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National Bank of Pakistan (NBP)

Aug 31, 2016

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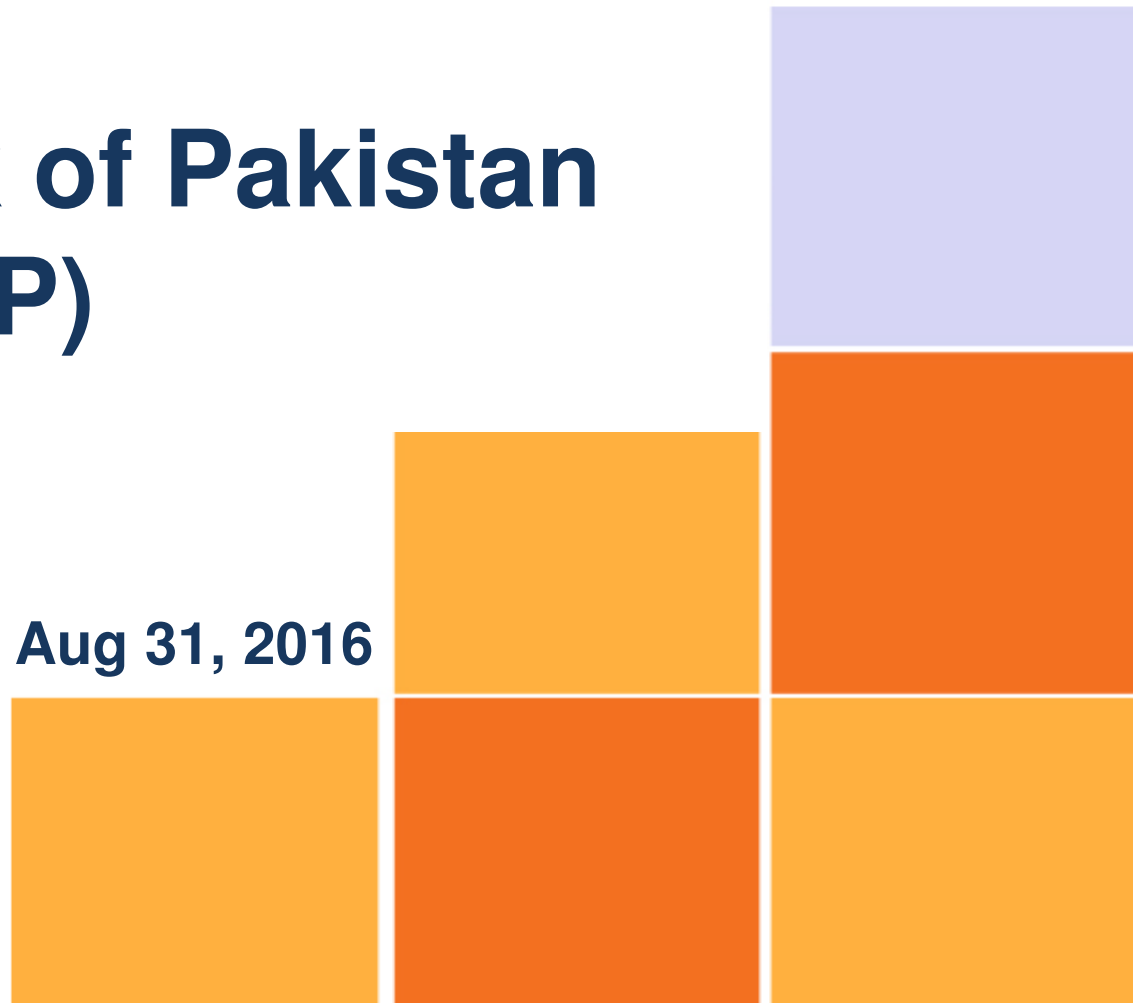
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Topline Securities, Pakistan

REP-057



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National Bank (NBP) – Improving asset quality to narrow valuation discount



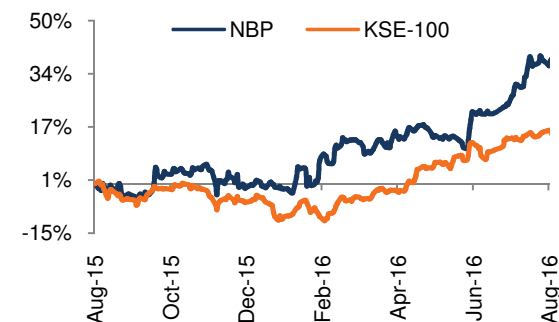
Economic recovery to drive loan recoveries & lower provision

