

May 21, 2009

Pakistan Market**Banking sector has outshone KSE in 2009****MORNING BRIEFING**

KSE100 Index: Closing 7060.72 ↓ (-7.13)

Despite concerns on asset quality and credit offtake, banking sector has witnessed relatively strong performance year to date. The sector outshined KSE 100 Index by a wide margin and posted average return of 31% vs 20% market return. After posting a healthy performance of 30% in 1QCY09, the weak banking sector performance at 1% vs 3% market return (from April 1st to May 20th), however, highlights investor concern on the sector's future outlook.

Looking forward, the sector's performance is likely to remain subdued on the back of rising NPL risk and slowdown in core advances growth. Additionally, we expect, pressure on Net Interest Income (NII) will intensify due to declining interest rate expectation.

6 banks outperform while 5 are laggards

Our analysis is based on 11 JS universe banks which represent 81% of the total sector market cap. According to our analysis, 6 banks outperformed the market during 2009 to date posting an average return of 54% as against market return of 20%. Moreover, 5 banks underperformed with an average return of 3% with main culprits being BAFL and BOP (Refer to table). BAFL suffered from rather dismal full year results as it booked huge impairment loss of Rs1.4bn, while delays in release of BOP's financial results and concerns over earnings quality kept investors on the side line.

Overall performance remained strong with the sector posting average return of 31% led admirably by NBP, HBL and MCB. After touching record lows in Jan 2009 due to huge foreign selling, interest in NBP was spurred on by buying from NIT (NBP is one of the scrips in the NIT managed State Enterprise Fund), high net worth individuals and institutional players. Moreover, better than expected result announcement and payout with full year 2008 results also contributed to the rally. HBL and MCB also remained as preferred investment stocks in the banking sector due to their fundamental strength as both announced strong financial results during the period.

Table: JS Banking sector performance in 2009

	1Q2009	YTD
Allied Bank	39.3%	46.4%
Askari Bank	39.9%	44.4%
Bank Al-Falah	-4.3%	-10.9%
Bank of Punjab	-16.0%	-5.5%
Faysal Bank	45.2%	8.2%
Habib Bank	92.8%	59.2%
MCB Bank	25.4%	49.0%
National Bank of Pakistan	75.1%	84.9%
NIB Bank	17.6%	17.3%
Standar Chartered Bank	-1.7%	6.9%
United Bank Ltd	39.1%	37.9%
KSE-100 Index	17.0%	20.4%

*As of May 20, 2009

Spreads & NIM remain strong in 1Q2009

Despite slowdown in credit offtake, NII of the banking sector remained strong during 1Q2009 driven primarily by higher interest spreads and margins (NIM) prevailing during the period. Average spread of the sector in 1Q2009 was recorded at 7.7%, an increase of 62bps YoY. Moreover, NIM for the JS Universe banks averaged 6.1% as against 5.5% recorded in 2008. Higher KIBOR and yield on Treasury bills were main reasons for the hike in NIMs and interest spreads as rise in cost of funds was more than offset by higher yields on earning assets.

Going forward, the trend is likely to reverse amid declining interest rates and a significant slowdown in credit offtake as economic growth slackens. In this backdrop, we expect advances growth to fall to 6% in 2009, while spreads are expected to decline by around 80-100bps by the end of the year.

Outlook: 'Market Weight' maintained

Deterioration of asset quality remains a major risk to the banking sector earnings in 2009 as reflected by Rs34bn increase in NPLs during 1Q2009. Moreover, contraction in

spreads and lower credit offtake will keep NII under pressure. Resultantly, we expect profits to decline by 5% in 2009. The sector is trading at 2009E PBV and PE of 1.0x and 7.9x, respectively. Hence we maintain a 'Market-Weight' stance on the sector with NBP our top pick for the sector at current levels.

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Also in focus**Banks 1Q2009 net NPLs surge to 3.9% of net loans**

State Bank of Pakistan (SBP) has released banking sector non-performing loans data as on Mar 31, 2009. As per which, Non Performing Loans (NPLs) of all scheduled banks in 1Q2009 increased by 9.8% to Rs379bn as on Mar 31, 2009 versus Rs345bn at the end of 2008.

Net NPLs of the banking system, increased by 5.1% or Rs6bn from Dec 31, 2008 figure of Rs111bn and stood at Rs117bn (3.9% of net loans) as at Mar 31, 2009. Rising NPLs continues to remain a major risk factor for the sector and was the major reason for 24% decline in sector profitability in 1Q2009. Given the current economic slowdown particularly the 6% contraction in the industrial sector NPLs are expected to continue with the upsurge in 2Q2009 as well.

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