

Commercial Banks

Overcoming headwinds- Resilient near-term profitability expected

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ASIAMONEYBest Securities House: 2023
Best Investment Bank: 2023**FinanceAsia**

Best Investment Bank: 2022



Best Equity House: 2022



Best Equity Advisor: 2021

Best Brokerage House: 2023
Corporate Finance House: 2023
Best Economic Research House: 2023
Best Equity Sales Person (Runner up): 2023
Best Equity Research Analyst: 2022Top 25 Companies
(2019, 2018 & 2017)Excellence Award
Leading Brokerage House for RDA 2021Best Money Market Broker
(Islamic) 2021

Robust near-term profitability outlook despite some headwinds

We expect near term profitability for the banking sector to remain robust in 1HCY24 despite potential future headwinds from a reversal in the policy rate cycle (cumulative 7% reduction in policy rates in CY24 starting 1QCY24). The lagged effect of asset repricing versus funding costs, potential balance sheet expansion and opportunities for capital gains on the Fixed PIB portfolio are likely mitigation factors against potential NIM reduction from rate cuts. That said, as highlighted in our note [“Tax on Windfall \(FX\) gains of Banks”](#), 4QCY23 profits shall be impacted by one-time windfall tax on 2021 and 2022 forex gains. On a normalized basis, earnings shall remain solid over the next few quarters with 12% growth in CY24 ([“Banks-Bumper profits YTD, more in the offing”](#)) despite potential hike in credit costs as result of implementation of IFRS-9 (Effective Jan'24). Amongst our coverage banks, we have relative preference for MEBL, UBL, MCB and BAFL as these offer the best mix of growth and dividend yield in our view.

Banking Sector- AHL's top picks

Banks

Investment Thesis

Risks

MEBL

- The bank holds the strongest deposit franchise with the lowest cost, minimal infection, and a substantial mix of current deposits (49% of total deposits).
- Achieving historic profitability in 9MCY23, we expect sustained growth with high margins due to no MDR on Islamic banks.
- Backed by a resilient provisioning buffer relative to performing loans, the bank offers superior asset quality.

- Introduction of a floor rate on savings deposits for Islamic banks.
- Competition from new entrants into the Islamic space

UBL

- UBL has garnered attention recently following its major shift in dividend policy which is anticipated to persist, all the while maintaining reasonable capital buffers.
- Given prudent domestic lending practices over the years, we see limited asset quality risks to the portfolio.

- Lower-than-expected payouts
- Maintaining or breaching CAR buffers/minimum threshold
- Asset quality deterioration
- Higher infection

MCB

- MCB has consistently upheld one of the industry's highest CASA ratios outlining a solid deposit franchise.
- The bank also enjoys one of the best asset-quality in the industry given very conservative lending policies.
- It has sustained an impressive payout ratio over the years (~75%) and with sufficient capital buffers (Tier 1 CAR – 17.04%) future dividend outlook appears promising.

- Rising infection leading to asset quality concerns
- Lower-than-expected deposit growth

BAFL

- BAFL stands out for its inexpensive valuations within our Banking coverage, despite enjoying one of the highest RoE within our coverage Universe.
- Laudable on multiple counts such as, diversified portfolio, focus on digitalization, stable dividend policy and strong fundamentals leading to higher profitability.

- Higher Cost to Income ratio given digital spending
- Asset quality stress from commercial portfolio
- Stress from International exposure (Afghanistan branch)

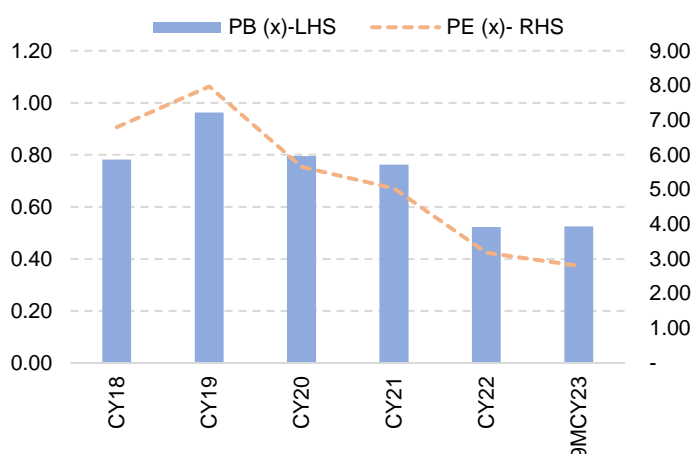
Source (s): AHL Research

Exhibit: Summary of key banking ratios

Ratios	Unit	MEBL		UBL		MCB		BAFL	
		CY23e	CY24f	CY23e	CY24f	CY23e	CY24f	CY23e	CY24f
Book value per share	PKR	93.6	122.6	187.3	196.6	183.5	203.4	80.7	97.8
Price to Earning	x	3.7	3.4	4.0	3.4	3.3	2.7	2.0	1.7
Price to Book	x	1.7	1.3	0.9	0.8	0.8	0.7	0.5	0.4
Return on Equity	%	48.8	40.1	23.4	25.3	30.3	29.1	27.9	24.6
Return on Assets	%	2.9	2.7	1.6	1.5	2.3	2.2	1.4	1.3
Cost to Income Ratio	%	27.5	29.4	35.7	32.1	32.3	33.0	42.9	42.8
NIMs	%	8.0	7.9	4.8	4.5	6.7	6.5	5.3	4.9
Infection Ratio	%	1.3	1.3	12.0	11.5	7.8	7.6	4.5	5.0
Coverage Ratio	%	176.2	183.7	92.3	89.2	82.9	79.6	132.6	125.5

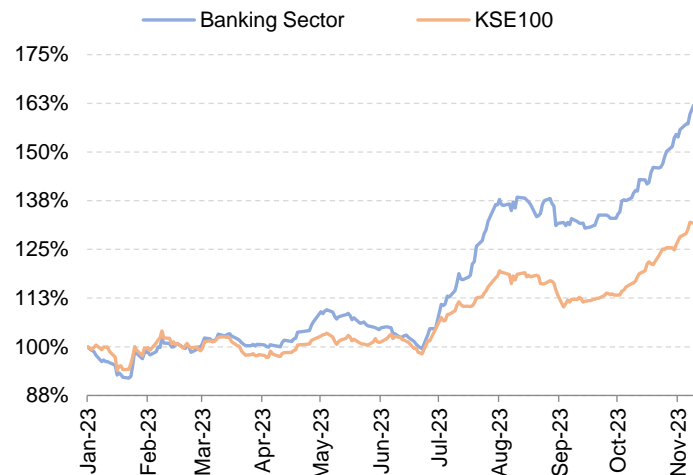
Sources: Company financials, AHL Research

