December 22, 2020

Strategy 2021

All-round turnaround!

- **The Pakistan market is coming from a low base, trades at an unusually large valuation discount, is seeing record corporate profits, and enters 2021 on a tailwind of strong local flows. We see a broad-based rally and expect the KSE-100 to reach an all-time high of 54,500pts by December 2021 (c.25% return).**
- **Pakistan withstood the pandemic better than many other countries, demonstrated by improved macroeconomic buffers. The anticipated resumption of the IMF program should continue the government's reform agenda and add to confidence. And, in a more risk-on environment for EM assets, FII flows may finally end their multiyear trend of outflows.**
- **Unlike the past five years, when defensive and cyclical sectors took turns to perform, 2021 brings triggers for multiple themes. Our liking extends from domestic-driven Construction to external-facing Textiles. While Pakistan offers several liquid Technology plays, it is very well placed for any pivot towards value, particularly through its Banks and E&P stocks.**

Moving in the right direction

While the pandemic is not yet over, Pakistan's economy has achieved sufficient grounds for sustainable pro-growth policies. At the same time, the expected resumption of IMF program should lead to continued reforms, especially in energy and taxation. Importantly, the exchange rate should remain stable – there are no immediate Balance of Payments concerns and it is telling that the PKR has appreciated 5% vs. the US$ in the last four months. Although interest rates are expected to rise by 100-150bps in 2021 to over 8%, this should not preclude equities from rerating, going by the high c 13%+ earnings yield. Politics – both domestic and regional – will likely remain noisy but the important takeaway is the likelihood of the PTI government staying in power. Taken together, these are powerful directional forces for business confidence and valuation rerating.

Valuation reversion can drive a record high

After three years of nearly zero returns and the KSE-100 still 17% off its all-time high, 2021 can be a headline year. Valuations are attractive not just relative to Pakistan's own history but also versus other markets (forward P/E of 7.3x vs. a cross-cycle average of 9.0x; discount to MSCI EM is 50% vs. 38% historically). Mean reversion alone can take the KSE-100 towards a new high. Local liquidity should continue to be the main driving force, but we do see the possibility of FII outflows ending in 2021, if not outright turning into inflows. If the latter is to happen, Pakistan should quickly reduce the valuation gap versus other markets.

Corporate profitability is turning heads

Pakistan Inc. is posting record numbers that are being appreciated by locals but largely ignored by foreign investors. The IMS Universe posted its highest ever normalized profits in 3QCY20 (up 37%yoy). This growth is spread across multiple sectors and set to continue – we see our coverage companies posting a 16% profit CAGR across the next three years. Investors are spoilt for choice in 2021: we remain bullish on Cements and Textiles and see material improvement in the investment case of IPPs. And if a pivot to value occurs, then Index heavyweights, Banks and E&Ps, are particularly well placed. Our top picks include DGKC, LUCK, HBL, POL, PSO, FFC, INDU, MTL, NML and EPCL. Outside our coverage we like ASL, POWER, CEPB and BOP best.

Risks: (i) Political disruption, (ii) a severe second phase of Covid-19, (iii) failure to resume the IMF program, and (iv) sticky inflation putting pressure on interest rates.

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Dec'21 Index Target: 54,500pts

Market Snapshot

KSE 100 Index	43,741
Market Cap (PKRbn)	8,028
Market Cap (US$mn)	50,149
Market Free Float	28%
CY20td Return (US$)	4%
Forward PE (x)	7.3x
Avg. Daily Vol (mnshrs)	324
Avg. Daily Td Val (PKR mn)	11,956
Avg. Daily Td Val (US$ mn)	73
CY20td KSE100 Index – High (pts)	43,767
CY20td KSE100 Index – Low (pts)	27,229

As on December 18th 2020 Price

Macro Projections

	FY20	FY21f	FY22f
CPI - FY avg.	10.80%	8.73%	7.50%
PR - FY end	8.00%	7.50%	9.00%
PKR/USD - FY end	168.1	165.0	175.0

Source: PBS, SBP & IMS Research

IMS Top Ten Picks

2021f	TP (PKR)	Upside (%)	P/E (x)	P/B (x)	DY
POL	475	13%	7.4	2.8	10.7%
HBL	175	28%	6.2	0.7	5.9%
LUCK	841	23%	12.5	2.1	1.3%
DGKC	155	42%	10.9	0.7	0.0%
FFC	136	26%	7.8	3.2	10.2%
PSO	300	41%	5.3	0.8	3.3%
NML	132	33%	8.4	0.5	5.0%
INDU	1,458	21%	10.4	2.1	4.7%
MTL	1,330	21%	11.4	9.2	8.2%
EPCL	57	17%	9.4	2.1	2.8%

Source: IMS Research

Top Picks

IMS Universe Top Ten Picks Valuation & Recommendation

	Mkt Cap (US$Bn)	Price (PKR)	TP (PKR)	Upside (%)	EPS (PKR)			PER (x)		PBV (x)		DY (%)		ROE (%)	
					21f	22f	23f	21f	22f	21f	22f	21f	22f	21f	22f
POL	0.74	419	475	13%	56.64	62.30	58.93	7.4	6.7	2.8	2.7	10.7%	11.4%	39%	41%
HBL	1.25	137	175	28%	22.14	25.73	29.29	6.2	5.3	0.7	0.7	5.9%	7.3%	12%	14%
LUCK	1.38	684	841	23%	54.77	127.38	145.93	12.5	5.4	2.1	1.9	1.3%	3.9%	17%	37%
DGKC	0.30	109	155	42%	10.02	24.86	27.23	10.9	4.4	0.7	0.6	0.0%	4.6%	6%	14%
FFC	0.86	108	136	26%	13.94	14.56	14.81	7.8	7.4	3.2	2.9	10.2%	10.9%	43%	41%
PSO	0.63	213	300	41%	40.07	42.00	45.03	5.3	5.1	0.8	0.7	3.3%	4.7%	15%	14%
NML	0.22	99	132	33%	11.88	13.73	15.20	8.4	7.2	0.5	0.5	5.0%	6.0%	6%	6%
INDU	0.59	1,205	1,458	21%	115.53	120.12	150.32	10.4	10.0	2.1	2.0	4.7%	8.5%	21%	20%
MTL	0.34	1,100	1,330	21%	96.71	112.06	122.08	11.4	9.8	9.2	9.0	8.2%	10.0%	83%	93%
EPCL	0.28	49	57	17%	5.21	5.71	6.18	9.4	8.6	2.1	1.8	2.8%	3.4%	24%	22%

Source: IMS Research

* *As of December 18, 2020 prices*

IMS Top Covered Stocks

Stocks	Thesis
POL	We like POL for over 10% DY and production growth in Tal block. Amid rebounding oil prices, POL's high sensitivity to oil prices is a key attribute to like. POL has also become active on the exploration front which leaves room for positive surprises during the year.
HBL	Legacy issues associated with NY branch are in the past. Management is keen to invest in alternate delivery channels. HBL is set to deliver mid-cycle ROEs of +15% where valuations are very attractive (CY21f P/B: 0.7x).
LUCK	Higher profitability from Kia-Lucky and commissioning of Lucky Power will increase consolidated earnings significantly. Additionally, core profitability will also rise amid better local demand and cement prices.
DGKC	Diverse portfolio along with upsurge in earnings amid higher local sales and spike in retention prices will unlock upside. Commencement of coal based CPP and WHR at Hub plant will increase DGKC FY22f earnings by c. 15%.
FFC	FFC is offering dividend yield of 10.2%/10.9% in CY21/22f in a low interest rate cycle. Also the increase in GIDC payment duration and closure of RLNG based plant (competition) will support the company's bottom-line
PSO	PSO's cash-flows has considerably improved, thanks to Govt. measures to inject liquidity into the Power sector. This has been the major trigger for the stock's rerating in the past. PSO has also consolidated market share in the key retail fuel markets which means more cash earnings in future.
NML	Core earnings are positioned to have a 3yr CAGR of 20%, due to the focus on value-added sales. NML's investment portfolio provides healthy dividends from other Nishat group companies (MCB, etc).
INDU	Our liking for INDU stems from sharp rise in volumes during FY21f (c.50%) amid new Yaris launch, healthy cash balances (PKR66bn) which may lead to new car launches, better rural demand on improving farmer dynamics. We estimate 3yr earnings CAGR of 32%.
MTL	MTL has raised its market share to 65% following recent improvement in farmer dynamics on announcement of the agri-package in May and end to GST in June 2021. A solid dividend policy (payout: 95%) and high ROEs (5yr average of 70%) firm up our liking.
EPCL	New PVC capacity of 100k tons will allow EPCL to capture greater market share and substitute imports. This, alongside a healthy core delta and depreciating PKR, will aid in earnings expansion, going forward.

IMS Top Non-Covered Stocks

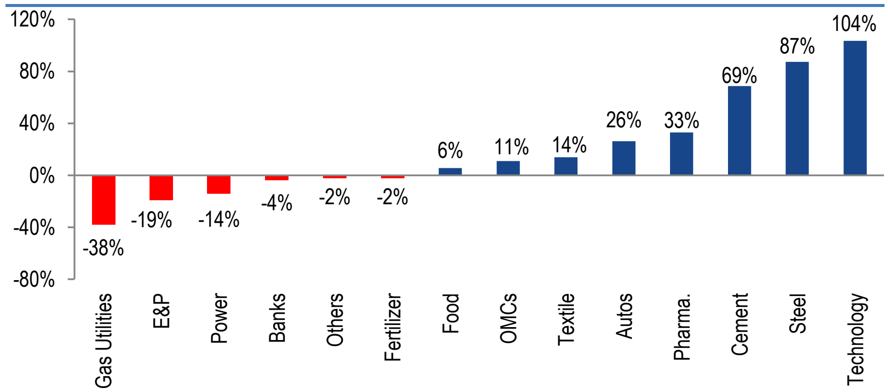
Stocks	Thesis
ASL	Strong demand from 2/3 wheelers, white goods and rising construction activity on the back of improving macros will unlock earnings potential for ASL. Lower interest rates and very high CRC-HRC spreads will further boost profitability.
POWER	POWER is expected to witness a significant jump in earnings post new expansion, coupled with declining variable costs and rising retention prices. This is in addition to lower finance cost in a low interest rate environment.
CEPB	Decline in international wood pulp, waste paper and coal prices will increase the company's gross margins. Recent debottlenecking on its existing plant will also increase the topline and ultimately profitability. Demand is expected to remain strong.
BOP	Our liking for BOP springs from (i) adequate capital buffers (CAR: 16.97%) leading to a sustainable cash payout, (ii) improving asset quality (coverage: 86%), (iii) impressive new management and (iv) attractive valuations (trailing P/B: 0.5x vs. a 15%+ ROE).

Market Review 2020

Like global markets, Pakistan market was struck by the Covid-19 pandemic during 2020, but it led to early instatement of pro-growth policies by Pakistani authorities.

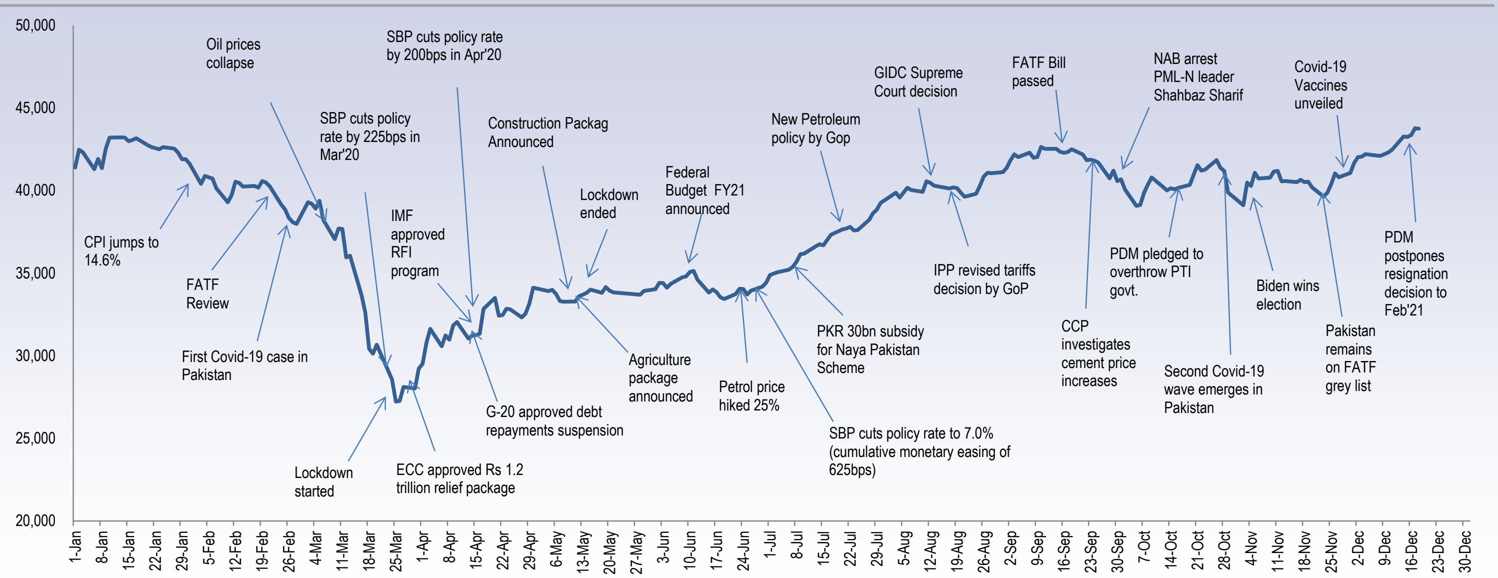
What a year! Although the coronavirus pandemic is in its second phase and vaccine rollout in Pakistan may take time, the country has seemingly withstood the pandemic better than others. This is backed by a manageable case load of c 50,000 active patients and improved macroeconomic buffers. At the onset of the outbreak, Pakistan set out on pro-growth monetary and fiscal policies with the IMF playing an understanding role. Pakistan tamed a stubbornly high inflation and averted a BoP crisis, thanks to swift external financial assistance and healthy remittances. With a semblance of normality returning (strict lockdowns were lifted in August) and corporate profitability doing much more than merely being resilient, it is no surprise that the market has rallied c.60% from its CYTD trough. Even so, it ends the year up a modest 7% (4% in US$ terms), marking the third consecutive year of range-bound calendar year performance. 2021 can be a banner year, however. Local liquidity is expected to remain strong and if foreign outflows finally end, the Index can post a new high, in our view (net FII selling of more than US$500mn in 2020, taking cumulative outflows since 2015 to over US$2bn).

Sector wise price performance 2020



Source: IMS Research

KSE100 Timeline

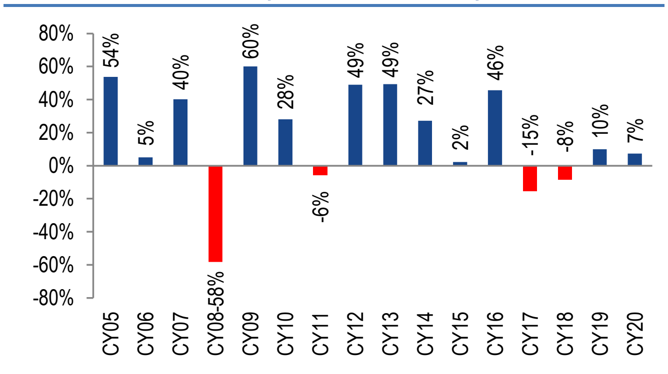


Source: IMS Research

2021 Investment Thesis

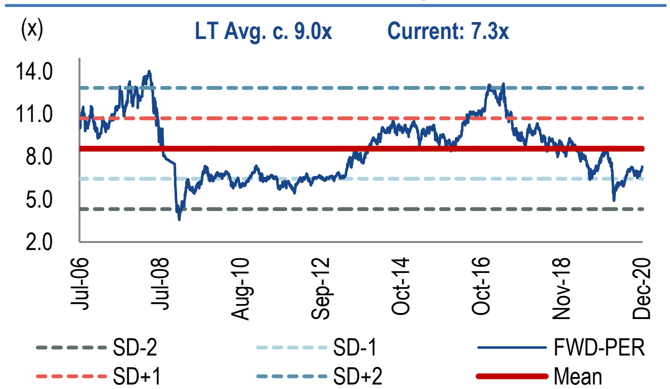
- The Pakistan market is coming from a low base, trades at an unusually large valuation discount, is seeing record corporate profits, and enters 2021 on a tailwind of strong local flows. We see a broad-based rally and expect the KSE-100 to reach an all-time high of **54,500pts by December 2021 (c.25% return).**
- **Pakistan withstood the pandemic better than many countries**, demonstrated by a manageable case load of c.50,000 active patients (0.02% of population) and improved macroeconomic buffers (the import cover is now 3.3 months and the PKR has appreciated by 5% vs. the US$ in the past four months). It enters 2021 with reasonable room for pro-growth policies while continuing reforms under an anticipated resumption of the IMF program.
- **Pakistan Inc. is emphatically delivering!** The IMS Universe posted record-high profits of PKR174bn in 3QCY20, up 37%yoy. This growth was broad-based and is expected to continue – our Universe is projected to post a 3yr profit CAGR of 16%.
- Despite clear positives on handling the pandemic and the strong showing by corporates, Pakistan not only trades at an unusually high discount relative to its own history (forward P/E of 7.3x vs. a cross cycle average of 9.0x), but also relative to other markets (discount to MSCI EM is c.50% vs. a historical discount of 38%). **We expect significant valuation rerating in 2021 (more than 20%)**. Importantly, we estimate that interest rates can increase moderately without impeding valuation rerating (our base case calls for a 100-150bps increase in interest rates to 8.0-8.5%).
- **Some of this valuation anomaly should be alleviated by an end to foreign outflows from equities**. In 2020, Pakistan saw net FII outflow of more than US$500mn, taking the cumulative outflow since 2015 to over US$2bn. While the SCRA suggests residual foreign holding of more than US$2.5bn, we believe some of this is strategic in nature; by our estimates, foreign money managers now hold less than US$1.3bn in Pakistan (active: US$800mn; passive: US$500mn).
- **Unlike the recent past, we expect several sectors to depict a rally in 2021**. The last time this happened, the KSE-100 returned c.50% pa in two consecutive years (2012-2013). We remain bullish on Cements and Textiles and see material improvement in the investment case of IPPs. Pakistan offers several liquid Technology stocks but if a pivot to value occurs, then Index heavyweights Banks and E&Ps are particularly well placed.

The KSE-100 has been nearly flat for the past four years



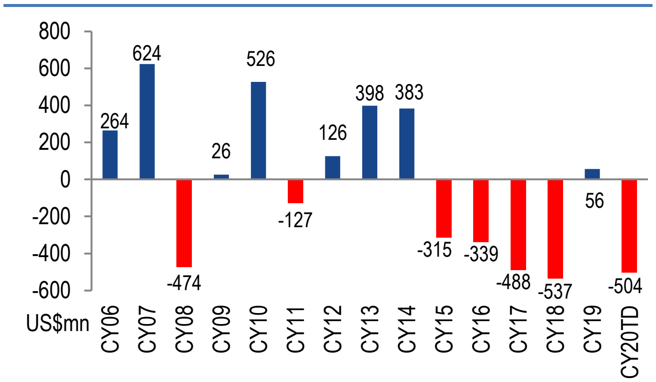
Source: IMS Research

Forward Market P/E of 7.3x is well below long-term mean of 9.0x



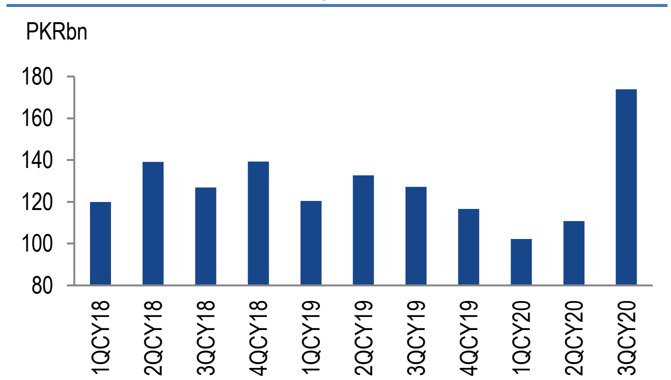
Source: IMS Research

Net foreign sell of cumulative c.US$2.0bn since 2015



Source: IMS Research

IMS Universe Profits rose to multiyear record levels in 3QCY20



Source: IMS Research

A broad-based rally

After years of flat returns, Pakistan market will stage a rebound

We expect Banks and E&Ps to join the cyclical sectors to lead a broad-based rally in 2021.

