

November 20, 2009

Pakistan Market**Banks: Seasonality drives offtake in October****MORNING BRIEFING**

KSE100 Index: Closing 9251.19 ↑ (+106.43)

After dismal offtake numbers in the first nine months of 2009, credit offtake has demonstrated improvement in Oct in line with the seasonality element. Offtake traditionally picks up in the last quarter of the calendar year as demand for credit from the agriculture sector, textile (cotton ginners), and other commodity operations is in full flow.

Gross advances rose by 1% or Rs41bn in Oct, which is in sharp contrast to the 9M2009 growth of 0.4%. Moreover, improving Net Foreign Assets (NFA) amid higher foreign inflows has helped deposits post a healthy 10.3% growth in 10M2009. Despite improving economic fundamentals, concerns over asset quality and higher interest rates continue to remain key bottlenecks in higher private sector credit flows. Resultantly, banks continue to park excess liquidity in their investments' portfolio, as reflected by the growth in investments (up 59% in the current calendar year).

Advances up 1% in Oct; prov. up 26% in 10M2009

In contrast to the credit offtake performance in 9M2009, gross advances rose by 1% to Rs3.2trn (US\$38.2bn) as of Oct 31, 2009. In Oct alone, credit offtake was recorded at Rs41bn amid seasonal demand for credit from agriculture, textile and commodity sector, which has been a traditional driver however the quantum of credit was still significantly lower compared to the Rs85bn credit disbursed in Oct 2008. Hence cumulative growth in advances during 10M2009 was recorded at a paltry 2% versus 17% in 10M2008. High interest rates, surge in NPLs and a contraction in LSM have contributed to the dismal offtake with banks preferring to focus on risk free investments.

Provisions for Non Performing Loans (NPLs) remained a key earnings dampener, rising by 26% or Rs56bn in 10M2009. There has been, however, some respite in the pace of new provisions as additions of only Rs1bn were recorded in Oct 2009 as against the average monthly provisions of Rs5bn in 3Q2009. Slowdown in NPL accretion in 3Q2009 and weak

credit offtake numbers have resulted in improved provisioning figures in the last few months.

Deposits up 10% as NFA rises by 74% in 10M2009

Deposits of the banking industry have reached Rs4.2trn (US\$15.1bn) as of Oct 31 2009, depicting a growth of 10% in the first 10 months of the year. After posting a 3% growth in 3Q2009, deposit grew 1% in Oct, compared to 2% contraction in Oct 2008. An improved money supply situation, particularly in Net Foreign Assets (NFA) in the last few months, has driven the continued upsurge in deposits. M2 expanded by 9% during the period while NFA grew by 74%. The 10% growth for the ten months is inline with past trends however it is significantly higher than the 4% growth witnessed in the corresponding period last year.

Investments up 59% in 10M2009

Given higher risk of NPLs, banks preferred investing in government securities as investments surged by 59% to Rs1.6tn (US\$18.6bn) as of Oct 31, 2009. This is supported by the M2 data which shows government borrowing from the banks stood at Rs319bn (US\$3.9bn) in 2009 to date. Going forward, given relative stability in deposits and no major appetite for credit at least in the short term, we could see investments consolidating at current levels in 4Q2009.

Outlook: Earnings growth of 12% in 2009

Despite improvement in key economic indicators during the last few months, the banking sector performance remains weak with the sector posting an earning decline of 23% in 9M2009. Higher provisions for NPLs, weak credit appetite and recognition of impairment losses have scarred the sector's performance during the period. That said, recent relaxation in FSV regime, slowdown in NPL accretion and improved credit offtake over the next few months will support sector's earnings in 4Q2009. Moreover, since 4Q2008 was one of the worst periods for the sector given the fact that provisions for NPL and impairment were at peak levels, sector earnings are likely to grow by 12% in 2009.

Reiterating our 'Market-Weight' stance, we flag BAFL as a likely outperformer given decent fundamentals and potential earnings trigger in case of the Warid sell off as BAFL holds 8.7% stake in the company.

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Also in focus**Telenor planning to stay long term in Pak**

In yet another development in the Telenor-Warid saga, Telenor's finance director Trond Westlie expressed the management's support for consolidation in the market and the willingness for a long term presence in Pakistan. He hinted however, at not getting involved in any transaction that would leave the existing venture cash strapped. We believe that there may have been initial talks between Warid Telecom and Telenor with price a likely bone of contention. Orascom has though clearly stated that it is not considering any M&A deal in Pakistan.

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