Exhibit: Attractive valuations- Banks trading at a discount



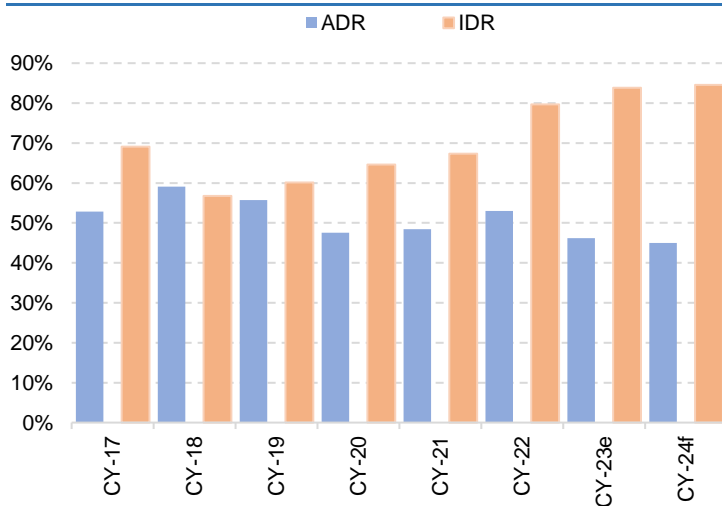
Source (s): SBP, AHL Research

Exhibit: Banking sector outperforms KSE100 FYTD



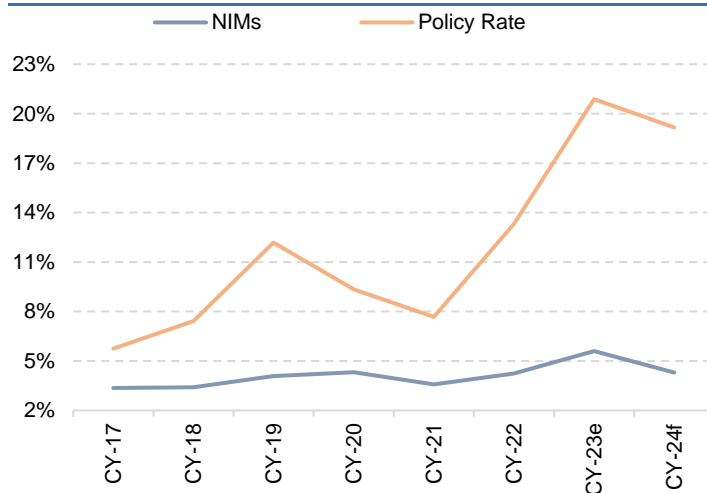
Source (s): SBP, AHL Research

Exhibit: Banks' portfolio remains tilted towards investments



Source (s): SBP, AHL Research

Exhibit: From Soaring High in CY23 to Contracting in CY24



Source (s): SBP, AHL Research

Meezan Bank Limited (MEBL)

Unparalleled excellence

The most robust deposit franchise nationwide, featuring the lowest deposit cost, lowest infection, the highest coverage ratio, and a substantial mix of current deposits. Achieved historically high profitability in CY23TD and is poised for sustained growth, aided by minimal interest expenses (as the Minimum Deposit Rate is not applicable to Islamic banks). The bank boasts strong asset quality metrics, including a high coverage of 170% plus and a provisioning buffer, offering ample capacity to absorb potential shocks to asset quality.

Highest RoE within the sector: MEBL has been able to benefit from the expanding Islamic banking industry in Pakistan, capturing almost ~8% of the deposit share of the total industry. Boasting an impressive ROE that exceeds 50% as of Sep'23, Meezan sets the benchmark for the highest ROE within the sector. For CY23E and CY24F, we expect RoE to clock-in at 48.8% and 40.1%, respectively.

NIMs jump significantly: In the outgoing 9Ms, Meezan boasted the highest NIMs among the banks under our coverage. This achievement is bolstered by a high yielding investment portfolio and a lagged impact on funding costs. Moreover, so far CY23 has turned out to be an exceptional year for the Bank profitability wise as the bank achieved its highest-ever PAT of PKR 59bn in 9MCY23, marking a substantial YoY increase of 63%. This remarkable performance can be attributed to the improved interest rate environment and the bank's low cost of deposits. Additionally, Meezan's balance sheet growth and high-profit margins contribute to a low-cost to income ratio of 28% in CY23TD, ranking among the lowest in the sector. Going forward, with interest rate reversal cycle expected in the coming months, we expect NIMs to normalize and come down from these levels to 7.9% in CY24F.

Supreme asset quality: The bank's stringent lending policy and adept credit risk management position it with lower exposure to NPLs compared to the industry. In anticipation of potential asset quality stress in a challenging macro environment, Meezan proactively accumulated provisioning buffers over the past three quarters. This effort has resulted in MEBL's Non-Performing Loans to gross advances ratio remaining significantly lower at 1.7% compared to the industry average of approximately 6.1%. Furthermore, during 9MCY23, the bank increased provisioning against NPLs by approximately 11% YoY from the same period last year, elevating the bank's coverage ratio to over 170%.

Adequate capital buffers: Capitalizing on its robust profitability, the bank has enhanced its capital ratios, with a CET-1 of 19.74% and a total CAR of 23.37% in 3QCY23—significantly exceeding the regulatory requirement of 11.5%. In our opinion, the strengthened capital ratios give an opportunity to augment the bank's payout ratio, potentially reaching 45-50%. Historically, the payout ratio has averaged around 38% over the last five years.

Valuation: We recommend an outperform stance on the stock, projecting a target price of PKR 232/share by Dec'24 and an estimated DY of 12% for CY24F. Currently, the stock is trading at a PB ratio and PE ratio of 1.3x and 3.4x, respectively, compared to its 5-year average PB of 3.2x and 5-year average PE of 7.5x.