The Pakistan market has returned a mere 6% since December 2017 (-26% in US$ terms), while the MSCI DM and EM indices are up 25% and 9% respectively. Many factors contributed to the poor returns – political instability, austere economic policies to tame a BoP crisis, foreign selling and an initial lack of decisiveness by the new government. Corporate profitability deteriorated and the market de-rated to 5.0x from a peak of 12x in mid-2017. Another key reason for poor market performance was that two of the Index heavyweights – Banks and E&Ps (both had negative returns in 2020) failed to lift the market in the previous few years, amid their own peculiar issues, while cyclical sectors were affected by the economic slowdown.

Going into 2021, we believe that most of the aforementioned factors, which dragged market returns in the recent past, have turned around. For the first time in at least five years, we are eyeing a broad-based market rally – because we see enough positive triggers for both cyclical/growth and defensive/value sectors to perform. The last time this happened, the KSE-100 returned c.50% pa in two consecutive years (2012-2013).

Pakistan Market has overcome most of the factors which led to poor returns in recent past

Factor	2018-20	2021 onwards
Political Disruption	PM Sharif disqualified. The PTI government took time to stabilize the economy and gain the market's confidence.	Civil-army relations remain harmonious and even a united opposition may not be enough to prevent a 5yr term for PTI.
Economic Instability	Pakistan's C/A deficit had ballooned to 4% of GDP which triggered hefty monetary tightening and PKR depreciation, derailing overall growth. Power tariff hikes under the IMF program pushed inflation higher. Fiscal imbalances remained high.	Pakistan is likely to reenter the IMF program after a temporary suspension due to Covid-19 and thus continue the reforms process. The economy is in the hands of experienced technocrats, who have been successful in instilling confidence.
Overvalued PKR	The combination of large C/A deficit and hefty external debt repayments led to nearly 40% depreciation of the currency. This dissuaded foreign investment in Pakistan (ex-CPEC).	The SBP's fx reserves imply an import cover greater than 3mths, and it has adopted a market-driven exchange rate regime. A Eurobond issue and potential hot-money flows into debt securities promise to contain PKR depreciation in 2021.
Foreign Selling	Foreign investors have sold a cumulative US$1.2bn of holdings in Pakistan since EM upgrade in June 2017. Above factors plus global withdrawal of funds from EM and FM were key reasons.	Foreign selling is likely to end in 2021, if not turn into fresh buying given interest in EM will return amid hunt for yield. The Technology sector is already attracting foreign interest and other sectors may follow suit.

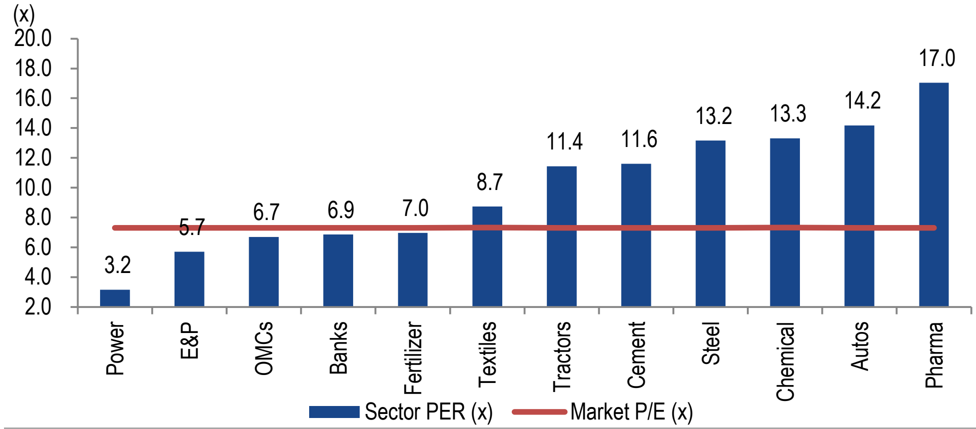
Source: IMS Research

Market set to rerate to 9.0x P/E

Revival of Index heavyweights will lift the market P/E to 9.0x from 7.3x at present.

We expect the Pakistan market to rerate to 9.0x, broadly at par with its long-term mean valuations. An earnings yield of 13%+ can withstand a higher-than-expected increase in interest rates and still support valuation rerating. Pakistan also deserves to rerate on preventing a major and long-lasting fallout on its economy due to the pandemic. At the micro level, positive surprises on earnings growth can cause valuations to catch up, while defensive sectors have significant room to rerate, having overcome specific risks of the past. A dissection of P/E across various sectors show that the cyclical and growth sectors are trading above 10x forward P/E, while the defensive and value sectors are trading below 6x forward P/E (which is the historical trough level for the market at large).

IMS Universe Sector P/E – 2021f



Source: IMS Research

We expect multiple sectors to rally in 2021. The last time this happened, in 2012/13, the KSE-100 returned c.50% in each of these years.

Based on the above, we infer that for the rally to continue: (i) cyclical sectors need to accelerate earnings growth (likely), and (ii) defensive sectors need to rerate to the high single-digits (likely). The following triggers support our thesis.

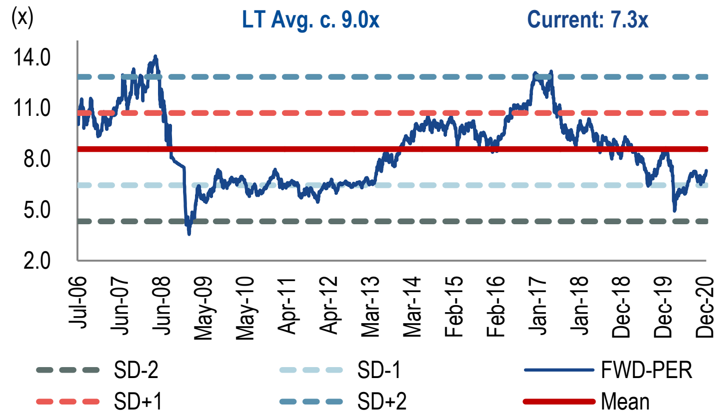
- International oil prices will continue to rise during 2021 as the global rollout of Covid-19 vaccines will unlock a pent-up demand phenomenon in the commodity > **Positive for E&Ps**
- Inflation in Pakistan will remain around 8-9% and an improved macroeconomic outlook will embolden the SBP to raise interest rates, albeit moderately > **Positive for Banks**
- Government's fiscal position should improve given a growing economy and thus lead to more public infrastructure spending > **Positive for Construction sectors**
- The exchange rate will remain stable within the 160-165 range as we see many avenues for forex inflows > **Positive for most cyclical sectors which rely on imported raw materials e.g. Automobiles**
- We believe the MoUs signed between the government and IPPs for settlement of outstanding circular debt will pave the way for a swift rebound in payouts from the sector > **Positive for IPPs**
- A return to the IMF program will lead to better policy measures to contain circular debt hereon, including expediting privatization in the Energy sector > **Positive for IPPs, E&Ps, and OMCs (especially PSO)**

Discount to MSCI EM should narrow to historical mean levels

Pakistan market trades at a c.50% discount to MSCI EM index vs. historical average discount of c.38%.

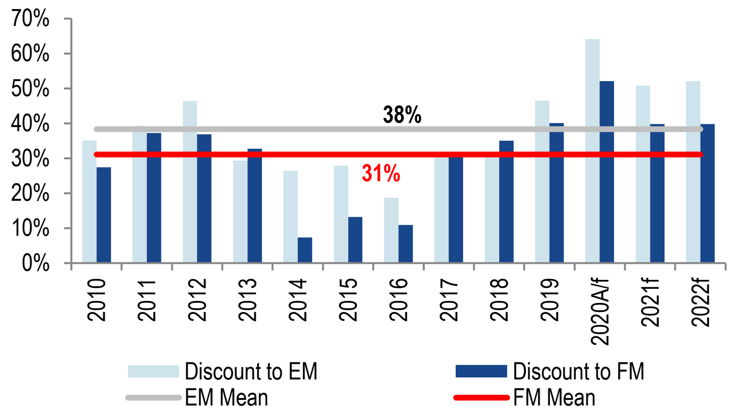
The Pakistan market is presently trading at c.50% discount to the MSCI EM index, compared to the historical average discount of 38%. The discount historically was attributed to political instability and recurring boom-and-bust cycles. We argue that Pakistan scores much better on both counts than in the recent past and the discount should at least converge to historical mean levels. Another reason which could explain the recent expansion of discount was the much smaller share of technology and investable consumer names in the KSE-100 Index compared to other markets. There are now investable tech stories in Pakistan and improved equity market performance and valuation unlocking for this theme may beckon more Consumer and Tech IPOs in the future (some were delayed by the pandemic in 2020 and the market rout earlier).

Forward Market P/E of 7.3x is well below long-term mean of 9.0x



Source: IMS Research

Discount to MSCI EM and FM indices are much higher than usual



Source: Bloomberg, IMS Research

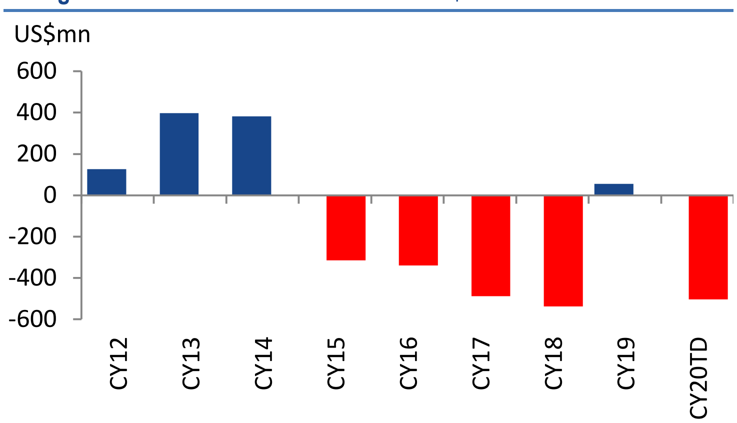
Foreign selling can end in 2021

As global funds turn bullish on the EM space, foreign selling in Pakistan should cease in 2021.

Foreign investors have been net sellers in Pakistan since 2015 and have cumulatively sold over US$2.0bn in the last five years (US$1.2bn since EM upgrade in mid-2017). This selling has been concentrated in Banking, E&P and Cement sectors – we understand some of these are no longer in vogue globally, in part due to the shift into Technology. It is worth pointing out that the two of the largest stocks on PSX by market cap, OGDC and HBL, are presently trading at EV/EBITDA of only c.2.0x and P/B of c.0.7x, respectively – largely because of foreign selling having depressed valuations. As foreign selling ebbs, it can provide a fillip to these Index heavyweights and drive the market towards our Index target (while reducing the valuation discount to the region).

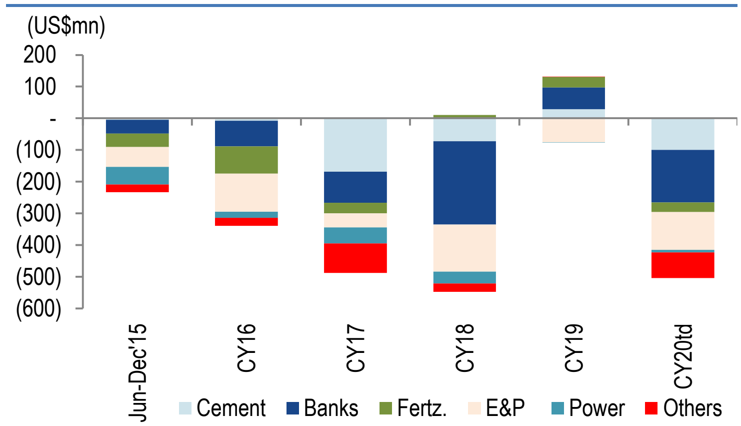
While the SCRA suggests residual foreign holding of more than US$2.5bn, we believe some of this is strategic in nature; by our estimates, foreign money managers now hold less than US$1.3bn in Pakistan (active: US$800mn; passive: US$500mn). We think that there is a good chance that foreign selling in Pakistan will end in 2021, if not turn into fresh buying. Global fund managers are expected to tilt their portfolios towards emerging markets in search of higher returns. While Pakistan suffers from a small weight in MSCI EM, we believe the story is good enough and the valuations cheap enough for it to once again attract foreign interest.

Foreign investors have sold cumulative US$2.1bn since 2015...



Source: NCCPL, IMS Research

...with bulk of the selling concentrated in Banks, E&Ps & Cements



Source: NCCPL, IMS Research

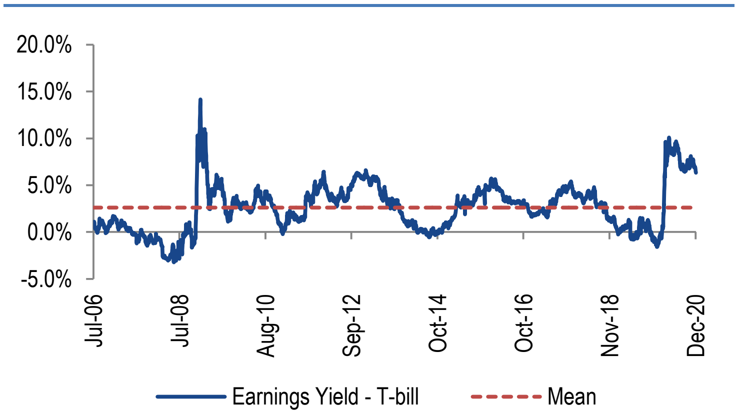
We expect the KSE-100 at 54,500 by December 2021

We estimate that the KSE-100 Index will reach 54,500pts by the end of 2021, returning about 25% for the year (from 18 Dec 2020 close). This is based on a weighted average blend of Index level based on our target P/E of 9.0x, P/B of 1.3x and the EY-12mth T-Bill spread of 2.5%. Underlying assumptions include (i) swift roll-out of Covid-19 vaccine globally, (ii) moderate increase in interest rates, (iii) international crude oil prices around US$55-60/bbl by December 2021, and (iv) end of selling by foreign investors.

KSE-100	Present	Target *	Index level- 21f
P/E	7.3	9.0	53,877
P/B	1.0	1.3	55,155
EY	13.8	11.0	54,421
Indicative Index level			**54,500**

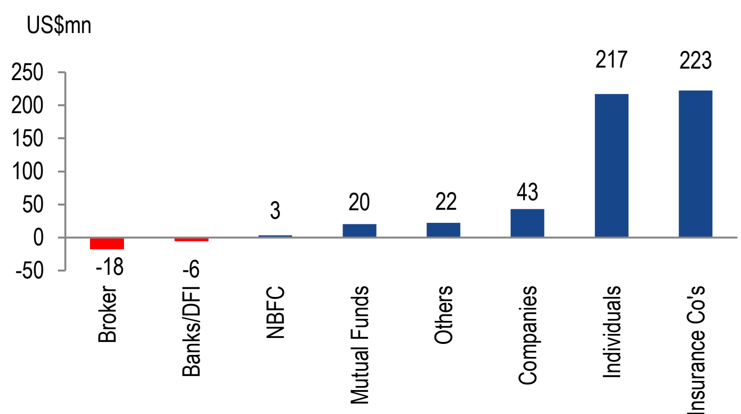
** Based on 15yr mean*

EY spread over 12mth T-Bill is 6.5ppt vs. historical mean of 2.5ppt



Source: Bloomberg, IMS Research

Local investors have driven the c.60% rally since March



Source: NCCPL, IMS Research

Valuation comparison for major EM/FM Countries

		P/E (x)		P/B (x)		Div Yld		EPS Growth		ROE	
County	**Indices**	**21f**	**22f**	**21f**	**22f**	**21f**	**22f**	**21f**	**22f**	**21f**	**22f**
Turkey	XU100	7.1	5.4	0.9	0.8	3.9%	4.5%	67.7%	31.5%	14.1%	14.5%
Pakistan	**KSE100**	7.3	6.1	1.0	1.0	6.0%	7.4%	20.1%	19.8%	14.3%	15.7%
Russia	RTSI$	8.4	7.1	0.9	0.8	6.4%	7.4%	53.0%	19.0%	9.1%	10.7%
Argentina	MERVAL	9.4	5.1	0.9	0.8	1.8%	4.8%	331.0%	84.2%	8.0%	0.6%
Srilanka	CSEALL	9.7	-	-	-	0.0%	0.0%	19.5%	-	12.2%	0.0%
Nigeria	NGSEINDX	10.2	9.0	0.3	0.2	4.9%	5.5%	7.5%	13.4%	20.1%	19.4%
Hong Kong	HSI	12.0	10.5	1.1	1.1	3.1%	3.5%	18.8%	14.5%	9.7%	9.9%
MSCI FM	**MXFM**	12.2	10.3	1.6	1.5	3.4%	4.8%	21.4%	18.9%	15.0%	15.8%
Brazil	IBOV	13.0	11.7	2.0	1.9	3.2%	4.2%	251.0%	11.2%	15.4%	15.6%
China	SHCOMP	13.1	11.5	1.4	1.3	2.3%	2.6%	16.9%	14.2%	9.5%	9.5%
Korea	KOSPI	13.5	11.3	1.1	1.0	1.8%	1.9%	45.7%	19.1%	11.5%	13.0%
Vietnam	VNINDEX	13.7	11.5	2.1	1.8	1.7%	2.4%	28.5%	18.8%	16.2%	16.9%
United Kingdom	UKX	14.6	12.3	1.6	1.5	3.9%	4.2%	48.2%	18.6%	6.2%	7.9%
MSCI EM	**MXEF**	14.9	12.8	0.0	1.5	2.4%	2.7%	32.4%	15.8%	10.1%	10.7%
Germany	DAX	15.3	13.3	1.6	1.5	2.9%	3.2%	29.5%	15.6%	8.9%	10.8%
Indonesia	JCI	16.3	11.9	2.0	1.9	1.9%	2.3%	50.1%	37.4%	14.2%	15.7%
Malaysia	FBMKLCI	16.8	15.7	1.5	1.5	3.4%	3.6%	10.6%	6.8%	8.7%	9.3%
Taiwan	TWSE	16.9	15.3	2.1	2.0	3.3%	3.6%	17.4%	10.2%	14.7%	15.2%
Thailand	SET	18.6	16.2	1.6	1.6	2.6%	2.9%	47.6%	14.7%	6.1%	8.1%
Philippines	PCOMP	19.4	15.6	1.7	1.5	1.5%	1.7%	39.6%	24.4%	8.8%	9.9%
MSCI DM	**MXWO**	**20.2**	**17.6**	**2.6**	**2.5**	**2.0%**	**2.2%**	**25.3%**	**14.9%**	**13.8%**	**22.0%**
India	SENSEX	21.1	17.1	0.0	2.6	1.4%	1.6%	36.6%	22.9%	13.7%	14.7%
America	SPX	21.5	18.6	3.7	3.4	1.7%	1.8%	21.9%	15.8%	29.1%	52.6%

Source: Bloomberg, IMS Research

3QCY20 depicted strong turnaround in corporate profitability…

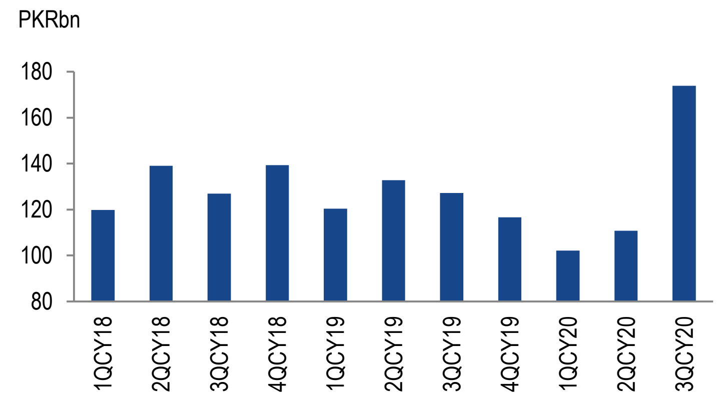
In the July-Sep 2020 quarter, the sample of about 65 companies that we track posted earnings growth of c.40% yoy compared to average 1% yoy in the previous four quarters. Note that this quarter immediately followed the period with Covid-19 lockdowns (in April-May). For context, the profitability of our Universe was flat between FY18-20.

