



BankIslami Pakistan Ltd (BIPL)

Green shoots



16th September 2020

Arif Rehman

+92-21-35309113

Syed.Arif.Rehman@fortunesecurities.com

REP-070

BIPL: Initiating with a BUY; Target Price PKR 16.7; Upside 47% (1/2)

We initiate coverage on BankIslami Pakistan Ltd (BIPL) with a BUY rating and issue a Jun'21 Target Price of PKR 16.7 per share, offering an upside of 47% from last close. Five years post amalgamation with KASB bank, BIPL has now reached a scale to deliver sustainable growth and profitability, in our view. Acquisition of KASB Bank in May'15, brought about its own challenges; withdrawal of deposits and NPLs. However, the acquisition also provided enhanced footprint (104 branches) and new bank clients to BIPL. The bank currently trades at a PB of 0.66x and CY20E/21E PE of 7.4x/7.7x. Though a long shot, government's recent moves around Eradication of Riba Act, 2019 may potentially accelerate Islamic banking further in the country and benefit pure play Islamic banks

- **Asset growth:** Overall balance sheet growth has been impressive where balance sheet expanded at a CY16-19 3yr CAGR of 16% with loan book growing at 19.2% during the period. This growth was largely funded by strong deposit mobilization, albeit at higher than market rates resulting in somewhat deterioration in the quality of deposit mix with CASA falling from over 72% in CY16 to briefly below 60% as of end of last year. Favorable regulatory environment (no minimum deposit rate on savings accounts) and general mindset of small depositors being largely indifferent to returns offered by Islamic banks will likely lead to improvement in profitability going forward
- **Availability of compliant govt. backed securities:** Availability of shariah compliant government paper is a major positive for Islamic banking in general. BIPL picked up PKR 35bn of Pakistan Energy Sukuk 1 (K+80bps) which was issued last year to tackle growing circular debt (now trimmed to PKR 27bn). Energy Sukuk II was also issued earlier this year at K-10bps These issuances help development of Islamic debt market allowing Islamic banks to channelize liquidity in Kibor plus government backed instruments
- **Improved capital adequacy:** Capital ratios (Tier1 / CAR : 14.3%/18.9% as of Jun'20) have improved over time and are currently at a comfortable level above the minimum requirement. Favorable regulatory environment for Islamic banks is also helping BIPL grow its balance sheet whereas product innovation and availability of sufficient amounts of shahriah compliant government securities will be a key growth driver
- **Focus on Technology:** 'OneTouch Banking' is amongst the pioneers in banking industry to facilitate withdrawal of funds from ATM or perform over the counter transactions in branches using biometrics only. Post 2018 incident, when a cyber security incident resulted in unauthorized usage of clients debit cards (amounting to USD 6.1mn), the bank has taken extra steps to further bolster its technology platform and cyber security to avoid such future incidents

BIPL: Initiating with a BUY; Target Price PKR 16.7; Upside 47% (2/2)

- **Consumer segment:** Consumer lending has remained a key forte for Islamic banks as given an option, Pakistani consumer prefers to opt for Islamic structure when taking personal credit (home or auto); BIPL has also focused on capitalizing this segment through its auto finance and home mortgage product portfolio. Housing finance portfolio has quadrupled in the last 5 years to PKR13.3bn (10% of total loan book). Additionally, despite low demand for auto finance last year, BIPL managed to increase its auto loan book by 13% in CY19 taking book size to PKR 12.1bn (9.2% of total loan book)

- **Management Change:** Late in 2018, Syed Amir Ali was appointed as the President and CEO replacing Mr Hassan Bilgrami who was the founding President and CEO of BIPL. Mr. Amir Ali is a seasoned professional with over 20 years of experience in diversified fields of Corporate Banking, Investment Banking, Oil & Gas and Professional Auditing. Since his arrival there have been several other key changes within the bank with acquisition of talent across the board from other competitor Islamic banks. We believe such changes will continue for some more time as the bank finds it right, combination under the new leadership to focus on writing more business and deliver value to shareholders

- **Key risks to our investment case:**
 - Higher than expected NPL formation
 - Slower than anticipated credit growth
 - Lesser issuances of Sukkuks by government and corporates
 - Regulatory fallouts and resulting penalties/fines
 - Technology breach similar to the card incident in 2018

Valuation : PKR 16.7/share, upside 47%

Key Financials

Financial Highlights (PKRmn)	CY18	CY19A	CY20E	CY21E	CY22E	CY23E
Net markup income	6,034	10,912	12,107	11,572	13,302	14,997
Fee Income	1,264	1,633	1,465	1,354	1,482	1,590
Reversals / (Provisioning)	(37)	(2,799)	(2,075)	(1,282)	(826)	(747)
PAT	213	1,032	1,702	1,625	2,603	3,420
EPS (PKR)	0.21	0.93	1.54	1.47	2.35	3.08
PE (x)	54.2x	12.2x	7.4x	7.8x	4.9x	3.7x
PB (x)	0.87x	0.64x	0.64x	0.59x	0.53x	0.48x
ROA	0.1%	0.4%	0.6%	0.5%	0.7%	0.8%
Tier 1 ROE	1.7%	7.4%	10.7%	9.2%	13.2%	15.4%
Tier 1 capital ratio	11.2%	11.7%	13.6%	13.6%	13.4%	13.5%
Total CAR	15.1%	14.9%	18.0%	17.6%	17.6%	18.2%

