TAURUS SECURITIES LIMITED
A Subsidiary of National Bank of Pakistan

Banks

Habib Metropolitan Bank Ltd

The next big thing in mid tier banks; an ideal blend of high earnings growth & double digit yield!

HMB PA	BUY
Stock price	30.4
Target price	**42.7**
Current upside/(downside)	40.3%
Outstanding shares (m)	1,048
Market Cap (PKR bn)	31.9
Free float	45%
3M Avg. daily value traded (PKRm)	8.9
3M Avg. daily volume (m)	0.3
12M High	34.1
12M Low	18.6

Key financials				PKR bn
Year end	CY13A	CY14F	CY15F	CY16F
NII	9.07	10.81	12.21	14.50
Non int. income	4.82	5.43	6.07	6.70
Underlying profit	7.23	8.76	9.87	11.77
Provisions	2.11	1.86	1.62	1.72
PBT	5.12	6.90	8.25	10.06
PAT	3.53	4.55	5.44	6.64

Key matrices	CY13A	CY14F	CY15F	CY16F
EPS	3.37	4.34	5.19	6.33
DPS	2.00	2.50	3.00	3.50
BVPS	26.7	28.2	30.2	33.1
P/E (x)	9.0	7.0	5.9	4.8
P/BV (x)	1.1	1.1	1.0	0.9
Dividend Yield	7%	8%	10%	11%
Earnings growth	4%	29%	20%	22%
ROA	1.2%	1.4%	1.4%	1.5%
ROE	13%	16%	18%	20%
NIM	3.5%	3.8%	3.8%	3.9%

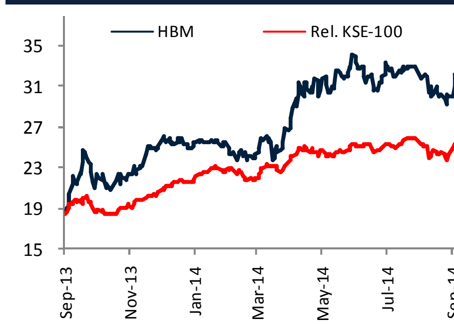
We initiate coverage on Habib Metropolitan Bank (HMB) with Dec'14 Target Price of PKR42.7/share. Although the scrip has outperformed the broader market during the past 12 months, we believe that materially improving fundamentals of the bank will continue to make it a preferred choice of investment. Our liking for the stock is under pinned by 1) margin expansion driven by massive investments in PIBs in 1HCY14, steady reduction expected in funding cost and declining expensive borrowing from FIs, 2) significant improvement in asset quality of the bank with coverage ratio and net NPL ratio hovering around 86% and 2.11%, respectively, 3) unmatched cost/income ratio amid similar banks & in comparison with much-envied-at Big-5 banks, 4) robust non markup income and 5) one of the highest dividend yield in banks owing to healthy CAR.

Earnings of HMB are expected to grow at an impressive 3-year CAGR of 22%. Earnings growth will emanate from continued B/S expansion, improvement in NIMs and contracting provisions due to enhanced asset quality. Thus, ROE of the bank is anticipated to traverse a similar trajectory. We expect ROE of the bank to improve to 21.7% in CY17 from 16.1% presently. The stock is currently trading at an attractive CY15 P/B and P/E of 1.0x and 5.9x, respectively. Our target price for the scrip is PKR42.7/share, eliciting a healthy upside of 40.3% from current level, alongside a solid CY14/CY15 dividend yield of 8%/10%. We recommend BUY!

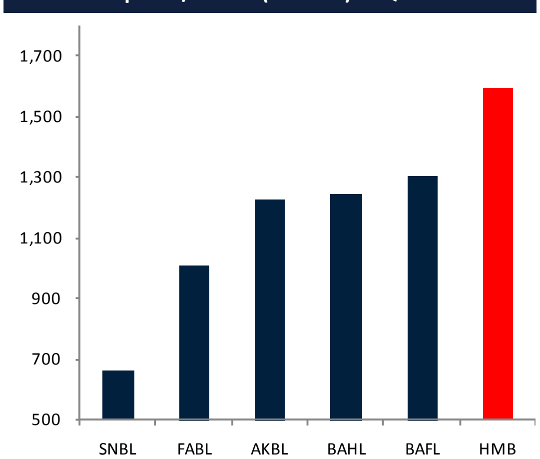
Efficient deposit mobilization amid limited branch network