The sharp improvement in 3Q20 was partly attributed to the "pent-up" demand from the previous quarter (inflicted by the lockdown). But, other reasons for such a resounding jump were (i) sharp monetary easing, (ii) higher volumes leading to better utilization across many industries, and (iii) a rebound in profit margins (often from losses in prior periods) as higher demand allowed price increases amid relatively stable PKR and receding inflation.

…which is likely to continue

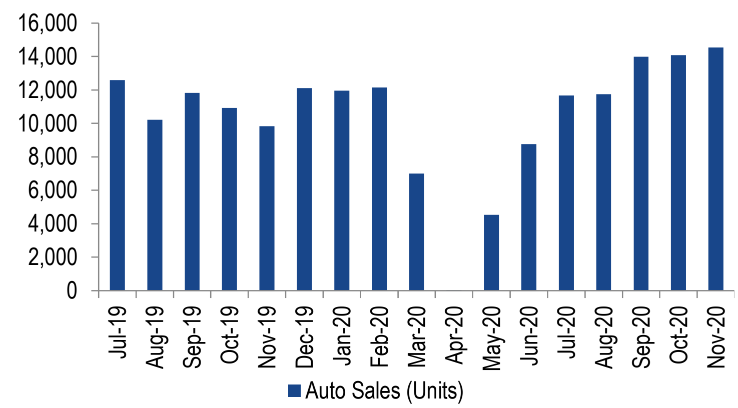
We expect corporate profitability to continue growing at a strong clip – led majorly by the cyclical sectors. The Cement sector will be the leader of profit growth for our Universe, followed by Autos, Textiles, and OMCs. We think that profit growth for the E&Ps and Banks will lag other sectors in 2021, and expect returns in these sectors to mostly be driven by valuation rerating on the back of higher oil prices and interest rate hikes, respectively.

IMS Universe profits rose to a record level in 3QCY20



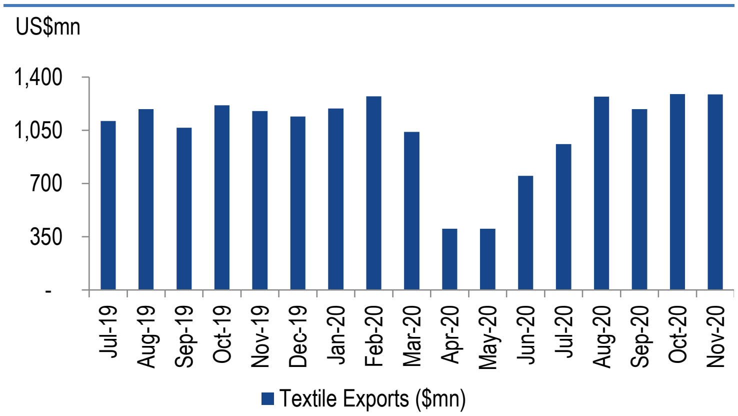
Source: IMS Research

Car Sales



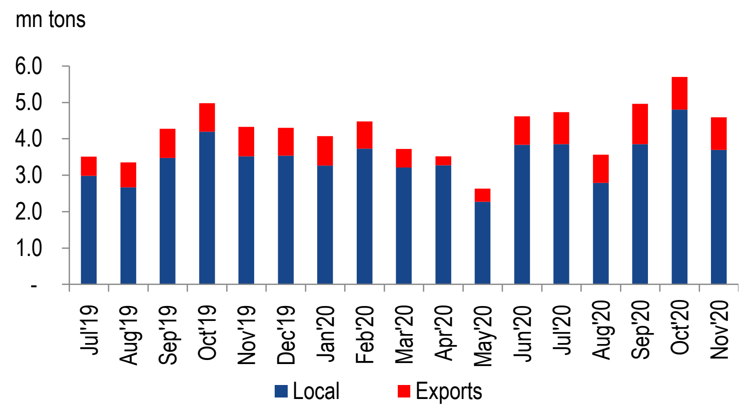
Source: PAMA

Textile exports



Source: PBS

Cement sales



Source: APCMA

Economy has finally found its footing

We think that how Pakistan has handled the Covid-19 pandemic is a testament to the strength of its economic recovery before the crisis, where it had amassed sufficient buffers to prevent a severe fallout. Of course, Pakistan would not have handled the crisis as well, had it not been for significant external assistance. Importantly, the pandemic enabled Pakistan to instate pro-growth policies earlier and much faster than we had thought before the crisis. We now expect the Economy to return to growth in FY21f, led mostly by the Manufacturing sector which has grown c.6% yoy during the July-October period. Note that Pakistan's economy is expected to rebound more quickly than other Asian economies (besides China). This is also attributed to a paltry tourism industry and Pakistan being much less tied to global trade than other Asian countries.

IMS Projections of major Economic Indicators

		FY16	FY17	FY18	FY19	FY20	FY21f	FY22f
GDP growth	*yoy*	4.5%	5.3%	5.8%	1.9%	-0.4%	2.7%	3.5%
Inflation	*yoy*	2.9%	4.2%	3.9%	6.8%	10.9%	8.7%	7.4%
Policy rate	*end June*	6.3%	6.3%	8.0%	10.5%	10.0%	7.5%	9.0%
C/A deficit	*US$bn*	4.9	12.1	19.0	13.5	3.0	1.6	3.3
CAD	*as % GDP*	1.7%	4.0%	6.1%	4.9%	1.1%	0.6%	1.2%
Exports	*US$bn*	22.0	22.0	24.8	24.3	22.5	24.3	25.9
Imports	*US$bn*	41.3	48.7	56.6	52.8	42.4	42.9	47.6
Remittances	*US$bn*	19.9	19.3	19.6	21.8	23.2	25.7	26.6
PKR/USD	*end June*	104.8	104.9	121.5	160.1	168.1	165.0	175.0
Fiscal deficit	*as % GDP*	4.6%	5.8%	6.6%	7.0%	8.3%	7.0%	n.a.

Pakistan has managed the Covid-19 pandemic better than many regional neighbors

Pre-Covid-19

- CAD manageable
- Fx reserves >3mth import cover
- Substantial foreign debt inflows for the first time
- PKR appreciated 8% from July 2019 to Feb 2020
- Primary surplus
- Positive IMF review
- Inflation very high over 11%
- Interest rates peaked at 13.25%

During Covid-19

- First negative GDP growth since 1950s due to lockdowns
- Lower oil prices and falling imports
- Record remittances & external financial assistance help avert a BoP crisis
- Outflows of debt money led to PKR depreciation of 7% and SBP Fx reserves falling to c.$10bn
- Fiscal deficit surged to 8.3% of GDP vs target of 7% due to stimulus packages
- High food inflation due to supply disruptions
- Sharp monetary easing of 625bps to contain economic contraction

Post Covid-19

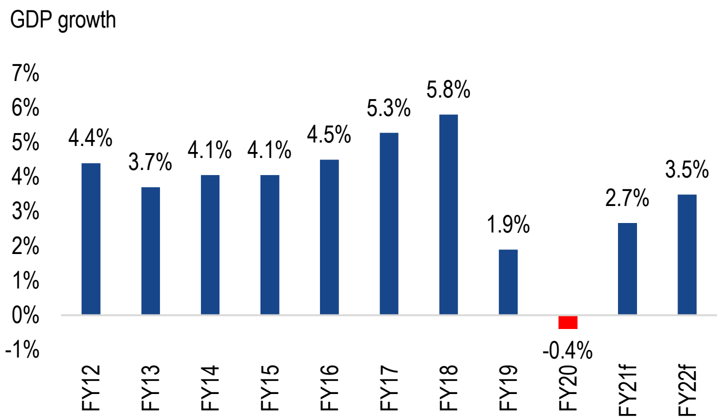
- GDP growth better than 2.0-2.5%
- Inflation will remain 8-9%
- PKR depreciation will be moderate, because of G20 repayment deferred until Jan 2022, Eurobond, privatizations, potential debt inflows
- Higher oil prices and other imports will normalize C/A balance
- Reentry into IMF program will bring back fiscal discipline.
- Govt will resort to more public private partnerships to ramp up infrastructure
- Global economy will support growth in exports, bring debt flows and Eurobond

Source: IMS Research

End of economic contraction is nigh

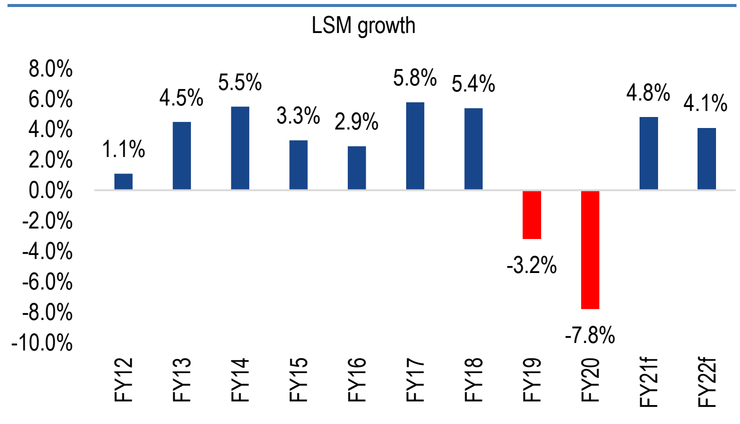
We expect Pakistan's GDP growth to cross 2.5% in FY21f, contrary to the IMF's forecast of 1% and more in line with SBP's projection of 2.1-2.5%. LSM growth will clock in at c.5% on the back of construction, automobiles, textiles, and food sectors among others. As such, even if Agriculture posts negative growth to the tune of 0.5-1.0% (unlikely as only cotton crop has been a drag so far), overall GDP growth should still be more than 2% as the largest sector Services is likely to rebound from a lockdown affected low base in FY20. This will mark the end of economic contraction since FY18, due first to austerity measures by the government and then the pandemic. Across the medium term, we also expect Pakistan to return to a virtuous cycle of growth, backed by good economic policies by the PTI government so far, and an imminent return to IMF program which should help avoid an expenditure binge ahead of next general elections in 2023.

Expected GDP growth of 2.7% exceeds SBP/IMF estimates…



Source: SBP, IMS Research

…led mostly by growth in LSM

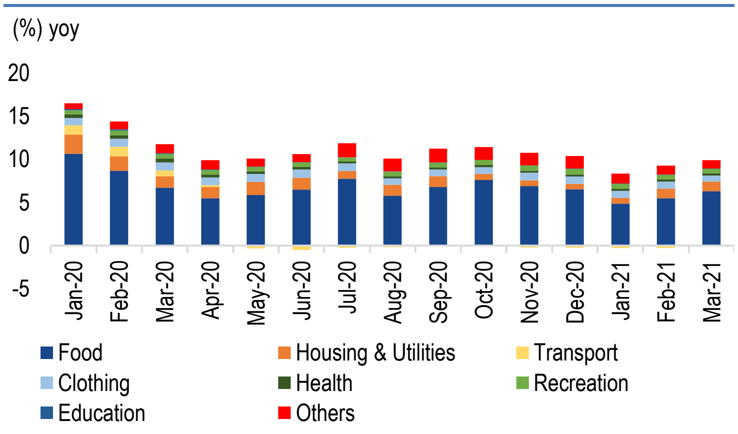


Source: Bloomberg, IMS Research

CPI will remain high due to oil prices…

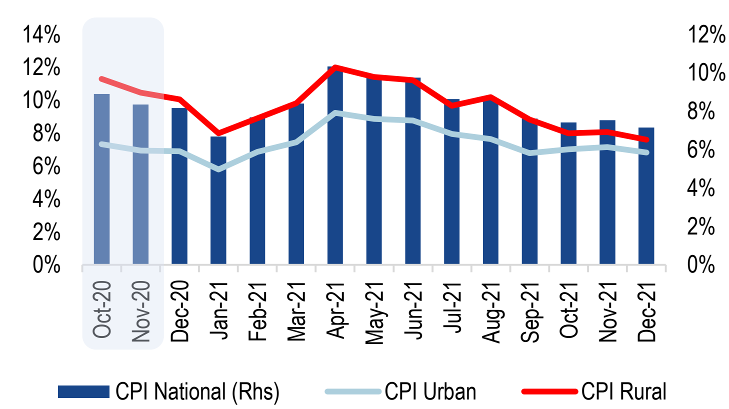
CPI will remain in the 8-9% range during 2021, where the deceleration in food inflation will be offset by higher international oil prices, which could hit US$60/bbl by December 2021, in our view. We estimate CPI to average 8.5% in CY21 and 7.5% thereon, while we expect international crude oil prices to average US$45-50 per barrel during 2HFY21, up from US$44/bbl during 1HFY21 so far. We estimate that every US$5.0/bbl increase in oil prices will increase CPI by at least 0.30ppt (only direct impact of about PKR6.0/liter increase in retail petrol prices and related indices).

Recent spikes in CPI was driven by high Food inflation



Source: SBP, IMS Research

CPI will remain 8-9% as higher oil prices will offset lower food inflation



Source: Bloomberg, IMS Research

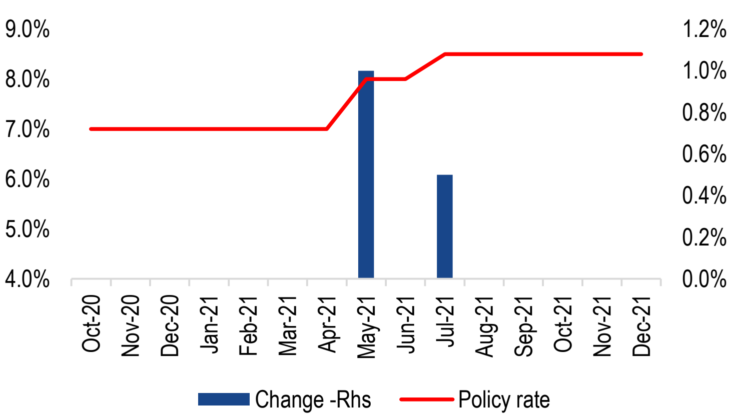
The government has addressed high prices of wheat and sugar through imports to overcome supply shortages of these and other commodities. We think spikes in food inflation will remain a sporadic phenomenon as many perishable items are prone to shortages; with rising oil prices, this could lead to irregularly high readings during the year. Note that core inflation has been steady around 7% during 2020. The combination of higher oil prices (second-round effects) and a momentum in the overall economy could mean that core inflation will likely creep up, which will have a bearing on the monetary policy given real interest rates will be negative at the start of 2021.

…and trigger increase in interest rates by mid-year

We expect 100-150bps increase in the Policy rate during 2021.

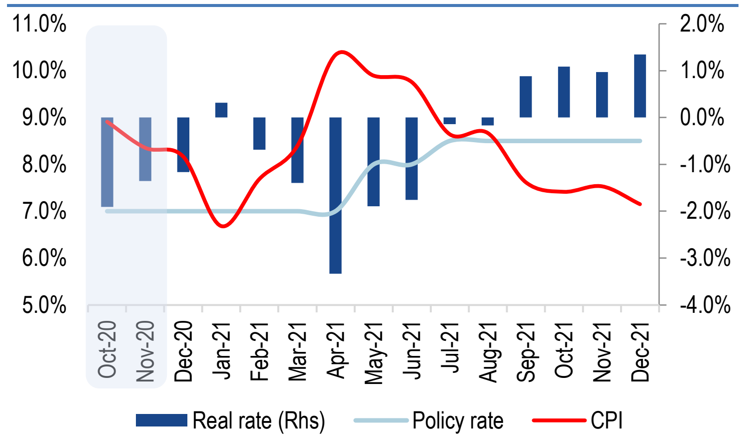
We expect that the State Bank of Pakistan (SBP) will commence raising interest rates toward positive real rates during 2021, and we see total increase of up to 150bps, from 7% to 8.5% by year-end – with the first move likely by May 2021. This is based on our expectation of still-high inflation (albeit single-digits), along with negative real interest rates and the sight of a world without Covid-19.

We expect cumulative increase of 150bps in Policy rate…



Source: SBP, IMS Research

…to build real rates to positive levels



Source: PBS, SBP & IMS Research

Higher interest rates are not expected to impede the KSE-100's rise.

Note that we see the increase in rates to be gradual, without disrupting the economic recovery. As per our discussion with many corporates, only if interest rates return to double digits (meaning an increase of 300bps or more), would it be seen as a negative trigger. For instance, as per cement companies, the recent rebound in private demand for cement has emanated from a combination of policy measures facilitating construction activities as well as low interest rates, not entirely the latter.

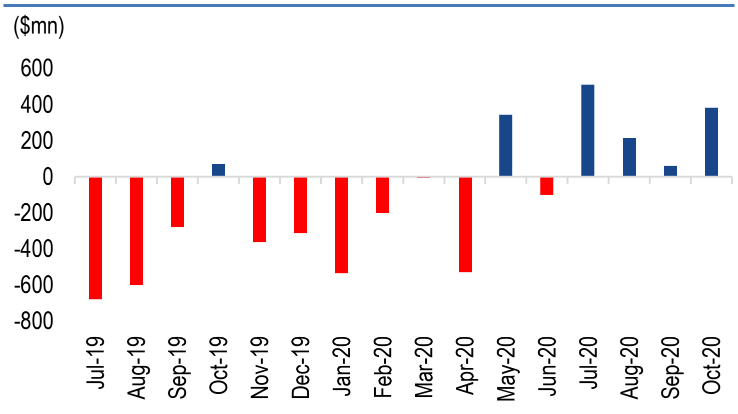
Secondly, many sectors have exhibited more than 10% volume or sales growth post lockdown and a return to profitability. These industries will deleverage with the help of higher profits and thus moderate the impact of the expected 100-150bps increase in interest rates, in our view.

External account and exchange rate stability

As before the pandemic, we expect the current account to be the least problematic economic indicator, if at all. The C/A posted a quarterly surplus in 1QFY21 for the first time since FY03, backed by record remittances, healthy exports and softer imports. We expect the CAD to clock in at 0.6% of GDP or c.US$2.0bn during FY21 vs. 1.1% of GDP the previous year. Key expectations are:

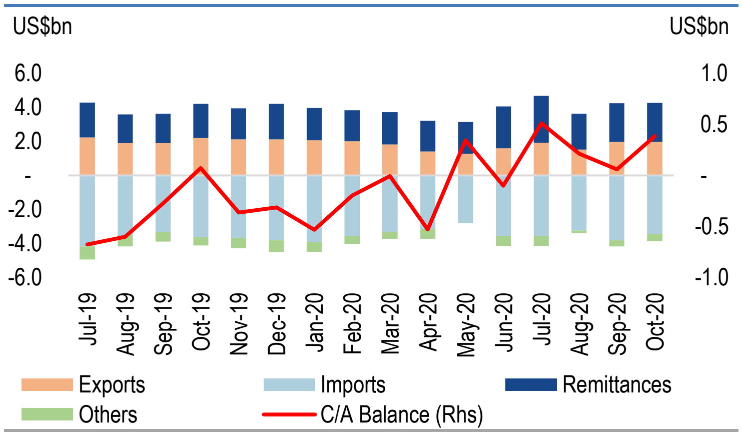
- **Exports** will continue to grow as the world emerges out of the pandemic. We understand that major textile exporters have orders up to full capacity until March 2021 i.e. for the summer season in the West. These orders were majorly booked before the developments of Covid-19 vaccines.
- **Remittances** crossed record levels since the lifting of lockdowns in Pakistan for a number of reasons. Some normalization can happen in a post-Covid-19 world, but we think that remittances have found a new normal and most of it will continue to be routed through digital and formal channels. We draw parallels with the period after the onset of US War on Terror, when the fear of global scrutiny against terror financing and money laundering dissuaded people from sending money from informal channels, leading to a step increase in remittances that proved to be durable.
- **Imports** will return to the monthly average of over US$4.0bn per month vs. US$3.5bn during June-October 2020, because of higher oil prices, and rising imports of machineries and other commodities. We estimate that every US$5.0/bbl higher oil prices would mean incremental petroleum and LNG imports of nearly US$1.0bn.