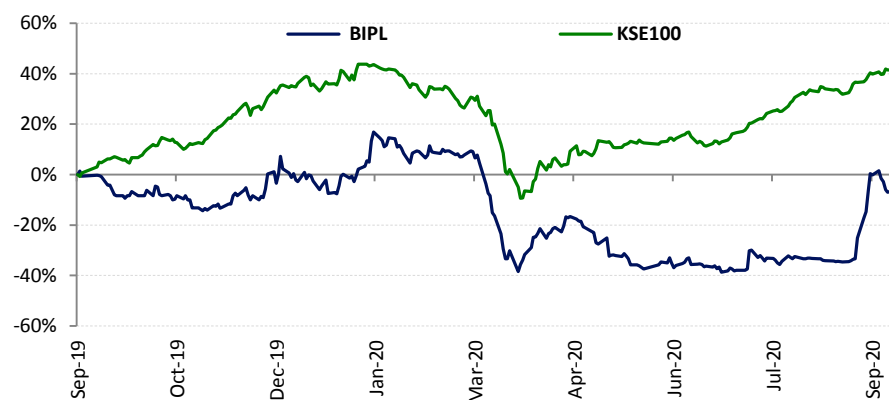
Valuation : Blended Target Price PKR 16.8/share

Blended Target Price		Multiple	Value/share
Target PB Valuation	PB multiple on Jun21E BVPS	0.92	17.1
Exit PE Valuation	PE multiple on CY23E EPS	5.92	18.3
PE Valuation	Rolling PE multiple on CY21/22/23 EPS		14.9
Excess Return based TP	COE: 15%; Terminal: 16.5%, growth: 9%		16.7
Blended Target Price (Jun'21)			16.7

Key Market Data

Current Price (PKR)	11.39
O/S shares (mn)	1,109
Mkt Cap (PKR mn)	12,628
52 week H/L	7.40 / 14.03
Free float (%)	23%
Free Float (mn)	252
Chief Executive	Syed Amir Ali
PB (current)	0.66x
PE (LTM)	7.83x

Relative Share Performance



Valuation Methodology

PB Target Valuation

Target PB valuation

Sustainable long term Tier 1 ROE	14.5%
June 21'E Tier 1 BVPS (PKR)	15.9
long term growth rate	9.0%
Cost of (Rf = 9%, MRP = 6%)	15.0%
Target PB (x)	0.92
Surplus (PKR per share)	2.6
Target Price (Jun'21) PKR/share	17.1

PE Multiple based valuation

PE Valuation	EPS	PE	TP
CY20E	1.54	9.0x	13.8
CY21E	1.47	7.8x	11.5
CY22E	2.35	6.8x	16.0
CY23E	3.08	5.9x	18.3
Target PE Valuation/share			14.9

Exit Multiple approach

Exit Valuation

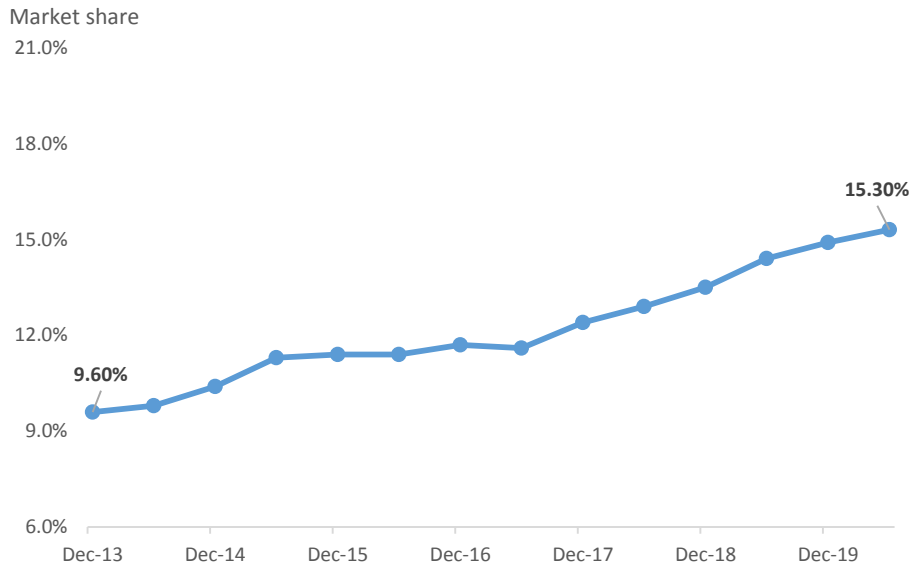
CY23E (PKR)	3.08
Target PE on CY23 EPS (x)	5.92
Target Exit Valuation/share	18.3

Excess return based valuation

Excess Return Valuation	CY20E	CY21E	CY22E	CY23E
Tier 1 BV (avg)	15,923	17,589	19,703	22,155
COE @ 15% (Terminal : 16.5%)	2,388	2,638	2,955	3,545
PAT	1,702	1,625	2,603	3,420
Excess Return	(686)	(1,014)	(352)	(125)
PV of Excess return	(686)	(1,014)	(328)	(100)
<i>Equity Value (Tier 1) Jun 21E</i>	17,589			
<i>Add: PV of Excess Return</i>	(1,442)			
<i>Add: PV of TV</i>	(539)			
<i>Add: Surplus on revaluation</i>	2,873			
Target Value (Jun'21)	18,481			
No. of shares	1,109			
TP Price (Jun'21) PKR / share	16.7			

