

April 06, 2009

Pakistan Market**Banks: Advances & deposits growth trend 1Q2009**

KSE100 Index Closing 7432.88 ↑ (+241.79)

MORNING BRIEFING

State Bank of Pakistan (SBP) recently released statistics of the scheduled banks' assets & liabilities as of March 28, 2009. According to details released, deposits in the first quarter (Jan – Mar) 2009 grew by 2%, however advances contracted by 3% as credit appetite slowed down considerably. In today's report, we analyze the released statistics and discuss our outlook on the banking sector.

Deposit up 2% as NFA rises by 6%

According to latest numbers, total customer deposits of the banking industry have reached Rs3.9tn (US\$48.1bn) as of Mar 28, 2009, depicting a growth of 2% from Rs3.8tn (US\$48.2bn) at the end of Dec 2008. This growth while lower than 5 years (2004-08) first quarter average annual growth of 3.5% is similar to the growth level in the first quarter of 2008.

Moreover, on an annualized basis the current growth is higher than 7% deposit growth witnessed in 2008. After a turbulent Oct 2008 when deposits contracted by 3% on account of liquidity crunch, deposit growth has since witness a marked turnaround. Attractive returns and 6% growth in Net Foreign Assets (NFA) since Jan 2009 have helped deposits to stabilize.

Gross advances down 3%, provisions up 10%

The gross advances of scheduled banks fell by 3% to Rs3.1tn (US\$38.0bn) as of Mar 28, 2008. However, after adjusting these advances against provisions of Rs233bn, net advances of the industry arrived at Rs2.8tn (US\$35.1bn).

Despite high interest rates, advances growth remained strong in 2008 mainly due to surge in credit offtake from the energy sector. However with economy slowing down considerably, particularly the industrial sector (Large Scale Manufacturing (LSM) down 8.9% in Jan 2009), credit offtake has declined during 1Q2009. Going forward, despite sharp fall in lending rates (6-month KIBOR down 295bps in 1Q2009), slowdown in economic growth is likely to keep credit offtake under pressure.

While gross advances declined by 3%, rising Non Performing Loans (NPLs) due to high lending rates and overall economic slowdown continues to remain a major concern for the sector. Non performing loans rose by a record Rs97bn (45%) in 2008, while provisions for NPLs were recorded at Rs52bn. This trend of rising provisions has continued in 2009 with provisions for NPLs rising by Rs20.8bn since end Dec 2008.

Investments up 17% in 1Q2009

After witnessing a fall of 19% or Rs230bn in 2008, banks' investment portfolio returned to normal levels as investments rose by 17% to Rs1.1tn (US\$14.2bn) as of Mar 28, 2008. Lower deposit growth and strong credit offtake from the public sector had resulted in banking offloading investments to facilitate lending in 2008. However, the decline in credit offtake during 2009 thus far has resulted in the growth in investment portfolio. Given, likely slowdown in advances growth and stability in deposits we could see investments consolidating at current levels in 2009.

Outlook: Earnings to remain depressed

The banking sector continues to remain under distress due a combination of economic slowdown & increasing asset quality concerns, which has forced banks to book heavy provisions for NPLs as well as impairment loss on equity investments.

Going forward, lower levels of economic activity will result in advances growth slowing down to 6% in 2009, while growth in NPLs is likely to remain on the higher side as well. Deposit growth on the other hand amid improving liquidity situation and falling yields on government paper is likely to exceed advances growth and stay close to 8% in 2009.

Given the above concerns, we expect profits to decline by 8% in 2009. Hence, we maintain a 'Market Weight' stance on the sector which trades at 2009E PE and PBV of 8.6x and 1.1x, respectively. Amongst the major scrips we have a 'Hold' stance on UBL, NBP and MCB, while 'Sell' on HBL.

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Also in focus**Cotton arrivals at 11.3mn bales in FY09 to date**

According to the latest numbers released by Pakistan Cotton Ginners Association (PCGA), cotton arrivals stood at 11.33mn bales as of Mar 31 2009, same as of last year. As expected in the tail-end of the season, arrivals have slowed down considerably in the last fortnight i.e. Mar 15 to Mar 31 2009 to only 29,208 bales. We do not expect cotton arrivals for FY09 to cross the 11.4mn mark.

Moreover, according to newspaper reports, government is contemplating on fixing cotton bales target at 13mn for the upcoming FY10 season. This target of 13mn bales anticipates a growth of around 14% from current FY09 season.

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