

Sarah Rehman, CFA

sarah.rehman@alfalahclsa.com
+92-21-35645090-95 (Ext: 338)

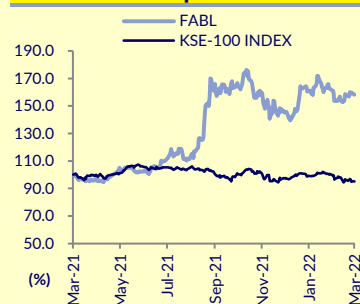
24 March 2022

Pakistan

Banks

Reuters Bloomberg	FYBL.PSX FABL PA
Priced on 22 March 2022 KSE100 @ 43,203.8	
12M hi/lo	PKR27.6/14.8
Dec-22 price target ±% potential	PKR44.0 +77.8%
Shares in issue Free float	1,517.7m 25.0%
Mkt. cap	USD206.7m
3M ADV	USD0.1m

FABL vs KSE100 performance



Source: PSX, Bloomberg

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Islamic conversion to steer profitability growth

Trading at an attractive CY22E PE/PB of 3.5/0.51x

FABL's deposits have grown at a CAGR of 16.4% over last three years despite ongoing Islamic conversion. Bank has rapidly grown Islamic deposits to PKR428bn in CY21 from PKR69bn in CY18, increasing their share in deposits to 67% from 17% over the same period. At CY22E EPS/DPS of PKR7.2/2.0, FABL trades at an attractive PE/PB of 3.5/0.51x and offers a DY of 8.1%. To add to our liking, FABL has one of the lowest infection ratios (5.6%) in our banking universe despite highest ADR of 61.5%. FABL has maintained a healthy Tier-1/Total CAR of 15.7/17.5% respectively as of CY21; hence it stands in a good position to increase payout going forward. Thus, we reinitiate coverage on FABL with a BUY call and Dec-22 price target of PKR44/sh (potential upside: ~78%).

Islamic conversion to steer the show: Faysal bank has been making inroads into the Islamic banking space whereby it has successfully converted ~67% of its deposits and 89% of the advances into Sharia compliant mode; the conversion fortunately coincides with a higher interest rate environment where Islamic banks' earnings shall jump most due to floating nature of assets. Ever since the conversion momentum has gathered pace (since CY18), the bank has posted a deposit CAGR of 16.4%. FABL posted highest-ever profitability in CY21. Going forward, we expect the bank to post EPS of PKR7.2/8.0/8.4 in CY22/23/24 with an ROE of 15.6/15.6/14.9% respectively. NIMs are expected to expand to 4.6% in CY22 from 3.5% in CY18.

Bank to apply for the Islamic banking license in CY22: The management expects to apply for an Islamic banking license somewhere in mid of CY22 (after converting 85-90% of the balance sheet). Although the pace of conversion has been rapid in the past four quarters (detailed graphs on subsequent pages), we have been conservative and assumed that FABL shall be able to apply for the license later than the stipulated date (probably) by CY22 end. Note that after achieving Islamic banking license, the remaining conventional operations shall be ring-fenced and converted later gradually.

Management indicated in a recent analyst briefing that a board meeting is planned in April 2022 to discuss the progress of conversion and decide if the bank is prepared to apply for an Islamic banking license.

89% of the advances have been converted: The bank has been following an 'Asset Led' model whereby conversion of conventional assets into Sharia compliant financing happens before deposit conversion. FABL has converted ~89% (CY20: 60%) of its advances into Islamic mode as of Dec-21.

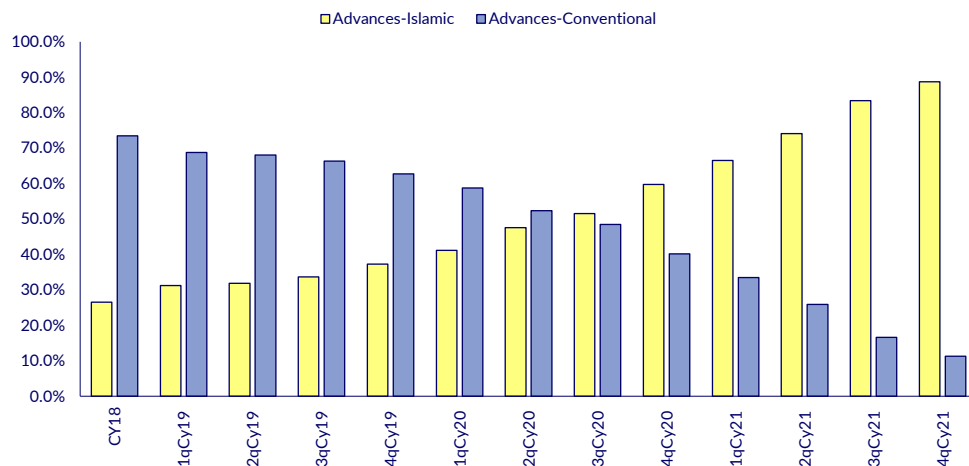
Financial Snapshot (Consolidated)