Islamic banks continue to capture market share

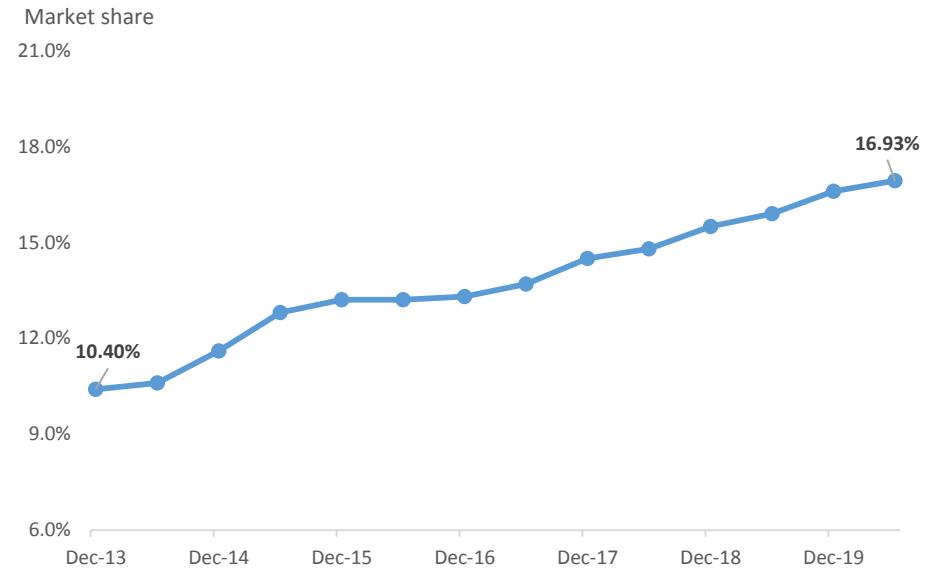
Islamic banks asset base has grown at 5yr CAGR of 22.2%



Source: SBP, Fortune Research

Islamic banking has continued to capture market share. Over the last five years alone, Islamic banking's market share (by asset base) has grown from 9.8% to 15.3%

Islamic banks deposit base has grown at 5yr CAGR of 21.1%



Source: SBP, Fortune Research

Similarly, Islamic banking deposit base has also grown at a much faster pace compared with overall banking sector (last 5yr CAGR of 21.1% vs 12.0% for the entire banking sector)

Pure play Islamic banks: A snapshot

MEBL has led the growth in Islamic banks

CAGR (CY15-19)	DIB	Al Baraka	MEBL	BIPL
Assets	+13.9%	+16.8%	+20.5%	+12.9%
Investments	+27.6%	+8.7%	+11.4%	+11.4%
Loan book	+14.1%	+12.2%	+24.2%	+17.7%
Deposit	+11.3%	+16.0%	+18.6%	+10.6%

Source: Company Accounts, Fortune Research

Snapshot financials of pure play Islamic banks

CY19 (PKRmn)	DIB	Al Baraka	MEBL	BIPL
Assets	264,639	161,982	1,121,258	283,096
Investments	49,157	24,195	225,646	55,194
Loans	177,922	75,444	493,775	131,775
Deposits	209,952	129,654	932,579	228,827
Equity	22,163	12,732	59,015	19,696
ROE	16.0%	(1.5%)	30.7%	6.8%

Source: Company Accounts, Fortune Research

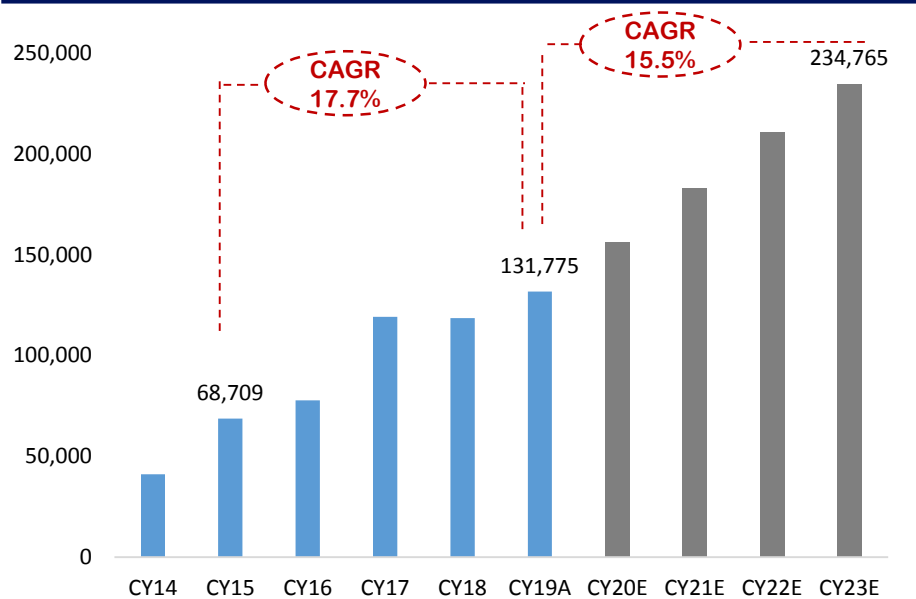
Meezan Bank has been the leader in Islamic banking due to its first mover advantage and has galloped its way to leadership status with an unparalleled position