- Investment Thesis:** We upgrade our stance on NBP to 'Buy' on the back of 28-36% increase in 2016-18 earnings estimates. This earnings revision is on the back of 1) asset recoveries & downward revision in our provisioning estimate, 2) higher than our estimated NII in 2Q2016 and 3) incorporation of 2Q2016 financial results. We revise up our target price by 36% to Rs82/share. The stock also offers dividend yield of 11%. Our liking for the stock stems from 1) improved asset quality & expected decline in provisioning, 2) strong capital adequacy ratio & likelihood of better dividend payout & 3) attractive valuation on PE & PBV basis.
- Macroeconomic recovery & lower provisions to drive bottom-line:** Improving macros and multi-year low interest rates have improved Non-Performing Loans (NPLs) and provisioning expense outlook for NBP. NBP has one of the highest Gross NPL ratio of 17.8% as compared to 11% of the industry and is a cause of concern for investors. This has resulted in high provisioning expense during the last few years. In 2015, it cost NBP Rs10.8bn (Rs3.1/share). Improved macros and strong surveillance is likely to bring down this number to Rs4bn in 2016 (Rs0.74/share). Provisioning against NPLs is already down 71% YoY in 1H2016 to Rs1.9bn.
- Strong dividend payout to continue:** NBP will continue with its strong dividend payout tradition as the bank enjoys above average CAR of 18% (industry average 16.5%). This is comfortably higher than SBP target of 10%. In 2015, NBP declared dividend of Rs7.5/share (payout ratio of 80%).

Report completed on Aug 31, 2016
Prices as of Aug 30, 2016

KATS Code	NBP
Bloomberg Code	NBP PA
Reuters Code	NBPK.KA
Market Price	Rs73.65
Market Cap	Rs156.7bn/US\$1.5bn
Free float Market Cap	Rs37.3bn/US\$355.5mn
1-Yr Avg. Daily Vol. (mn)	1.4
1-Yr Avg. Daily Val. (mn)	Rs83.2/US\$0.8
1-Yr High/ Low	Rs73.6/51.2
Estimated free float	24%
Share outstanding (mn)	2,127.51
Index weight	1.77%

NBP vs KSE-100 Index



Source: PSX, Topline Research

National Bank (NBP) – Improving asset quality to narrow valuation discount



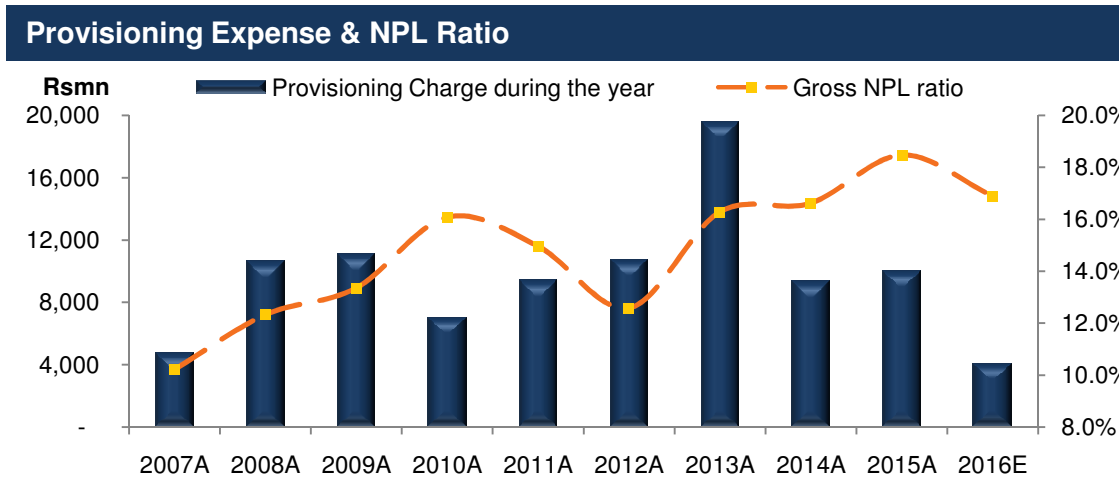
- In 2016, we expect NBP to announce dividend of Rs8/share which translates into dividend yield of 11%. This is significantly higher than the prevailing risk free rates of ~6% and average market dividend yield of 5%. NBP also offers one of the highest dividend yields among the companies in Topline Universe.
- **Valuation discount to narrow:** NBP has historically traded at a discount to its book value due to concerns over asset quality and sustainability of its earnings. It has traded at discount to Topline banking universe average PBV of 1.3x. We believe that improving earnings outlook amid decline in loss ratio and absence of major NPLs on overseas operations, this discount will narrow down and NBP will converge to its estimated year end book value of Rs81/share with expected ROE of 12-13%.
- **Key Risks:** We flag 1) resurfacing of NPLs, 2) substantial cut in interest rates, 3) deterioration of Pakistan macros as key risks, & 4) political interference.