Year to 31 Dec	CY20	CY21	CY22E	CY23E	CY24E
EPS	4.4	5.5	7.2	8.0	8.4
EPS growth	11.3%	25.0%	31.0%	11.0%	5.2%
P/E	5.6	4.5	3.4	3.1	2.9
DPS	0.0	1.5	2.0	2.8	3.0
Div. Yield	0.0%	6.1%	8.1%	11.1%	12.1%
P/BV	0.62	0.57	0.51	0.46	0.42
BVPS	39.7	43.6	48.6	53.8	59.3
ROA	1.0%	1.1%	1.2%	1.3%	1.3%
ROE	11.6%	13.2%	15.6%	15.6%	14.9%

Source: Company Accounts, Alfalah CLSA Research

Figure 1

89% of the advances have been converted through an 'Asset-led' model



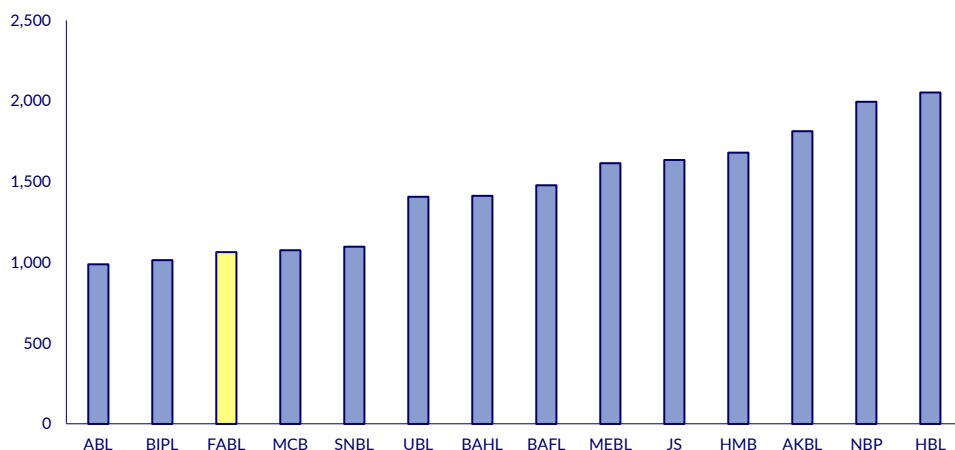
Source: Source: Company Accounts, Alfalah CLSA Research

More than 50% of the deposits converted into Islamic:

- ❑ The bank has managed to convert ~67% of its deposits and 98% of its branches into Islamic as of Dec 2021. Currently, 595 branches are Islamic out of 606 total branches. We have assumed 100% deposit conversion by CY23 end.
- ❑ Noteworthy is the fact that even deposit conversion has not inhibited FABL's deposit growth momentum where deposits grew at a CAGR of 16.4% since CY18. We have assumed 7/11% deposit growth in CY22/CY23 respectively.
- ❑ Banks' focus on low-cost deposits has been yielding fruit. Note that the bank's focus on current account has led to lower cost of deposits in the course of two years where current account mix has moved up by 300bps to ~33%.
- ❑ Note that Faysal Bank has one of the lowest deposit/branch ratios, which presents an opportunity for the bank to increase deposits further while containing the operating costs. Below is a snapshot of per branch deposits for all the banks.

