

October 21, 2009

**Pakistan Market****Banks: FSV benefit, 2009 earnings revised up 12%**

KSE100 Index: Closing 9569.07 ↑ (157.78)

**MORNING BRIEFING**

Speculations over the last few months regarding further relaxation of the forced sale value (FSV) benefit finally came to end as State Bank of Pakistan yesterday issued a circular with respect to amendments in prudential regulations relating to FSV. According to the circular, banks would be allowed to take 40% benefit of FSV for pledged stocks and mortgaged residential, commercial and industrial properties (land and building only) held as collateral against non-performing loans (NPLs) effective Sep 30, 2009.

Moreover, an upgrade of classified advances upon rescheduling/restructuring has also been introduced in the amendments to Prudential Regulations. The two key takeaways from the amendments however relate to the 40% FSV benefit on industrial properties and the up-gradation of classified advances upon restructuring. Though the exact impact of the FSV benefit is difficult to estimate given the limited information available, we approximate the new FSV relaxations to boost 2009 earnings by around 11-12%. At a time when banks' profits are facing pressures from rising provisions, the availability of FSV benefit could trigger short term rally in banking stocks.

**FSV benefit: 2009 earnings revised up by 11-12%**

New regulations particularly the availability of 40% FSV benefit on industrial property would be a major boost to the profitability and help to enhance the balance sheet strength of the sector. Moreover, an additional 10% FSV benefit on pledged stocks and mortgaged commercial and residential properties would contribute towards reduced provisions for the sectors. According to latest numbers, the size of total NPLs as of June 30, 2009 stands at Rs398bn with a coverage ratio of 70%, while we estimate NPLs to rise to Rs412bn by Sep 2009. Our assumption is based on the decrease in pace of NPL accretion and the increase in NPLs during (Mar – Jun 2009) quarter of Rs18bn.

Based on our discussions with various industry experts and analyzing the Sept 2007 (pre FSV removal regime), we

expect the sector profits to rise by 11-12% taking our earnings growth expectation for 2009 to 10-11% from -1% earlier. Banks would recognize the FSV benefit in 4Q2009. Please refer to the below table for impact on individual banks.

**Benefit of upgrade on restructuring portfolio**

One of the most interesting aspects of the revised prudential regulation relates to the restructuring portfolio. According to the new regulations, banks would be allowed to upgrade the NPL classification category by one notch on all classified loans and advances restructured after Jan 1, 2009. Moreover, on fully meeting the terms and conditions of the restructuring for a continuous period of 1 year and cash recovery of atleast 5%, the classification may be further upgraded by one category.

Further, provisioning of the rescheduled portfolio is also limited to 50% of the difference between provisioning requirements of the upgraded and original category. As mentioned above, it is very difficult to estimate the actual impact of this special provision as there is no information on the loans that would be reclassified by the commercial banks. As per our discussions with some experts, we could see banks taking advantage on around 25% of the classified portfolio. Whatever the quantum, the potential reclassification would shore up the balance sheet of the banking sector.

**Table: Impact of FSV on major banks**

Bank	Impact/sh (Rs)	Prev EPS (Rs)	New EPS (Rs)	% Δ
ABL	0.78	7.50	8.28	10%
AKBL	0.84	1.10	1.94	NM
BAFL	0.35	1.50	1.85	23%
FABL	0.49	2.30	2.79	21%
HBL	1.86	12.71	14.57	15%
MCB	0.65	20.87	21.52	3%
NBP	1.24	11.51	12.75	11%
UBL	0.76	7.75	8.51	10%

Source: JS Research

**Recommendation: 'Market-weight' maintained**

We maintain a 'Market-weight' stance on the banking sector as we believe that there are no significant changes in the sector dynamics including risks that the sector currently faces. While short term earnings would get a boost and strengthen the balance sheet, there would be no major change in the cash flow position. Moreover, lackluster advances growth remains intact, though accretion of NPL has slowed down. Amongst the major scrips FABL, NBP & BAFL remain our preferred picks at current levels.

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