NBP: Key Numbers

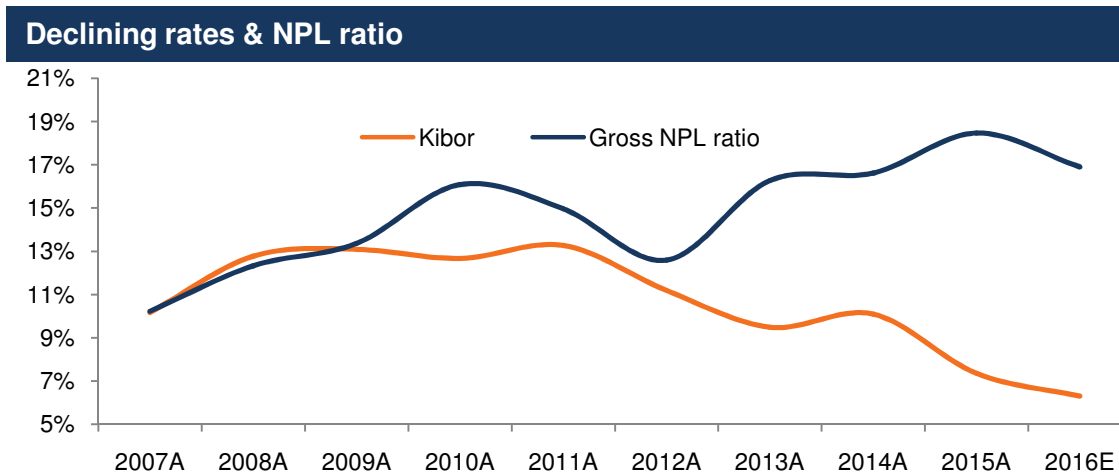
	2014A	2015A	2016E	2017F	2018F
EPS	7.6	9.4	9.5	10.5	11.4
Earnings Growth	205%	25%	1%	10%	9%
PE at Rs73.7	9.7	7.8	7.7	7.0	6.4
Dividend Yield	7%	10%	11%	12%	12%
ROE	9%	12%	12%	13%	14%
PBV	0.9	0.9	0.9	0.9	0.9

Source: Company Accounts, Topline Research

Provisioning Expense & NPL ratio to go down



Source: Company Accounts, Topline Research



Source: SBP, Company Accounts

- Provisioning expense that has affected NBP's bottom-line significantly over the years is likely to fall amid major recoveries and improving macros. In 2016, we expect provisioning expense to come down to Rs4bn vs. Rs11bn in 2015. In 1H2016, provisioning expense has already come down by 71% to Rs1.9bn.

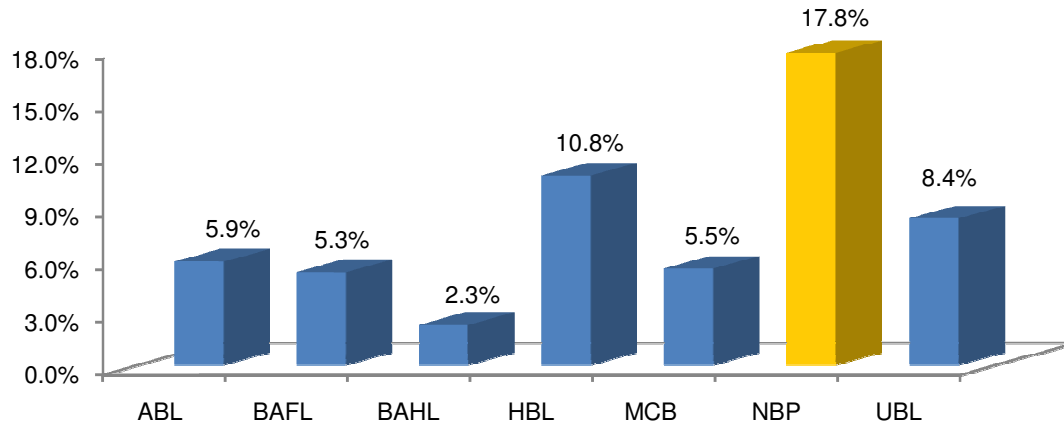
- Another key issue restricting provisioning charge is lack of international NPL accretion. To recall, NBP incurred heavy losses (NPLs of ~Rs15bn) against Bangladesh operations.

- Multi-year low interest rates and economic recovery also remain key elements in improving asset quality.

- Management of the company also expects a 40-50% decline in provisioning due to this improved outlook.

