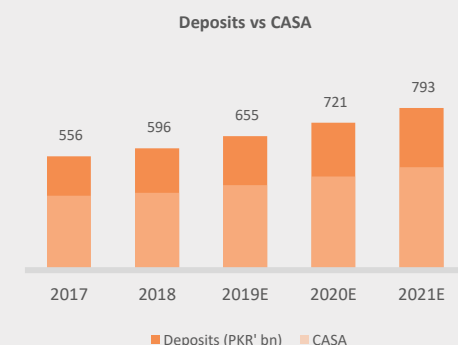
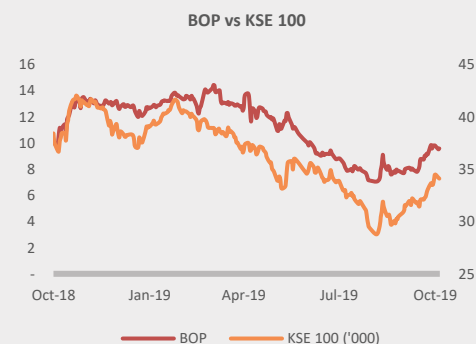
Cost Efficiency Has Always Remained a Key Strength

BOP has successfully contained its operational expenses to 53.38% of total income in CY18 which is one of the lowest in its peers. Going forward, we expect the operational expenses to be confined at around 48% on account of the bank's firm

Key Statistics

Symbol	BOP
TP - Dec 20	13.00
LDCP	9.79
Upside	33%
Free Float (mn)	1,116
Market Cap. (Rs.mn)	25,882

Symbol	P.B
MEBL	2.57
MCB	1.37
UBL	1.11
HBL	1.05
Peer Average	1.53
BOP	0.62
Discount	59%



Sources: ACPL Research, Company Financials, PSX

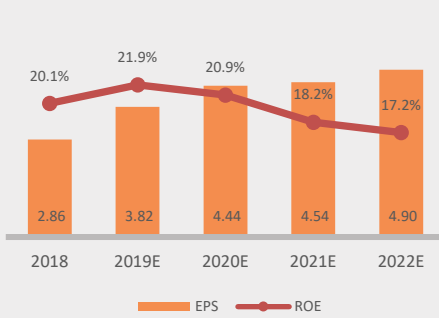
M. Fawad Naveed

Phone: (+92) 42 38302028; Ext: 117

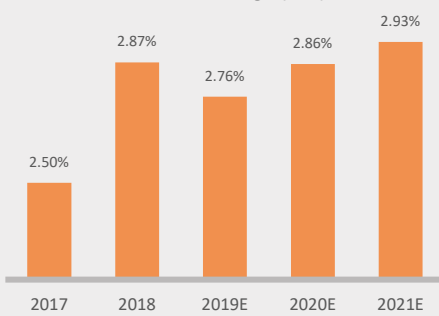
Email: fawad@abbasiandcompany.com

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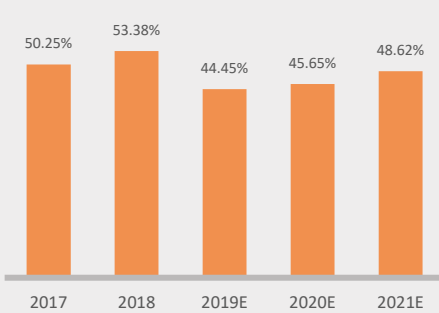
EPS vs ROE



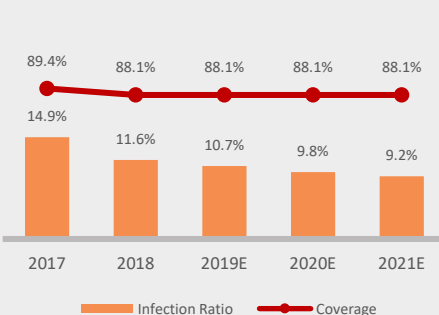
Net Interest Margin (NIM)



Operating Cost to Income



Infection Ratio vs Coverage



Sources: ACPL Research, Company Financials, PSX

commitment to bring further efficiency into its operations.