C/A balance has turned a consistent surplus since July 2020



Source: PBS, IMS Research

Current Account breakup



Source: PBS, SBP & IMS Research

We expect the resumption of the IMF program to be a key trigger.

The time is ripe for the Pakistani authorities to tap into international capital markets for a new Eurobond issue of about US$2.0bn, and complement it with privatization transactions, in our view. In the latter, Pakistan still has to sell two RLNG based power plants valued at about US$2.0bn. Recent ramp up of changes (mostly planned downsizings) at the national airline PIA and Pakistan Steel Mill also suggests that these may be ultimately offered for some partial sales to strategic investors.

IMF program expected to resume in early 2021

As per the SBP, resuming the IMF EFF program is imminent, where both IMF and Pakistan government already agree on broad policy measures.

There is a high likelihood that Pakistan will reenter the IMF program during 2021. As per the SBP, talks between the Pakistan government and the IMF are in advanced stages, where both agree on power tariff hikes and measures to increase tax collection but have yet to reach a conclusion on the timing. The government has already initiated measures such as: (i) making changes in the SBP Bill for greater autonomy, (ii) ECC has approved amendments to the NEPRA Act, (iii) the government has signed an MoU with the IPPs for lower future capacity payments in return of settlement of outstanding circular debt, and (iv) the tax filing deadline has not been extended beyond 8 December 2020, the first time in recent memory that the deadline has not been extended multiple times.

We think that entering into an IMF program will help Pakistan expedite the following measures:

- **Build up forex reserves** not only through IMF's own flows but also pave the way for Eurobond issuance (up to US$2.0bn).
- **Privatization** of RLNG based power plants, along with partial sale of stake in some of the loss-making SOEs, where the government has already kick-started work on revitalizing the national airline PIA and Pakistan Steel Mills (downsizing underway).
- **More Energy sector reforms**, where besides tariff hikes and privatization, IMF and other multilaterals can help in improving recoveries while the cost of electricity will likely creep up amid higher oil and coal prices
- **Strengthen regulatory environment**, especially in the Banking and Energy sectors, with the changes being enacted in the NEPRA and SBP Acts.

We agree that accomplishing these tasks will likely take a number of years; however, we are encouraged by the direction and there should still be interim improvement in removing structural weaknesses and impediments to future growth. It is worth pointing out that the IMF program (once it resumes) is likely to end close to the end of term of PTI government, which could mean fiscal discipline till close to the elections. This paints a supportive picture for not just 2021 but also for the next few years.

The reform process is on track

Bold steps which will have far-reaching impacts

Repeat IMF programs have been a feature of the past but Pakistan is now aiming for more sustainable and inclusive growth.

About 18 months ago, and one year into its term, the PTI government belatedly opted for an IMF program. The initial macroeconomic adjustment was painful but macroeconomic stability has been achieved, with Pakistan set for sustainable and inclusive GDP growth going forward. This was seen in early 2020 before the disruption caused by the coronavirus pandemic, but the economy has not derailed and has arguably emerged on a stronger footing. During this time, the government has continued with its improved decision making. Some notable developments are listed below:

- **Handling of the Covid-19 outbreak**: Pakistan has fared better than regional countries, including India, where the impact of outbreak and lockdown were both adequately mitigated. In Pakistan, the active case load is c.50,000 patients (0.02% of population). It is also one of the few countries where GDP contraction in 2020 was moderate and is expected to rebound more quickly.
- **More empowered economic management team:** Dr. Abdul Hafeez Shaikh has been elevated from Advisor Finance (de facto minister) to the formal status of Finance Minister. The SBP Governor Dr. Reza Baqir also appears entrenched in his role. The continuity of the economic management team ensures smooth negotiations with the IMF, and solid grounds to build on previous reforms such as interest rate setting and exchange rate management. The post of FBR Chairman has not seen this level of continuity but, as the decision to not postpone the tax filing deadline indicates, the push on tax reforms is present.
- **Downsizing in SOEs:** The government has proceeded with its plans to reduce overstaffing at PIA and Pakistan Steel Mills, which requires political will. This should pave the way for privatization / stake divestment going forward, which would thereby sustainably reduce the fiscal burden.
- **Settlement with the IPPs:** Unprecedented, as the IPPs agreed to trim future project ROE payments in exchange for settlement of past payments. A win-win, in our view, which will significantly slow the buildup of circular debt due to capacity payments of redundant power plants.
- **GIDC Settlement:** Though the matter was settled by the Supreme Court in the government's favor, it was the PTI government which strove to settle the outstanding receipts of over PKR450bn (c.1% of GDP), which is non-tax revenue, and pass the case to the Court.
- **Investigation into petrol shortage:** The independent report has reportedly highlighted several loopholes in the regulatory environment of downstream oil sector, which enabled malpractices by some parties. Petrol shortage also arose during the PML-N government's tenure in 2015, but the case was not as thoroughly investigated. Appropriate corrective measures will significantly streamline a very important sector.

Noisy politics is nothing new; the government remains strong

We do not see the PDM rally as a material threat to PTI government completing its term and the political noise should die down soon.

The Opposition has united in a coalition of more than 10 parties (collectively called the Pakistan Democratic Movement or PDM for short), and demands the ouster of the PTI government (or at least the resignation of Prime Minister Imran Khan) on the contention that the 2018 general elections were not fair. The government, in response, believes that this united opposition front is nothing more than a response to the corruption cases against opposition politicians.

The PDM has held a series of rallies in several cities over the past few months and it has now threatened to resign from the National and Provincial Assemblies (collectively the PDM has 46% seats in the National Assembly, the PPP has government in Sindh and the PML-N is the second largest party in Punjab). To this end, opposition lawmakers have already submitted their resignations to their respective party chiefs and a final decision will be taken in February 2021.

PTI govt holds majority in the NA and can also gain majority seats in the upcoming Senate elections - dominating both houses of Parliament which is good for tough reforms.

PTI's standing in the two Houses of Parliament

Seat in Senate		
PTI	18	17%
Others	23	22%
Coalition	*41*	*39%*
PPP	19	18%
PML-N	30	29%
Others	14	13%
Opposition	*63*	*61%*
Total Seats	**104**	

Seats in National Assembly		
PTI	156	46%
Others	21	6%
Coalition	*177*	*52%*
PPP	55	16%
PML-N	84	25%
Others	20	6%
Opposition	*159*	*46%*
Others	6	2%
Total Seats	**342**	

Source: National Assembly, Senate websites

We believe that the Opposition has limited room for maneuverability and that the PTI government is on track to complete its 5yr term. We base this premise on:

- **Threats to PDM unity:** The PDM coalition is unwieldy and has varying political objectives. When PML-N Chief Nawaz Sharif criticized the army chief, the PPP was seen to quickly distance itself from those comments. In addition, the PPP appears to have limited incentives to resign. In the last two general elections, the PPP has been confined to being a regional party and arguably has little to gain from fresh elections.

Recent by-elections in Gilgit-Baltistan and sustained harmonious relations between the Army and PTI government evoke optimism for political stability in near future.

- **Not all opposition lawmakers may resign:** The calls for resignations have been led by Maryam Nawaz (daughter of the aforementioned Mr. Sharif and herself disqualified from holding public office for 10 years), and by Maulana Fazl-ur-Rehman of the JUI-F who did not win a seat in 2018. At this point, it is unclear whether all opposition lawmakers will be willing to give up their seats, a factor which could give rise to intra-party factions and possibly splinter the PDM.
- **No quorum shortfalls:** We understand that even if PDM members resign from their seats, PTI and its coalition will still have seats to carry on the government (by-elections will have to be held on the vacant seats). In addition, Senate elections are due to be held in March 2021 with almost two-thirds of retiring senators belonging to the opposition. While lawmaking could be slow in the coming few months, it should be back on track post Senate elections, with the PTI and its allies expected to gain a majority.
- **Continued popularity of the PTI:** In the recently held Gilgit Baltistan elections, the PTI emerged with a clear majority, in line with pre-election polls. This seems to suggest that even in the unlikely event of mid-term national elections, the PTI should still emerge as the winner.
- **Strong civil-military relations:** We understand that the army and the government remain on the same page. Importantly, there appears to be a general consensus to set Pakistan's economy on a sustainable footing through home-grown reforms rather than relying on transactional bilateral relationships in a fluctuating geopolitical setting.

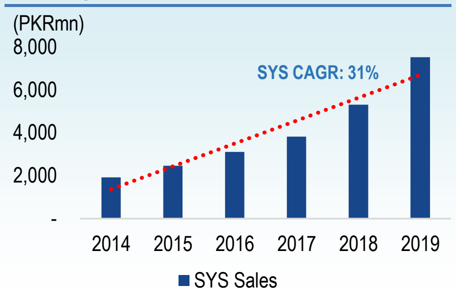
Technology in Pakistan

Despite the handsome rally in Tech stocks, there is still room for upside, as Pakistan's Tech companies boast a massive growth potential. The domestic IT export sector is also incentivized by the government, and enjoys corporate tax exemption until 2025. As exports form the bulk of revenues, the firms also benefit from PKR depreciation. Note that Pakistani government is simultaneously supporting greater digitization in Pakistan and ramping up incentives to boost future IT exports. Service offerings include Consultancy, BPO, Management Solutions, Fintech to even Licensing among others. We expect the market to assign premium valuations to the sector, which has also recently garnered interest from foreign investors (which have turned away from conventional EM themes). We highlight that the three stocks below trade at average P/E of 20-25x compared to 35-40x in case of Indian Tech companies, even though the Pakistani companies export to the same markets as their Indian counterparts.

Systems Ltd (SYS PA)

Systems Ltd (SYS) is the largest IT exporter in Pakistan (c.80% of revenue from exports), offering digital transformation, BPO, software implementation and consultancy services. The services are long-term in nature, with 90% of revenue recurring. It serves over 400 customers in North America, Europe, Middle East and Pakistan (Majorly concentrated in N.A c.40% of revenue). It is further penetrating into the European market with currently c.10% revenues derived from the region. Covid-19 has provided multiple growth opportunities for SYS due to changing market dynamics, where companies globally are striving to optimize costs through greater digitization. Apart from its core business, SYS has also diversified into Fintech (since 2015) under the banner of One-load (EP systems Pakistan) – providing financial solutions to retailers. The phenomenal 5-yr revenue and net profit CAGR of 31%, with average gross and net margins hovering c.31% and 20%, boasts attractive valuation. The management believes that Pakistan can double its IT exports in the next two years, where SYS will be a major beneficiary, hence justifying premium multiples. We expect SYS to have a forward P/E of 25x (lower than global peers), which is well justified by the past growth trajectory, management quality and promising future growth plans.

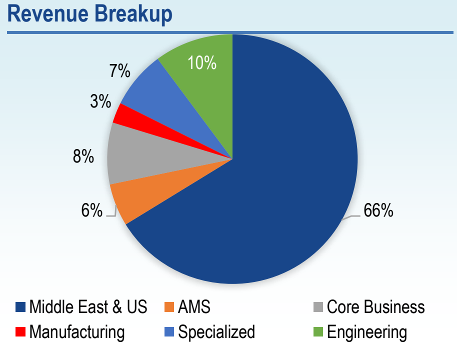
Topline growth



Avanceon Ltd (AVN PA)

Avanceon Ltd (AVN) is involved in industrial automation, process control, systems integration, energy management solutions and support services. The company has been in the automation business since 1984 and its clients are well diversified across various sectors as well such as Oil & Gas, FMCG, Chemicals and Pharmaceuticals. The After Market Support Engineering & Technical Services business of the company has been merged into Octopus Digital, a 100% wholly owned subsidiary of AVN, which helps businesses digitalize their manufacturing, supply chain and financial workflows. The subsidiary is planning for an IPO to tap into a large investor base to raise capital, which will unlock new growth avenues for it. AVN generates around 50-60% of the revenues from exports and the management is looking to penetrate further. It expects to enter the Nigerian market soon, which help them boost revenues and profitability, by entering into contracts with Nigerian multinational oil firms. This will aid in achieving the management's goal of doubling their business operations by 2022, vs. 2018 levels, as witnessed historically, where the revenue has grown at a CAGR of 33%, alongside outstanding gross margins and net margins of around 30% and 20%, respectively.

Revenue Breakup

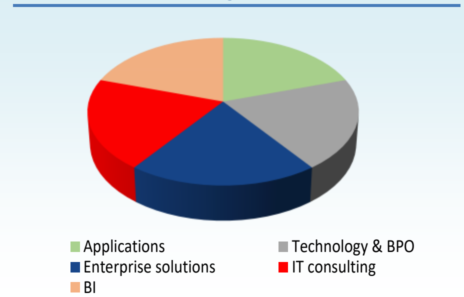


Netsol Technologies (NETSOL PA)

Netsol Technologies Ltd (NETSOL), incorporated in 1966 and having a global clientele of over 200 companies, provides software solutions for the global asset finance and leasing industry. The group generates its Core revenue through the export of (i) Software licenses (8%), (ii) implementation and consulting services (55%) and (iii) post contract support and maintenance (37%), alongside generating partial revenue through BPO. Netsol Financial Suite (NFS), alongside NFS Ascent and NFS Digital, provide solutions to auto, equipment, banking and big ticket finance companies to run their retail and wholesale finance businesses.

The company is aiming to transition from its traditional license based model to SaaS (Software as a Service) model, which will generate greater revenue through medium and large scale businesses, not relying on licenses. NETSOL's revenue (5yr CAGR of 12%) is entirely generated through exports (denominated in US$). The costs, however, are denominated in both US$ and PKR, with gross margins clocking in c.35% on average over the past 5 years. NETSOL competes with peers outside Pakistan, as the Company's business is entirely based outside Pakistan. The stock has rallied more than two-folds FYTD. We think it is well placed to benefit from SaaS model through greater customer penetration in the medium sized businesses.

Services Portfolio (weights not available)



Risks

Issues with Covid-19 vaccines

One of the key assumption behind out market outlook is the swift rollout of Covid-19 vaccines globally, which will drive global economic recovery and thus higher crude oil prices. Any reports of fatalities or severe side effects could jeopardize the rollout and thus elongate the pandemic. Alternately, a worse second wave or mutation of the virus will make things much worse before they improve. This can have repercussions for Pakistan's exports, the planned Eurobond issue and other capital flows.

Opposition parties gain momentum

Higher political noise will delay market rerating and can overshadow positives from economic improvement and corporate profitability. The PTI has to instate other reforms such as amending the SBP and NEPRA Acts. Stronger Opposition will make it difficult for the government to pass these and other seemingly unpopular measures. It will also make hurdles in the privatization of loss-making SOEs, which at least the PPP does not support.

Failure to resume the IMF program

This might happen if the government disagrees on the timing of sharp increases in power tariff and tax hikes. The delay will dampen market confidence and could even de-rate the market. A lot of multilateral flows and thus BoP stability hinge on the IMF program.

Inflation beat expectations and triggers monetary tightening

Higher-than-expected inflation can emanate from sustainably high food prices, potentially due to global supply disruptions or a pent-up demand phenomenon leading to a surge in prices. Secondly, international crude oil prices above US$60/bbl could also cause the CPI to rise above 10%. This will accelerate the increase in interest rates (more than 100-150bps expected for 2021f).

Negative surprises on corporate profitability

This is a related risk to the worsening of Covid-19 pandemic or higher monetary tightening, affecting the cyclical sectors mostly. Recall that we see Cement and other cyclical sectors contributing most of the expected earnings growth. Worsening Covid-19 pandemic can negatively affect exports and remittances.

Biden government adopts a tough stance towards Pakistan

Donald Trump discontinued CSF payments and initially adopted a tough rhetoric with Pakistan, but the Obama's tenure was fraught with drone attacks in Pakistan. Our base-case assumption is that US foreign policy for Pakistan should not change under Biden administration, but a tougher US stance towards China, than Trump had, can spillover to Pakistan. This can have negative implications for capital flows (aside from China).

Sector Outlook & Top Picks

Overweight

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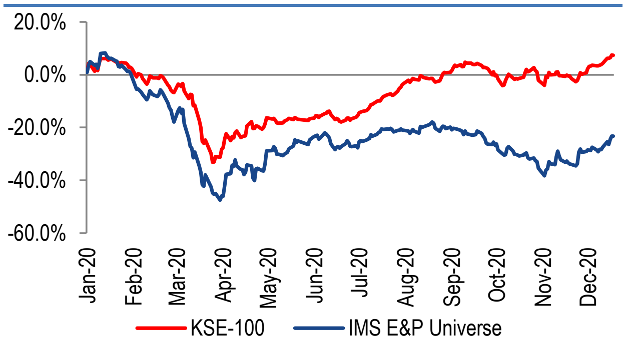
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
OGDC	Buy	150	36	5.3	4.6	0.6	7.3%
PPL	Buy	140	47	5.8	5.0	0.7	4.2%
POL	Buy	475	13	7.4	6.7	2.8	10.7%

Sector price performance



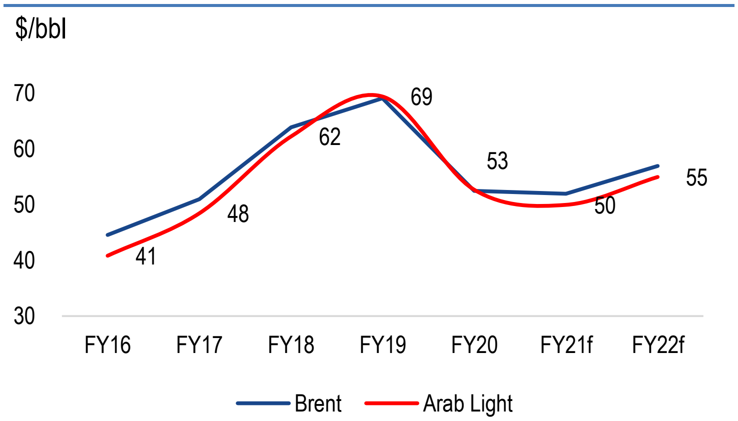
Source: IMS Research

Oil Exploration & Production

This could be the year

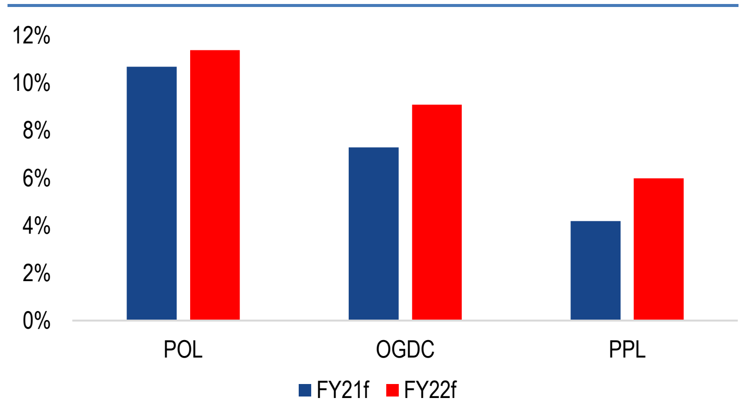
- **Global oil prices will recover to pre-pandemic levels:** The major reason why we are Overweight on E&Ps is the expectation that international crude oil prices will recover to US$55-60/bbl by end of 2021. This is predominantly driven by the expected rollout of Covid-19 vaccines and a "pent-up" demand phenomenon. Threats from Iran resuming supplies and climate change will take time to put pressure on oil prices, in our view.
- **Production will remain flat but higher prices will lift ROEs:** Major projects that will be commissioned during the year include two compression projects at Nashpa-Mela (up to 100mmcfd additional gas), and Qadirpur project which promised to enhance the field's life. Both projects benefit OGDC and PPL. In case of POL, commencement of production at Mamikhel South and Mardankhel-4 wells (delayed drilling) will drive production growth. Higher oil prices will lift future ROEs for them.
- **Exploration plans are mixed:** Despite lower oil prices, OGDC has set out to drill a record 45 wells in FY21, while PPL's plans are more scaled back due to cash-flow issues amid rising circular debt. POL's recent drilling programs have not been very successful, but it plans to drill two exploratory wells in DG Khan and Kirthar blocks.
- **Circular debt could be problematic:** On the one hand, resuming IMF program will lead to measures which are likely to stall the buildup; on the other hand, higher oil prices (LNG) could exacerbate recoveries from the gas utilities, in our view.
- **Risks:** (i) Higher oil prices will also threaten circular debt buildup and cash-flows for OGDC and PPL, and (ii) at higher stock price levels, the government may revive plans of secondary offerings in OGDC/PPL.

