



United Bank (UBL)

Earnings revised down, Downgraded to “Hold”

Umair Naseer^{AC}

umair.naseer@topline.com.pk

Tel: +9221-35303330

Topline Securities, Pakistan

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United Bank (UBL): Downgraded to “Hold”

- **Investment Thesis:** Post announcement of UBL’s 2Q2018 financial results, we revise down our earnings estimate for UBL by ~25% for 2018-20 on the back of higher pension charge, up tick in international NPLs & its consequent provisioning. We downgrade the stock to ‘Hold’ rating on the stock given lack of clarity over further charge/reversal of some of the pension cost. Furthermore, regulatory developments regarding the sector will also impact UBL’s earnings outlook. It currently trades at a 2019 PE of 7.8x and PBV of 1.1x with ROE of 17%.
- **Downward earnings revision on higher pension & provisioning charge:** UBL announced earnings of Rs2.8/share during 2Q2018, down 40% YoY whereas 1H2018 earnings declined by 53% to Rs5.1/share. This was primarily due to higher than expected pension charge of Rs8bn booked in 1H2018 (Rs6bn booked in 1Q2018) & higher provisions on international book. We thus revise down our EPS estimate for UBL by ~25% to Rs14/Rs21/Rs23 in 2018/19/20 to account for these numbers and future expectations.
- **Pension charge remained higher than expectations:** UBL booked pension charge of Rs2bn (Rs1.1/share) in 2Q2018 in addition to Rs6bn (Rs3.2/share) booked in 1Q2018. The increase in pension amount was due to the fact that bank also included the cost of retrenched employees in its calculation during 2Q2018, who were separated under the Golden Handshake Scheme introduced in 1997 for its employees. The bank has also sought clarification from Supreme Court whether to treat this additional cost of retrenched employees for which we await for further clarity. The management of the bank has also stated that the verification of eligible pensioners is under process and any further charge or reversal can not be ruled out going forward, which creates uncertainty regarding future earnings outlook of the bank.

- **UBL eyeing higher coverage on international books:** UBL has been gradually increasing its coverage ratio on its international advances to mitigate risks going ahead. Coverage ratio of international advances improved from 63% in 2Q2017 to 71% in 2Q2018, which is in contrast to domestic coverage, which stands at 89%. Along with higher coverage, NPLs on international book has also increased from Rs15bn in 2Q2017 to Rs30bn to 2Q2018, which has led to higher provisioning charge during the quarter. Consequently, UBL booked provisioning charge of Rs3.7bn during 1H2018 vs. reversal of Rs400mn during same period last year. We expect UBL to book total provisioning charge of Rs7.4bn in 2018 that will take coverage ratio on international book to 76%. Every 10% increase in coverage on international book increases provisioning charge by Rs3bn (Rs1.6/share) for the bank. This coupled with risk of higher NPLs associated with sharp rise in interest rates poses key risk for the bank.
- **New York operations and its compliance:** UBL entered into a revised agreement on Jul 2, 2018 with Federal Reserve Bank of New York (US Fed) relating to UBL's New York branch's international remittance services. The new agreement requires UBL to take steps to strengthen its Bank Secrecy and Anti Money Laundering (AML) Compliance, Customer Due Diligence and Suspicious Activity Monitoring and Reporting programs. The FED has not imposed any penalty or fine yet and the bank has vowed to fully comply to the regulatory requirement of international & local jurisdictions. Given UBL has started to lower its scope of operations in New York & is complying to U.S regulation, we do not expect any major uptick in expenses. We estimate an additional compliance cost of US\$5-6mn per year for the bank .
- **International advances now constitute 24% of the total loan book:** Given concerns on international operations and slowdown in GCC countries, UBL has been scaling down its international operations, which now contributes around 24% of the total loan book compared to 28% in Dec 2017. Further reduction in international exposure will help reduce risks faced by the bank going ahead.

