Banks 2QCY22 profits to decline with high taxation

Commercial Banks — Overweight

Jul 25, 2022

Pakistan Equities
Commercial Banks

Key Points

- Combined 2QCY22 profit of our banking sector coverage universe is estimated to decline by 31%YoY/41%QoQ.
- While NII and NFI are estimated to improve by 25%YoY and 5%YoY, respectively, higher taxation (incorporating the tax measures announced in the Federal budget for FY22) is expected to result in the decline in profit for the quarter.
- During the outgoing quarter, yield on fixed rate bonds have increased by 91-130bps, which would have a negative impact on CARs of the banks particularly HBL from our coverage universe that may result in containment of dividend payout.
- After the plunge of 21% CY22TD in the banking sector index of the PSX, our coverage universe for banks is now trading at CY22E Tier-1 P/B and PER of 4.3x and 0.7x, respectively. While we have buy recommendation on all of our coverage banks, we prefer, UBL, BAFL, MCB and BAHL as our preferred ones.
- Going forward, higher interest rates on one hand would bolster core incomes of the sector, however, we do not rule out higher risks to asset quality.

2QCY22 profits to drop 31%YoY/41%QoQ

Combined profit of banks under our coverage is expected to shrink by 31%YoY/41%QoQ, primarily due to higher effective tax rates during the quarter. For 1HCY22, the combined profitability of banks under our coverage is expected to come down by 4.1%. Within our coverage universe, AKBL and MEBL are expected to post positive growth in their profitability during 2QCY22 with increased balance sheet size and contained expenses as the main reasons for growth for the former and no minimum deposit rate as the reason for growth for the latter. As far as the cash payouts are concerned, these would also come down for the quarter along with the earnings. For banks with relatively high mix of fixed rate long-term bonds in their investments, increase in secondary market yields of such bonds would result in erosion of equity hence affecting CAR, and could result in lesser payout. We believe HBL qualifies for this risk.

Next Bank Universe

	2Q CY22E	2Q CY21	YoY	1Q CY22	QoQ	1H CY22E	1H CY21	YoY
Interest/Profit Earned	408,148	249,767	63.4%	340,360	19.9%	748,508	484,788	54.4%
Interest/Profit Expensed	250,537	123,822	102.3%	194,057	29.1%	444,594	239,601	85.6%
Net Interest/Profit Income	**157,611**	**125,946**	**25.1%**	**146,303**	**7.7%**	**303,914**	**245,187**	**24.0%**
Fee, Commission, etc.	25,350	21,053	20.4%	25,896	-2.1%	51,246	42,384	20.9%
Dividend Income	1,561	1,540	1.4%	2,662	-41.4%	4,223	2,912	45.0%
Income from FX	5,850	5,224	12.0%	9,138	-36.0%	14,988	10,105	48.3%
Capital Gains/(Losses)	82	3,848	-97.9%	1,109	-92.7%	1,191	9,123	-86.9%
Others	3,065	2,630	16.5%	1,406	118.0%	4,472	5,346	-16.4%
Non-Interest Income	**35,908**	**34,295**	**4.7%**	**40,211**	**-10.7%**	**76,120**	**69,871**	**8.9%**
Total Income	**193,519**	**160,241**	**20.8%**	**186,515**	**3.8%**	**380,033**	**315,058**	**20.6%**
Operating Expenses	90,638	80,523	12.6%	97,979	-7.5%	188,617	161,929	16.5%
Provisions & Write-offs	4,062	3,467	17.1%	117	n/a	4,179	6,505	-35.8%
Others	2,280	1,879	21.3%	2,008	13.5%	4,287	3,364	27.5%
Profit Before Tax	**96,539**	**74,371**	**29.8%**	**86,410**	**11.7%**	**182,950**	**143,260**	**27.7%**
Tax	65,956	30,093	119.2%	34,365	91.9%	100,320	57,039	75.9%
Profit After Tax	**30,584**	**44,385**	**-31.1%**	**52,068**	**-41.3%**	**82,652**	**86,328**	**-4.3%**
Profit for Equityholders	**30,449**	**44,121**	**-31.0%**	**51,819**	**-41.2%**	**82,268**	**85,816**	**-4.1%**