Other pure play Islamic banks have also shown healthy growth in balance sheet and we expect these banks to continue to register above sector average growth rate, going forward

BIPL is a distant second Islamic bank behind Meezan Bank. DIB with similar asset base as BIPL has been generating sustainable ROE of 14-16% over the last two years. We expect BIPL's ROE to reach 13-14% by CY23

Balance sheet growth to lead profitability

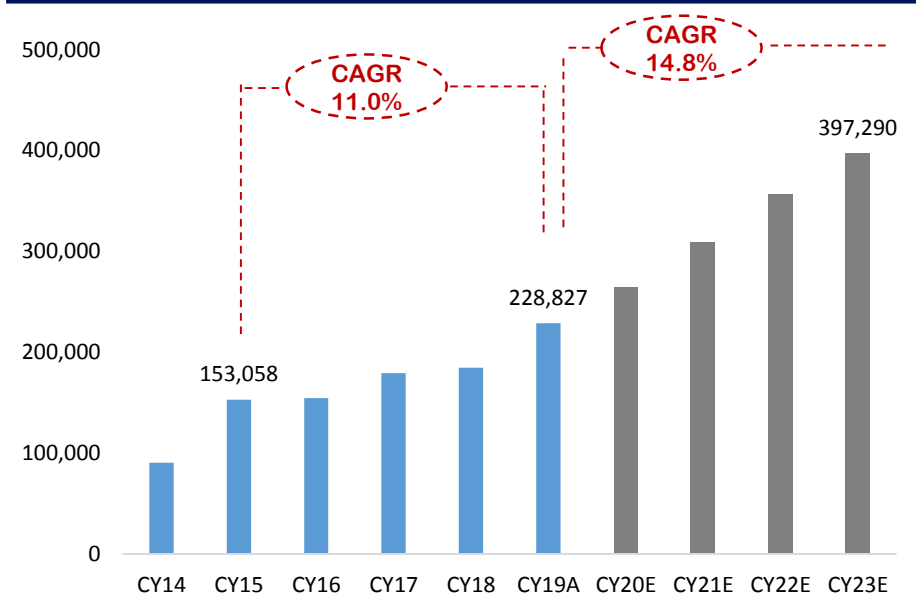
We expect BIPL's loan book to grow steadily to around 235bn by CY23



Source: Company Accounts, Fortune Research

BIPL has recorded loan book growth of c.18% over the last four years (after normalizing KASB bank's acquisition). We expect loan book to grow at a slightly lower CAGR of 15.5% over CY20-23 vs overall banking sector expected loan book growth of 12% p.a

BIPL's deposit base is expected to reach c.PKR 400bn by CY23



Source: Company Accounts, Fortune Research

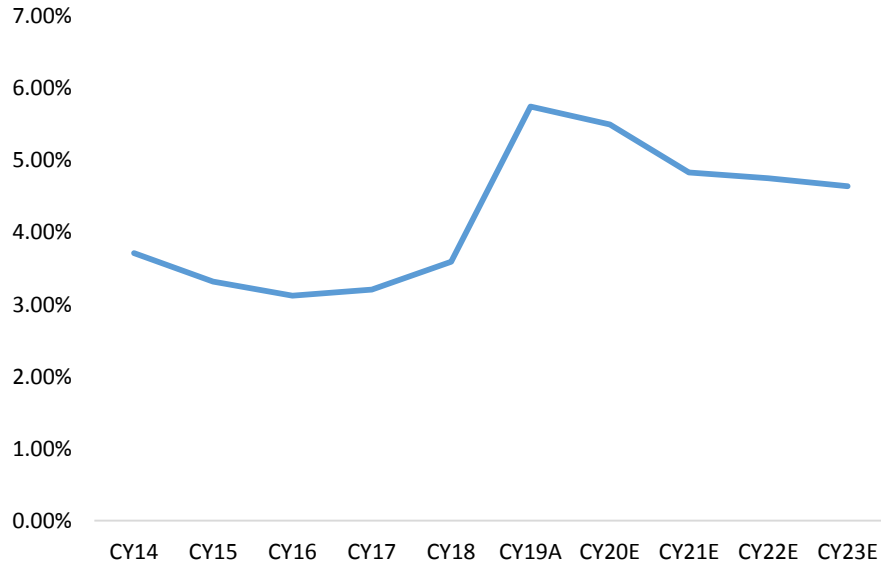
BIPL's deposit base has grown at 11% CAGR over CY15-19

The reason for slightly lower growth historically has been due to acquisition of KASB bank in CY15 which propped up deposit base by 70% in CY15 (from PKR 90bn in CY14 to PKR 153bn in CY15)

However, we expect BIPL's deposit base to record c. 15% CAGR over CY20-23

Net margins have peaked; CASA improvement to cushion an otherwise sharp contraction