Despite limited branch network of the bank (174 branches currently) and with 12 branches rolled out each year on average over past 4 years, deposit mobilization of the bank has remained impressive. Deposits of the bank have risen in line with the industry deposit growth, at a 4-year CAGR of 15%, thus maintaining its market share at around 3% during the past few years. It is also worthwhile to note that HMB has been very efficient in mobilizing deposits given its limited branch network. Deposits per branch of the bank is significantly better than peer banks, with the

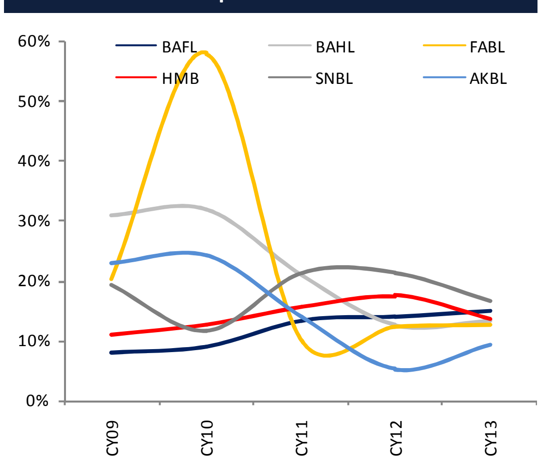
Price performance



Deposits/branch (PKR mn) - 2QCY14



Deposits Growth



Rohit Kumar
rohit.kumar@taurus.com.pk
Direct: +92-21-35216403

TSL Research

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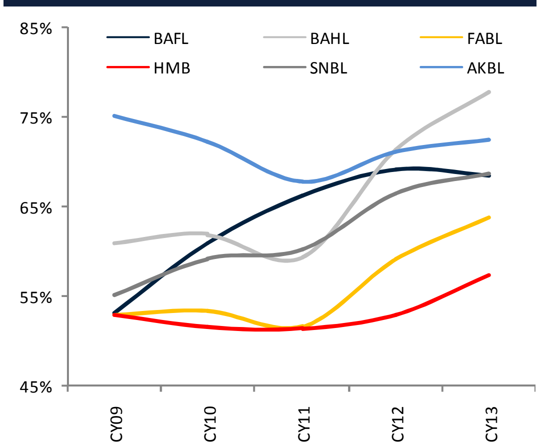
bank's deposit per branch of PKR1.59bn at 2QCY14 end, while for BAFL, BAHL and FABL deposits/ branch remained at PKR1.30bn, PKR1.25bn and PKR1.01bn, respectively.

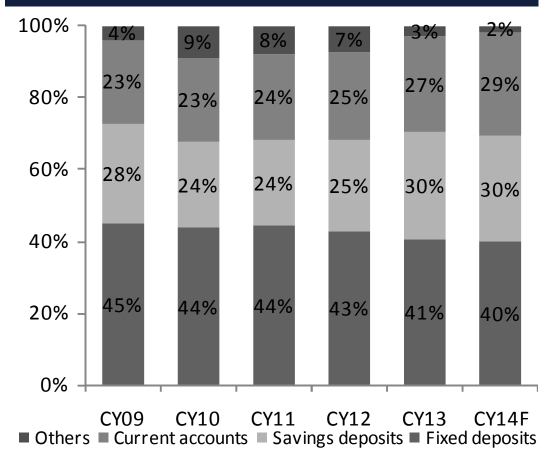
CASA catching up

Being a middle tier bank with merely 174 branches and presence in limited cities, the bank has previously relied heavily upon expensive fixed deposits and offered lucrative rates on saving accounts, which have kept the CASA of bank depressed during the past. However, during the last two years, the bank has geared up its efforts to improve its deposit mix, therefore, CASA of the bank has shown signs of improvement. The bank has shed its fixed deposits (46% of total deposit at CY12 end to 40% at 2QCY14 end) and resultantly improved its CASA from 49.7% at CY12 end to 56.7% at 2QCY14 end. Within CASA, current accounts have witnessed major improvement increasing from 24.5% at CY12 to 28% at 2QCY14 end. Going forward we expect the bank to further shed its high cost fixed deposits and replace them with cheaper CASA, which will help the bank to keep its funding cost under check. We expect CASA to improve to 63% by CY17 and a concurrent reduction in deposit cost.