MEBL

Summary Data

Target Price (Dec'24)	232.0
Last Closing	162.0
Upside (%)	43.2
Shares (mn)	1,790
Free float (%)	25
Market Cap. (PKR mn)	289,973
Market Cap. (USD mn)	1,017

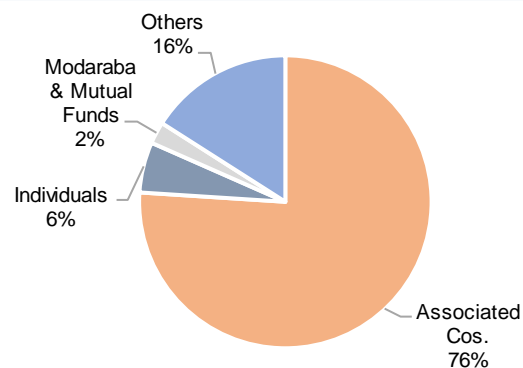
Recommendation

BUY

Price Performance

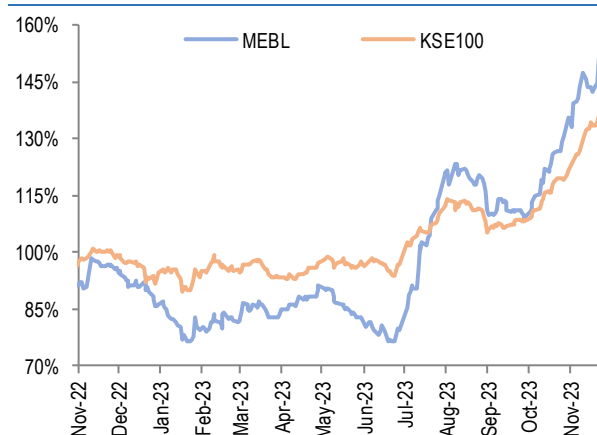
	3M	6M	12M
Return (%)	32.4	92.8	64.7
Avg. Volume (000)	1,548	1,542	1,297
ADTV (mn) - PKR	200	184	143
ADTV (000) - USD	689	640	520
High Price - PKR	153.3	153.3	153.3
Low Price - PKR	110.4	77.5	77.5

Shareholding Pattern



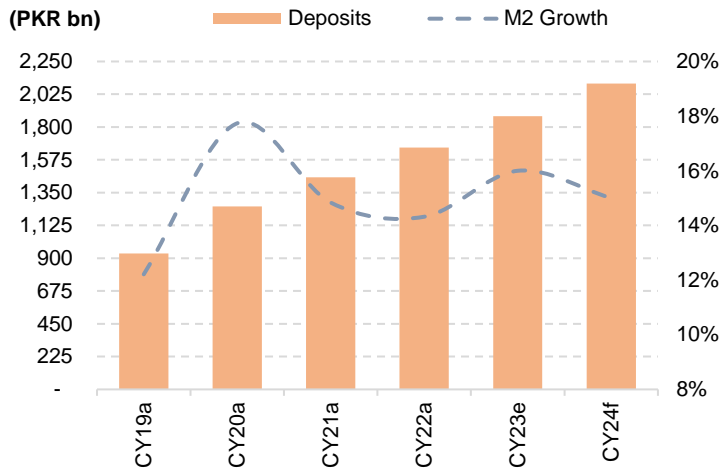
Source: Company Financials, AHL Research