United Bank (UBL): Provisions & Pension Charge Key Risks

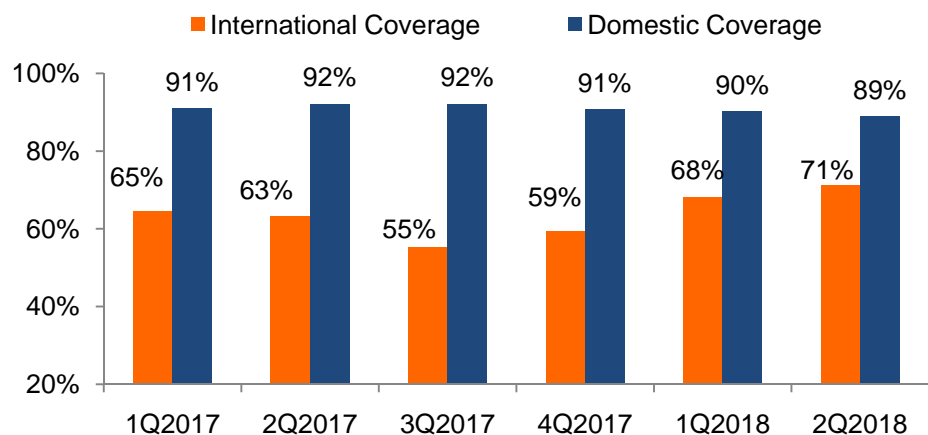
- Regulatory developments:** Introduction of deposit insurance mechanism and IFRS 9 may also impact UBL's bottom line going forward. We estimate the bank to bear additional cost on deposit insurance by around Rs1.6bn (Rs0.85/share) annually. Regarding IFRS 9, the bank's coverage ratio currently stand at around 80%, where domestic coverage is around 89%. We wait for further detail on the same by SBP going forward, however any additional 5% provision charge could impact bottom-line of UBL by Rs2.9bn (Rs1.5/share).
- NII on domestic operations to grow given rising rates:** NII of the bank is anticipated to grow on average by 10% in 2018-20 as SBP has already raised policy rate by 175bps to 7.5% which is expected to increase to 9.75% by 2020. This will likely support NII of the bank's NIMs led by domestic NII growth. We expect NIMs to grow from 3.7% in 2017 to 4.3% in 2020.
- Key Risks:** Key risks for the bank include 1) higher than expected provisioning charge, 2) increase in NPLs, 3) further addition in pension charge, & 4) any penalty or fine on international business.

UBL: Key Numbers					
	2016A	2017A	2018E	2019F	2020F
EPS	22.7	21.4	14.0	20.7	22.9
Earnings Growth	6%	-6%	-34%	48%	10%
PE at Rs161.6	7.1	7.6	11.5	7.8	7.1
Dividend Yield	8%	8%	7%	8%	8%
ROE	22%	19%	12%	17%	17%
PBV	1.2	1.1	1.2	1.1	1.0

Source: Company Accounts, Topline Research

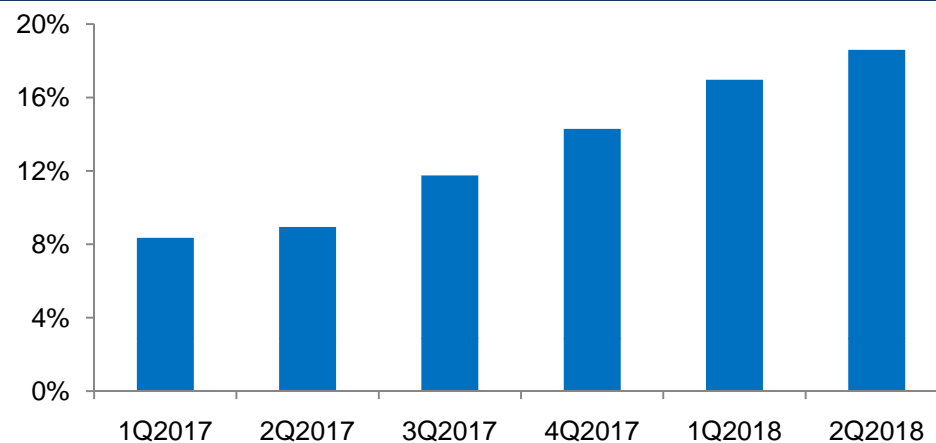
UBL: Key Ratios

Coverage on International & Domestic Advances



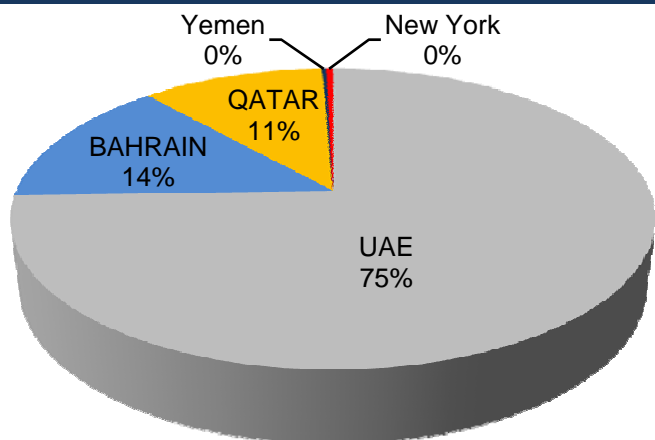
Source: Company Accounts, Topline Research