We believe crude oil has entered a bull market (average prices)



Source: Bloomberg, IMS Research

DY is a key valuation metric for E&Ps amid slow production



Source: IMS Research

Oil & Gas Development Co Ltd

Symbol: OGDC Rating: Buy TP: PKR150/sh

Price discovery due for long

Catalysts
- Improvement of production at Qadirpur and Uch through compression projects
- Exploration yields big discovery
- Government settles outstanding circular debt

Risks
- Aggressive drilling plans lead to large dry well expenses
- Government revives plans of secondary public offering
- Cash-flows and payouts worsen

Oil & Gas Development Company Limited

Price (PKR)	110.32
Bloomberg / Reuters	OGDC PA/OGDC.KA
Mkt Cap (US$mn)	2,964
Upside (%)	36%
Fwd D/Y (%)	7%
Total Return (%)	43%
12m Hi-Low (PKR/sh)	154.21/75.01
6m Avg. D. Vol ('000 shrs)	2,284.80
6m Avg. Td Val (US$mn)	1.48

Significantly undervalued and headwinds have subsided
OGDC is trading at a FY21f P/E of 5.3x and EV/EBITDA of c.2.0x. Foreign selling in the stock has largely completed and the government's fiscal situation has improved, ruling out SPOs in the near term, in our view. This means that there could be better price discovery in the stock, in our view. In the backdrop of rising oil prices, we estimate that OGDC trades at an implied oil price of about US$30/bbl. Additionally, it has a dividend yield of 7%/9% for FY21/22f.

Compression project to help plateau production
The compression project at Nashpa-Mela (completion due in Dec 2020) will increment gas output by c.100mmcfd (equivalent to 8% of FY21f EPS). Otherwise, much of OGDC's development capex will be employed in containing the depletion rate at mature fields. During 2021, OGDC will commission the compression project at Qadirpur, to elongate the life of the field and arrest the depletion rate. A similar project is planned for Uch (completion due Dec 2022).

Aggressive exploration program
In FY21, OGDC plans to drill a record 45 wells, 21 of which are exploratory (mostly in Frontier blocks). This is positive, because greater aggression is warranted given declining production, but can lead to more dry well expenses and dampen earnings – and potentially slow the long-due price discovery.

OGDC - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	27.53	23.27	20.69	24.22	25.38
EPS Growth (%)	50%	-15%	-11%	17%	5%
P/E (x)	4.0	4.7	5.3	4.6	4.3
P/B (x)	0.8	0.7	0.6	0.6	0.6
DPS (PKR)	11.0	6.8	8.0	10.0	15.0
DY (%)	10%	6%	7%	9%	14%
ROE (%)	20%	15%	12%	13%	13%
EV/EBITDA (x)	2.2	2.6	1.8	1.5	1.4

Source: IMS Research

About the Company
Oil & Gas Development Co Ltd is the largest E&P in Pakistan by reserves, exploration acreage and production. The Government of Pakistan directly owns 75% of the company. Its oil and gas production stands at about 38,000bpd and 1,000mmcfd respectively.

Pakistan Oilfields Ltd

Symbol: POL Rating: Buy TP: PKR475/sh

Good prospects for Tal overshadow Jhandial issues

Catalysts

- Commencement of Mamikhel South discovery (Tal)
- Resolution of security issues at Mardankhel-4 well (Tal)
- Success at two exploratory wells

Risks

- Jhandial-2 well deemed unsuccessful and write-down of its reserves
- Sharp decline in global oil prices

We like POL more than other E&Ps

In the past, we had issues with POL's paltry reserves life and concentration in Tal block. The latter has turned out to be more a virtue than weakness as Tal continues to grow production with new finds and development drilling (not true for the largest assets of OGDC and PPL). Two factors set apart POL from peers, (i) high sensitivity to oil prices, when we see global prices continuing to rise in 2021, and (ii) much better cash-flow position and in turn payouts than peers, because of less exposure to the gas chain, which is now the prime source of fresh circular debt. POL has sector-leading FY21/22f DY of 11%.

Additions in Tal block are key

The addition to production of Mamikhel South discovery by March 2021 will have an earnings impact of PKR4.0/sh (8% of FY21f EPS). Drilling of Mardankhel-4 well has been delayed to beyond FY21; based on the reserves upgrade recently, we expect it to yield production equivalent to PKR1.5-2.0/sh. Together, these additions will offset the depletion at Makori East and Maramzai.

Exploration can lead to more upside

POL will drill two exploratory wells in DG Khan and Kirthar blocks. We also think that MOL is likely to ramp up exploratory drilling in the Western areas of Tal block. This can make POL a better play for overall production growth.

POL - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	59.44	57.69	56.64	62.30	58.93
EPS Growth (%)	48%	-3%	-2%	10%	-5%
P/E (x)	7.1	7.3	7.4	6.7	7.1
P/B (x)	3.1	3.0	2.8	2.7	2.5
DPS (PKR)	50.0	50.0	45.0	48.0	45.0
DY (%)	12%	12%	11%	11%	11%
ROE (%)	48%	42%	39%	41%	36%
EV/EBITDA (x)	2.6	2.9	2.7	2.4	2.5

Source: IMS Research

Pakistan Oilfields Limited

Price (PKR)	419.32
Bloomberg / Reuters	POL PA/PKOL.KA
Mkt Cap (US$mn)	743
Upside (%)	13%
Fwd D/Y (%)	11%
Total Return (%)	24%
12m Hi-Low (PKR/sh)	473.43/241.11
6m Avg. D. Vol ('000 shrs)	351.06
6m Avg. Td Val (US$mn)	0.83

About the Company

Pakistan Oilfields Ltd is the sole E&P of the Attock Oil group, which has 21% stake in Tal block (its largest asset). It operates several blocks in Punjab and KPK province. POL's oil and gas production stands at about 7,000bpd and 80mmcfd respectively.

Overweight

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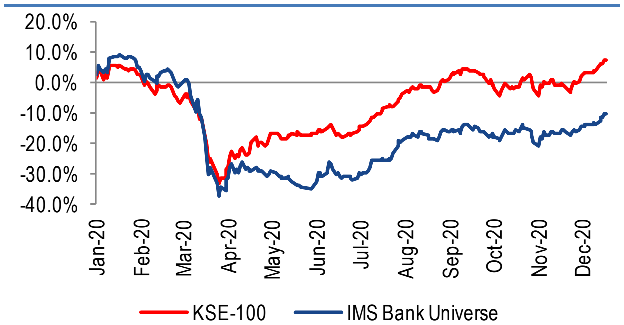
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
ABL	Buy	110	31	5.6	5.2	0.7	10.7%
MCB	Buy	235	27	7.4	7.1	1.2	10.8%
HBL	Buy	175	28	6.2	5.3	0.7	5.9%
UBL	Buy	155	20	7.2	5.7	0.8	8.1%
BAFL	Buy	45	28	5.6	4.9	0.6	8.6%
MEBL	Buy	120	13	9.0	7.4	1.8	4.7%

Sector performance



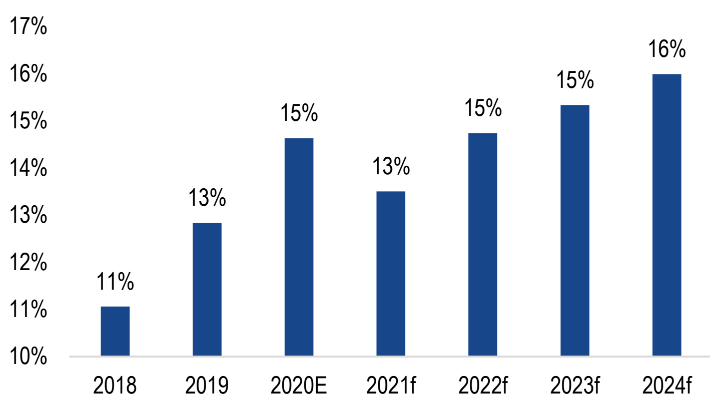
Source: IMS Research

Commercial Banks

Ripe for rerating

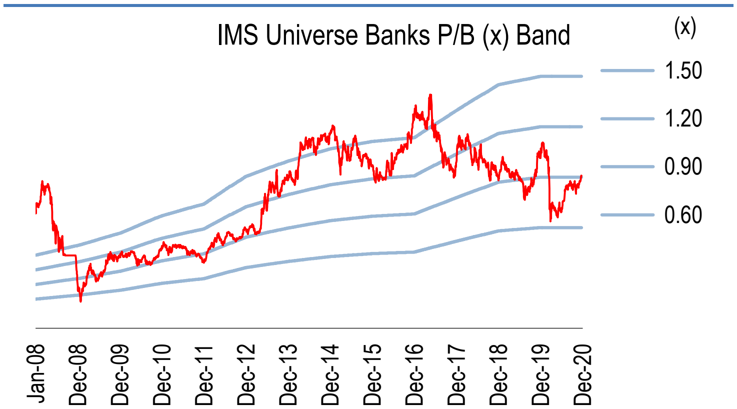
- **Balance-sheet growth to offset NIM compression:** We upgrade our stance on Pakistan Banks from Marketweight to Overweight. We expect interest rates to rise to 8%+ in CY21, after declining by a sharp 625bps to 7% in CY20. NIMs will initially come off (by 55bps in CY21f) before expanding across the medium term. Loan growth should accelerate to 12% vs. 9% in 2020f as the economy shifts into growth. We expect IMS Banks to have a 3-yr earnings CAGR of 13% for IMS Banks, where discounted valuations (CY21f PB of 0.9x and PE of 6.9x) have significant room to re-rate.
- **Adequate provisioning buffer in place to deflect any asset quality shocks:** Banks have raised general provisioning buffer to c. 1% of the domestic loan book in CY20f ahead of SBP's loan deferment and restructuring relief lifting next year. This should lead to a lower provisioning charge in CY21f, where we think banks are adequately fenced against upcoming IFRS-9 implementation. We expect the cost of risk to come off from 135bps in CY20 to c.100bps in CY21 before normalizing at 50bps over the medium term. This is due to (i) high provisioning coverage of c.90%, (ii) limited consumer exposure (7-8% of the loan mix) and (iii) loans to the public sector (government guaranteed) having a c.20% share in total loans**.**
- **ROEs set to expand – valuations are cheap:** ROEs for the banks in our coverage are expected to accelerate over the medium term as interest rates begin to rise, and are likely to retain the upward trajectory to cross c.16% by 2024f. This should help rerate valuations, where the sector trades at a median 2021f P/B of 0.9x and P/E of 6.9x. Banks such as HBL and UBL are even cheaper.
- **Risks:** (i) Greater than expected asset quality deterioration, (ii) regulatory risks (Single Treasury Account) and higher taxation on income from government securities, and (iii) higher admin expenses

ROEs to rise through the cycle



Source: Company Accounts, IMS Research

Valuations have room to expand, particularly for the big banks



Source: IMS Research

HBL Bank Ltd

Symbol: HBL Rating: Buy TP: PKR175/sh

Lots of room for a catchup rally

Catalysts

- Quicker than expected reduction in the cost of risk
- Results from the bank's ongoing push on digital
- Quick improvement in the cost/income ratio

Risks

- Greater-than-expected NPLs in CY21f
- Failure to deliver cost efficiencies
- Any fresh issues in the international business
- Continued foreign selling suppressing valuations

Legacy issues are over

HBL has emerged from its legacy issues with the US authorities – ending their enforcement actions in Sep'20 (NY Branch closed in Mar'20) and eliminating the risk of a follow-up fine. HBL has underperformed the market this year (-13% CYTD) and trades at a 50% discount to its 5yr average P/B of 1.15x and P/E of 9.0x vs. a mid-cycle ROE of over 15%. Valuations are still attractive – despite the recent rally-where better-than-expected cost control can lead to further upside.

Quality franchise, with a robust domestic business

HBL's admin expenses are normalizing as Legal & Consultancy charges have ended. HBL has prudently increased its general provisions to c.1% of domestic loans, which may lower the provisioning burden in CY21f even when SBP's loan deferment relief lifts. Rebounding fee income (c.20% growth in CY21f) together with expected rise in interest rates next year should kick start sustained earnings growth.

A 40% payout is sustainable

In part due to SBP moratorium on sector dividends, HBL's CAR has risen to 17.8% vs. 15.3% same period last year. This, coupled with a strong earnings trajectory, can sustain a 40% cash payout, in our view.

Habib Bank Limited

Price (PKR)	136.53
Bloomberg / Reuters	HBL PA/HBL.KA
Mkt Cap (US$mn)	1,251
Upside (%)	28%
Fwd D/Y (%)	6%
Total Return (%)	34%
12m Hi-Low (PKR/sh)	171.78/94.78
6m Avg. D. Vol ('000 shrs)	1,973.24
6m Avg. Td Val (US$mn)	1.53

HBL- Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	10.45	21.24	22.14	25.73	29.29
EPS Growth (%)	27%	103%	4%	16%	14%
P/E (x)	13.1	6.4	6.2	5.3	4.7
P/B (x)	0.9	0.8	0.7	0.7	0.6
DPS (PKR)	5.0	8.0	8.0	10.0	11.5
DY (%)	4%	6%	6%	7%	8%
ROE (average)	7%	13%	12%	14%	14%
NIMs	4.3%	4.7%	4.2%	4.2%	4.2%
Loan to Deposit	48%	42%	41%	41%	42%
Growth in Loan Book	8%	0%	9%	12%	14%

Source: IMS Research

About the Company

Since privatization in 2004, HBL is 51% owned by the Aga Khan Fund for Economic Development (AKFED). It is the largest bank in Pakistan by branches (1600+) and balance sheet size (assets: c US$22bn) and is the second largest bank by market capitalization.

MCB Bank Ltd

Symbol: MCB   Rating: Buy   TP: PKR235/sh

Superior risk-reward metrics

Catalysts

- An earlier and greater than expected lift in the CA proportion
- A return to net provisioning reversals
- Accelerated profit growth from its Islamic banking subsidiary

Risks

- Lower than expected recoveries from NIB's NPL book
- Risk of lagging behind in terms of innovation and ADC including digital due to conservative stance
- Quicker than expected reduction in the cash payout ratio

MCB Bank Limited

Price (PKR)	184.78
Bloomberg / Reuters	MCB PA/MCB.KA
Mkt Cap (US$mn)	1,368
Upside (%)	27%
Fwd D/Y (%)	11%
Total Return (%)	38%
12m Hi-Low (PKR/sh)	224.41/132.89
6m Avg. D. Vol ('000 shrs)	591.21
6m Avg. Td Val (US$mn)	0.63

Going from strength to strength

MCB remains a safer proposition relative to peers, given (i) stronger asset quality, (ii) superior ROE generation (c.20% through the cycle), (iii) good cost control, and (iv) capital strength (Sep'20 CAR: 20.6%). A greater-than-expected improvement in the deposit mix (more towards CA) can unlock further value. MCB trades at a 2021f P/B of 1.2x and P/E of 7.4x where our target price offers an upside of 27% or 1 yr return of 38%.

Conservative lending should work in MCB's favor

MCB's conservatively structured loan book (limited consumer & SME exposure) and tight lending standards provide comfort on asset quality, where we expect credit costs to not exceed 65bps over the medium term. Instead, we draw attention to management's plans to optimize the CASA mix (current a/c stood at c.35% in Sep'20) and medium-term growth prospects from its Islamic banking subsidiary.

An ideal blend of growth and yield

MCB has room to improve its ROE through consistently high payouts (last 5yr average: 85%) particularly as there is significant room for RWA optimization (RWA density is +50% vs. 30-40% for peers). We see MCB's mid-cycle ROE rising to 19-20% which can rerate valuations.

MCB - Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	20.14	24.85	25.05	26.13	29.05
EPS Growth (%)	17%	23%	1%	4%	11%
P/E (x)	9.2	7.4	7.4	7.1	6.4
P/B (x)	1.3	1.1	1.2	1.1	1.1
DPS (PKR)	17.0	20.0	20.0	20.0	21.0
DY (%)	9%	11%	11%	11%	11%
ROE (average)	15%	16%	16%	17%	18%
NIMs	4.7%	5.2%	4.6%	4.5%	4.5%
Loan to Deposit	45%	38%	38%	38%	39%
Growth in Loan Book	-3%	-4%	9%	14%	13%

Source: IMS Research

About the Company

Established in 1947, MCB Bank Limited is one of the largest Banks in Pakistan. Malaysian based Maybank International Berhad has held a strategic 18.8% stake in the Bank since 2008 followed by D.G. Khan (8.6%) and NML (7.4%). MCB is the largest bank by market capitalization (US$1.4bn) with an asset size of (US$11bn).

Cement

Overweight

Rahul Hans
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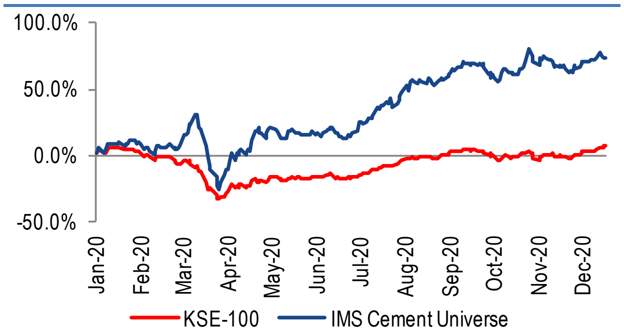
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
DGKC	Buy	155	42	10.9	4.4	0.7	0.0%
LUCK	Buy	841	23	12.5	5.4	2.1	1.3%
MLCF	Buy	48	16	10.1	7.6	1.3	0.0%
FCCL	Buy	27	28	10.4	7.0	1.4	0.0%
KOHC	Buy	235	10	10.8	7.9	2.0	0.9%
CHCC	Buy	150	12	11.9	6.8	2.1	0.0%
PIOC	Buy	130	36	12.6	5.5	1.8	0.0%

Sector price performance

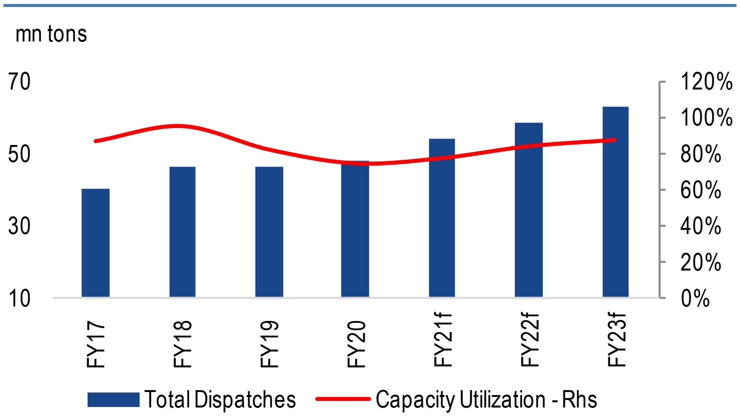


Source: IMS Research

Robust growth prospects

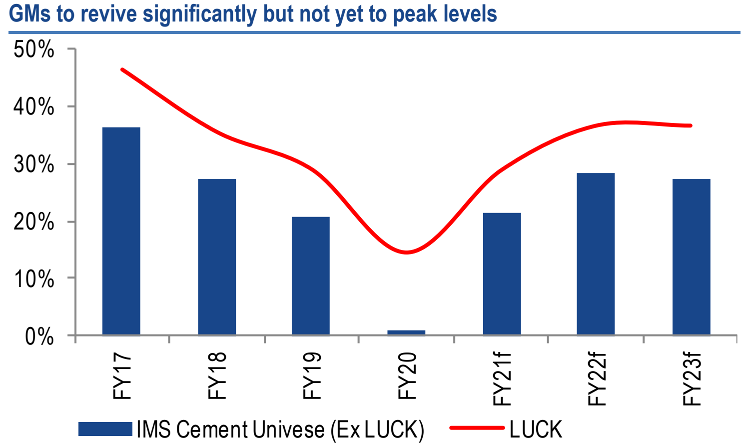
- **Dispatches on the rise:** The announcement of (i) construction package in July 2020, (ii) low cost housing scheme, (iii) amnesty scheme for developers, and (iv) construction of dams, are set to boost cement demand in the coming years. We expect local cement dispatches to grow by 10% in FY21/22f and 8% thereafter.
- **Profitability is set to revive:** The outlook for cement sector has improved significantly, given that the profitability of the sector is set to revive massively on the back of higher retention prices and lower variable costs. The impetus for higher retention prices are lower discounts/FED and a major jump in local cement prices.
- **Expansion is on the card but will take time:** North players including (BWCL, FCCL, DGKC, KOHC and PIOC) are actively pursuing to expand in the North region and have reportedly applied for an NOC. But the catch is: this time the majority of expansions will be green-field, which usually takes 3-4 years to come online. Nonetheless, we think that the risk of underutilization for the next 2-3 years is less probable.
- **South players is to offer more upside:** Local utilization of South region was c.35% vs. total utilization of c.88% in 1QFY21. However, we believe that the recently announced construction packages will lead to a surge in local demand in the South region. Companies will be able to sell more locally rather than export low-margin clinker. Additionally, the presence of North based players in South region has declined significantly after massive demand witnessed in North along with improvement in retention prices there. This will also help South players to sell more in their region and cut exports.
- **Risks:** (i) Cement pricing indiscipline, (ii) sustainably high international oil and coal prices, (iii) increase in interest rates and (iv) slower-than-expected demand.