Relative Performance



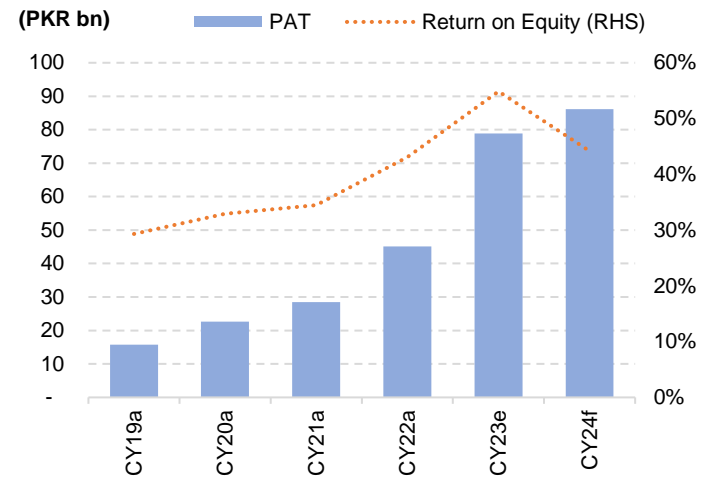
Source: Bloomberg, AHL Research

Exhibit: Tracking deposit and M2 growth in tandem



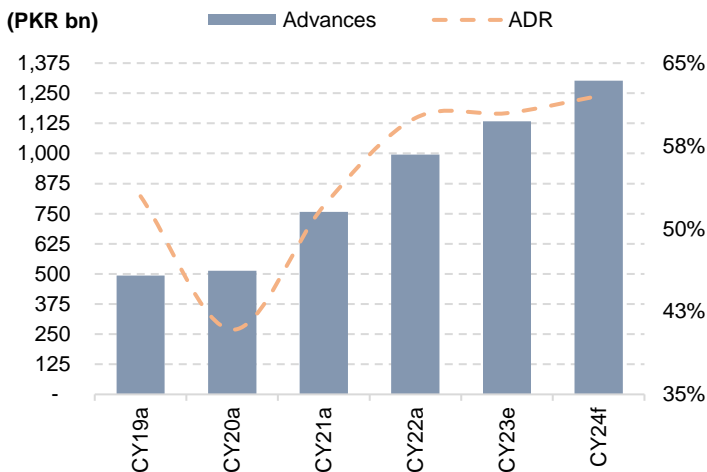
Source (s): SBP, AHL Research

Exhibit: CY23's profitability highs faded in CY24F



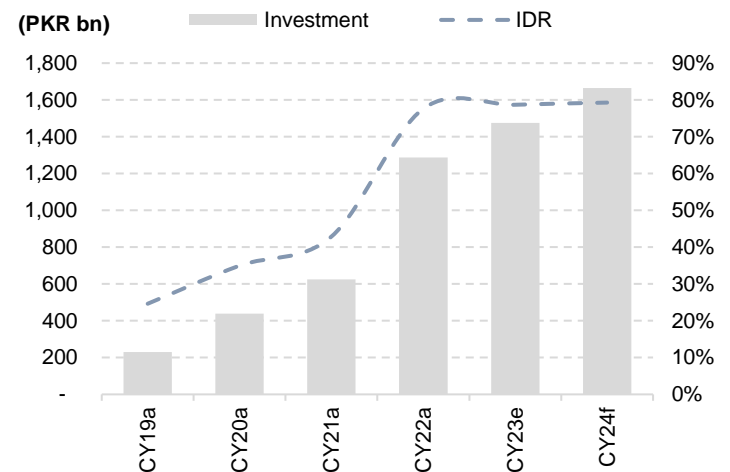
Source (s): SBP, AHL Research

Exhibit: ADR on the path to improvement



Source (s): SBP, AHL Research

Exhibit: IDR projections point to continued strength



Source (s): SBP, AHL Research

Overcoming headwinds- Resilient near-term profitability expected

United Bank Limited (UBL)

Robust dividend yield

UBL has recently gained prominence in the banking sector, primarily attributable to its remarkable dividend policy shift initiated in Dec'22. Subsequently, UBL has adopted an aggressive strategy in dividend payouts, and this approach is expected to continue. However, UBL, we believe will ensure the maintenance of a healthy buffer of capital well above the stipulated minimum requirement. With conservative lending practices on the domestic front, the bank aims to contain any potential decline in asset quality. Furthermore, the bank's prospects on the international business are optimistic, particularly given the economic rebound in the GCC economies.

Leading the league in terms of payout: UBL's dividend declaration in CY23TD pleasantly surprised the market. Benefiting from improved profitability and strong capital buffers, the bank significantly increased its absolute payout to PKR 33/share for the 9MCY23. Moreover, as of 3QCY23, UBL's total CAR stands at a robust 16.5%, comfortably exceeding regulatory requirements and leaving room for sustaining high payouts. We foresee the management maintaining a payout ratio of around 80%, suggesting a promising payout going forward too, hence we expect a dividend yield of 25% in CY24F.

Improved CA mix supports topline: The bank's emphasis on bolstering the CA portion has led to an enhanced average current account to deposit ratio, reaching 45% by Sep'23 compared to the 44% recorded in CY22. Additionally, the average CASA has risen to 82%, up from the 79% reported in CY22. Despite these positive developments, there has been an uptick in the bank's cost of deposit, reaching ~6.6% in 9MCY23, compared to 5.7% in CY22, attributed to interest rate hikes during this period. Going forward, it is anticipated that the bank will persist in its focus on digitalization and the expansion of Islamic branches. These strategic initiatives are aimed at laying the groundwork for deposit growth, with the expectation of further improvement in average CA deposits. This, in turn, is expected to provide support to the topline.

Profitability momentum to continue: The bank's NIMs are projected to be 4.5% in CY24F compared to ~4.8% in CY23E. This estimation is based on factors such as volumetric growth in balance sheet, improving CA proportion, lower cost of funding, to name a few. As a result of these factors, the ROE is expected to increase to 25.3% in CY24F, surpassing 23.5% that is expected to be recorded in CY23E. This profitability will be further supported by a slight dip in the Cost/Income ratio is projected to rise to 32.1%, down from 35.7% in CY23E. The decrease in the Cost/Income ratio is attributed to mainly on the back of slowdown in overall inflationary pressures and uptick in total income. All said, the expansion of the branch network will keep upside concerns to the overall cost side.

Valuation: We recommend an outperform stance on the stock, projecting a target price of PKR 248.2/share by Dec'24 and an estimated DY of 25% for CY24F. Currently, the stock is trading at a PB ratio and PE ratio of 0.8x and 3.4x, respectively, compared to its 5-year average PB of 0.9x and 5-year average PE of 7.4x.

UBL

Summary Data

Target Price (Dec'24)	248.2
Last Closing	164.9
Upside (%)	50.6
Shares (mn)	1,224
Free float (%)	40
Market Cap. (PKR mn)	201,818
Market Cap. (USD mn)	707

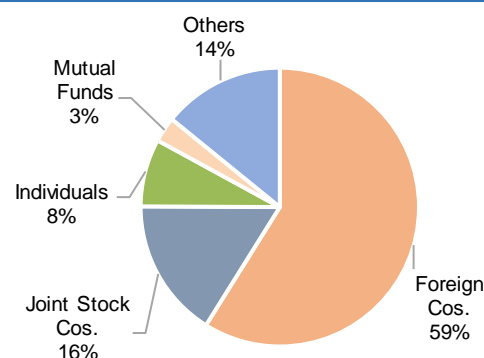
Recommendation

BUY

Price Performance

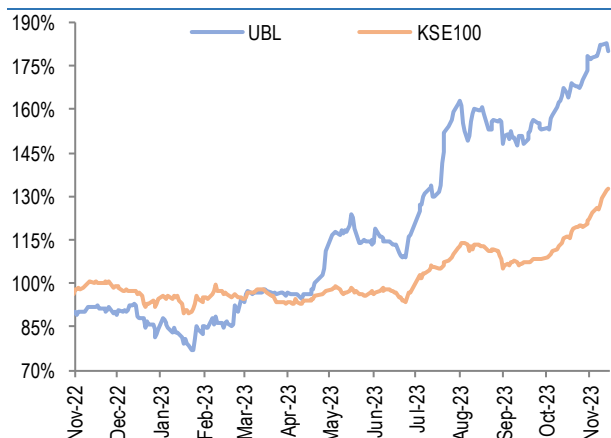
	3M	6M	12M
Return (%)	20.3	63.8	105.6
Avg. Volume (000)	1,371	1,359	1,185
ADTV (mn) - PKR	28	23	16
ADTV (000) - USD	100	81	51
High Price - PKR	164.4	164.4	164.4
Low Price - PKR	129.4	95.4	67.6

