

May 31, 2010

## Pakistan Market

## UBL: Reiterate liking at current levels

MORNING BRIEFING



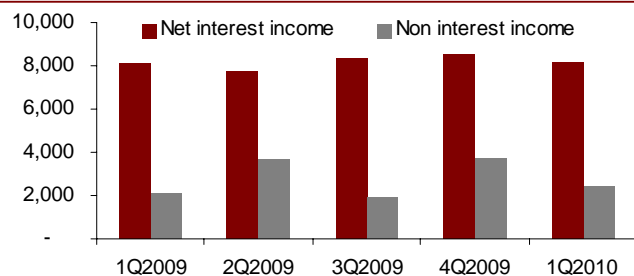
KSE100 Index: Closing 9521.15 ↑ (+81.18)

We reiterate our liking for UBL at current levels, with the scrip offering a 27% upside to our fair value of Rs70. The bank remains our top pick in the sector, more so after underperformance over the past month, as it has lost 16% in May compared to broader Index decline of 9%. We believe, the bank continues to remain in a healthy state and is well set to post earnings growth of 15% in 2010. Further, first quarter results reaffirmed banks focus towards CASA deposits to drive NII growth; while a big jump in fee income helped earnings northwards. The stock currently trades at a 2010E PBV and PE of 0.9x and 5.9x.

## CASA focus, Fee income to drive earnings

UBL registered earnings growth of 10% in 1Q2010, with profits of Rs2.8bn (EPS Rs2.27) versus Rs2.5bn (EPS Rs2.07) in the same period last year. Net Interest Income (NII) increased marginally as declining interest expenses were shrugged off by lower interest earned on lower yields during the period. Total deposits were down 8% in the quarter, with 75% of the reduction coming from high cost deposits. Advances too reduced by 5% to Rs361bn, with decline witnessed in commercial & consumer divisions. This rebalancing of portfolio is likely to enable the bank to take advantage once credit off-take starts picking up. Moreover, focus on CASA continues to reflect positively on the financials and is expected to tackle any taper off in yields going forward.

## QoQ income breakup (Rs mn)



Source: Company accounts

Further, Non Interest Income grew by a healthy 15% to Rs2.4bn. The growth was primarily led by higher fee income, up 14%YoY to Rs1.5bn, rising on behalf of increased commission on cash management and better corporate finance fee. We believe the pick up in Non Interest Income is an industry wide phenomenon, led by greater degree of economic activity plus better returns, and is expected to be among the key growth driver in the next few quarters.

## Change in YoY deposit structure

	Mar-10		Mar-09	
	Rs bn	Avg. Yield/Cost	Rs bn	Avg. Yield/Cost
Saving Deposits	165	4.9%	155	5.7%
Current deposits	142	0.0%	124	0.0%
Fixed deposits	136	7.0%	180	9.5%
Other deposits	9	0.0%	11	0.6%
Total deposits	451	4.0%	469	5.7%
CASA	68%		59%	

Source: UBL

## Provision to slide QoQ

Although provisions for NPLs rose 8%YoY to Rs1.7bn in 1Q2010, it declined 10% from the final quarter of last year. Resultantly, NPL ratio has now inched upwards to 11.3% as of March, with coverage standing at 72%. We opine these to have peaked last year and our expected decline over the next few quarters. Moreover, management continues to focus on restructuring bad loans, which leaves the door open for reversals going forward.

## Hike in tax rates to damper earnings

Talk of a possible hike in tax rate on banks by 250bps to 37.5% remains a risk on the cards – and a possible cue to recent under performance of the sector (down 6% last week). If the tax rate is implemented, we estimate UBL earnings for 2010 and 2011 to drop by 2.7% and 3.0% respectively, from current estimates.

## Outlook: 'Buy' maintained

Although tax rate hike is a near term risk, the possibility of the new rate coming through the budget is low, in our view. Further, we remain confident in bank's strategy to on low cost deposits and shedding expensive one's to continue to pay dividends in the coming quarter. The developments on Dubai Worlds debt resolution will also bode well for bank, where it has an exposure of US\$20mn, ~0.3% of its international loan book. On the local front, management continues to work on restructuring bad loans and creating possibility of future write backs. Our full year earnings estimate for 2010 and 2011 stand at Rs10.5bn (EPS Rs8.6) and Rs12.9bn (EPS Rs10.5). We reiterate our 'Buy' call on the stock which trades at a 2010E PBV and PE of 0.9x and 5.9x.

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## Also in focus

## Urea prices remain intact at Rs855 per bag

News reports today, quoted that urea prices have further been increased by Rs70 to Rs925 per bag. However, as per our discussions with the fertilizer manufacturers, the three key players (FFC, FFBL and Engro) have kept their prices unchanged at Rs855 per bag. As of now, our valuations and earning estimates remain intact for the all the said companies.

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