NIMs Likely to Remain Intact Owing to High ADR

Despite possessing one of the lowest CASA to deposit ratio (63%) amongst its peers, the NIM of the bank is likely to remain intact owing to high ADR. In spite of slowdown in economy and industrial growth, the ADR of BOP stood at 64% in CY18 as compared to its peers' average of 56% due to which it stands out amongst its peers. Going forward, we expect the average NIMs to remain stable at around 2.9% in coming 3-4 years as compared to 2.87% in CY18.

Highest Proportion of T-Bills in Investments Last Year

As per the annual report of CY18, 94% of BOP's investments were parked in T-Bills as compared to its peer's average of 62%. Therefore, we expect BOP as one of the largest beneficiaries of rate hike due to its distinct ability to park its majority investments in long-term debt securities at a higher rate by maturing its short-term securities or selling them at attractive rates.

Valuation

BOP is offering an attractive CY20E ROE of 21% and is currently trading at CY20E PE of 2.21x. Furthermore, the script is trading at a CY20E P/B of 0.46x which offers a massive discount of 54% relative to its historical 5-year average of 0.99x. We have a **BUY** stance on the script with a Justified P/B based Dec-20 TP of Rs.13 which provides an upside potential of 33%. Furthermore, it also offers an attractive dividend yield of 8% which makes the total return of 41%.

Key Risks to Valuation

- Earlier than expected cut in interest rate
- More than expected rise in NPLs
- Formation of TSA

Key Ratios

Profitability Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Yield on Earning Assets	%	7.72	7.24	5.78	5.66	7.00	11.38	11.29	10.62	9.90	9.16
Interest Cost	%	5.25	4.65	3.47	3.17	4.13	8.62	8.43	7.69	6.95	6.21
Net Interest Margin	%	2.47	2.59	2.31	2.50	2.87	2.76	2.86	2.93	2.95	2.94
Operating Cost to Income	%	52.90	39.64	47.78	50.25	53.38	44.45	45.65	48.62	50.05	51.61
Return on Equity	%	14.42	20.94	17.44	-11.17	20.05	21.87	20.89	18.23	17.21	15.38
Return on Assets	%	0.66	1.01	0.89	-0.51	1.06	1.20	1.28	1.20	1.19	1.07
Balance Sheet Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Deposits Growth	%	11.66	9.54	20.87	22.74	7.06	10.00	10.00	10.00	10.00	10.00
CASA to Deposits	%	61.27	62.98	68.68	65.29	63.45	63.45	63.45	63.45	63.45	63.45
Advances to Deposits	%	49.76	58.51	57.82	53.17	64.12	78.28	77.71	77.33	76.88	76.56
Investments to Deposits	%	45.25	46.95	44.07	43.59	35.27	34.55	33.96	33.42	32.93	32.48
PIBs to Investments	%	38.95	52.18	37.73	14.38	0.12	0.12	0.12	0.12	0.12	0.12
T Bills to Investments	%	56.52	41.98	57.05	80.45	93.49	93.49	93.49	93.49	93.49	93.49
Gross Infection Ratio	%	28.23	22.80	18.70	14.91	11.60	10.70	9.80	9.20	8.50	8.00
Provisioning Coverage	%	47.98	53.61	57.25	89.42	88.14	88.14	88.14	88.14	88.14	88.14
Net Infection Ratio	%	17.00	12.07	8.96	1.82	1.53	1.16	1.07	1.01	0.94	0.89
Capital Adequacy Ratio	%	10.20	10.49	12.28	9.73	13.17	13.64	14.94	15.88	16.51	16.68
Leverage Ratio	%	0.00	3.26	3.35	2.57	3.40	3.58	4.01	4.32	4.52	4.57
Operational Analysis		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Market Share - Deposits	%	4.10	4.03	4.05	4.50	4.46	4.46	4.46	4.46	4.46	4.46
Market Share - Advances	%	4.42	5.24	5.27	5.23	5.40	5.40	5.40	5.40	5.40	5.40
Market Share - Investments	%	3.04	2.63	2.79	2.88	2.82	2.76	2.72	2.67	2.63	2.60
No. of Branches		364	406	453	536	576	634	697	767	843	928
Investment Ratios		2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Dividend Per Share		0.00	0.00	0.00	0.00	0.75	0.75	0.80	1.00	1.50	2.00
Dividend Yield	%	0.00	0.00	0.00	0.00	7.66	7.66	8.17	10.21	15.32	20.43
Dividend Cover	x	0.00	0.00	0.00	0.00	3.81	5.09	5.54	4.54	3.27	2.42
Retention Ratio	%	100.00	100.00	100.00	100.00	73.79	80.36	81.96	77.99	69.40	58.73
Payout Ratio	%	0.00	0.00	0.00	0.00	26.21	19.64	18.04	22.01	30.60	41.27
No. of Shares	('m)	2644	2644	2644	2644	2644	2644	2644	2644	2644	2644
Earnings Per Share		1.05	1.80	1.84	-1.26	2.86	3.82	4.44	4.54	4.90	4.85
Book Value Per Share		7.31	8.58	10.54	11.25	14.27	17.46	21.23	24.92	28.49	31.51
Price to Earnings	x	9.29	5.45	5.33	-7.79	3.42	2.56	2.21	2.15	2.00	2.02
Price to Book Value	x	1.34	1.14	0.93	0.87	0.69	0.56	0.46	0.39	0.34	0.31