Shareholding Pattern



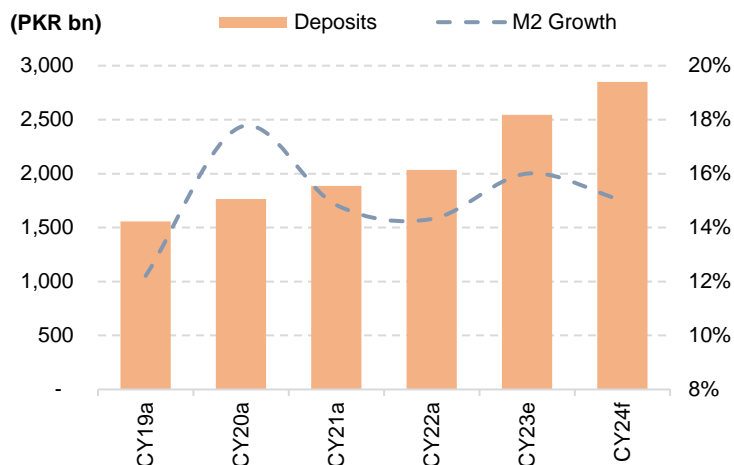
Source: Company Financials, AHL Research

Relative Performance

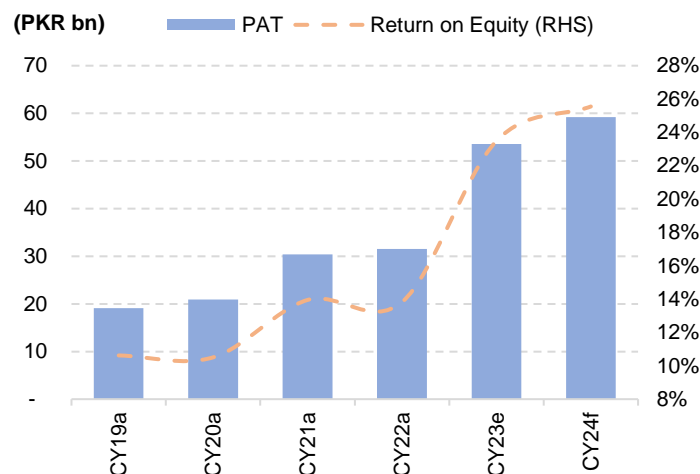


Source: Bloomberg, AHL Research

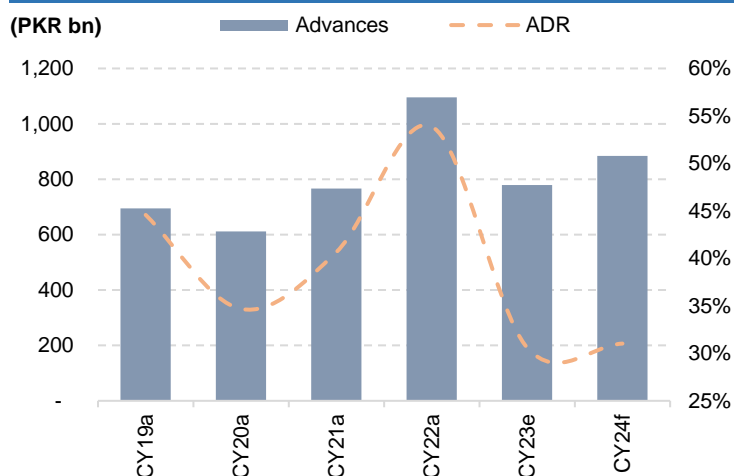
Overcoming headwinds- Resilient near-term profitability expected

Exhibit: Slowing deposits growth in comparison to CY23


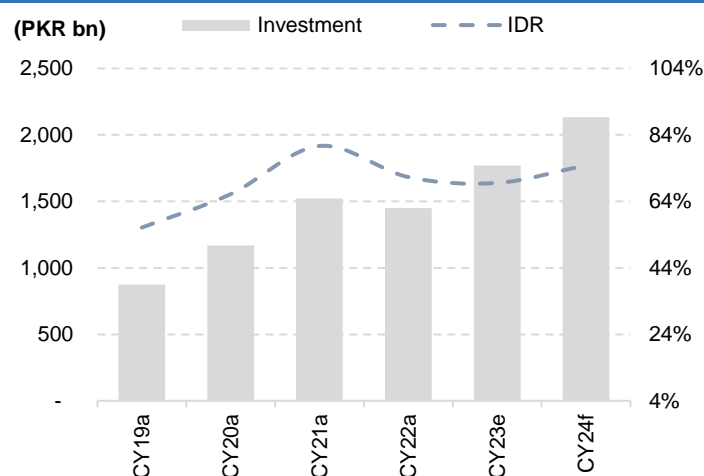
Source (s): SBP, AHL Research

Exhibit: Profitability to pursue steady rise in CY24F


Source (s): SBP, AHL Research

Exhibit: ADR improvements tread slowly


Source (s): SBP, AHL Research

Exhibit: IDR's ascent: A look at the persistent Highs


Source (s): SBP, AHL Research

MCB Bank Limited (MCB)

A safe bet

MCB stands out in the banking industry with a consistently high CASA ratio, showcasing its risk-averse approach and adherence to conservative lending practices. Complementing this stability, the bank has maintained an impressive payout ratio of approximately 75%. With a substantial capital buffer in place, MCB is not only well-prepared for unforeseen challenges but also poised for future growth in dividends, potentially surpassing the currently projected figures.

Steady dividend stream to sustain: MCB's CAR is currently at 19.6%, which is well above the regulatory requirement. Moreover, bank's ROE generation is expected to stay above 30% in CY23E, as full impact of repricing occurs and interest rates peak. Sufficient CAR provides buffer to maintain its dividend stream, which is currently at 75% payout. It is evident from the payout strategy that the bank focuses to maintain a steady payout policy in dividends. However, with strong capital levels and higher profitability (CY23E: PKR 47.2/share), we believe, MCB has ample room to improve its payout ratio.

Best CASA mix in industry: MCB runs one of the most efficient and solid deposit franchises in the country, in our view. The bank's CASA ratio has remained around 90% consistently over the past several years, allowing it to maintain above-peer average NIMs. The bank has been focusing on improving its current deposit mix as evident in the bank reported number of 3QCY23, where the current deposit mix to total deposits stands at ~45%, from previous levels of late thirties in CY22. Management expects this mix to sustain.