Source: Company Financials; Next Research

Budget FY22 brought higher taxes for the banks

In the FY22 budget, the government increased corporate tax rates for banks from 35% to 39%. This would be applicable on 1QCY22 income also. Moreover, the government also increased super tax for banks on CY22 income to 10%. Therefore, additional 6% super tax would also be charged to 1QCY22 income. Tax rates on income derived from investment in federal government securities in case gross ADR does not exceed 40%, has been increased to 55% from 40% earlier, and if it is more than 40% but does not exceed 50% than the tax rate has been increased to 49% from 37.5% earlier. This change would be applicable from CY21. Therefore, HBL, MCB, and UBL from our coverage universe who had gross ADRs of less than 50% at the end of CY21, would book this increased tax during the outgoing quarter. Effective tax rate for these three banks for 2QCY22 would be 72%, 80%, and 76%, respectively, which is expected to come down to 49% in 3QCY22 and to a normalized rate of 43% from 1QCY23, assuming gross ADR remains above 50%. For the rest of the banks in our coverage, effective tax rate is expected at 58%-61% for 2QCY22, which is expected to come down to 49% from 3QCY22 and to 43% from 1QCY23, assuming gross ADRs remain above 50%.

Key Data

Mkt. Cap. (USDmn)	
Mkt. Cap. (PKRbn)	
Index Weightage (KSE-100)	
Listed Companies	

Source: PSX, Next Research

EPS estimates

	2Q CY22 E	YoY	QoQ	1H CY22 E	YoY
AKBL	1.63	50%	-43%	4.49	38%
BAFL	1.87	-4%	-34%	4.69	20%
BAHL	3.02	-24%	-32%	7.49	-8%
BOP	0.52	-59%	-29%	1.24	-34%
HBL	3.63	-43%	-37%	9.41	-22%
MCB	2.71	-59%	-65%	10.38	-17%
MEBL	4.54	41%	-20%	10.20	32%
UBL	3.47	-42%	-54%	11.07	-10%

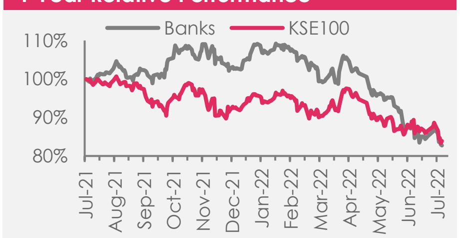
Source: Company Financials; Next Research

DPS estimates

	2QCY22E	1HCY22E
AKBL	-	-
BAFL	2.25	2.25
BAHL	-	-
BOP	-	-
HBL	1.25	3.50
MCB	2.00	7.00
MEBL	1.50	3.25
UBL	2.00	7.00

Source: Company Financials; Next Research

1 Year Relative Performance



Source: PSX, Next Research

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Double-digit growth in balance sheet

At the end of Jun’22, deposits of the banking sector increased by 15.2%YoY/7.8%MoM with average deposits during the quarter growing by 15.7%YoY/6.1%QoQ. Gross advances of the sector increase by 21%YoY/0.6%MoM at the end of Jun’22 with ADR of 47.7% compared to 45.4% of Jun’21. Average 2QCY22 advances increased by 22.2%YoY/7%QoQ. Investments of the banking sector at the end of Jun’22 also increased by 26.8%YoY/12%MoM taking IDR to 76.4% compared to 69.4% of Jun’21. Average 2QCY22 investments increased by 22.8%YoY/9.6%QoQ.

Core income to improve

Average 6-month KIBOR recorded an increase of 322bps during 2QCY22, NII of banks is estimated to increase by 25%YoY/8%QoQ as a result of a modest increase in NIMs and expansion in balance sheet. Within the non-interest income fee and commission income is expected to register a growth of 20%YoY while declining by 2%QoQ. The YoY increase may be attributable to higher trade activities compared to the previous year. FX income can report a positive surprise given the extreme volatility during the quarter. While we do not expect a significant deterioration in the asset quality of the banking sector during the outgoing quarter, we expect provisions to increase by 17%YoY.

Outlook

While we maintain our overweight stance on the banking sector, we highlight deterioration in asset quality with inflationary pressures and slow down in growth. We also highlight revaluation risk of long-term fixed rate bonds in case the secondary market yields go further up. Currently secondary market yields of 3/5/10-year fixed rate PIBs are 13.2%/13.2%/13%, compared to a policy rate of 15%. For perspective, average 5-year and 10-year premium of 3/5/10-year fixed rate PIBs over the policy rate are 1.1%/1.4%/1.8% and 1%/1.5%/2.1%, respectively. However, most of the banks have diversified their bond portfolios to floating rate bonds with a few exceptions. Moreover, NIMs of the banking sector are yet to peak with the delayed impact of repricing of asset and liabilities. The sector has plunged 21% during CY22TD and at current levels, average Tier-1 P/B and PER of our coverage universe is at 0.7x and 4.3x, respectively. While we have buy recommendation on all of our coverage banks, we prefer, UBL, BAFL, MCB and BAHL as our preferred ones.

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