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	29,522	31,266	29,674	34,668	46,893	90,523	97,840	100,433	102,163	103,246
Mark-up / Return / Interest expensed	-20,526	-20,199	-17,430	-19,095	-26,840	-61,559	-66,155	-66,311	-65,865	-64,695
Net Mark-up / Interest Income	8,996	11,068	12,244	15,574	20,053	28,964	31,685	34,122	36,298	38,550
Fee and commission income	906	824	975	2,807	3,245	3,408	3,748	4,123	4,535	4,989
Dividend income	33	51	62	91	82	117	126	145	173	188
Foreign exchange income	184	109	75	109	227	60	142	142	142	142
(Loss) / gain on securities	667	5,005	2,524	1,316	28	36	789	868	955	1,050
Other income	1,000	1,635	1,658	269	92	82	91	100	110	121
Total non-markup / interest income	2,790	7,624	5,294	4,591	3,673	3,702	4,896	5,378	5,915	6,490
Non mark-up / interest expenses										
Operating expenses	-6,215	-7,390	-8,346	-10,089	-12,613	-14,505	-16,680	-19,182	-21,101	-23,211
Workers' Welfare Fund	0	0	0	0	0	0	0	0	0	0
Other charges	-20	-20	-34	-43	-54	-16	-19	-23	-28	-33
Profit Before Provisions	5,552	11,282	9,159	10,033	11,060	18,145	19,882	20,295	21,085	21,796
Provisions / (reversal of provisions)	-1,245	-3,753	-1,109	-14,731	1,148	-1,323	-661	-1,816	-1,149	-2,088
Profit before income tax	4,307	7,529	8,050	-4,698	12,208	16,823	19,221	18,478	19,936	19,708
Income tax expense	-1,519	-2,781	-3,192	1,376	-4,645	-6,729	-7,496	-6,467	-6,977	-6,898
Profit for the year	2,787	4,748	4,858	-3,322	7,564	10,094	11,725	12,011	12,958	12,810
EPS	1.05	1.80	1.84	(1.26)	2.86	3.82	4.44	4.54	4.90	4.85