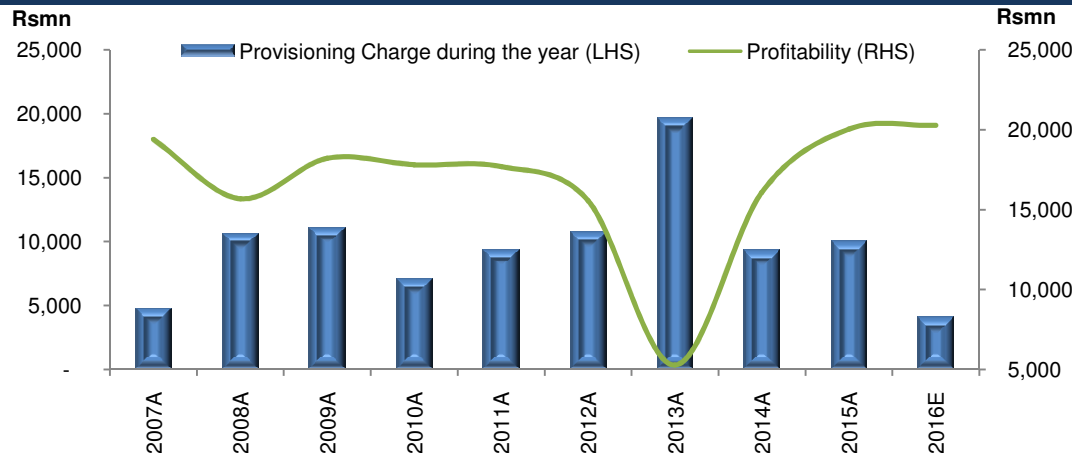
NPL still higher but on declining trend

Bank wise NPL ratio (Jun 30, 2016)



Source: Company Accounts, Topline Research

Provisioning & Profitability



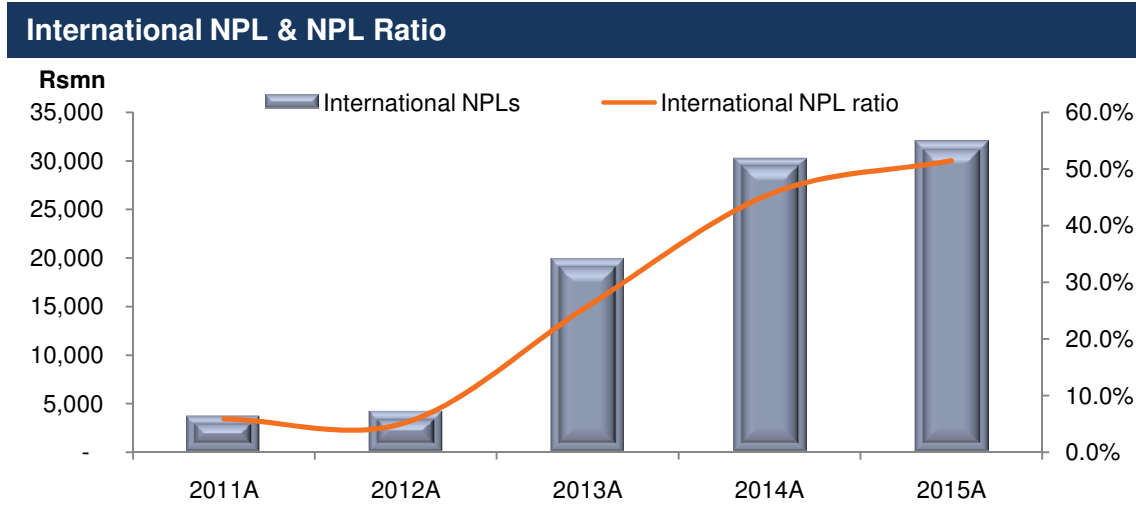
Source: Company Accounts, Topline Research

- NBP has the highest NPL ratio amongst the peers and consequently a higher provisioning charge. In a declining or improving NPL scenario, NBP is likely to benefit more compared to peers due to profound impact on the bottom-line.