NPL ratio on international book



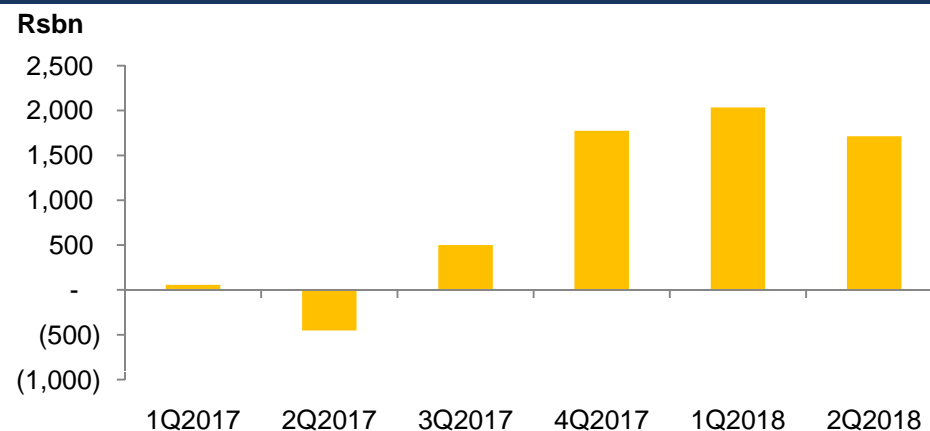
Source: Company Accounts, Topline Research

International Advances by Geography



Source: Company Accounts, Topline Research

Provisioning Expense/Reversal against NPLs



Source: Company Accounts, Topline Research

United Bank (UBL): Financial Snapshot

Consolidated Income Statement

Rsmn	2016A	2017A	2018E	2019F	2020F
Mark-up / Interest earned	101,755	110,580	133,965	160,571	168,744
Mark-up / Interest expense	42,934	52,488	71,817	87,887	91,003
Net Markup Income	58,821	58,092	62,148	72,685	77,742
Non-Interest Income	25,134	24,296	24,511	22,045	24,671
Operating expenses	36,253	38,941	41,130	44,651	48,668
Provisions/Reversals	1,605	2,776	9,185	9,955	10,197
Profit before taxation	46,097	40,671	36,344	40,124	43,548
Profit after taxation	27,783	26,190	17,178	25,372	27,980
EPS (Rs)	22.7	21.4	14.0	20.7	22.9

Source: Company Accounts, Topline Research

Consolidated Balance Sheet

Rsmn	2016A	2017A	2018E	2019F	2020F
Paid-up capital	12,242	12,242	12,242	12,242	12,242
Shareholders' equity	128,024	140,908	142,174	157,109	169,928
Total equity	163,729	174,494	165,684	178,269	191,087
Deposits	1,245,792	1,366,158	1,420,804	1,498,948	1,581,391
Total liabilities	1,498,013	1,930,866	1,809,423	1,906,322	2,008,550
Net advances	537,782	642,507	719,912	800,021	895,398
Net investments	838,262	1,124,921	942,428	953,749	954,829
Total assets	1,661,742	2,105,360	1,975,107	2,084,590	2,199,637

Source: Company Accounts, Topline Research

Key Ratios

	2016A	2017A	2018E	2019F	2020F
Earnings Growth	6%	-6%	-34%	48%	10%
PE at Rs161.63	7.1	7.6	11.5	7.8	7.1
Dividend Yield	8%	8%	7%	8%	8%
PBV	1.2	1.1	1.2	1.1	1.0
Return on performing loans	6.3%	6.0%	7.0%	8.4%	8.5%
Cost of deposits	4.0%	4.0%	5.2%	7.0%	7.0%
Net interest margin (NIM)	4.5%	3.7%	3.6%	4.3%	4.3%
NII/ Gross Income	70.1%	70.5%	71.7%	76.7%	75.9%
Cost / Income ratio	41.7%	46.7%	47.0%	46.6%	47.0%
Deposit growth	11.2%	9.7%	4.0%	5.5%	5.5%
Credit growth	10.2%	19.5%	12.0%	11.1%	11.9%
Investment growth	11.3%	34.2%	-16.2%	1.2%	0.1%
Return on equity (ROE)	22.5%	19.5%	11.9%	16.6%	17.1%
Return on assets (ROA)	1.8%	1.4%	0.8%	1.2%	1.3%
Advances-to-deposit (ADR)	43.2%	47.0%	50.7%	53.4%	56.6%
Investment-to-deposit (IDR)	67.3%	82.3%	66.3%	63.6%	60.4%
CASA	73.5%	73.1%	46.0%	44.6%	43.3%
Gross infection ratio (%)	8.0%	7.7%	7.7%	9.0%	9.0%
Net infection ratio (%)	0.9%	2.0%	1.6%	2.0%	2.0%
Coverage ratio (%)	89.9%	76.0%	80.0%	79.5%	79.5%
Number of Branches	1,340	1,350	1,360	1,370	1,380

Source: Company Accounts, Topline Research

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Buy	Stock will outperform the average total return of stocks in universe
Neutral	Stock will perform in line with the average total return of stocks in universe
Sell	Stock will underperform the average total return of stocks in universe

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Market Weight	= Weight in KSE-100 Index
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