CASA



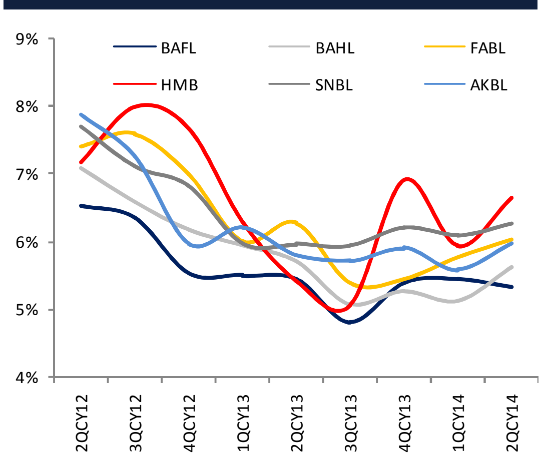
Deposit Mix Trend



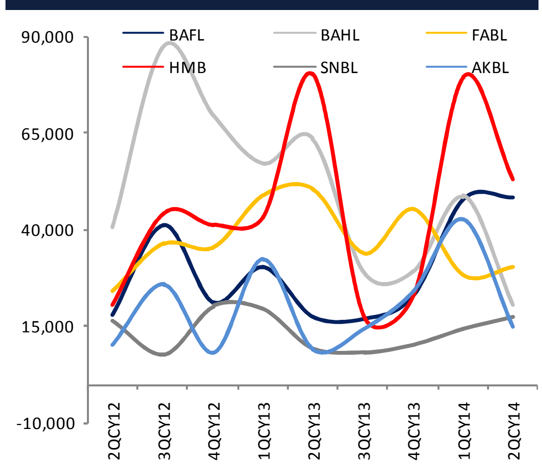
Elevated funding cost - a result of massive borrowings from FIs and low CASA

Deposit cost of the bank has remained exorbitantly high in the past, with funding cost as high as 8.2% witnessed in CY11, and averaging 7.2% during past 5 years. As a result, despite decent asset yields, net interest margins of the bank have remained suppressed, averaging merely 3.3% during the said period. We attribute high funding cost to 1) massive borrowing from financial institutions

Cost of Funds



Borrowings



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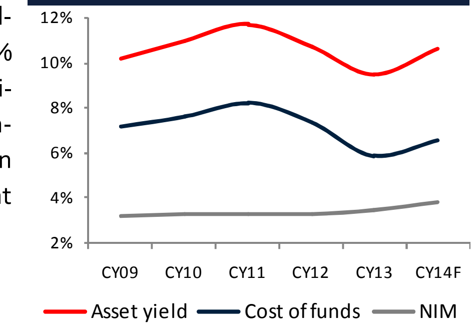
(which are at around KIBOR), and 2) low CASA ratio. The bank has relied excessively on borrowings from financial institution and high costs associated with these borrowing had inflated overall funding cost of the bank. Borrowings have averaged at PKR52bn during past 5 years (borrowings as a %age of total deposits averaged at 30% during the same). However, analysis of recent quarters indicates that borrowings as %age of deposits have waned, and we expect the phenomenon to continue in coming quarters as well. Furthermore, as discussed previously, with the bank's attention turned towards deposit mix, CASA has started to exhibit signs of improvement during the recent quarters. Consequently, we project the cost of funds to decline to taper off going forward.