Profitability to remain strong: To navigate the phase of declining interest rates, MCB is poised to sustain its profitability growth by leveraging its high CASA ratio, allowing for an initial advantage of lower cost of deposits. The anticipated profitability surge will be driven by an initial increase in NII, as the effects of downward deposit repricing come into play, coupled with lower operating and provisioning expenses due to the bank's low-risk profile and ample coverage ratio. NIMs are expected to reach to ~6.5%, and we project a deposit base growth of ~12%, given the bank's strategic focus on cultivating low-cost deposits. MCB is forecasted to achieve an EPS of PKR 47.2/54.0 in CY23E/24F, followed by a DPS of PKR 29/33, respectively.

Cautious and strategic asset deployment: The bank has adopted a cautious approach to lending and has strategically managed its asset deployment with optimal prudence amid economic slowdown and monetary tightening. This is evident in its IDR of 72% and an ADR of 36%. While the IDR aligns with industry peers, the ADR is significantly lower than the industry average of 45%, underscoring the bank's deliberate strategy of prioritizing investments over aggressive lending. Simultaneously, the bank's infection ratio stands at 7.8%, with an anticipated decrease as the bank adopts a more discerning approach to minimize NPLs.

Valuation: We recommend an outperform stance on the stock, projecting a target price of PKR 272.9/share by Dec'24 and an estimated DY of 22% for CY24F. Currently, the stock is trading at a PB ratio and PE ratio of 0.7x and 2.7x, respectively, compared to its 5-year average PB of 0.95x and 5-year average PE of 7.8x.

MCB

Summary Data

Target Price (Dec'24)	272.9
Last Closing	153.7
Upside (%)	77.6
Shares (mn)	1,185
Free float (%)	35
Market Cap. (PKR mn)	182,144
Market Cap. (USD mn)	639

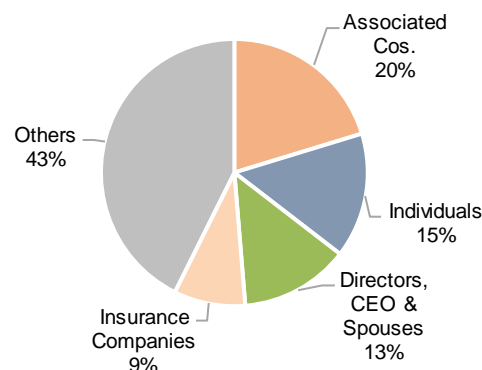
Recommendation

BUY

Price Performance

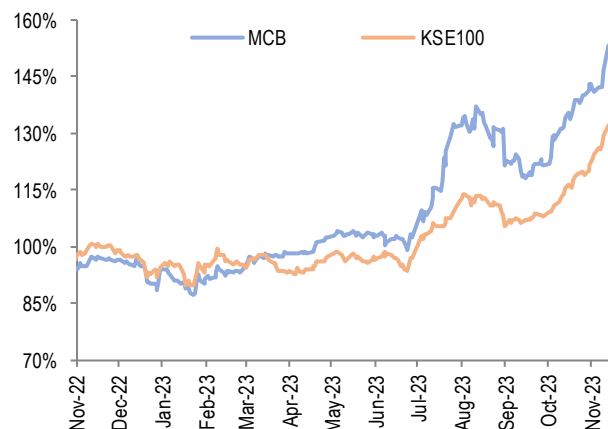
	3M	6M	12M
Return (%)	16.2	47.5	58.4
Avg. Volume (000)	883	885	636
ADTV (mn) - PKR	122	118	82
ADTV (000) - USD	416	407	290
High Price - PKR	154.3	154.3	154.3
Low Price - PKR	119.0	99.6	87.7

Shareholding Pattern



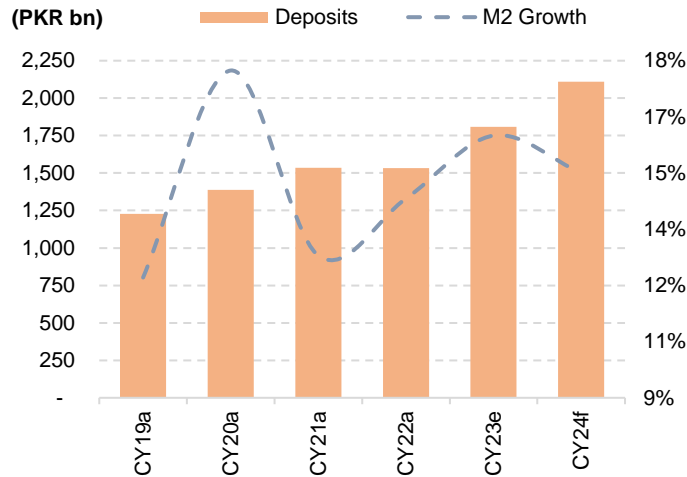
Source: Company Financials, AHL Research

Relative Performance

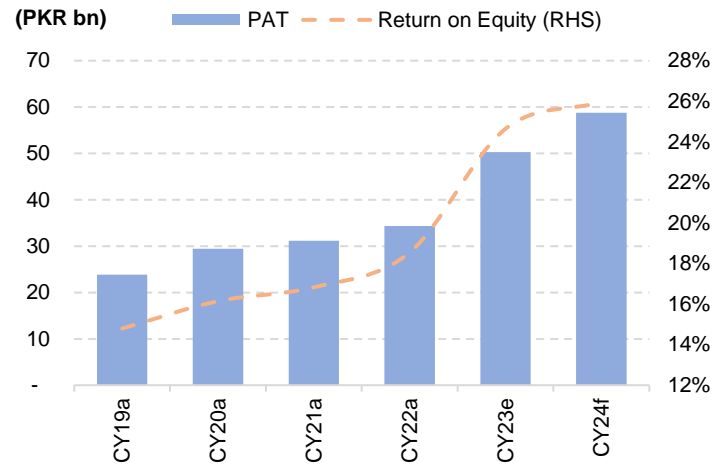


Source: Bloomberg, AHL Research

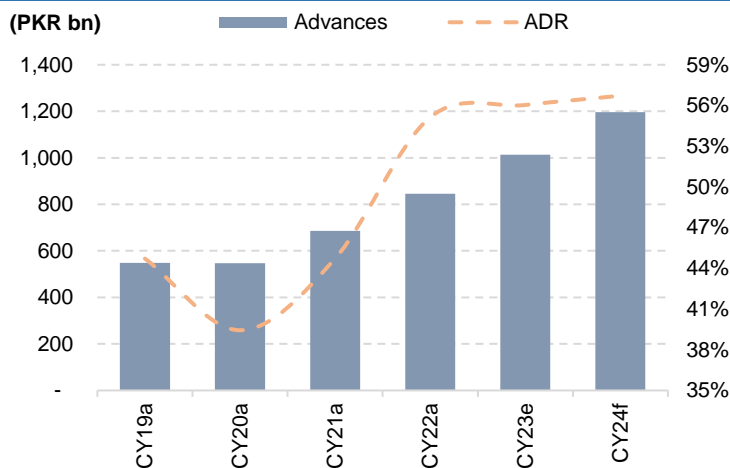
Overcoming headwinds- Resilient near-term profitability expected