Net Profit Margins have peaked and will taper off going forward

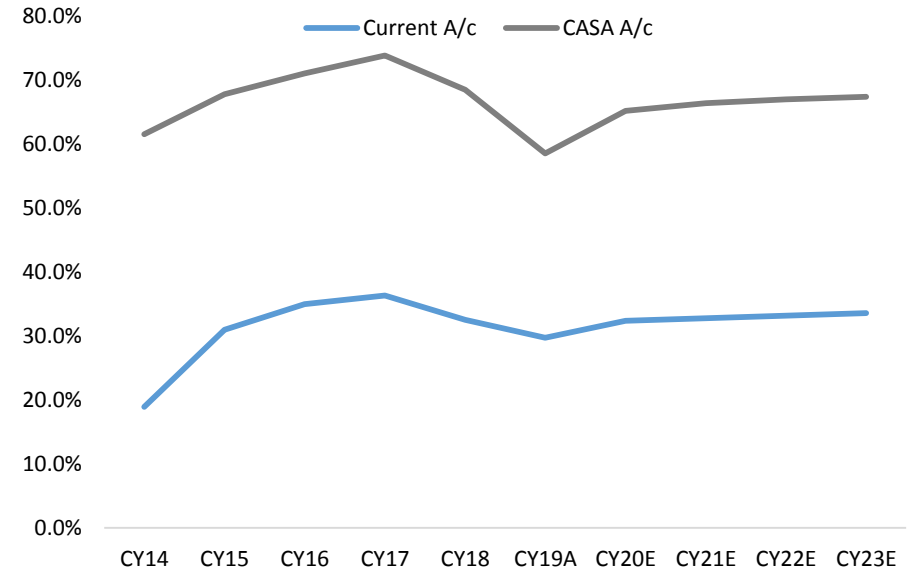


Source: Company Accounts, Fortune Research

Net Profit Margin peaked in CY19 at 5.75% and is likely to average at 5.50% for CY20. For 1HCY20 margin has further expanded to 6.10% due to lagged impact of repricing on assets whereas deposit costs adjusted downwards immediately with the announcement of policy rate.

Our SBP policy rate assumption: CY21/CY22/CY23 : 7.9%/8.5%/8.5%

CASA mix will improve with sharp fall in interest rates

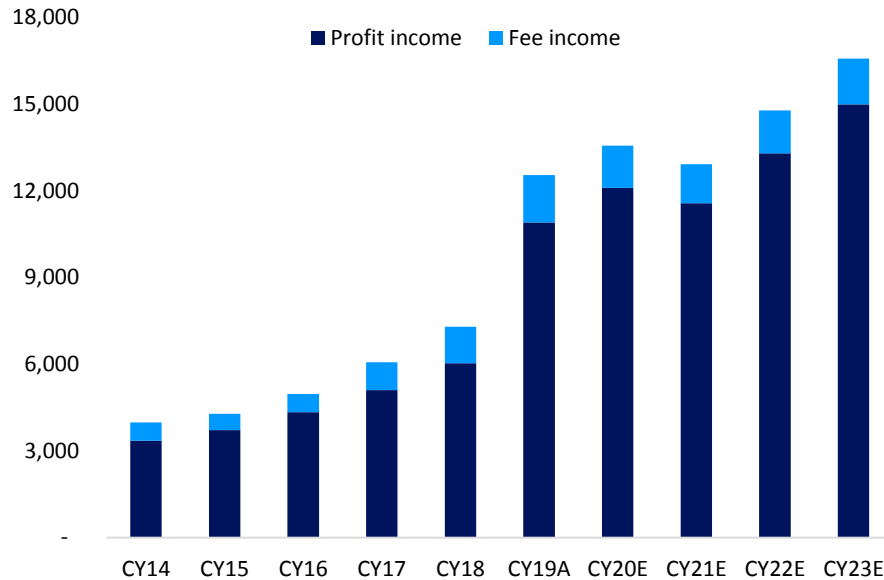


Source: Company Accounts, Fortune Research

CASA mix has fallen sharply over the last two years from 73.8% (Dec'17) to 58.5% (Dec'19) as BIPL struggled to raise deposits cheaply and investors flocked to lock-in higher yields through term deposits in a high interest rate environment. However, with sharp reduction in interest rates and resulting lower yields offered by banks now on fixed deposit, we expect return of funds towards CASA. This is already visible in Jun'20 accounts where CASA mix has jumped back to 64.4% (+600bps since Dec'19)

Establishing critical mass to operate profitably

Loan book growth + margin expansion led to sharp increase in revenue

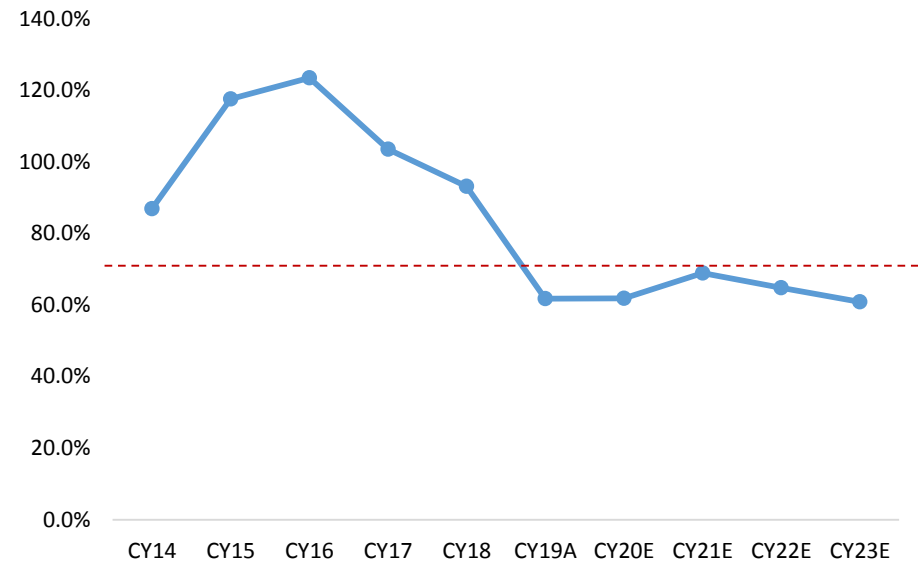


Source: Company Accounts, Fortune Research

Total revenue has risen from under PKR 4bn in CY14 to PKR 12.5bn as of CY19 led by overall balance sheet expansion, increase in loan book as well as investment book and further enhanced by higher spreads in CY19