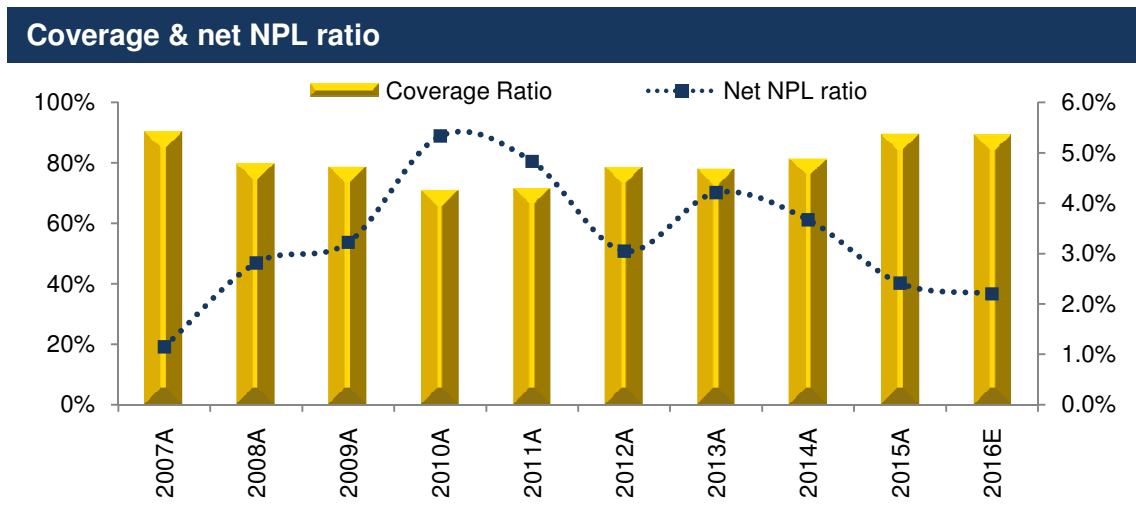
- In 2Q2016, gross NPL ratio improved to 17.8% as against full year 18.5% for 2015. Similarly, provisioning expense in 1H2016 has declined by 71% to Rs1.9bn. Management has highlighted that recoveries on international front (Bangladesh operations) and domestic operations (mainly from Sugar and Textile sectors) has led to this recovery.

- Management expects this trend to continue due to increase recovery efforts.

NPLs on international business to decline



Source: Company Accounts, Topline Research



Source: Company Accounts, Topline Research

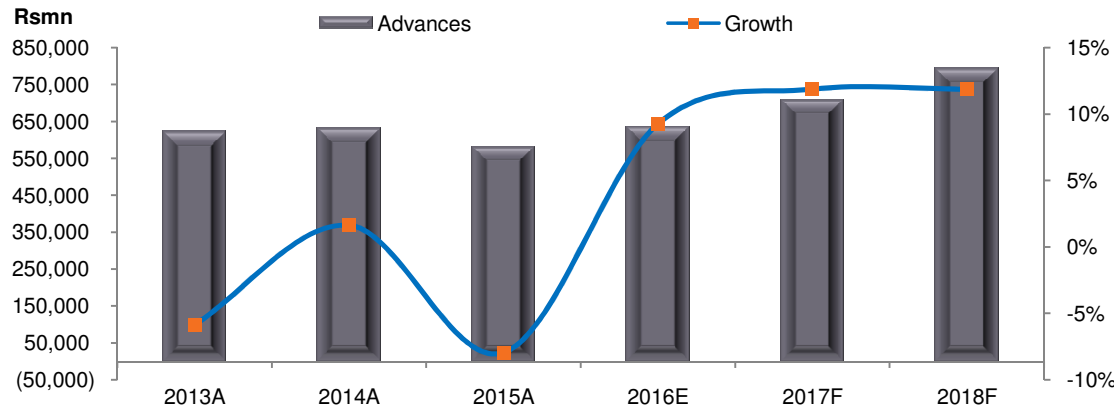
- NPLs on the international operations constitutes around 25% of the total NPLs of the bank. NPLs specifically against Bangladesh operation has led to sharp spike in provisioning expense in 2013 and 2014 and thus lower earnings.

- In 1H2016, the bank has not only witnessed improvement on international operation but also on local operations. As a result, 1H2016 profitability was up 62% despite lower capital gains and falling interest rates.

- Over 80% of NBP remains covered and net NPL ratio of the bank is 2.2% from 5.3% in 2010.