Local demand will expand utilization levels



Source: APCMA, IMS Research

GMs to revive significantly but not yet to peak levels



Source: IMS Research

Lucky Cement Limited

Symbol: LUCK Rating: Buy TP: PKR841/sh

Best in class

Catalysts

- Timely commissioning of LEPCL
- KLM profitability exceed expectation
- Improved dynamics of Iraq and Congo operations
- Foreign buying in the stock will stretch value

Risks

- Delay in commissioning of LEPCL.
- Sustained increase in international coal and oil prices
- Slower-than-expected demand
- Sluggish increase of cement prices

Lucky Cement Limited

Price (PKR)	683.98
Bloomberg / Reuters	LUCK PA/LUKC.KA
Mkt Cap (US$mn)	1,382
Upside (%)	23%
Fwd D/Y (%)	1%
Total Return (%)	24%
12m Hi-Low (PKR/sh)	702.14/310.3
6m Avg. D. Vol ('000 shrs)	1,001.46
6m Avg. Td Val (US$mn)	3.70

Most cost efficient producer

LUCK is the most cost-efficient cement producer in the industry, largely because of its heavy reliance on WHR and in-house power generation (mostly gas based CPP), which is almost half of the price of grid cost per unit. The company's fixed variable cost/ton is relatively lower than total industry (apart from KOHC) because of lower depreciation expense. Still-low cost of energy and increase in retention prices (on rising cement prices and lower FED and trade discounts) will elevate gross margins by 14/8ppt in FY21/22f.

KLM is the new game changer

Kia Lucky Motors (LUCK subsidiary) posted PKR1.5bn operating profits in 1QFY21 and has so far launched three car models (an SUV, MPV and a hatch-back). The company is selling c.1,500 units since July 2020 and is expected to post decent profitability in FY21, where we assume gross margins of 9%.

Lucky Electric will lift earnings significantly

LEPCL, which is a 660MW coal based power plant, is expected to come online in 4QFY21. The company will be able to contribute PKR46.6/sh or 36% to the total consolidated earnings of LUCK in FY22f. LEPCL will also be a cash cow in LUCK's portfolio for future growth opportunities.

LUCK - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	35.03	18.96	54.77	127.38	145.93
EPS Growth (%)	-7%	-46%	189%	133%	15%
P/E (x)	19.5	36.1	12.5	5.4	4.7
P/B (x)	2.3	2.2	2.1	1.9	1.8
DPS (PKR)	6.5	-	9.2	26.6	32.7
DY (%)	1%	0%	1%	4%	5%
ROE (%)	13%	6%	17%	37%	39%
EV/EBITDA (x)	13.6	27.9	12.9	7.6	5.9

Source: IMS Research

About the Company

Owned by Yunus Brothers Group (YBG), LUCK is the largest cement producer of in Pakistan with an annual capacity of about 12.2mn tons. Beside cement operation in Pakistan, LUCK has cement manufacturing plants in Iraq and DR Congo. The other strategic investments of LUCK are in the Auto, Chemical, Power and Food sectors.

D.G. Khan Cement Co. Ltd

Symbol: DGKC   Rating: Buy   TP: PKR155/sh

Many positives to unlock profitability

Catalysts

- Shifting towards in-house power generation – coal based CPP and WHR
- Opening up of exports in South Africa through removal of ADD there
- Market rally will enhance the value of investment portfolio

Risks

- Delay in commissioning of Coal based CPP and WHR.
- Increase in interest rates
- Cement price disparity in South region, because of North producers sell in South
- Further delay in MCB dividends

D.G. Khan Cement Company Limited

Price (PKR)	109.19
Bloomberg / Reuters	DGKC PA/DGKH.KA
Mkt Cap (US$mn)	299
Upside (%)	42%
Fwd D/Y (%)	-
Total Return (%)	42%
12m Hi-Low (PKR/sh)	117.63/50.05
6m Avg. D. Vol ('000 shrs)	5,066.31
6m Avg. Td Val (US$mn)	3.23

Profitability is set to return

DGKC is expected to post earnings of PKR4.4/10.8bn in FY21/22f from losses of PKR2.16bn in FY20 mainly because of (i) higher local and export retention prices, (ii) lower variable cost amid lower energy prices, (iii) double-digit growth in local sales and 625bps decline in interest rates. Shift of exports from South plant to local market will also boost the company's earnings significantly.

Energy projects should reap good results

DGKC has announced the installation of 30MW coal based power plant along with a 10MW WHR plant at its plant in Hub, Baluchistan. The project is expected to come online by June 2021, and entailed an investment of c.PKR9.0bn. Presently, Hub plant is solely relying on grid electricity and the inclusion of both plants will boost DGKC's earnings by PKR3.77/sh (or c.15%) in FY22.

Portfolio is well aligned to mitigate risks

DGKC has a diversified portfolio – consisting of Banks (MCB, UBL), Textile (NML, NCL), Insurance (AICL), Automobile (Hyundai Pakistan), Dairy (Nishat Dairy) and Packaging (Nishat Paper). These cumulatively add a value of PKR46/sh in DGKC's June 2021 TP of PKR155/sh. Besides this, DGKC will be able to receive handsome amount of dividend from portfolio companies.

DGKC - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	3.67	(4.93)	10.02	24.86	27.23
EPS Growth (%)	-82%	n.m	n.m	148%	10%
P/E (x)	29.7	(22.2)	10.9	4.4	4.0
P/B (x)	0.7	0.7	0.7	0.6	0.5
DPS (PKR)	1.0	-	-	5.0	5.5
DY (%)	1%	0%	0%	5%	5%
ROE (%)	2%	-3%	6%	14%	14%
EV/EBITDA (x)	8.5	17.9	6.6	2.9	2.2

Source: IMS Research

About the Company

Majority of the stake in DGKC is owned by the Mansha family. DGKC is present in both South and North regions with an annual capacity of 7.1mn tons, and is considered among the premier cement brands in Pakistan. The company also has investments in the Group's banking, textile, automobile, dairy and packaging companies.

Pioneer Cement Ltd

Symbol: PIOC Rating: Buy TP: PKR130/sh

Energy projects underpin earnings growth

Catalysts

- Increase in market share post commissioning of the new capacity
- New coal based CPP and WHR will reduce variable cost significantly
- Price increases in the North region

Risks

- Every 1% increase in interest rates will reduce EPS by PKR1.0
- Sustained increase in international coal and oil prices
- Slower-than-expected demand
- Delay in increase of cement prices

Pioneer Cement Limited

Price (PKR)	95.52
Bloomberg / Reuters	PIOC PA/PION.KA
Mkt Cap (US$mn)	136
Upside (%)	36%
Fwd D/Y (%)	-
Total Return (%)	36%
12m Hi-Low (PKR/sh)	104.88/22.81
6m Avg. D. Vol ('000 shrs)	2,128.13
6m Avg. Td Val (US$mn)	1.10

Recent expansion will boost topline

PIOC's recent annual expansion of 3mn tons (online since FY20) coupled with the surge in local demand underpin our expectation of double-digit sales growth in FY21/22f. Moreover, better retention prices amid (i) higher retail cement prices, (ii) discontinuation of discounts and reduced FED will elevate gross margins by 23/8ppt in FY21/22f.

Variable costs expected to decline

PIOC has recently commissioned 12MW coal based CPP and 12MW WHR (in addition of 10MW previously). Another coal based CPP of 12MW is expected to come online in a month or so. The installation of both these plants will reduce variable cost considerably as PIOC's total reliance was only on grid electricity. Where the coal based CPP per unit cost is much lower than grid cost. Thus the impact of FY22 earnings will be c.PKR4.1/sh.

Risk of recent past has vanished

The company's debt has increased significantly owing to recent expansions and losses in the last five quarters. PIOC's debt to asset has increased to 55% in 1QFY21. That said, lower-for-longer interest rates (7-8%) and healthy EBITDA of c.PKR5.5/8.0bn in FY21/FY22 will place PIOC in a better position to retire its debt obligation.

PIOC - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	3.48	(0.92)	7.60	17.25	20.62
EPS Growth (%)	-52%	n.m	n.m	127%	20%
P/E (x)	27.5	n.m	12.6	5.5	4.6
P/B (x)	2.1	2.1	1.8	1.4	1.1
DPS (PKR)	1.0	-	-	3.5	4.0
DY (%)	1%	0%	0%	4%	4%
ROE (%)	8%	-2%	15%	28%	27%
EV/EBITDA (x)	20.3	n.m	8.6	4.4	3.7

Source: IMS Research

About the Company

PIOC cement is one of the leading cement brands in the North region. The company's total annual capacity has increased to 5.2mn tons after their recent expansion of 3.0 tons per annum. The current capacity wise share of Pioneer Cement is 7.5%. The company is majorly owned by the Mega Conglomerate.

Fertilizer

Risks are in the price; D/Y is attractive

Marketweight

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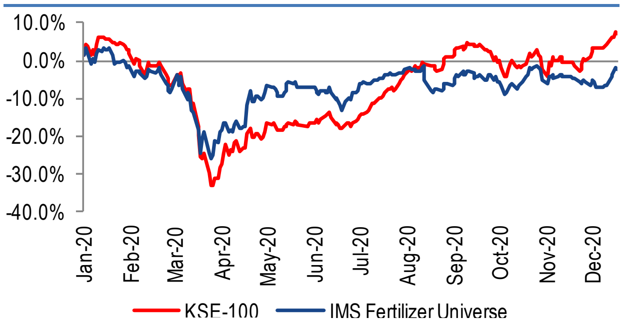
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
FFC	Buy	136	26	7.8	7.4	3.2	10.2%
ENGRO	Buy	380	22	6.8	7.3	0.7	10.2%
EFERT	Buy	75	18	6.3	8.6	1.8	15.3%
FATIMA	Neutral	30	1	6.8	7.4	0.7	4.2%
FFBL	Neutral	22	(5)	7.2	7.1	1.7	2.6%

Sector performance



Source: IMS Research

- **Urea demand to remain stable:** Industry Urea demand is expected to remain stable at 5.8mn tons in CY21 and onwards (same as the average in the past 5 years). Lower Urea prices and better farmer economics can support Urea sales in the coming years. The need for raising Urea prices is not pressing anymore, as FBR has provided relaxation to fertilizer producers regarding input sales tax adjustments for dealers with annual turnover of above PKR100mn.

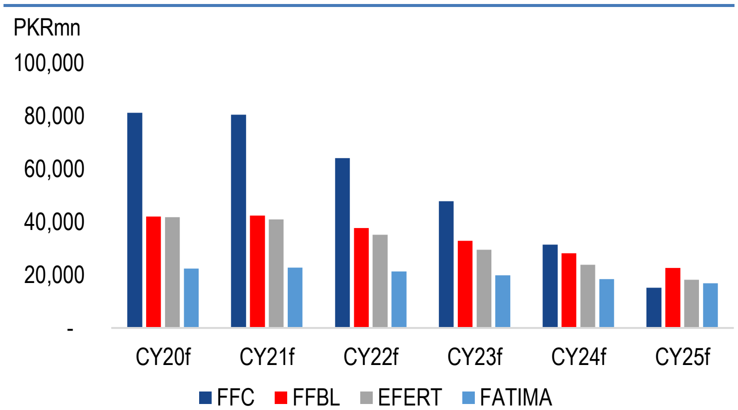
- **GIDC payment risk almost eased off:** Increase in duration of GIDC payment over 48 months, compared to 24 monthly installments previously, will meaningfully ease working capital constraints across the industry, and some companies will continue to earn from their short-term investments in the interim. But the risk of imposition of GIDC on EFERT Enven plant and FATIMA remains, despite weak grounds, in our view.

- **Urea Inventory levels will be manageable:** RLNG based Urea production has been discontinued in the wake of rising international oil and LNG prices. The government has provided additional gas to EFERT to ensure availability. We therefore believe that Urea Inventory levels will remain sufficient and within the government's desired range.

- **Dividend yield is very attractive:** Fertilizer sector will return in the spotlight courtesy decent DYs in a low interest rate environment. Presently FFC is offering CY21/22f DY of c.10%/11% while EFERT is offering a superior yield of c.15%/11%. These compare well with yields on 3/10yr PIBs – presently trading at c.8%/10%.

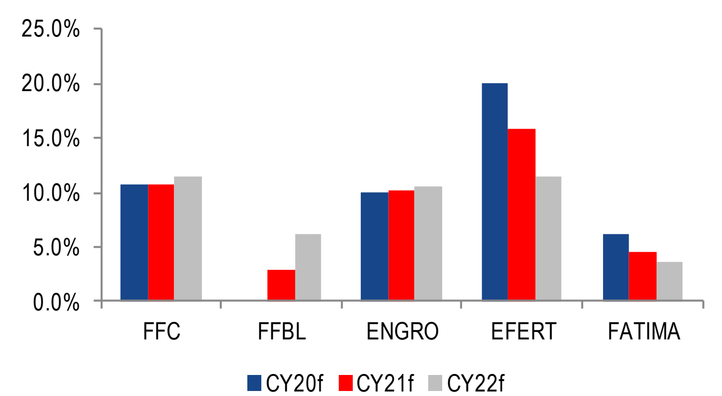
- **Risks:** (i) Increase in gas prices, (ii) slower-than-expected demand, (iii) delay in receipt of sales tax and subsidy amounts, and (iv) RLNG based plant operations throughout the year.

GIDC payments will lower payables considerably (total outstanding in PKRbn)



Source: IMS Research

Offering decent dividend yields amid low interest rates



Source: IMS Research

Fauji Fertilizer Co. Ltd

Symbol: FFC Rating: Buy TP: PKR136/sh

Defensive stock with superior yield

Catalysts

- Increase in GIDC payment period
- Increase in interest rates lift earnings on cash equivalents
- Higher oil prices will keep RLNG based producers at bay

Risks

- RLNG based players are operational
- Increase in feed and fuel gas prices and government intervention in Urea price hike
- Delay in receipt of subsidy and sales tax amount

Fauji Fertilizer Company Limited

Price (PKR)	108.18
Bloomberg / Reuters	FFC PA/FAUF.KA
Mkt Cap (US$mn)	860
Upside (%)	26%
Fwd D/Y (%)	10%
Total Return (%)	36%
12m Hi-Low (PKR/sh)	114.54/82.71
6m Avg. D. Vol ('000 shrs)	1,049.39
6m Avg. Td Val (US$mn)	0.69

Earnings to remain steady

FFC is the market leader of the Fertilizer industry in terms of market share. The Urea offtake of FFC is expected to remain at c.2.5mn tons in CY21 and beyond, as compared to their capacity of 2.05mn tons (utilization level of 125%). Therefore, the market share of the company will remain above 40%. Despite trimmed other income amid low interest rates and depleting short-term investments, FFC is expected to post EPS of PKR13.94/14.56 and DPS of PKR11/11.75 in CY21/22f while offering CY21f dividend yield of 10%.

Revised GIDC installment period will provide much relief

Increase in duration of GIDC payments over 48 months (potentially also including 12 months grace period), compared to 24 monthly installments previously, will support the company's working capital position and enable it to earn more on short term investments compared to the scenario of 24mth long payment durations previously. The total GIDC amount that FFC has to pay is c.PKR62bn.

Well aligned triggers with minimal risks

Discontinuation of GIDC on feed and fuel gas and increase in installments of GIDC have mitigated much of the risk associated with the stock, and it now offers a superior risk-reward profile. Downside risk can emerge from dilution of market share owing to government allocation of gas to RLNG based plants.

FFC - Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	13.45	14.73	13.94	14.56	14.81
EPS Growth (%)	19%	10%	-5%	4%	2%
P/E (x)	8.0	7.3	7.8	7.4	7.3
P/B (x)	3.8	3.5	3.2	2.9	2.8
DPS (PKR)	10.8	11.0	11.0	11.8	12.5
DY (%)	10%	10%	10%	11%	12%
ROE (%)	49%	50%	43%	41%	39%
EV/EBITDA (x)	5.4	4.2	4.1	4.4	4.5

Source: IMS Research

About the Company

Owned by the Fauji Foundation, FFC is one of the premier brands of urea in Pakistan, with an annual capacity of 2.05mn tons and a market share of over 40%. FFC also owns 49.9% in FFBL, the only DAP manufacturing company in Pakistan.

Engro Fertilizer Co. Ltd

Symbol: EFERT Rating: Buy TP: PKR75/sh

Unmatched yield; yet ignored

Catalysts

- GIDC deemed not applicable on Enven plant
- Extension of concessionary gas arrangement until 2023 by the government
- Pricing power returns

Risks

- Early discontinuation of concessionary gas
- Disrupted supply of gas available on swing basis
- Increase in feed and fuel gas prices despite increase in Urea prices

Rebound strongly

In January 2020, when the government discontinued GIDC on feed and fuel gases, likewise reduced Urea prices, EFERT (along with FATIMA) was initially negatively affected. But higher dispatches post 1QCY20 and better product mix other than conventional range of products have adequately supported the topline. We also believe that the downside risk to earnings has been somewhat mitigated by greater gas allocation for its base plant, which will ultimately enable EFERT to sell urea at maximum utilization level, in our view.

Obscurity regarding concessionary gas persist…

Uncertainty regarding GIDC collection from Enven plant and discontinuation of concessionary gas will keep a check on the stock's upside. The concessionary gas arrangement might end in 2023, but we have conservatively assumed it to end in CY21. Regarding GIDC imposition on Enven plant, we have not incorporated any payables, because Fertilizer Policy 2001 supports EFERT's case that no tax, cess of fees will be recovered from a plant that underwent an expansion under the policy.

…yet offering good DY

Despite lower earnings post discontinuation of concessionary gas in 2021, EFERT is offering handsome DY of 16%/11% respectively.

EFERT - Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	12.63	11.91	10.08	7.36	7.33
EPS Growth (%)	-3%	-6%	-15%	-27%	0%
P/E (x)	5.0	5.3	6.3	8.6	8.7
P/B (x)	2.0	1.8	1.8	1.8	1.8
DPS (PKR)	13.0	12.3	9.8	7.0	7.0
DY (%)	20%	19%	15%	11%	11%
ROE (%)	38%	35%	29%	21%	20%
EV/EBITDA (x)	3.0	2.9	3.1	3.9	4.1

Source: IMS Research

Engro Fertilizers Limited

Price (PKR)	63.6
Bloomberg / Reuters	EFERT PA/ENGR.KA
Mkt Cap (US$mn)	530
Upside (%)	18%
Fwd D/Y (%)	15%
Total Return (%)	33%
12m Hi-Low (PKR/sh)	75.56/50.72
6m Avg. D. Vol ('000 shrs)	2,528.33
6m Avg. Td Val (US$mn)	0.98

About the Company

EFERT is a subsidiary of Engro Corporation (c.56% owned by ENGRO) and a renowned name in Pakistan's fertilizer industry. EFERT has c.32% market share in Urea. Engro is also a leading importer and seller of Phosphate products, which are marketed extensively across Pakistan as Phosphoric fertilizers.