We expect total revenue growth to slightly decline next year (CY21) as margin contraction plays out before gradually rising from CY22 onwards

Cost / Income has improved significantly as bank reached a critical size..

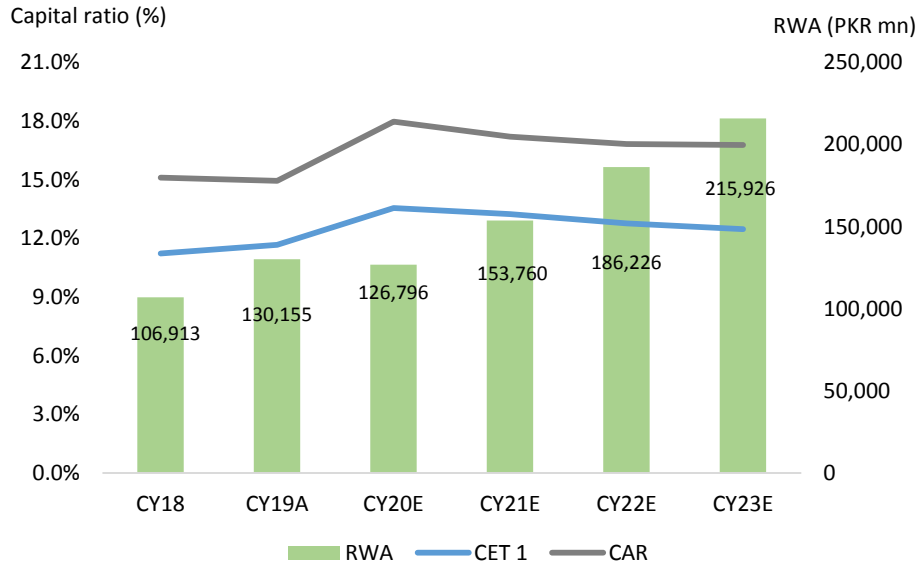


Source: Company Accounts, Fortune Research

With over 250% increase in earning assets since CY15, BIPL has been able to earn sufficient revenues starting 2018 to overcome its fixed overheads cost – Cost/Income has fallen to 61.8% in CY19 and is expected to remain at these levels in CY20 before rising to 69% next year as net margins shrink and cost base continues to expand...

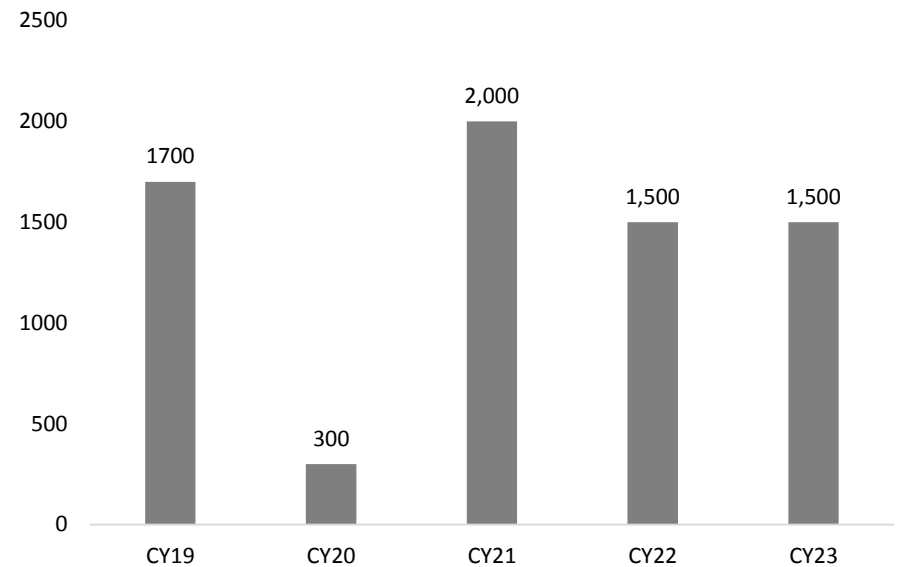
Capital ratios are comfortable; expect more ADT1 issuances for continued growth

RWA density fell 900bps in last two years to 41% as of Jun'20



Source: Company Accounts, Fortune Research

We expect ADT1 issuances to continue to support Tier 1 capital



Source: Company Accounts, Fortune Research

RWA density has fallen from c.50% in CY18 to about 41% as of Jun'20

We expect RWA density to gradually go back up to 44%-46% range as relaxations offered by central bank are gradually implemented as COVID19 related affects on the economy dissipate

We expect low interest rates to prevail for some time, our base case scenario assumes SBP policy rate gradually shifting up by 150bps with first rate hike of 50bp starting early CY21