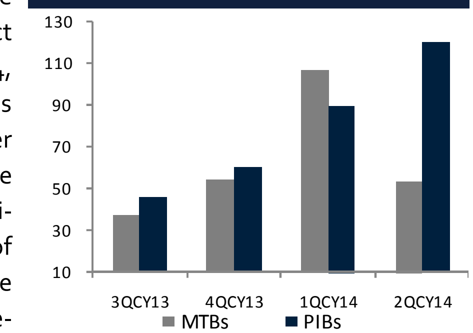
Asset yield, Cost of funds and NIM



PIBs to further embellish NIM

Owing to high deposit cost, NIMs of the bank have remained dismal in the past and as discussed previously, with the reduction in borrowings and tilt towards low cost deposits, NIM should witness improvement. In addition to that, the recent shift of the entire banking industry whereby exposure of the banks in long term government papers has increased manifold would also positively impact NIM of HMB. In line with the industry wide trend, HMB has parked ~PKR60bn in PIBs in 1HCY14, taking its total exposure in PIBs to PKR120bn at 1HCY14 end from ~PKR60bn at CY13 end and PIBs as %age of total investment rose from 42.1% at CY13 to 58.6% at 1HCY14 (highest among the peer banks), which will materially bolster the interest income of the bank and its partial impact can be seen in 2QCY14 results of the bank where the asset yields expanded by 57bps to 9.62%. Our estimates suggest that, additional yield pickup from PIBs would result in annualized after tax impact of PKR0.9/share and would result in NIM expansion of 43bps going forward. We also downplay the associated risk to equity as we do not expect significant hike in DR rate/PIBs yields and also because ~PKR30bn were invested in 2Q when the yields were already high.

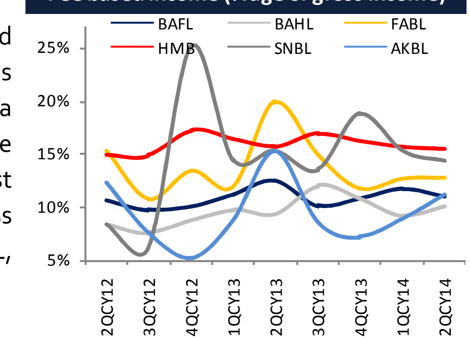
MTBs and PIBs exposure (PKR bn)



Fee, commission & brokerage income remains elevated

Historically the bank has earned handsome non mark up income, which has constituted around 40% of gross income. However, in recent times, NFI has been reduced down to 35% of total gross income, due to significant slowdown in forex income and dividend income, and NFI has grown at a 4-yeard CAGR of merely 7% p.a. Despite slowdown in NFI, fee, commission and brokerage income of the bank continues to remain robust as compared to its peers, which serves to reduce interest rate sensitivity and provide stable source of return to the bank. Fee based income as %age of gross income for the bank averaged at 16% during past 8 quarters (15% during 2QCY14) and for BAHL, BAFL and FABL it averaged at 10, 11% and 14% respectively during the same.

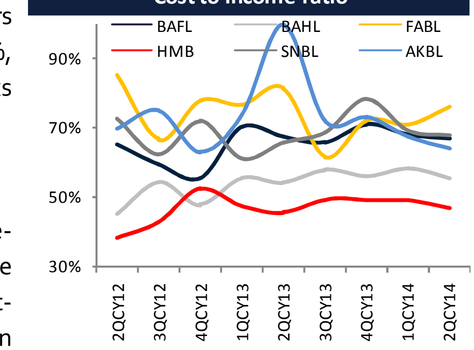
Fee based income (%age of gross income)



Low cost to income compared to peers.

Limited branch network has enabled the bank to keep its operating costs under check. Cost to income ratio of the bank is one of the lowest in the industry, averaging at 40% during past 5 years and clocked in at 47% during 2QCY14. BAFL, BAHL and FABL had cost to income ratio of 67.2%, 55.7% and 73.0% respectively during 2QCY14; therefore, compared to other banks, HMB looks quite efficient in maintaining its non markup costs.

Cost to income ratio



De-risking of balance sheet has resulted in improved asset quality

Owing to strategic tilt towards loans, advances to deposit ratio of the bank has remained high previously, in north of 70%, peaking at 75% in CY10. However, with deteriorating asset quality of the whole banking universe, plagued with delinquencies, non performing loans of HMB began to flutter, burgeoning by ~PKR11bn in the next 3 years from merely PKR6.4bn in CY09 to PKR17.7bn in CY12. Thus, gross NPL ratio, which was merely 6% in CY09 rose massively to 15% by CY12, with NPL ratio also treading the similar path jumping from 1.7% to 5% in the same period. However, in recent times the bank has significantly held back its funds from risky advances and parked them in relatively low risk investments in order to improve its asset book. Furthermore, with cautious lending stance, and continued recognition of provisions, asset quality of the bank started to exhibit