Horizontal Analysis

	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Mark-up / Return / Interest earned	22.01%	5.91%	-5.09%	16.83%	35.26%	93.04%	8.08%	2.65%	1.72%	1.06%
Mark-up / Return / Interest expensed	1.73%	-1.59%	-13.71%	9.55%	40.56%	129.36%	7.46%	0.24%	-0.67%	-1.78%
Net Mark-up / Interest Income	123.83%	23.03%	10.63%	27.19%	28.76%	44.43%	9.40%	7.69%	6.38%	6.21%
Total non-markup / interest income	-22.41%	173.23%	-30.56%	-13.28%	-20.00%	0.80%	32.24%	9.84%	9.99%	9.72%
Non mark-up / interest expenses										
Operating expenses	19.5%	18.9%	12.9%	20.9%	25.0%	15.0%	15.0%	15.0%	10.0%	10.0%
Workers' Welfare Fund	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other charges	-58.1%	1.2%	68.8%	27.6%	24.6%	-70.0%	20.0%	20.0%	20.0%	20.0%
Profit Before Provisions	134.4%	103.2%	-18.8%	9.5%	10.2%	64.1%	9.6%	2.1%	3.9%	3.4%
Provisions / (reversal of provisions)	-296.7%	201.5%	-70.4%	1228.1%	-107.8%	-215.2%	-50.1%	175.0%	-36.7%	81.7%
Profit before income tax	43.5%	74.8%	6.9%	-158.4%	-359.9%	37.8%	14.3%	-3.9%	7.9%	-1.1%
Income tax expense	42.9%	83.1%	14.8%	-143.1%	-437.6%	44.9%	11.4%	-13.7%	7.9%	-1.1%
Profit for the year	43.8%	70.3%	2.3%	-168.4%	-327.7%	33.4%	16.2%	2.4%	7.9%	-1.1%
EPS	43.8%	70.3%	2.3%	-168.4%	127.7%	33.4%	16.2%	2.4%	7.9%	-1.1%

Source: ACPL Research, Company Financials

Advances Analysis

For the Year 2018	Gross Advances	Infection Ratio	NPLs Coverage
Textile	16.3%	34.9%	85.9%
Government public sector enterprises	15.4%	0.0%	0.0%
Trading & commerce	12.0%	13.5%	90.9%
Individuals	10.0%	1.8%	78.9%
Federal & provincial governments	9.9%	0.0%	0.0%
Production & transmission of energy	6.5%	5.7%	99.5%
Others	4.3%	9.4%	93.6%
Cement	3.8%	9.2%	61.4%
Sugar	3.3%	8.3%	97.7%
Agriculture, forestry, hunting and fishing	2.8%	7.3%	91.3%
Services	2.8%	8.3%	99.1%
Chemical and pharmaceuticals	2.1%	0.8%	100.0%
Food & allied	2.0%	36.0%	90.1%
Construction	1.8%	18.9%	88.8%
Cable, electrical & engineering	1.7%	25.7%	99.7%
Fertilizer	1.2%	2.3%	81.1%
Electronics and electrical appliances	1.2%	0.8%	100.0%
Transport, storage and communication	1.1%	4.4%	83.6%
Oil & gas	0.7%	2.7%	93.6%
Automobile and transportation equipment	0.6%	77.7%	100.0%
Financial	0.4%	19.6%	100.0%
Footwear and leather garments	0.2%	70.6%	38.7%
Total	100.0%	11.6%	88.1%

Source: ACPL Research, Company Financials

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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

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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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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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RESEARCH DEPARTMENT

6 - Shadman, Lahore
 Phone: (+92) 42 38302028; Ext 116, 117
 Email: research@abbasiandcompany.com
 web: www.abbasiandcompany.com

HEAD OFFICE

6 - Shadman, Lahore
 Phone: (+92) 42 38302028
 Email: info@abbasiandcompany.com
 web: www.abbasiandcompany.com

BRANCH OFFICE

42 - Mall Road, Lahore
 Phone: (+92) 42 37320707
 Email: info@abbasiandcompany.com
 web: www.abbasiandcompany.com