In this backdrop, we expect credit demand to remain healthy over the next 3 years and accordingly incorporate BIPL's loan book to grow at a c.16% CAGR over the next 3 years. We assess that BIPL will need to raise fresh Tier 1 capital to keep Tier 1 ratio above 12.5%

Financials

Financial Highlights (PKRmn)	CY18	CY19A	CY20E	CY21E	CY22E	CY23E	Income Statement (PKRmn)	CY18	CY19A	CY20E	CY21E	CY22E	CY23E
Net markup income	6,034	10,912	12,107	11,572	13,302	14,997	Profit earned	12,204	23,651	25,402	25,080	30,619	35,158
Fee Income	1,264	1,633	1,465	1,354	1,482	1,590	Profit expensed	(6,170)	(12,737)	(13,295)	(13,508)	(17,317)	(20,161)
Reversals / (Provisioning)	(37)	(2,799)	(2,075)	(1,282)	(826)	(747)	Net Margin	6,034	10,912	12,107	11,572	13,302	14,997
PAT	213	1,032	1,702	1,625	2,603	3,420	Fee income	1,264	1,633	1,465	1,354	1,482	1,590
EPS (PKR)	0.21	0.93	1.54	1.47	2.35	3.08	Total Revenue	7,298	12,546	13,572	12,926	14,784	16,587
PE (x)	54.2	12.2	7.4	7.8	4.9	3.7	Operating expenses	(6,858)	(7,824)	(8,590)	(8,981)	(9,690)	(10,234)
PB (x)	0.87	0.64	0.64	0.59	0.53	0.48	Profit before prov. and taxes	440	4,720	4,982	3,946	5,093	6,353
ROA	0.1%	0.4%	0.6%	0.5%	0.7%	0.8%	Provisioning charge	(37)	(2,799)	(2,075)	(1,282)	(826)	(747)
Tier 1 ROE	1.7%	7.4%	10.7%	9.2%	13.2%	15.4%	PBT	403	1,921	2,906	2,664	4,268	5,606
Tier 1 capital ratio	11.2%	11.7%	13.6%	13.2%	12.8%	12.5%	Tax	(190)	(777)	(1,203)	(1,039)	(1,664)	(2,186)
Total CAR	15.1%	14.9%	18.0%	17.2%	16.8%	16.8%	PAT	213	1,032	1,702	1,625	2,603	3,420
							EPS (PKR)	0.21	0.93	1.54	1.47	2.35	3.08

Balance sheet (PKRmn)	CY18	CY19A	CY20E	CY21E	CY22E	CY23E	Ratios / key metrics	CY18	CY19A	CY20E	CY21E	CY22E	CY23E
Cash and balances with treasury banks	14,293	14,640	27,628	31,208	35,342	38,916	ROA	0.31%	0.41%	0.57%	0.48%	0.66%	0.76%
Balances with other banks	833	1,878	3,307	3,869	4,526	5,131	ROE (Tier 1)	1.7%	7.4%	10.7%	9.2%	13.2%	15.4%
Lending to financial institutions	18,174	42,912	30,375	33,529	37,009	40,851	Infection ratio	10.6%	11.2%	11.3%	10.8%	10.1%	9.7%
Investments	38,832	55,194	54,563	67,988	87,028	105,765	Coverage ratio	72%	85%	81%	81%	81%	81%
Advances	118,571	131,775	156,146	182,669	210,625	234,765	Provisioning (PKRmn)	(37)	(2,799)	(2,075)	(1,282)	(826)	(747)
Operating fixed assets	6,663	12,717	13,331	15,595	18,244	20,684	CASA mix	68.4%	58.5%	65.1%	66.3%	66.9%	67.3%
Deferred tax asset	7,530	5,622	6,113	6,113	6,113	6,113	CA mix	32.5%	29.7%	32.3%	32.7%	33.1%	33.5%
Other assets	10,848	18,359	17,795	20,817	24,353	27,610	BVPS (with revaluation) PKR/sh	13.1	17.8	17.7	19.2	21.5	23.6
Total assets	215,743	283,096	309,258	361,788	423,241	479,836	BVPS (excl. revaluation) (PKR/sh)	11.4	13.6	15.1	16.6	18.9	21.0
Bills payable	3,242	3,645	4,811	5,848	7,108	8,640	Capital Adequacy Ratio (CAR)	15.1%	14.9%	18.0%	17.2%	16.8%	16.8%
Borrowings	7,820	15,104	6,506	9,490	16,599	29,031	Tier 1 Ratio	11.2%	11.7%	13.6%	13.2%	12.8%	12.5%
ADT 1 borrowings	0	1,700	2,000	4,000	5,500	7,000	Fee income / Total income	17.3%	13.0%	10.8%	10.5%	10.0%	9.6%
Deposits and other accounts	184,693	228,827	264,244	309,128	356,437	397,290	Earning assets (rate)	6.8%	11.6%	10.7%	9.4%	9.8%	9.7%
Other liabilities	5,473	14,125	12,048	12,048	12,048	12,048	Cost bearing liabilities (rate)	3.2%	5.8%	5.2%	4.6%	5.0%	5.0%
Total liabilities	201,228	263,400	289,609	340,514	399,364	453,657	Spread	3.6%	5.8%	5.5%	4.8%	4.8%	4.6%
Paid-up capital	10,000	11,008	11,008	11,008	11,008	11,008	Our SBP policy rate assumption: CY21/CY22/CY23 : 7.9%/8.5%/8.5%						
Reserves	969	1,186	1,186	1,186	1,186	1,186							
Unappropriated profit	1,695	2,876	4,582	6,207	8,810	11,111							
Surplus on revaluation	1,851	4,626	2,873	2,873	2,873	2,873							
Total equity	14,515	19,696	19,649	21,274	23,877	26,178							