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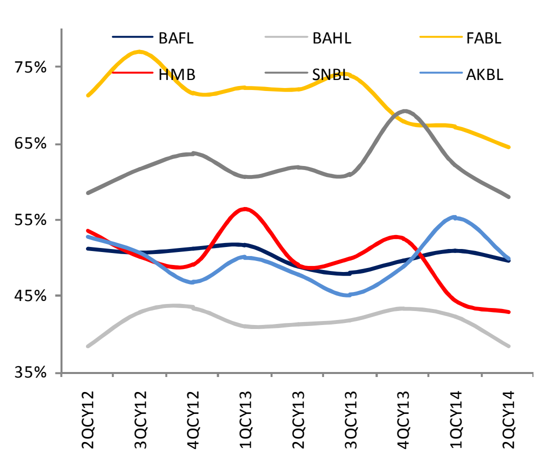
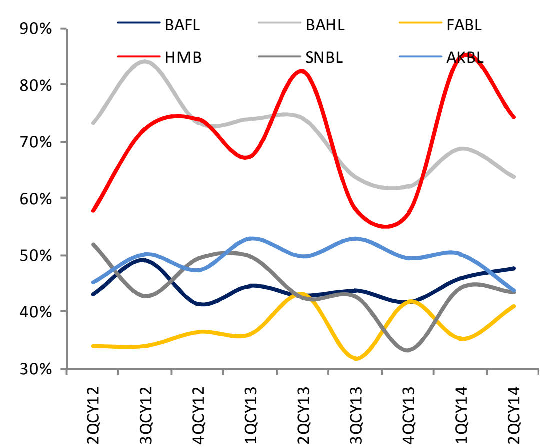
signs of improvement. Coverage ratio has again reached at a healthy level of 86% at 2QCY14 end, and gross NPL and net NPL ratio have also improved to 13.3% and 2.1% respectively. Moreover, it is also pertinent to note that majority of the NPLs at 2QCY14 end are concentrated in loss category (~99% of total NPLs) and bank has not recorded any significant buildup of NPLs in recent periods, which indicate significant slowdown in provision expense, unless NPLs again spiral out of control.