Figure 2

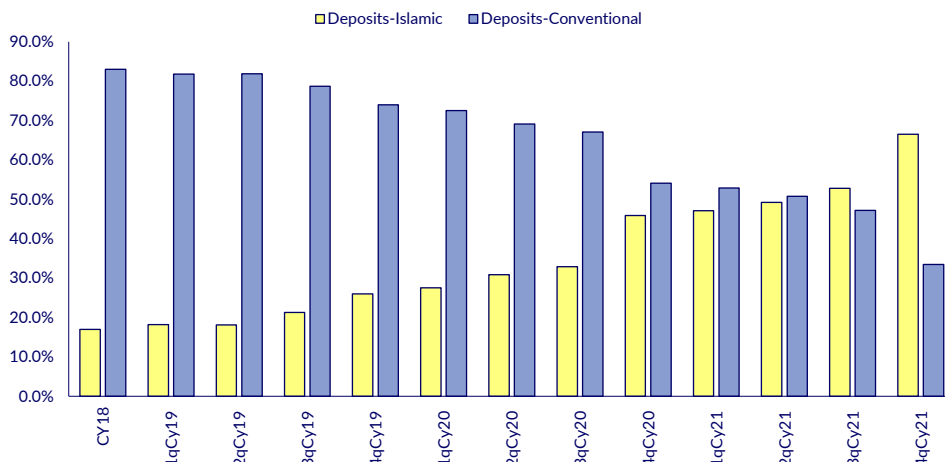
Deposit/branch PKRmn



Source: Company Accounts, Alfalah CLSA Research

Figure 3

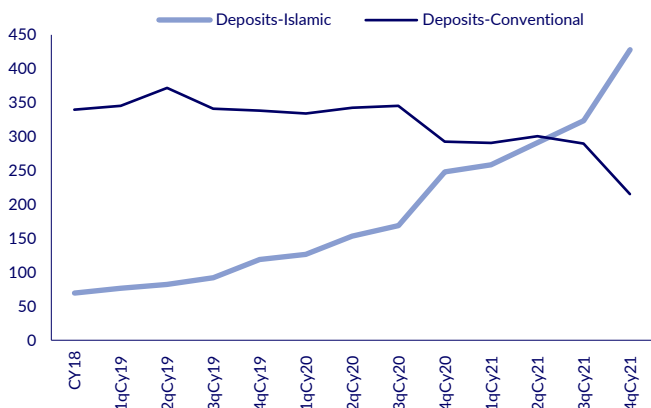
FABL has converted ~67% of its deposits into Islamic



Source: Company Accounts, Alfalah CLSA Research

Figure 4

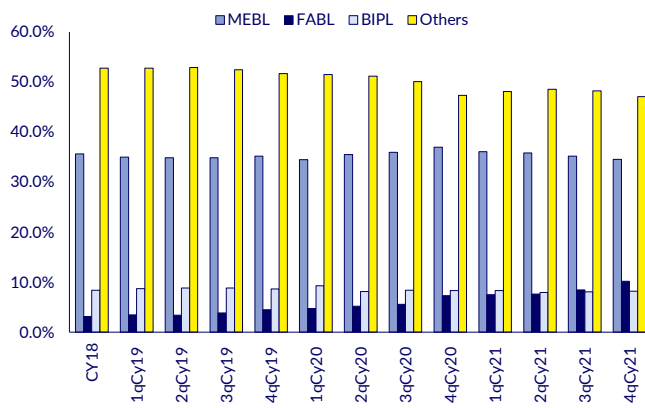
Bank has rapidly grown Islamic deposits to PKR428bn in CY21



Source: Company Accounts, Alfalah CLSA Research

Figure 5

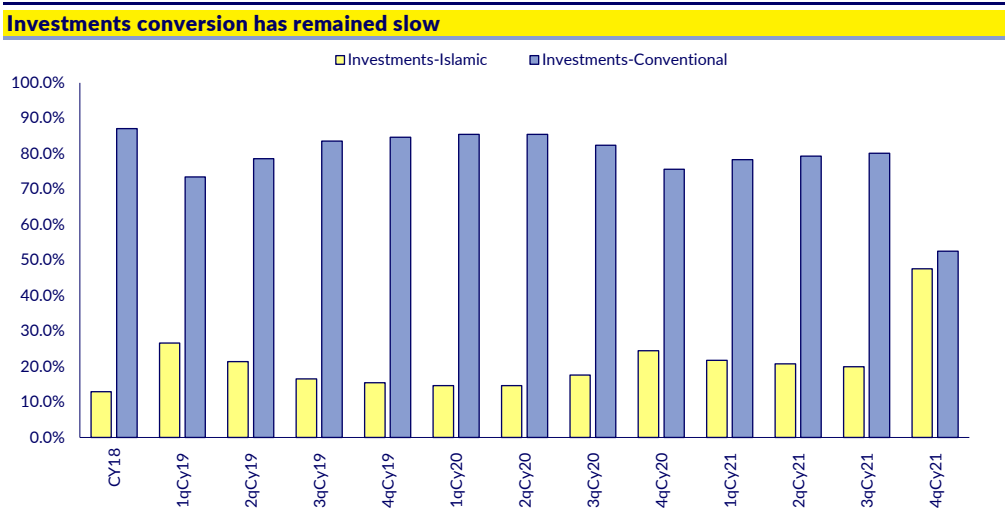
Islamic market share has grown to 10.2% in CY21 from 3.2% in CY18



