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## Pakistan Banks

### Higher tax rate to hit earnings by 47% QoQ

#### Pre-tax profitability to remain flattish QoQ

Imposition of super tax of 10% and higher ADR-related taxation in FY23 budget is likely to dent AFS banking universe's profitability by ~47% QoQ in 2QCY22 (effective tax rate: 58-80%). However, on a pre-tax basis, profits are expected to increase by 2.5% QoQ. NII is estimated to increase by 6.5% QoQ on account of asset repricing and heightened yields on investments. We expect higher provisioning expenses and declining fee income QoQ. Due to aforementioned reasons, we project a lower dividend payout this quarter. Our overweight stance on the sector remains intact, with UBL, MCB, HMB, MEBL and FABL as preferred picks. The sector is trading at CY22E PB/PE of 0.7/4.1 and CY23E PB/PE of 0.6/2.5, respectively.

**Earnings to increase slightly on a pre-tax basis:** Robust balance sheet expansion, higher interest rate environment and controlled expenses would keep the sector profitability afloat on a pre-tax basis. Overall 2QCY22 profitability is expected to take a hit of ~47% due to one-time super tax of 10% in Budget FY22-23.

Asset repricing is expected to reflect in 2QCY22 (impact of rate hikes till Dec-21). Recent rate hikes in April, May and July 2022 would be priced in the upcoming quarters.

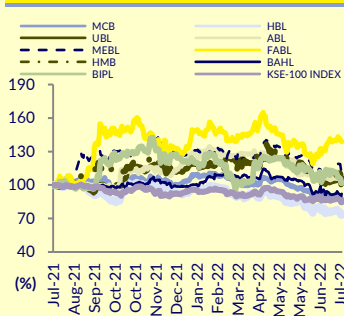
**Fee income to remain strong, provisioning to increase:** Fee income is expected to grow by 19% YoY, however, there would be a slight decline QoQ as historical trend suggests. On the provisioning side, we project higher QoQ provisioning expenses (PKR 7.2bn vs PKR 1.7bn QoQ); note that we have already build up considerable provisioning expenses in our estimates.

**Effective tax to be 58-80%:** In 2QCY22, effective taxation of banks is estimated to range from 58-80%. Recall that the government imposed a super tax of 10% for FY23 (Tax year: CY22) on banking companies. A poverty alleviation tax of 4% is expected to continue in CY23 and onwards. Furthermore, tax on income from government securities was increased from 37.5% to 49.0% for banks having an ADR of 40-50% and from 40% to 55% for banks having an ADR less than 40%. Therefore, the overall taxation impact would be higher for HBL, UBL, MCB and ABL.

**Dividend payout to continue:** Due to a sharp hit on profitability, banks are expected pay much lower dividends with high likelihood that HBL might skip dividend due to CAR concerns (Mar-22 Tier-1 CAR: 12.01%, which is close to regulatory limit of 11.0%), Other than that, UBL/MCB/ABL/MEBL are expected to pay dividend of PKR 2.5/2.0/1.5/1.5 per share.

**Overweight stance on the sector:** Despite higher taxes, we have an overweight stance on the banking sector due to attractive valuations. Moreover, decent deposit growth (up 15.2% YoY), NIMs expansion, strong fee income and attractive dividend yields warrant attention (AFS banking universe CY22/23E DY of 10.4/18.5%). The sector is trading at cheap multiples; CY22E PB/PE of 0.7/4.1 and CY23E PB/PE of 0.6/2.5x respectively.

**Banks vs KSE100**



Source: PSX, Bloomberg

### Bank's profitability

EPS (PKR/sh)	2QCY22	1QCY22	2QCY21	QoQ	YoY
MCB	2.5	7.7	6.6	-68.0%	-63.1%
HBL	3.5	5.8	6.4	-38.7%	-44.2%
UBL	3.2	7.6	5.9	-58.2%	-46.7%
ABL	1.5	4.2	4.2	-64.6%	-64.0%
MEBL	4.1	5.6	4.1	-26.6%	0.8%
FABL	1.1	1.5	1.3	-25.3%	-15.5%
HMB	1.8	3.4	2.9	-46.4%	-36.2%
BAHL	2.7	4.4	4.2	-40.0%	-36.0%

### DPS (PKR)

MCB	2.0	5.0	5.0
HBL	0.0	2.3	1.8
UBL	2.5	5.0	4.0
ABL	1.5	2.0	2.0
MEBL	1.5	1.8	1.3
FABL	-	-	0.5
HMB	1.0	-	2.0
BAHL	-	-	-

Source: Company Account, Alfalah CLSA Research

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