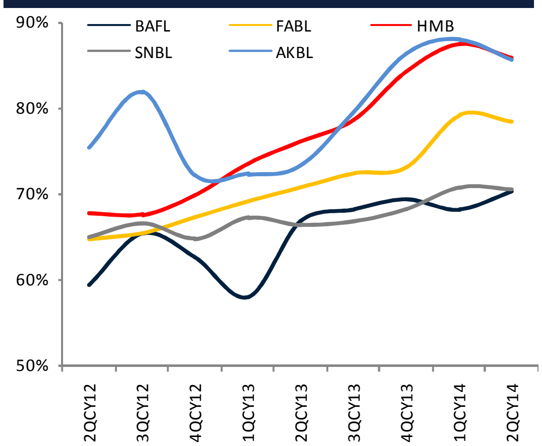
Advances to Deposits



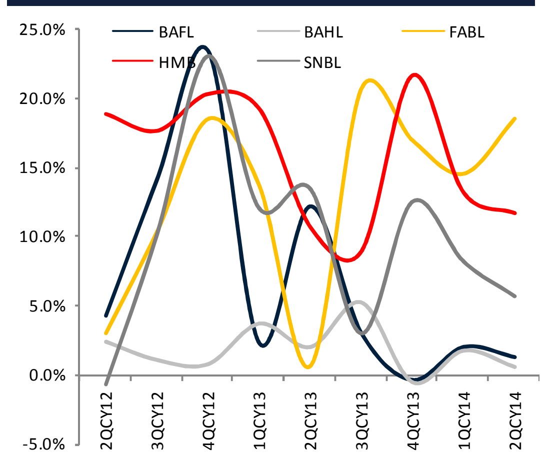
Investments to Deposits



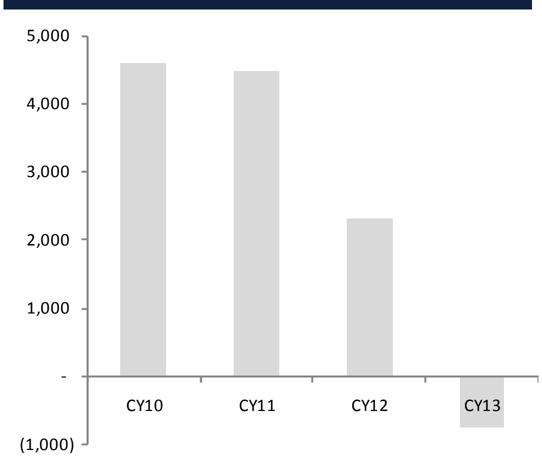
Coverage Ratio



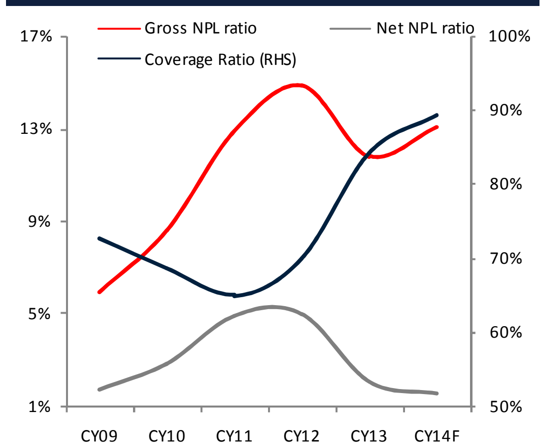
Provision charge to gross income



NPLs Accretion



Asset Quality Indicators



Provision expense, which has remained inflated in the past, and averaged around 21% as a percentage of gross income during CY09-CY13 period, has lost its vigor in recent quarters owing to

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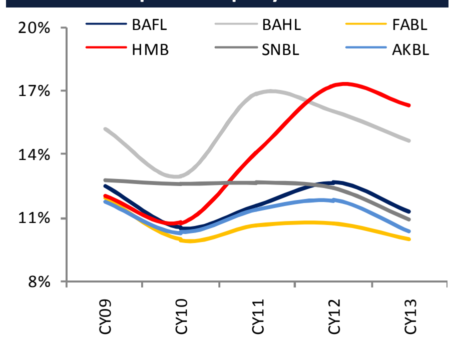
material improvement in asset quality. From the peak of PKR3bn in CY10, provisions have tapered off to PKR2.1bn in CY13, and are further expected to contract to PKR1.9bn in the current calendar year. Thus, provisions as a %age of gross income are expected to clock in at merely 10% during CY14, with concurrent improvement in gross and net NPL ratio.

Healthy Capital Adequacy warrants positive dividend outlook.

Another offshoot of the ongoing transition from ADR to IDR has been improvement in CAR of the bank, which not only indicates how much the cushion/capacity the bank has to withstand various risk, such as credit and operation risk, but also signals the dividend paying capacity of the bank. With growing profitability of the bank, and stagnating risk weighted assets, CAR of the bank has improved remarkably, clocking in at 16.3% at CY13 end against 10.77% at CY10 end. Tier 1 ratio has also improved impressively and currently remains much above other middle tier banks, clocking in at 15.6% at CY13 end against 10.8% in CY10. The bank has consistently paid cash dividend in the past 5 years, with sole exception in CY10, when only 20% stock dividend was announced. Furthermore, avg. payout ratio in the past 3 years has averaged around 55% and we have assumed the ratio to remain in the same range in future years as well, which translates into hefty cash dividends of PKR2.5/share in CY14 and PKR3.0/share in CY15, translating into enticing dividend yield of 8% and 10% respectively, hard to find elsewhere in the banking sector. In addition, we expect the bank to meet any unusual demand for credit off take in future, in case of which the bank will be comfortable in increasing its ADR due to its decent CAR.

Capital Adequacy Ratio



About the company

Habib Metropolitan bank was incorporated in 1992 as a public limited company. It is a subsidiary of Habib bank AG Zurich (incorporated in Switzerland) which has 51% stake in the company. It currently has 174 branches, including 6 Islamic banking branches. It is listed on Karachi, Lahore and Islamabad stock exchange.