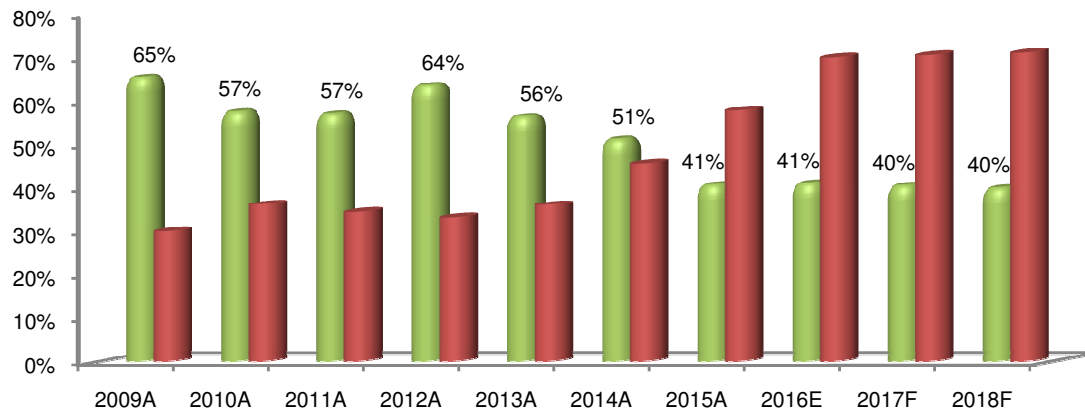
Advances growth to pick up

Advances growth



Source: Company Accounts, Topline Research

ADR vs. IDR

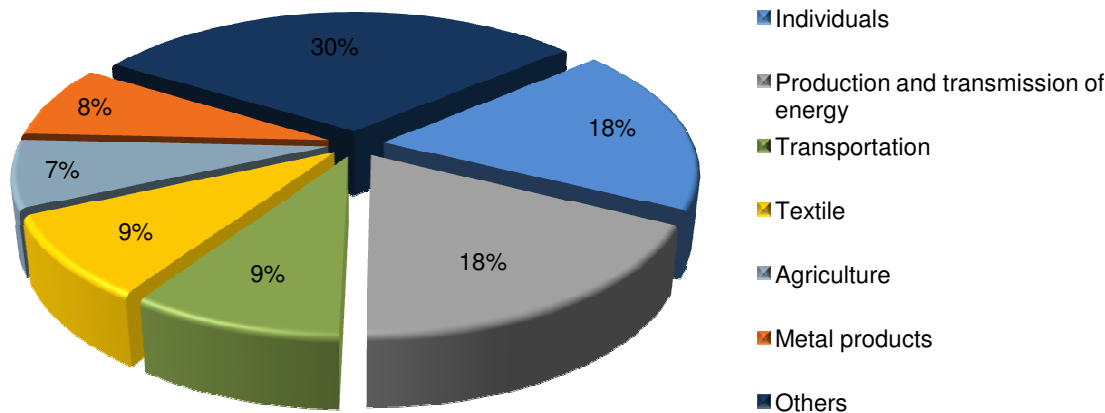


Source: Company Accounts, Topline Research

- Advances growth of NBP during the past years have remained lackluster however it is expected to pick up going forward due to improving macros and higher demand of infrastructure and power projects.
- One of the major development on this front has been Rs100bn Neelum Jhelum Hydro Power Project under which NBP is likely to disperse Rs35bn as a lead financier.
- Due to Neelum Jhelum Project and other related projects we anticipate advances to grow by 11% in 2016-18 as against decline of 4% during last 3-years.

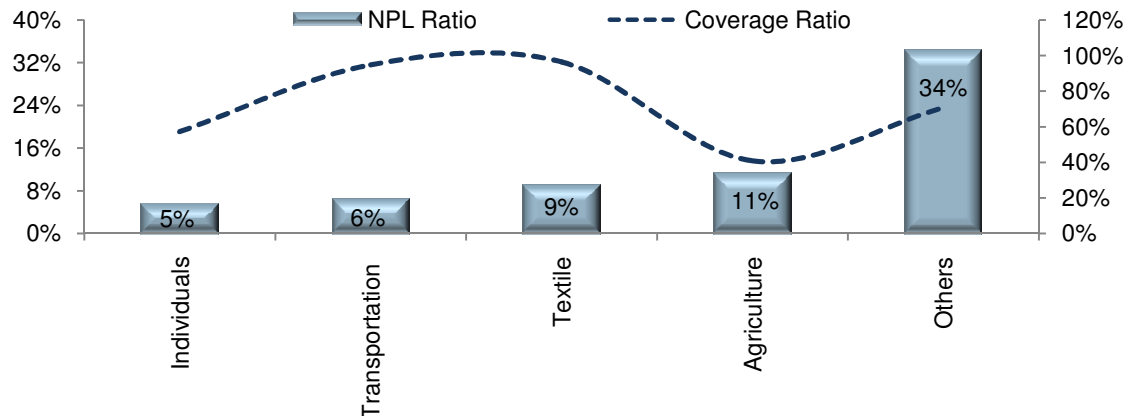
Major concentration in Energy Sector & Power Sectors

Sector wise advances breakup (Dec 31, 2015)



Source: Company Accounts, Topline Research

Sector wise NPL & coverage ratio (Dec 31, 2015)