Engro Corporation Ltd

Symbol: ENGRO Rating: Buy TP: PKR380/sh

Evolution towards more stability

Catalysts

- Clarity on investment plan
- Extension of EFERT's concessionary gas arrangement until 2023
- Global PVC margins sustain recent highs
- PKR depreciation lifts power profits

Risks

- Imposition of GIDC on EFERT Enven plant
- Exposure to circular debt grows
- Further delay in undertaking any new project.

Engro Corporation Limited

Price (PKR)	312.49
Bloomberg / Reuters	ENGRO PA/EGCH.KA
Mkt Cap (US$mn)	1,125
Upside (%)	22%
Fwd D/Y (%)	10%
Total Return (%)	32%
12m Hi-Low (PKR/sh)	366/237.65
6m Avg. D. Vol ('000 shrs)	676.55
6m Avg. Td Val (US$mn)	1.25

Profit mix altered in favor of more stable earnings

Initially EFERT was considered as the major earnings contributor of ENGRO's consolidated profitability; but after the commencement of Engro Powergen Thar Power Ltd and the expansion and growth of its petrochemical arm – EPCL, there has been a shift in the mix. This is the reason that the discontinuation of concessionary gas in 2021 will only affect ENGRO's earnings by 7% in FY22. Thus, we expect the company to post nearly flat earnings in FY22 (PKR42.92 vs. EPS of PKR46.21 in FY21).

Guidance on investment plan is key

The company is surveying options for investments including, but not limited to, Naphtha cracking Plant, RLNG Terminal, expansion of Towering Business and any other investment in Thar. The cash and equivalents on ENGRO's books stands at c.PKR62bn (Sep'20). Any new investment will lead to an opportunity cost of interest earned on the cash but can add decent value in the company's portfolio and future earnings.

Attractive valuations and yield

ENGRO trades at a CY21f P/E of 6.8x, at a c.31% discount to previous 5yr averages, primarily due to anticipated earnings of Engro Powergen Thar. The company is also expected to pay dividend of PKR32/33 per share in CY21/22f, implying the dividend yield will be 10%/11% in CY21/22f.

ENGRO - Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	28.70	45.96	46.21	42.92	44.67
EPS Growth (%)	30%	60%	1%	-7%	4%
P/E (x)	10.9	6.8	6.8	7.3	7.0
P/B (x)	0.9	0.8	0.7	0.7	0.6
DPS (PKR)	24.0	31.0	32.0	33.0	35.0
DY (%)	8%	10%	10%	11%	11%
ROE (%)	9%	13%	11%	9%	9%
EV/EBITDA (x)	4.6	3.1	2.8	2.8	2.4

Source: IMS Research

About the Company

ENGRO is a subsidiary of Dawood Hercules Corporation Ltd. The principal activity of the Company, is to manage investments in subsidiary companies, associated companies and joint venture, engaged in fertilizers, PVC resin manufacturing and marketing, food, energy, LNG and chemical terminal and storage businesses.

Overweight

Abdul Ghani Mianoor
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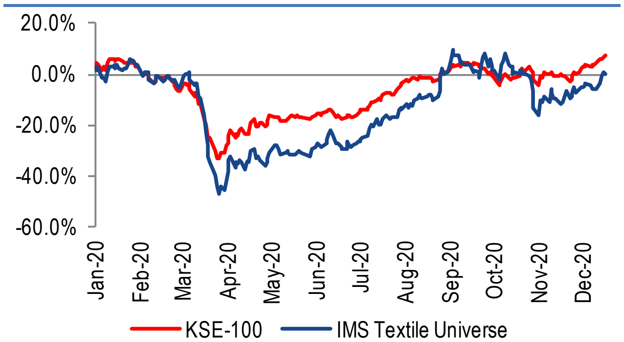
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
NML	Buy	132	33	8.4	7.2	0.5	5.0%
ILP	Buy	80	24	9.9	8.1	2.9	5.0%
GATM	Buy	50	37	6.6	5.3	0.9	6.8%

Sector performance



Source: IMS Research

Textiles

Healthy order flows to sustain growth

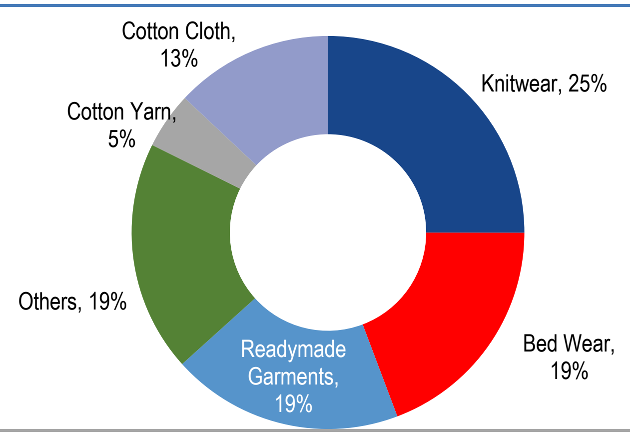
- **Strong order flows for the sector:** Following the lifting of lockdowns globally after the first wave of Covid-19, Pakistan's textile sector witnessed a surge in exports (up by an average 25% mom since April). The rise in exports is largely attributed to the higher demand for Home Textiles. We believe that the US-China trade spat, which had led to an influx of rerouted orders to Pakistan, is likely to remain so under Biden administration. The sector currently has strong order flows for the next 3-6 months (industry operating at full capacity), where we believe that the orders rerouted from regional competitors may continue beyond June.

- **Exports oriented focus of the government:** The government has repeatedly highlighted the importance of exports on the economy and have thus provided incentives to the exporting sectors in the form of subsidized utility tariffs, low interest rates (EFS, LTFF and TERF), sales tax refunds and DLTL have improved Pakistan's global competitiveness. We believe that the government will continue to facilitate the sector.

- **Formulation of the new textile policy:** The Textile Policy 2020-25 is expected to ramp up the sectors competitiveness through the reduction in power tariffs (US¢7.5/kWh), gas tariff (PKR786/mmbtu vs. PKR852mmbtu currently) and RLNG at US$6.5/mmbtu. The policy will maintain the subsidized borrowing rates, while also continuing the duty drawbacks. The long-term policy is likely to attract more investments into the sector, which may lead to the fulfilment of the US$25bn exports target (by 2025).

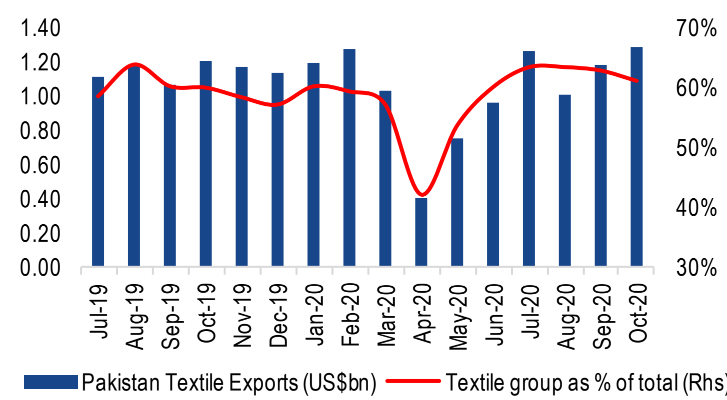
- **Risks:** (i) Significant PKR/US$ appreciation, (ii) discontinuation of subsidized utility tariffs, (iii) aggressive incentives by governments of competing regions, (iv) volatility in cotton rates, and (v) sluggish global recovery due to prolonged lockdowns.

Garments and Home Textiles together make c.60% of Textile Exports



Source: PBS, IMS Research

Textiles exports have recovered after a sharp fall



Source: PBS

Nishat Mills Ltd

Symbol: NML   Rating: Buy   TP: PKR132/sh

Core earnings positioned to grow

Catalysts

- Sooner than expected recovery in exports destinations
- Quick model launches by Hyundai Nishat Motor
- Textile Policy 2025

Risks

- Significant PKR appreciation
- Discontinuation of subsidized utility tariffs
- Aggressive incentives by governments of regional competitors
- Prolonged second wave

Nishat Mills Limited

Price (PKR)	99.43
Bloomberg / Reuters	NML PA/NISM.KA
Mkt Cap (US$mn)	218
Upside (%)	33%
Fwd D/Y (%)	5%
Total Return (%)	38%
12m Hi-Low (PKR/sh)	117.81/54.07
6m Avg. D. Vol ('000 shrs)	1,362.15
6m Avg. Td Val (US$mn)	0.79

Rise in core earnings to lift profitability

Our liking for NML stems from the expected rise in core earnings, where we estimate core earnings to have a 3yr CAGR of 20% (FY21-24f). The current exports momentum in the value-added segment is likely to continue, as the company is currently operating at full capacity with the filling of orders till March 2021. We believe that the demand for Home Textiles will remain strong for the remainder of FY21 (until the global inoculation). Garments demand is expected to rebound following the easing of lockdowns. The shift from yarn exports to local sales, will also lead to a rise in core earnings (c.20% of sales).

Expansions in the value-added segments

NML's expansion into the Terry segment is expected to commence during 2QFY21 with an initial capacity of 10tpd. Gross margins are expected to clock in at c.20% following the completion of Phase-II (30tpd in FY2022). NML currently plans on expanding the capacities of the other value-added segments, in light of the strong demand for the segments (c.22% yoy rise in sales in 1Q).

Strong investment portfolio

NML's investment portfolio (other Nishat group companies) provides a cushion against textile sector headwinds through support to the bottom line; average c.58% of pre-tax earnings (dividends), with exposures in the autos (HNML), cement, financial services and power among others.

NML - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	16.66	9.97	11.88	13.73	15.20
EPS Growth (%)	43%	-40%	19%	16%	11%
P/E (x)	6.0	10.0	8.4	7.2	6.5
P/B (x)	0.5	0.5	0.5	0.5	0.4
DPS (PKR)	4.0	4.0	5.0	6.0	6.0
DY (%)	4%	4%	5%	6%	6%
ROE (%)	8%	5%	6%	6%	7%
EV/EBITDA (x)	5.3	7.4	6.6	5.6	5.0

Source: IMS Research

About the Company

Nishat Mills Limited is a flagship company of the Nishat group. It is one of the largest vertically integrated textile companies and exporters in Pakistan. The company operates in the spinning, weaving, home textiles and garments segments, with a total of 34 manufacturing facilities located in Lahore, Faisalabad, Sheikhapura and Ferozewatan.

Interloop Ltd

Symbol: ILP Rating: Buy TP: PKR80/sh

Expansions to trigger strong financial performance

Catalysts
- Sooner-than-expected recovery in export destinations
- Profitability in the denim segment
- Textile Policy 2020-25
- Strong sales growth leading to higher margins than expected

Risks
- Significant US$/PKR appreciation
- Discontinuation of subsidized utility tariffs
- Prolonged second wave, hampering global recovery
- Delays in completion of expansion projects

Interloop Limited

Price (PKR)	64.36
Bloomberg / Reuters	ILP PA/INTR.PSX
Mkt Cap (US$mn)	350
Upside (%)	24%
Fwd D/Y (%)	5%
Total Return (%)	29%
12m Hi-Low (PKR/sh)	72.11/32.03
6m Avg. D. Vol ('000 shrs)	910.05
6m Avg. Td Val (US$mn)	0.34

Hosiery expansion to strengthen profitability
ILP is one of the largest hosiery manufacturers in the world, with c.3-4% global market share. The hosiery segment contributes over c.85% of the revenues, while enjoying healthy margins of c.30% (3yr average). We believe there is further room for margins to expand in this segment, particularly after (i) strong set of results in 1QFY21 (revenue up 29% yoy), (ii) rise in hosiery prices (US$5.37 from US$4.90 in FY20) and (iii) completion of hosiery plant V (current capacity: 12,000 dozen pairs/day; 2022f target: 42,000 dozen pairs/day). Revenues are estimated to have a 3yr CAGR of 12% and earnings of 8% over FY21-24.

Denim segment to add to topline
The Denim segment commenced in Dec'19 and generated c.PKR1.0bn revenue in FY20. Phase-I of the expansion has been completed where the capacity is currently 20,000pcs per day out of a planned 40,000pcs per day (phase-II by FY22). ILP has been successful in adding renowned brands for denim, while also getting orders rerouted from China. The segment is expected to breakeven by 4QFY21, where margins of c.15% are possible, in our view.

Premium valuations
ILP trades at a FY21/22f P/E of 9.9x/8.1x, which is justified by its market leadership, while reaping ROEs of 34% (average) for FY21/22f.

ILP - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	5.82	1.30	6.53	7.99	8.19
EPS Growth (%)	36%	-78%	404%	22%	3%
P/E (x)	11.1	49.7	9.9	8.1	7.9
P/B (x)	3.2	3.4	2.9	2.5	2.1
DPS (PKR)	3.0	2.0	3.3	3.8	4.0
DY (%)	5%	3%	5%	6%	6%
ROE (%)	38%	7%	32%	33%	29%
EV/EBITDA (x)	9.2	16.7	8.6	7.3	7.0

Source: IMS Research

About the Company
Interloop is one of the largest hosiery manufacturers in the world, with a global market share of 3-4%. ILP operates in the hosiery, spinning, denim and apparels segments, with the capacity to produce c.700mn pairs of socks p.a. ILP presently has a manufacturing presence in 3 countries and services in 4.

Overweight

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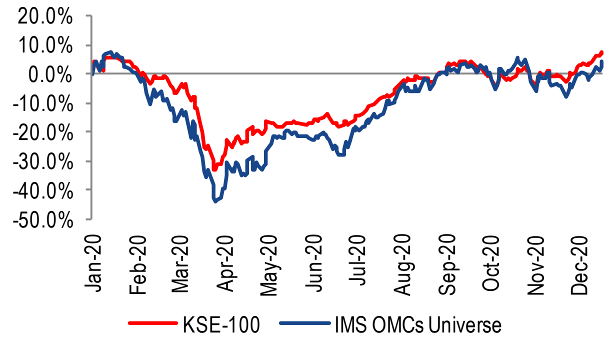
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
PSO	Buy	300	41	5.3	5.1	0.8	3.3%
APL	Buy	400	19	8.8	7.3	1.7	5.3%
SHEL	Sell	215	(14)	20.0	15.1	4.5	3.2%

Sector performance



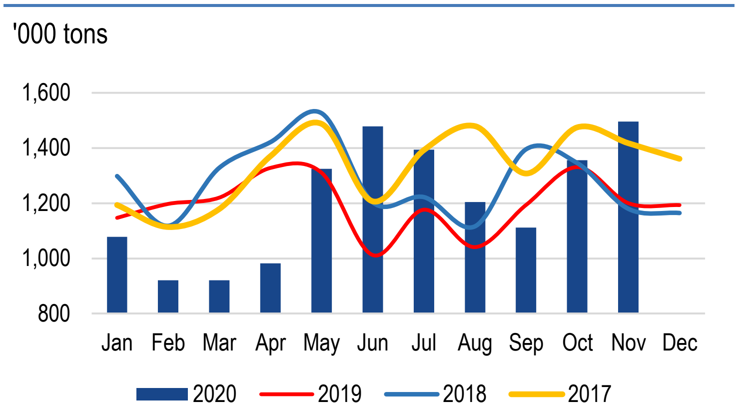
Source: IMS Research

OMCs

Positives keep on coming

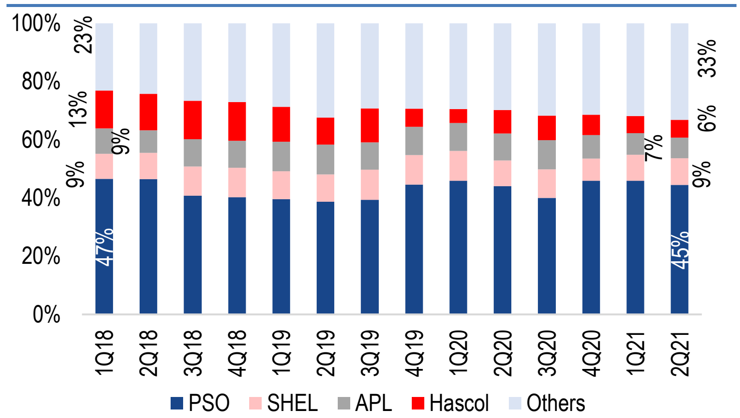
- **Volumes emerging from trough levels:** Post Covid-19 lockdown, petroleum consumption rose handsomely by 11% yoy in 5MFY21. Sales of Mogas and HSD rose 9% and 12% yoy; the latter reflects pickup in industrial activity (LSM grew 6.6% yoy during July-Oct 2020). This is happening in the backdrop of more moderate competition and improving regulatory environment – more conducive for profit growth.
- **Good regulatory changes:** In 2020, the government passed favorable measures, such as biweekly price revisions which passes on gyrations in oil prices and PKR in the prices and moving away from PSO's import prices. A new Petroleum policy, in concert with the findings of an investigation report on past petrol shortages, is likely to lead to further improvements in the competitive landscape (more stringent requirements for new entrants), ultimately favoring the incumbents, in our view.
- **OMC margins increase on the cards:** Based on the average headline CPI of 10.8% during FY20, the next revision in fixed margins on HSD and Mogas could be about PKR0.30/liter on top of PKR2.81/liter at present. We estimate that this will have an annualized EPS impact of PKR3.5/ 3.3/ 3.5 per share on PSO / SHEL / APL. The catalyst is already incorporated in our estimates but will rejuvenate stock prices.
- **Circular debt buildup should be moderate:** Pakistan's re-entry into IMF program, settlement with the IPPs for outstanding payments and probable revival of privatizations (of Discos) will help contain the buildup and also settle some of the outstanding amount, in our view. Thus, PSO is one of our top picks in the OMC space.
- **Risks:** (i) Sharp increase in international oil prices will make petroleum less affordable and hurt volume growth, and (ii) resurgent competition from small OMCs.

Combined sales of retail fuels edging towards all-time highs



Source: IMS Research

PSO & incumbents will consolidate market share (ex-FO) from smaller OMCs



Source: IMS Research

Pakistan State Oil

Symbol: PSO Rating: Buy TP: PKR300/sh

Strengths back in focus

Catalysts

- MoU with IPPs culminate in cash injection in the Power sector
- Regulatory changes consolidates competition from small OMCs
- Government announces incentives for refineries to upgrade

Risks

- Increased competition among the incumbents
- Lack of regulatory oversight to curb malpractices and smuggling
- Drain of cash for Pakistan Refinery leads to little improvement in payouts

Pakistan State Oil Company Limited

Price (PKR)	213.27
Bloomberg / Reuters	PSO PA/PSO.KA
Mkt Cap (US$mn)	625
Upside (%)	41%
Fwd D/Y (%)	3%
Total Return (%)	44%
12m Hi-Low (PKR/sh)	216.85/113.98
6m Avg. D. Vol ('000 shrs)	1,846.05
6m Avg. Td Val (US$mn)	2.14

Encouraging trends in circular debt

PSO has demonstrated considerable improvement in cash flows since two Energy Sukuk issues and other measures by the government. The next trigger for cash-flows is when the government starts to disburse cash to IPPs as per the MoUs signed recently. Resumption of IMF program can lead to stalling of the buildup. All in all, PSO's cash-flows will progressively improve, which historically has helped shrink the valuation discount with the market.

Regaining strength in retail fuels means more cash earnings

Simultaneously, PSO will consolidate its market shares in the key markets of HSD and Mogas. This will be driven by its stake in the white oil pipeline and potential regulatory changes that help diminish competition from smaller OMCs, in our view. Note that the retail fuels (cash sales) presently comprise over 65% of total revenues, compared to c.20% in FY14. This also means amplified impact of inventory gains, as oil prices are expected to rise ahead.

Turnaround of PRL holds key to payout policy

We expect PSO to re-rate but not due to an improvement in payouts. This time PSO needs to conserve cash for upgrade projects of Pakistan Refinery. We, however, await a new Petroleum Policy, which may have more incentives for upgrade projects by refineries, thus enabling more cost-efficient borrowing.

