REP-300

Commercial Banks

Confidence and clarity: The broader perspective for banks

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Confidence and clarity: The broader perspective for banks

Pakistan's federal cabinet has approved an ordinance that revises the tax structure for the country's banking sector. According to media sources, the new policy eliminates the ADR-related tax on income from government securities (10-16%), which had previously been imposed on banks. At the same time, the ordinance raises the corporate tax rate for banks.

The corporate tax hike: A necessary trade-off?

- The abolition of the ADR tax is undoubtedly a welcome relief for banks, but it comes at a price. In exchange for removing this tax, the government has raised the corporate income tax rate for banks from 39% to 44% for the tax year ending December 31, 2024.
- Moreover, the government has already laid out a plan to gradually reduce the corporate tax rate over the next few years. Starting in 2026, the rate will drop to 43%, and by 2027, it will further decrease to 42%.
- This rise in tax rates is projected to have an impact on earnings across the sector, with our estimates suggesting a 10% reduction in banking sector earnings in CY24, 8% in CY25, and 6% in CY26.
- This increase in tax is expected to generate between PKR 62bn to 65bn in total revenue from all banks in the current year, we believe, helping government achieve its tax collection targets.

The bigger picture: Clarity and confidence for Banks

- While the banking sector faces immediate challenges in terms of tax burdens and profitability, the abolition of the ADR tax has provided a much-needed sense of clarity.
- For much of the past two years, banks have operated in an environment of uncertainty, constantly adjusting to shifting tax policies and regulatory demands.
- The removal of the ADR tax has offered a degree of stability, allowing banks to refocus on their core operations without the looming pressure of meeting ADR targets just to avoid additional tax costs.
- This clarity is crucial for investors and analysts, as it paves the way for more predictable earnings trajectories. While the increased tax rates will undoubtedly have a negative impact on earnings per share (EPS) in the short term, the elimination of the ADR-related tax is expected to allow banks to better manage their lending activities moving forward.
- With the government’s commitment to gradually reducing the corporate tax rate, there is reason for cautious optimism about the future. As a result, we maintain a broadly positive outlook on the banking sector.
- On average, we have revised our expectations for the banking sector’s return on equity (ROE) from an earlier estimate of 20% to 18.8%. While this marks a reduction, it is not an insurmountable challenge, given the clarity now afforded to the sector.

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ADR-related tax abolished, corporate tax rates revised

Exhibit: Tax amendments (Previous vs. revised)

	Previous	Revised	CY24	CY25	CY26	Previous (ADR-related additional tax) on income from Govt. securities	Tax rate	Abolished
Corporate tax	39%		44%	43%	42%	ADR < 40%	55%	
Super tax	10%		10%	10%	10%	40% < ADR < 50%	49%	
Total tax	49%		54%	53%	52%	ADR > 50%	39%	

Source: FBR, AHL Research

Exhibit: Revised taxation impact on AHL banking universe

Banks	Revised EPS (PKR)			EPS impact (PKR)			P/E (x)		ROE (%)	
	CY24e	CY25f	CY26f	CY24e	CY25f	CY26f	CY25f	CY26f	CY25f	CY26f
FABL	15.6	13.4	14.7	(1.7)	(1.1)	(0.9)	3.6	3.2	18.0	17.5
MEBL	52.6	33.8	35.8	(2.0)	(2.9)	(2.2)	6.8	6.4	25.1	23.8
AKBL	12.1	13.4	14.4	(1.3)	(1.1)	(0.9)	2.7	2.5	16.9	16.5
BAFL	26.7	26.2	27.7	(2.9)	(2.2)	(1.7)	3.1	2.9	22.3	20.5
BOP	3.2	4.4	5.5	(0.4)	(0.4)	(0.3)	2.1	1.7	14.3	15.5
HBL	37.3	39.4	46.1	(4.1)	(3.4)	(2.9)	4.0	3.4	13.9	14.9
MCB	49.5	49.1	51.4	(5.4)	(4.2)	(3.2)	5.5	5.2	23.8	23.4
NBP*	4.7	21.4	27.0	(0.5)	(1.8)	(1.7)	2.8	2.2	11.1	13.3
UBL	52.2	53.6	55.6	(5.7)	(4.6)	(3.5)	7.0	6.7	23.5	22.6

Source (s): AHL Research, *this doesn't include any new/additional liability in pension case, ** MEBL has already booked ~PKR 6bn in Sep'24 financials

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Likely to stay in focus

ARIF HABIB LIMITED

Despite recent developments in Pakistan's banking sector, following banks are expected to remain in focus, presenting attractive investment opportunities for investors looking for upside potential at current market prices.

Habib Bank Limited (HBL)

HBL remains fundamentally strong, supported by a resilient asset portfolio, a strategically positioned investment book, a high CASA mix, lower-than-industry infection ratios, and healthy spreads. The bank prioritizes reinvestment for growth and sustainable dividend payouts. Our earnings projection for HBL in CY25 is PKR 39.4 per share. With the stock currently trading at a P/B of 0.5x, well below the average P/B of 0.8x for our coverage banks, HBL appears undervalued. Additionally, the bank offers a dividend yield of 11.5%, which translates into a total return of 31%, making it an attractive investment opportunity.

United Bank Limited (UBL)

UBL has garnered significant attention in the banking sector due to its bold shift in dividend policy, initiated in Dec'22, leading to a more aggressive approach in dividend payouts. We expect this strategy to continue into the following year. With our projected EPS for CY25 at PKR 53.6, supported by strong capital adequacy, an impressive 23.5% ROE—among the highest in our banking universe—and a dividend yield of 12.2%, UBL stands out as an attractive investment opportunity offering solid returns.

Bank of Punjab (BOP)

BOP stands out as a major beneficiary of the recent removal of Minimum Deposit Rate (MDR) requirements in the banking sector. With 88% of its deposits coming from non-individual accounts, BOP is well-positioned to capitalize on the enhanced margins and profitability resulting from this policy shift. The stock offers a compelling total return of 56%, backed by an attractive valuation with a P/B ratio of just 0.3x, the lowest in the sector, making it an appealing investment opportunity.

Askari Bank Limited (AKBL)

AKBL, with a solid local currency savings deposit ratio of 54.7%, is also poised to benefit from the MDR removal. The bank's revised earnings outlook for CY25 is an EPS of PKR 13.4, reflecting its strong fundamentals and growth potential. Despite these positives, the stock has underperformed in terms of price performance, trading at a P/B ratio of 0.4x, presenting a significant entry point for investors. With a robust capital base and an expected improvement in its payout ratio, AKBL is projected to offer a dividend yield of 16.5% for CY25, adding further appeal to its investment case.

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2025 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
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 0% and +15% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than 0% from last closing of market price(s)

Equity Valuation Methodology

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

- Discounted Cash Flow (DCF)
- Dividend Discount 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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Arif Habib Limited (AHL) has a shareholding in HBL, NBP and BOP.