Exhibit: Anticipating deposits growth shifts in CY24F


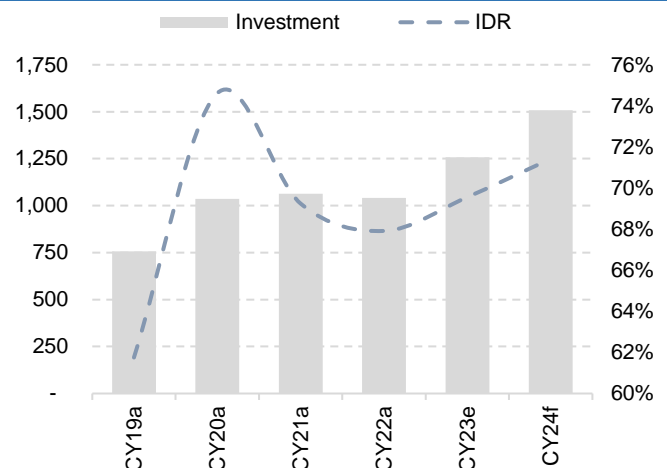
Source (s): SBP, AHL Research

Exhibit: Profitability- From peak to plateau


Source (s): SBP, AHL Research

Exhibit: ADR shows signs of improvement amid sluggishness


Source (s): SBP, AHL Research

Exhibit: IDR's Ascent: A look at the persistent highs


Source (s): SBP, AHL Research

Overcoming headwinds- Resilient near-term profitability expected

Bank Alfalah Limited (BAFL)

Achievements on multiple fronts

BAFL stands out as a strong contender in our banking universe, with a robust outlook for CY24F. The bank is set to capitalize on volumetric growth in its balance sheet which is expected to provide support to the bank's overall profitability. Moreover, BAFL has adopted a conservative approach by proactively building provisioning buffers to mitigate potential asset quality shocks. Additionally, the bank is making substantial strides in various segments, particularly in the realm of digital banking, reflecting its aggressive growth strategy.

Low-cost Deposits: As of Sep'23, BAFL has experienced a 31% YoY increase in its deposits, reaching a substantial sum of PKR 1.82trn. This surge has contributed to a current CASA Ratio of 71%, as of the end of Sep'23, in comparison to the 74.0% reported during the same period last year. Moreover, a significant portion of the bank's deposits, ~14-15%, is attributed to Islamic banking, reflecting a sustained growth trajectory in this sector. The bank is actively expanding its Islamic Banking division and has successfully opened 65 new branches in CY23TD. Looking ahead, BAFL anticipates the establishment of 160 new branches in the upcoming calendar year, with a noteworthy focus on Islamic banking, aiming to open 100 branches dedicated to Islamic services. This strategic expansion aligns with the bank's emphasis on securing low-cost deposits and Islamic deposits, which do not carry a Minimum Deposit Requirement. Consequently, this approach is expected to provide significant support to the bank's top-line performance in the foreseeable future.

Well-positioned books: The investment book of BAFL comprises 18% of Fixed PIBs while the rest 82% includes a major chunk of Floater PIBs and remaining T-Bills. The average yield of the portfolio is around 14% with an average duration of 3 years. Moreover, the bank's loan book experienced an 11% YoY decline in 3QCY23, resulting in a Gross ADR of 38.9%. The bank maintains a robust coverage ratio at over 112%, and the infection ratio is reported at 5.4%. In the outgoing quarter, provisioning mainly included subjective downgrading but the management believes that this subjective provisioning would disseminate moving forward as IFRS-9 is to be implemented in CY24.

Capital concerns addressed: Bank has been consistent with its dividend policy of paying out interim and final dividend which takes the average (3-yr) payout to ~45%. We expect the bank to continue healthy payouts, going forward. As far as CAR position is concerned, it currently stands at 15.5%, comfortably above the regulatory limit. It's worth mentioning that BAFL has consistently upheld stable capital ratios, consistently residing in the 14-15% range. This stability persists even after executing a PKR 6.0bn share buyback, concurrently demonstrating improvement in its dividends.

Valuation: We recommend an outperform stance on the stock, projecting a target price of PKR 67.1/share by Dec'24 and an estimated DY of 18% for CY24F. Currently, the stock is trading at a PB ratio and PE ratio of 0.4x and 1.7x, respectively, compared to its 5-year average PB of 0.7x and 5-year average PE of 5.2x.

BAFL

Summary Data

Target Price (Dec'24)	67.1
Last Closing	41.6
Upside (%)	61.4
Shares (mn)	1,577
Free float (%)	39
Market Cap. (PKR mn)	65,531
Market Cap. (USD mn)	230