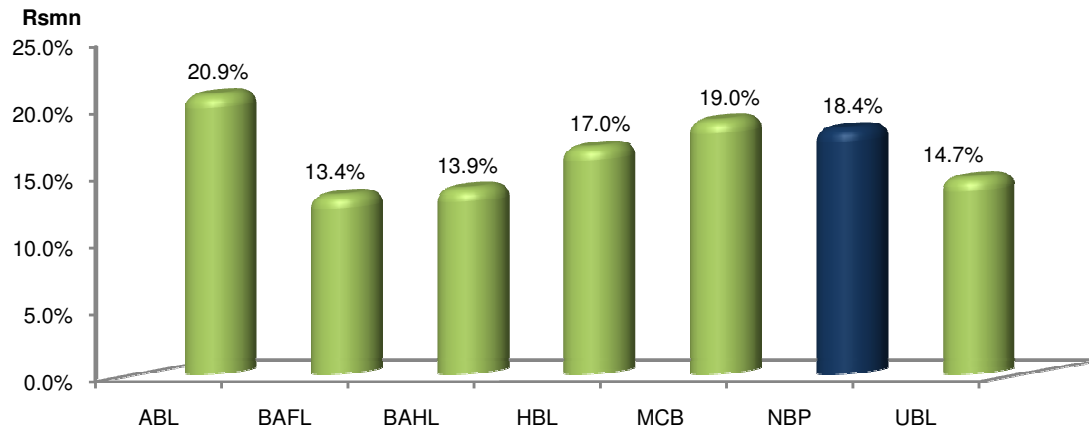


Source: Company Accounts, Topline Research

▪ NBP's major concentration is in Energy & power sectors but they are mostly provided for.

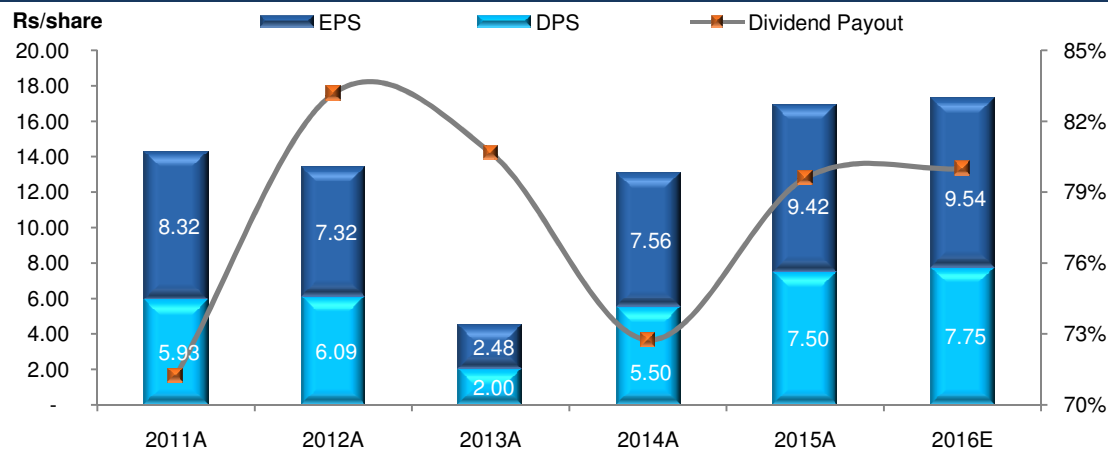
NBP enjoys one of the highest CAR ratio

Bank wise CAR ratio (Dec 31, 2015)



Source: Company Accounts, Topline Research

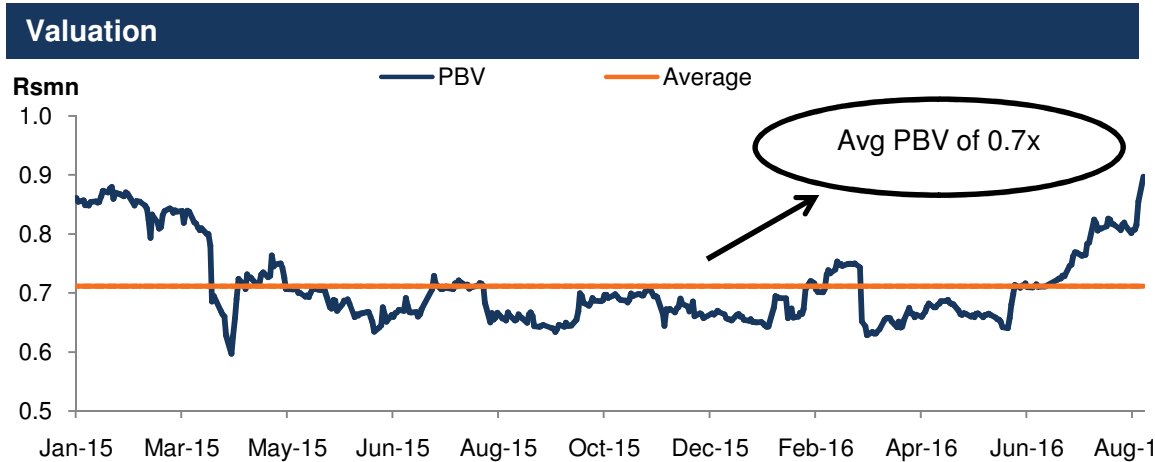
Dividend and Payout ratio (Dec 31, 2015)



Source: Company Accounts, Topline Research

- NBP is well covered in terms of capital adequacy. CAR of 18.4% is well above SBP requirement of 10% and is highest followed by ABL and MCB.
- Strong CAR has led to strong payout ratio for the company over the years and is expected to continue going forward.
- Comfortable CAR will help NBP to lend aggressively in future.