Source: Company Accounts, Alfalah CLSA Research

Conversion of Investments remain on the lower side: Islamic banks were faced with dearth of investment avenues from the very beginning. In the recent years, issuance of two Energy Sukuks as well as various Ijara Sukuks from time to time by the government has provided opportunities to Islamic banks, still there remains a gap to be fulfilled. Thus, for FABL, as compared to advances, the Sukuk conversion has been on much lower side. As of Dec-21, ~47% of the investments of FABL are of Islamic nature. Going forward, we have assumed complete conversion by CY24, until then, profits from conventional investments shall be ring-fenced and not accounted in mark-up income.

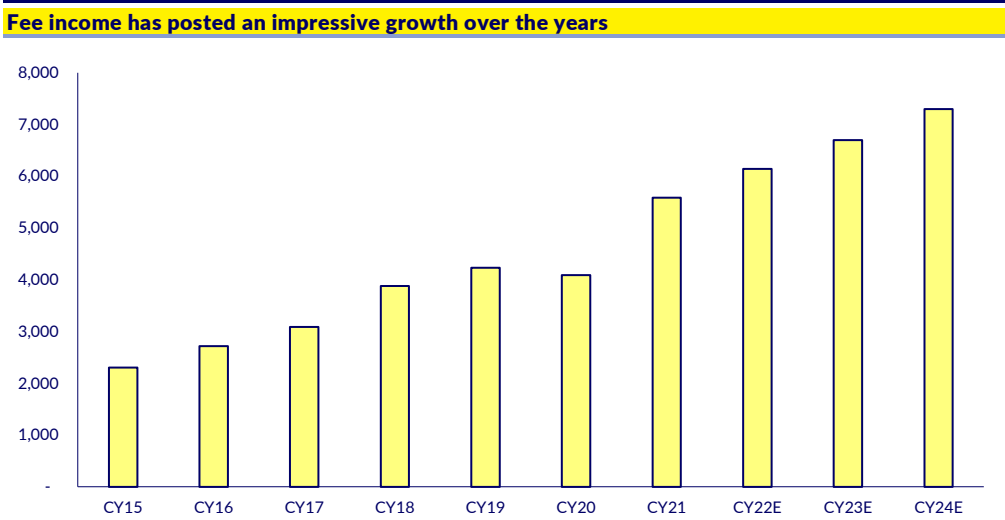
Figure 6



Source: Company Accounts, Alfalah CLSA Research

Stellar growth in fee income to continue: The fee income has grown at a phenomenal pace (~32% in CY21 from CY19 levels), primarily driven by debit and credit card fee and consumer finance related fee. Thus, going forward, non-funded income is expected to provide a boost to earnings. We have assumed growth in fee income to the tune of 10/9% in CY22/C23 on a high CY21 base income of PKR5.6bn.

Figure 7

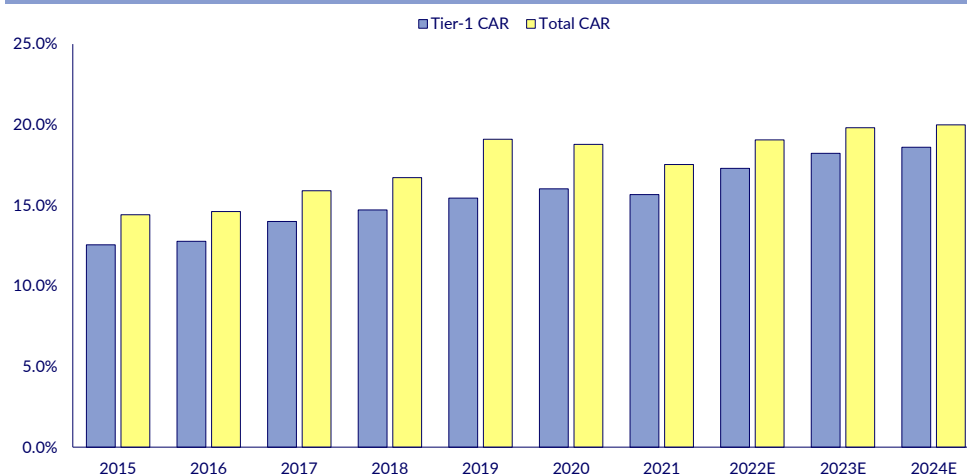


Source: Company Accounts, Alfalah CLSA Research

Considerable buffer in CAR can lead to a higher payout: Bank's Tier-1/Total CAR as of Dec 2021 of 15.7/17.5% is well above the minimum requirement, having a buffer of 6.2/6.0%, hence the bank stands in a position to increase payout going forward. We have assumed a dividend payout ratio of 30/35% for CY22/C23, resulting in a dividend yield of 8.1/11.1% respectively.