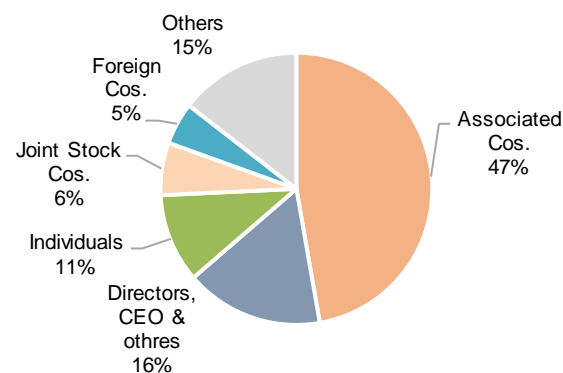
Recommendation

BUY

Price Performance

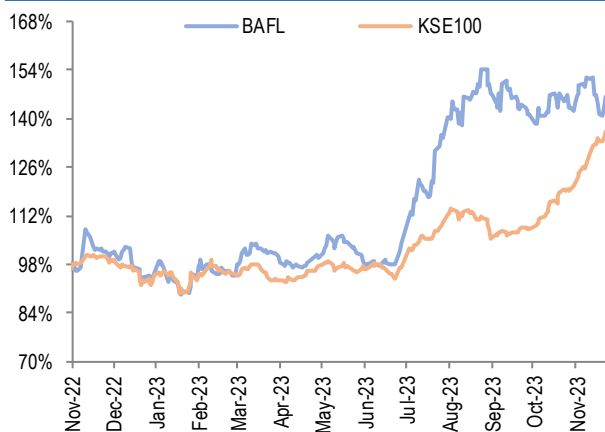
	3M	6M	12M
Return (%)	-1.0	51.0	50.1
Avg. Volume (000)	2,728	2,330	2,720
ADTV (mn) - PKR	111	88	91
ADTV (000) - USD	380	305	349
High Price - PKR	42.0	42.0	42.0
Low Price - PKR	37.7	26.5	24.3

Shareholding Pattern



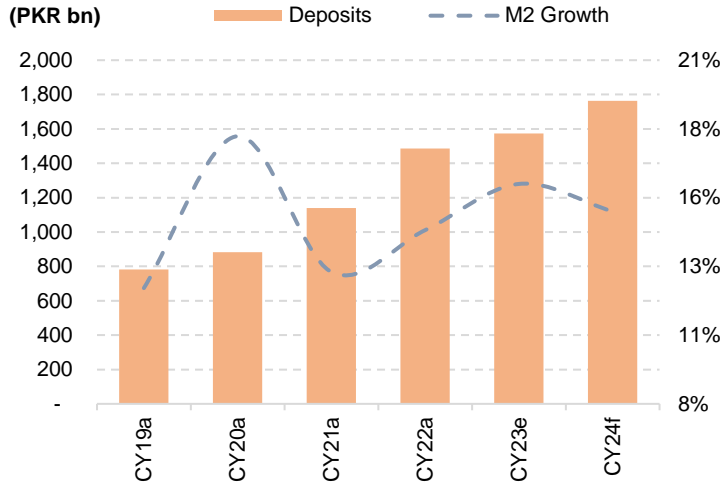
Source: Company Financials, AHL Research

Relative Performance

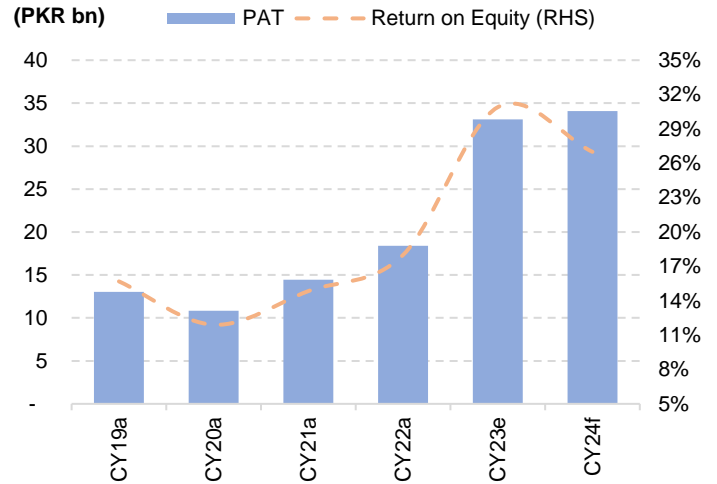


Source: Bloomberg, AHL Research

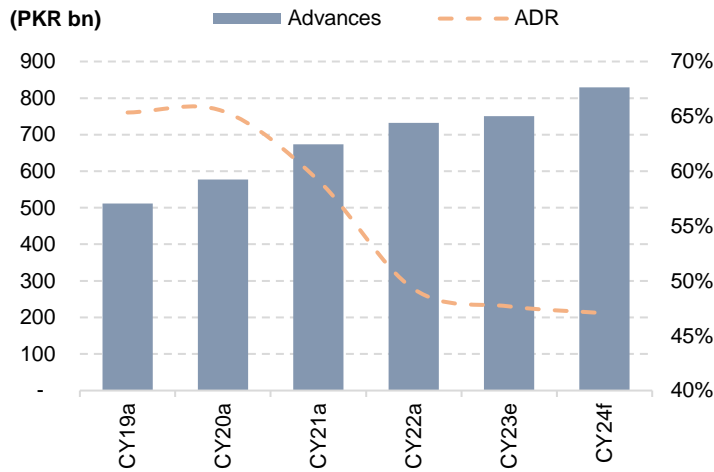
Overcoming headwinds- Resilient near-term profitability expected

Exhibit: Bracing for a milder pace in deposits growth


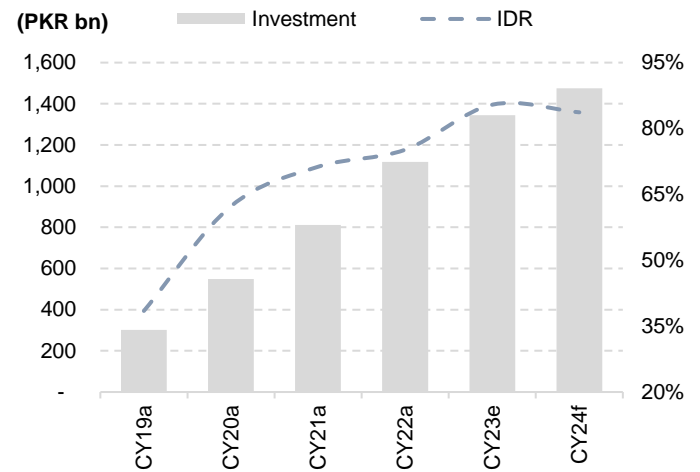
Source (s): SBP, AHL Research

Exhibit: CY23E profits soar, CY24F eyes moderation


Source (s): SBP, AHL Research

Exhibit: Advances to grow slow and steady


Source (s): SBP, AHL Research

Exhibit: Investments uphill journey continues


Source (s): SBP, AHL Research

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BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
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Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discounted Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserved Base Valuation (RBV)**

Risks

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**

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In order to avoid any conflict of interest, we hereby disclosed that;

Arif Habib Limited (AHL) has a shareholding in NBP and BOP.