NBP has historically traded at a discount to its book value



▪ NBP's has historically traded at a Price to Book Value (PBV) of less than 1 due to asset quality concerns and earnings volatility. With improving asset quality and expected uptick in ROE to ~13%, we anticipate NBP to converge to its book value.

Source: Company Accounts, Topline Research

Pakistan Banks Valuation

	Symbol	2017 PE	2017 PBV	2017 ROE
Allied Bank	ABL	6.5	1.1	17%
Bank Al-Falah	BAFL	5.9	0.8	13%
Bank Al-Habib	BAHL	6.9	1.1	16%
Habib Bank	HBL	9.2	1.6	17%
MCB Bank	MCB	9.9	1.6	16%
National Bank	NBP	7.0	0.9	13%
United Bank	UBL	8.0	1.3	17%

Source: Company Accounts, Topline Research

Financial Snapshot

Consolidated Income Statement

Rsmn	2014A	2015E	2016F	2017F	2018F
Mark-up / Interest earned	115,250	114,386	110,370	121,750	141,809
Mark-up / Interest expense	70,100	59,999	57,880	66,370	82,290
Net Mark-up / Interest income	45,150	54,387	52,491	55,380	59,519
Non-Interest Income	31,399	35,104	31,954	34,075	37,510
<i>Capital Gain</i>	8,660	12,283	5,835	4,825	5,013
Gross Income	76,549	89,491	84,444	89,455	97,029
Operating expenses	44,113	45,374	48,150	51,960	56,196
Pre provision & taxes profits	32,436	44,117	36,294	37,495	40,833
Provisions/Reversals	9,303	9,945	2,984	3,127	3,399
Profit before taxation	23,133	34,173	33,310	34,368	37,435
Profit after taxation	16,085	20,043	20,285	22,339	24,333
EPS (Rs)	7.6	9.4	9.5	10.5	11.4

Source: Company, Topline Research

Consolidated Balance Sheet

Rsmn	2014A	2015E	2016F	2017F	2018F
Paid-up capital	21,275	21,275	21,275	21,275	21,275
Shareholders' equity	114,023	119,202	123,259	127,727	132,593
Total equity	182,593	171,655	173,125	175,136	177,668
Deposits	1,234,405	1,431,535	1,549,637	1,754,964	1,988,374
Total liabilities	1,367,066	1,540,219	1,790,900	2,016,759	2,273,510
Net advances	630,230	580,094	633,778	709,011	793,194
Net investments	561,768	826,247	1,086,319	1,238,999	1,413,901
Total Assets	1,549,659	1,711,874	1,964,025	2,191,895	2,451,179

Source: Company, Topline Research

Key Ratio

	2014A	2015E	2016F	2017F	2018F
Return on performing loans	11.5%	9.7%	7.9%	7.7%	8.2%
Cost of deposits	7.5%	5.7%	4.7%	4.5%	5.0%
Net interest margin (NIM)	4.1%	4.2%	3.4%	3.0%	2.9%
NII/ Gross Income	59.0%	60.8%	62.2%	61.9%	61.3%
Cost / Income ratio	53.5%	49.0%	56.1%	57.2%	57.0%
Deposit growth	12.0%	16.0%	8.3%	13.3%	13.3%
Credit growth	1.6%	-8.0%	9.3%	11.9%	11.9%
Investment growth	41.7%	47.1%	31.5%	14.1%	14.1%
Return on equity (ROE)	9.4%	11.3%	11.8%	12.8%	13.8%
Return on assets (ROA)	1.1%	1.2%	1.1%	1.1%	1.0%
Advance-to-deposit (ADR)	51.1%	40.5%	40.9%	40.4%	39.9%
Investment-to-deposit (IDR)	45.5%	57.7%	70.1%	70.6%	71.1%
CASA	76.5%	76.9%	76.9%	76.9%	76.9%
Gross infection ratio (%)	16.6%	18.5%	16.9%	16.1%	15.4%
Net infection ratio (%)	3.7%	2.4%	2.2%	2.1%	1.9%
Coverage ratio (%)	81.0%	89.1%	89.1%	89.1%	89.1%
Number of Branches	1,377	1,424	1,434	1,444	1,454

Source: Company, Topline Research

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Buy	Stock will outperform the average total return of stocks in universe
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Sell	Stock will underperform the average total return of stocks in universe

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