Figure 8

Strong capital buffers

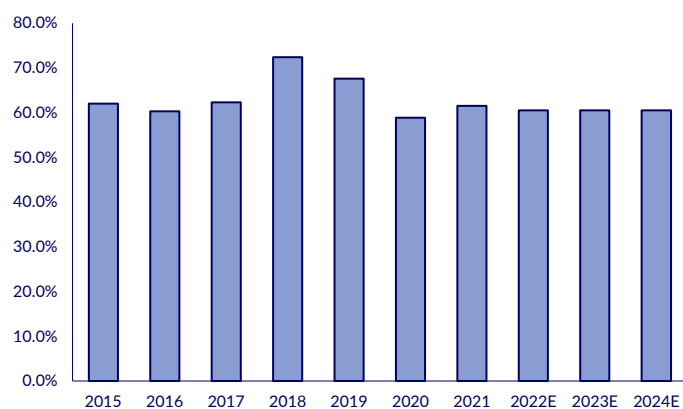


Source: Company Accounts, Alfalah CLSA Research

Highest ADR along with lower infection ratio: The bank commands highest ADR in the banking universe: FABL's ADR stands at 61.5% as of Dec-21. The bank has performed well to improve its asset quality, reducing its infection ratio to 5.6% in Dec-21 from double digits in CY17. We anticipate the infection ratio to decline slightly going forward. The coverage ratio stands at 88%; we have assumed an average coverage of ~93% from CY22-CY26.

Figure 9

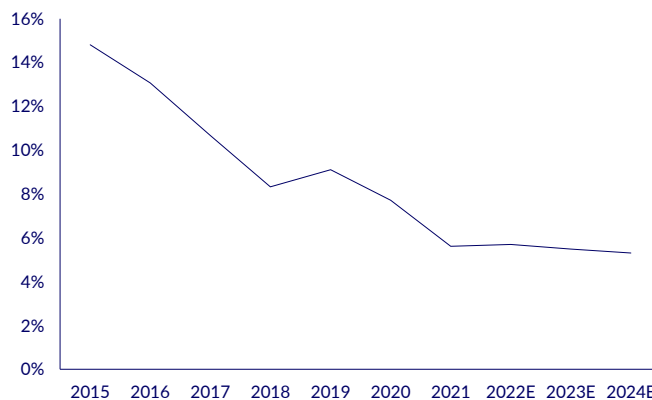
Highest ADR (61.5%) in our banking universe



Source: Company Accounts, Alfalah CLSA Research

Figure 10

Infection ratio has declined to 5.6% in CY21 from 14.8% in CY15



Source: Company Accounts, Alfalah CLSA Research

Figure 11

Dupont analysis

	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Net profit margin	21.10%	21.10%	20.30%	24.00%	24.40%	24.90%	24.10%	24.10%
Avg. total assets turnover	4.20%	4.60%	4.90%	4.40%	5.10%	5.30%	5.20%	5.20%
Equity multiplier	13.2	12.4	11.6	12.5	12.6	11.9	11.8	11.8
ROE	11.70%	12.20%	11.60%	13.20%	15.60%	15.60%	14.90%	14.90%

Source: Company Accounts, Alfalah CLSA Research

Figure 12

Comparative Analysis with other Islamic banks			
CY22E	FABL	MEBL	BIPL
P/E	3.5	5.4	4.6
P/B	0.5	1.9	0.6
DY	8.1%	6.7%	0.0%
ADR	60.5%	52.1%	52.5%
IDR	51.5%	41.0%	36.2%
ROE	15.6%	39.2%	12.8%
NIMS	4.6%	5.6%	4.1%
Deposit/branch (PKR Mn)	1063	1614	1014

Source: Company Accounts, Alfalah CLSA Research

Investment thesis: We reiterate our BUY call on FABL with Dec-22 price target of PKR44/sh, implying an upside of ~78%.

We expect the bank to post earnings of PKR7.2/8.0 in CY22/23 along with a dividend payout of PKR2.00/2.75/sh respectively offering an attractive CY22/23 dividend yield of 8.1/11.1%.

Key valuation methodology

We have used two stage Gordon growth model to value FABL

Upside risks include 1) Higher rate hikes 2) Provisioning reversals.

Downside risks include: 1) Economic slowdown affecting deposit and advances growth 2) Delays in getting Islamic banking license.

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