Analyst Certification

The research analyst on the cover of this report certifies that: 1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; 2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) expressed by the research analyst(s) in this report; 3) he/she does not have a financial interest in any and all of the subject securities or issuers aggregating more than 1% of the value of the company(s); 4) he/she or its close relative has not served as a director/officer/associate in the past three years in any and all of the subject securities or issuers; 5) he/she or its close relative has received any compensation from any and all of the subject securities or issuers in the previous 12 months; and 6) he/she has not traded in the subject security(ies) or issuer(s) in the past 7 trading days and will not trade in the next 5 trading days of issuing a coverage initiation or a material Target Price revision report.

Valuation Methodology

To arrive at period-end Target Price(s), FSL uses different valuation methodologies:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (PE, PB, PS, PCF)
- Equity and Asset return based methodologies (EVA, RI, etc.)

Key risks

- Higher than expected NPL formation
- Slower than anticipated credit growth
- Lesser issuances of Sukkuks by government and corporates
- Regulatory fallouts and resulting penalties/fines

Acronyms

bps	basis points	LCY	Local Currency
BVPS	Book Value per share	MRP	Market risk premium
CAGR	Compounded Annual Growth Rate	NAV	Net Asset Value
CAPM	Capital Asset Pricing Model	NPV	Net Present Value
DCF	Discounted Cash Flow	PB	Price-to-Book Value
DDM	Discounted Dividend Model	PCF	Price-to-cash flow
DE	Debt-to-Equity	PE	Price-to-Earnings
DPS	Dividend per share	PKR	Pakistani Rupee
DY	Dividend yield	ppt	percentage point
EPS	Earnings per share	PS	Price-to-Sales
EUR	Euro	PV	Present Value
EV	Enterprise Value	RFR	Risk-free rate
EVA	Economic Value Added	RI	Residual Income
FCF	Free Cash Flow	ROA	Return on Assets
FCFE	Free Cash Flow to Equity	ROE	Return on Equity
FCFF	Free Cash Flow to Firm	SOTP	Sum of the Parts
FCY	Foreign Currency	TP	Target Price
g	Growth	TSR	Total Stock Return
IRR	Internal Rate of Return	USD	US Dollars
JPB	Justified Price-to-Book Value	WACC	Weighted average cost of capital

Rating

BUY	TSR > 15%
HOLD	-10% > TSR > 15%
SELL	TSR < -10%
NR	Not Rated

TSR = Capital gain + DY

Old Rating

Overweight	TSR > 15%
Marketweight	0% > TSR > 15%
Underweight	TSR < 0%

Disclosure

The investment recommendation(s) take into account both risk and expected return. FSL based the long-term Target Price estimate on fundamental analysis of the subject security(ies)'s future prospects, after having taken perceived risks into consideration. FSL have conducted extensive research to arrive at the investment recommendation(s) and target price(s) for the subject security (ies). Readers should understand that financial projection(s), target price estimate(s) and statement(s) regarding future prospects may or may not be realized. Forward looking statement(s), opinion(s) and estimate(s) included in this report constitute FSL's judgment as of this date and are subject to change without prior notice. The target price(s) stated in reports on company update(s), initiation(s) and corporate action adjustment(s) of stocks listed on the PSX are on a 12-month basis. All other reports on PSX-listed securities, such as scoops, sector or company commentaries, do not include, denote, or imply any changes to target price(s).

Disclaimer

The research report prepared by Fortune Securities Limited (hereinafter referred as FSL) are based on public information and the report is for information purposes only and does not constitute nor it is intended as an offer or solicitation for the purchase or sale of security(ies) or other financial instruments. FSL makes every effort to use reliable, comprehensive information, but it makes no representation that the information contained herein is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of FSL or any of its associated entities. FSL has established information barriers between business groups and associations maintaining complete independence of this research report. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. FSL recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

FSL has taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon.

Copyright and confidentiality

No part of this document may be reproduced without the written permission of FSL. The information within this research report must not be disclosed to any other person if and until FSL has made the information publicly available.

Research Team

Research Team

Syed Arif ur Rehman

Director Research & Business Development

- +92 213 5309113
- Syed.Arif.Rehman@fortunesecurities.com

Mahnoor Shafqat

Research Analyst

- +92 213 5309119
- Mahnoor.Shafqat@fortunesecurities.com

Wajid Rizvi

Head of Research

- +92 213 5309086
- Wajid.Rizvi@fortunesecurities.com

Muqheet Naeem

Research Analyst

- +92 213 5309119
- Muqheet.Naeem@fortunesecurities.com

Arvind Anand

Deputy Head of Research

- +92 213 5309119
- Arvind.Anand@fortunesecurities.com

Kishan Sidi

Database Manager

- +92 213 5309119
- Kishan.Sidi@fortunesecurities.com

Hasnain Murtaza

Research Analyst

- +92 213 5309119
- Hasnain.Murtaza@fortunesecurities.com.