PSO - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	29.16	(13.77)	40.07	42.00	45.03
EPS Growth (%)	-11%	n.m	n.m	5%	7%
P/E (x)	7.3	n.m	5.3	5.1	4.7
P/B (x)	0.8	0.9	0.8	0.7	0.6
DPS (PKR)	8.0	2.0	7.0	10.0	14.0
DY (%)	4%	1%	3%	5%	7%
ROE (%)	12%	-6%	15%	14%	14%
EV/EBITDA (x)	8.2	85.3	4.3	3.2	2.5

Source: IMS Research

About the Company

Pakistan State Oil Co Ltd is majorly owned by the Government of Pakistan, which also has a controlling interest in the company. It is the market leader with over 40% market share, courtesy being the largest importer, and has the largest network of 3,500 pumps and storages.

Attock Petroleum Ltd

Symbol: APL Rating: Buy TP: PKR400/sh

Best risk-reward in the space

Catalysts

- Double-digit growth in retail fuels continue
- Govt. allocates more fund to road construction, lifting asphalt demand
- Commission of Port Qasim storage facility

Risks

- Inventory losses hurting payout
- Issues with group refineries which compromise supplies and reduce its market share
- Resurgent competition

Quality over quantity

APL is the second largest OMC in Pakistan with an overall market share of 10% in FY20. About 80% of total revenues come from retail fuels, a very desirable attribute, which explains its superior ability to generate cash earnings. This leads to consistent payout ratio of over 80%. We expect a 3yr EPS CAGR of 8% along with average DY of 10% over the next three years.

Recent storage expansions should enable APL to outperform industry

Backed by recent storage expansions, APL can already maintain 40/28 days' equivalent inventory of HSD/Mogas, slightly better than in case of PSO. During FY21, APL will commission a 40,000 tons of storage facility at Port Qasim, which will help penetrate the South markets. We thus expect APL to increase its market share by 2-3ppt in the medium term. In the backdrop of rising oil prices, bigger inventories is a boon and will amplify profits.

Gaining strength in an evolving furnace oil market

APL had c.20% share of the furnace oil market in 5MFY21, compared to its overall share of 10%. It is capitalizing on more creditworthy demand from industries as FO prices remain economical in Pakistan. APL also supplies the fuel to the most efficient RFO based IPP, which is still relevant in the generation mix. Recall FO sales have better profit margins than retail fuels.

APL - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	39.79	10.13	38.36	46.26	53.73
EPS Growth (%)	-30%	-75%	279%	21%	16%
P/E (x)	8.5	33.3	8.8	7.3	6.3
P/B (x)	1.8	1.8	1.7	1.6	1.5
DPS (PKR)	20.0	9.0	18.0	32.0	40.0
DY (%)	6%	3%	5%	9%	12%
ROE (%)	21%	5%	20%	23%	25%
EV/EBITDA (x)	6.0	22.1	5.3	4.4	3.8

Source: IMS Research

Attock Petroleum Limited

Price (PKR)	336.97
Bloomberg / Reuters	APL PA/APL.KA
Mkt Cap (US$mn)	210
Upside (%)	19%
Fwd D/Y (%)	5%
Total Return (%)	24%
12m Hi-Low (PKR/sh)	394.43/211.87
6m Avg. D. Vol ('000 shrs)	63.99
6m Avg. Td Val (US$mn)	0.13

About the Company

Attock Petroleum Ltd is engaged in the marketing of petroleum and related products including. It is majorly owned by the Attock Oil group and is thus vertically integrated with an E&P, two oil refineries and a power plant. APL has a leadership position in asphalt and other deregulated POL products.

Marketweight

Abdul Ghani Mianoor
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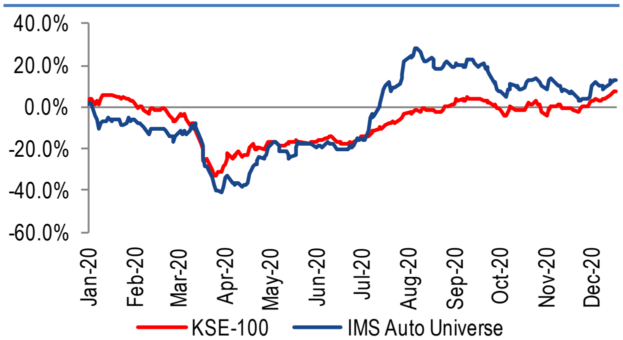
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
INDU	Buy	1,458	21	10.4	10.0	2.1	4.7%
HCAR	Neutral	365	12	19.0	9.7	2.5	1.5%
PSMC	Neutral	235	5	(69.4)	34.3	0.8	0.0%

Sector performance



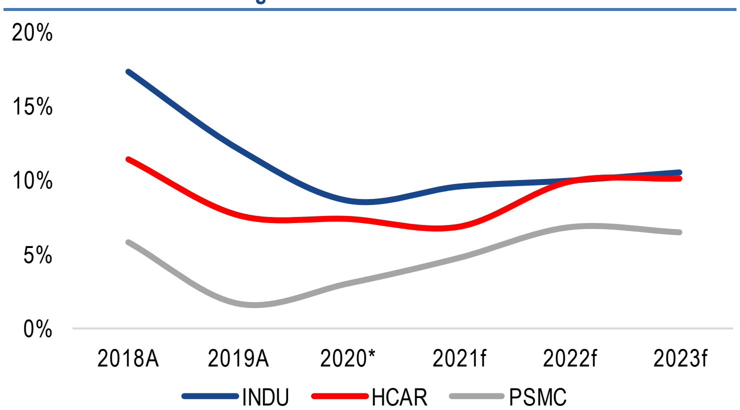
Source: IMS Research

Autos

Time is ripe

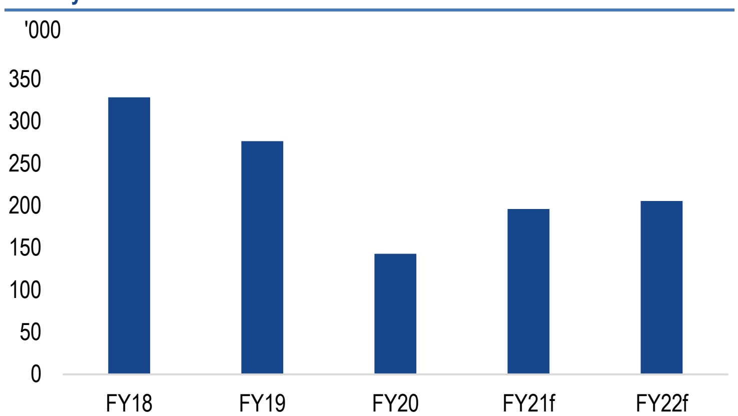
- **Volumes to drive profitability:** Industry sales are likely to witness a robust 37% yoy recovery, during FY21, to c.196,000 units due to strong pick-up in auto financing (courtesy low interest rates, 7% in Dec'20 vs. 13.25% SPLY), improving macro environment post-lockdown and the entrance of new players by June 2021. We believe the impact of auto-financing is yet to be seen (presently 25-30% of sales), relative to prior years (c.50%). New model launches by the current incumbents are a key catalyst for industry sales.
- **Healthy margins recovery:** Industry margins rose by c.2ppt to 6.3% in 1QFY21 vs. 4.7% in SPLY and gross losses in 4QFY20. The rebound in gross margins is likely to improve further due to the rise in volumetric sales and recent appreciation in the PKR/US$. The present supply chain issue originating from Asian ports has led to air shipping of parts, which is more expensive than the conventional seaborne imports. This however may keep margins in check temporarily, in our view.
- **New models to thwart competition:** The outgoing ADP is likely to lead to an influx of new entrants by June 2021, backed by lower-for-longer interest rates and uptick in GDP growth. We believe that incumbents are likely to introduce new models, in order to thwart increasing competition from the new entrants, such as the new Honda City, Toyota Yaris, Corolla (facelift) and a potential replacement for the Suzuki Swift.
- **Formulation of new auto policy likely to improve profitability:** The new auto policy, which is expected to be developed by June 2021 may potentially lead to a reduction in taxes such as FED and ACD. This in turn, would improve margins and lower car prices (taxes make up 30-40% of car prices), thus further strengthening sales in our view.
- **Risks:** (i) Sharp PKR/US$ depreciation, (ii) sluggish economic recovery due to second wave of the pandemic, (iii) delays in new model launches, and (iv) loss of significant market share to the new entrants.

GMs to rise on the back of greater volumes



Source: Company Account, IMS Research

Industry sales set for a rebound



Source: PAMA, IMS Research

Indus Motors Ltd

Symbol: INDU Rating: Buy TP: PKR1,458/sh

Most well-positioned OEM

Catalysts

- New model launches such as the Corolla X facelift and Cross
- Additional restrictions on used imports
- Sharper economic recovery
- Upcoming Auto Policy

Risks

- Significant PKR depreciation
- Rise in interest rates
- Decline in farmer income due to poor crop performance, impacting rural sales
- Delays in new model launches

Sales growth on the back of new model launches

During the 5MFY21 period, INDU's sales rose 87% yoy on the back of strong demand for the Yaris (c.11,000 units, contributing more than half of INDUs sales). Due to the sufficient cash balances, INDU may launch new models during the year, potentially the new global Corolla, in order to thwart competition from new entrants (we believe INDU to be shielded from competition relative to HCAR). The company plans on introducing the Corolla Cross CBU and the Corolla facelift by January 2021, which may potentially boost sales especially for Corolla, which witnessed a 23% mom rise in sales during FY18. We see 79% earnings growth for INDU in FY21f and a 3yr CAGR of 32%.

Healthy financial strength

Due to the strong order backlogs, INDU currently has PKR66bn cash and short term investments, which in turn lead to healthy other income. The liking of INDU in rural areas (c.60% of sales), relatively shields INDU from competition, thereby reinforcing sales and in turn margins. We see volumes during FY21/22f to rise by an average 26% for INDU, led by sales for the Yaris (c.50% of sales).

Attractive valuations

INDU trades at FY21/22f P/E of 10.4x/10.0x (discount of 6% to peak P/E of 11x), while offering ROEs of 22% for both years. Due to the healthy profitability, INDU currently provides a D/Y of 5%.

INDU - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	174.49	64.66	115.53	120.12	150.32
EPS Growth (%)	-13%	-63%	79%	4%	25%
P/E (x)	6.9	18.6	10.4	10.0	8.0
P/B (x)	2.4	2.3	2.1	2.0	1.9
DPS (PKR)	115.0	30.0	57.0	102.0	127.0
DY (%)	10%	2%	5%	8%	11%
ROE (%)	36%	13%	21%	20%	25%
EV/EBITDA (x)	4.3	9.2	5.6	5.3	4.3

Source: IMS Research

Indus Motor Company Limited

Price (PKR)	1204.6
Bloomberg / Reuters	INDU PA/INDM.KA
Mkt Cap (US$mn)	591
Upside (%)	21%
Fwd D/Y (%)	5%
Total Return (%)	26%
12m Hi-Low (PKR/sh)	1429.98/700.38
6m Avg. D. Vol ('000 shrs)	32.83
6m Avg. Td Val (US$mn)	0.25

About the Company

Indus Motors Limited is a JV between the House of Habib and Toyota Motor Corporation Japan for assembling, manufacturing and marketing of Toyota vehicles in Pakistan since July 01, 1990. INDU assembles four vehicles in Pakistan which include the Corolla, Yaris, Hilux and Fortuner.

Overweight

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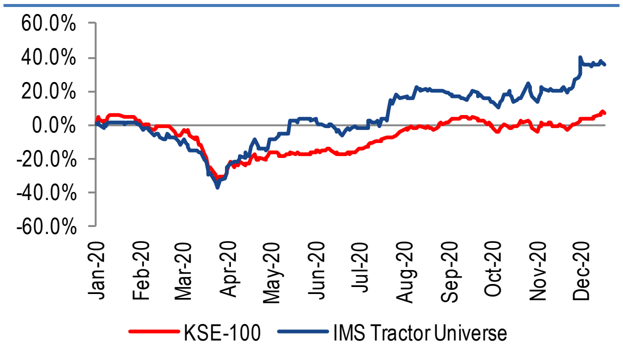
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY (%) 21f
MTL	Buy	1,330	21	11.4	9.8	9.2	8.2%
AGTL	Buy	455	21	11.6	10.1	9.2	7.8%

Sector performance



Source: IMS Research

Tractors

Positives have aligned

- **Rise in farmer income to drive sales:** The incomes of farmers are set to rise on the back of the agriculture package (announced in May), which had given subsidies on various farmer inputs such as pesticides and fertilizers, the reduction in GIDC on fertilizer production and rise in minimum support prices of commodities such as wheat. The strong agricultural performance (apart from cotton), has led to a sharp 31% yoy rise in tractor sales during 5MFY21, which is likely to continue.

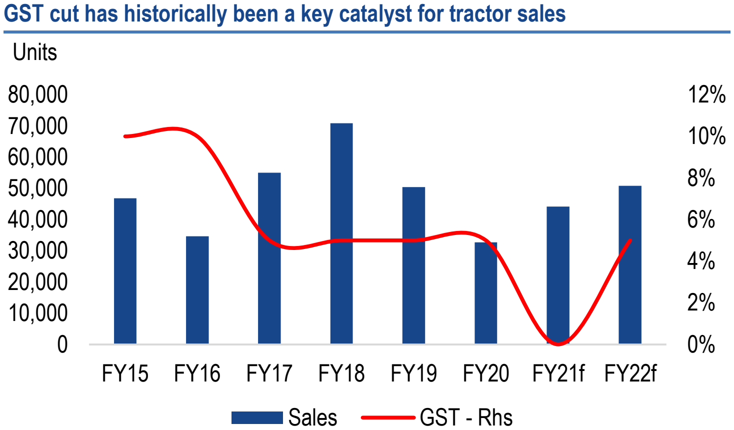
- **Reduction in GST has historically been a key trigger for sales:** Tractor sales have a strong inverse relationship with GST, where a change in the GST regime has significantly moved tractor volumes. In FY14 the GST had risen from 10% to 16%, which led to a c.35% decline in tractor sales, while during the following year, sales rose c.40% as the increase in GST had been reversed. A similar scenario was seen during FY17/18, where a decline in GST led to c.50% rise in sales. Although only for one year, the recently approved subsidy is likely to further enhance industry sales, in our view.

- **Healthy margins amid high localization levels:** The tractor industry enjoys consistently high margins (5yr average of 24%), on the back of high localization levels of over 90% for both the listed players. The localization thus relatively shields the sector from significant currency movements as compared to the Autos sector.

- **ROEs to remain robust:** ROEs for the sector have historically remained high with a 5yr average of 75%, and are likely to improve by 5ppt to c.80% during the year. The sector is expected to continue its high dividend payouts, which have a 5yr payout ratio of c.140% (highest in our IMS Universe), due to the lack of expansion plans.

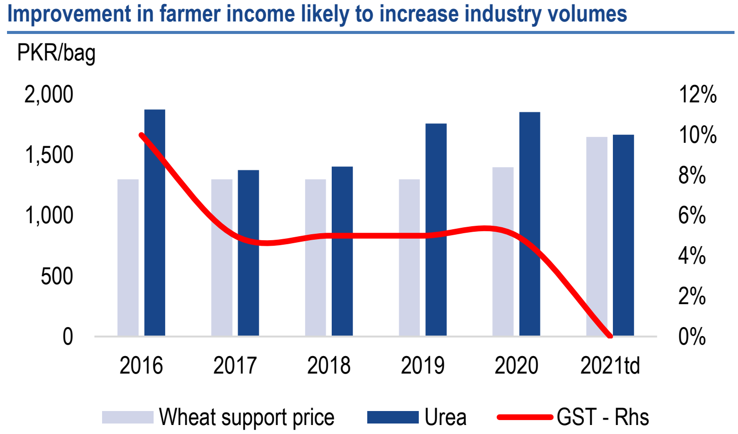
- **Risks:** (i) Increase in taxes on tractors/parts, (ii) higher farm input costs, (iii) damage to crops due to floods, pests and unfavorable weather, and (iv) unfavorable macroeconomic environment.

GST cut has historically been a key catalyst for tractor sales



Source: PAMA, IMS Research

Improvement in farmer income likely to increase industry volumes



Source: IMS Research

Millat Tractors Ltd

Symbol: MTL   Rating: Buy   TP: PKR1,330/sh

Multiyear high volumes driving growth

Catalysts

- Increase in exports sales
- Higher than expected tractor sales due to GST abolishment and uptick in construction activities
- New model launches by Hyundai-Nishat Motors (18% share)

Risks

- Higher farm input prices, impacting tractor sales
- Higher costs passed on by vendors due to rise in commodity prices and significant PKR depreciation
- Deteriorating macro environment
- Poor crop performance

Millat Tractors Limited

Price (PKR)	1099.52
Bloomberg / Reuters	MTL PA/MILM.KA
Mkt Cap (US$mn)	342
Upside (%)	21%
Fwd D/Y (%)	8%
Total Return (%)	29%
12m Hi-Low (PKR/sh)	1134.07/468.49
6m Avg. D. Vol ('000 shrs)	33.74
6m Avg. Td Val (US$mn)	0.19

Sales to post robust rebound amid improving agrarian environment

The rise in sales post-lockdown (53% yoy) is largely attributed to the various incentives given to the agriculture sector in the form of the agri-package (May), GIDC reduction on fertilizer production and rise in support prices on crops (on strong crop performance). The upward momentum is likely to continue on the back of (i) recent notification for the reduction of GST (to 0% from 5%) by the FBR of PKR1.5bn, until June 2021, and (ii) exports oriented focus of the management (target of 10,000 tractor exports in the next 5 years). Hence, we expect a 36% rise in volumes of MTL to c.30,000 units and expect earnings to rise by c.80% for FY21/22f.

Diversification into Hyundai Nishat Motors

Following the overwhelming response for the Tucson, HNML plans on entering the sedan market (Elantra) to compete with the Corolla and Civic. The expected growth in the Autos sector is likely to be a key catalyst for MTL which has an 18% stake in HNML. However, we expect HNML to become profitable within 2-3 years.

Attractive valuations

We expect a secular rise in FY21/22f ROEs to c.80%/90% for MTL (vs, 5yr avg. of 70%) and high payouts of 95%/100% in FY21/22f, bringing D/Y to 8%/10%.

MTL - Valuation Snapshot

	FY19A	FY20A	FY21f	FY22f	FY23f
EPS (PKR)	70.54	39.42	96.71	112.06	122.08
EPS Growth (%)	-41%	-44%	145%	16%	9%
P/E (x)	15.6	27.9	11.4	9.8	9.0
P/B (x)	8.1	9.7	9.2	9.0	8.9
DPS (PKR)	75.6	50.0	90.0	110.0	120.0
DY (%)	7%	5%	8%	10%	11%
ROE (%)	48%	32%	83%	93%	99%
EV/EBITDA (x)	10.0	15.2	7.7	6.5	5.9

Source: IMS Research

About the Company

Millat Tractors manufactures Massey Ferguson tractors in Pakistan. It operates in a duopoly (over 60% market share) with Al-Ghazi Tractors being the other. MTL has 4 subsidiaries (shareholding ranging from 46% to 75%) with Bolan Castings (BCL) being the major one (46% shareholding).

Overweight

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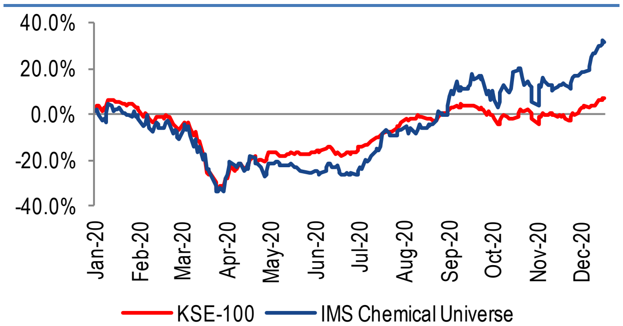
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
ICI	Buy	900	20	19.6	18.8	3.1	2.5%
EPCL	Buy	57	17	9.4	8.6	2.1	2.8%
LOTCHEM	Neutral	15	(3)	12.2	12.0	1.3	1.1%

Sector performance



Source: IMS Research

Chemicals

Well poised for growth

- **New expansion to aid EPCL in capturing greater market share:** PVC expansion (100,000 tons) set to come online by 1QCY21, and will drive volumetric growth for EPCL (historically operating at c.100% utilization). We expect it to capture the existing import market of c.60,000 tons and capitalize on the domestic demand growth.

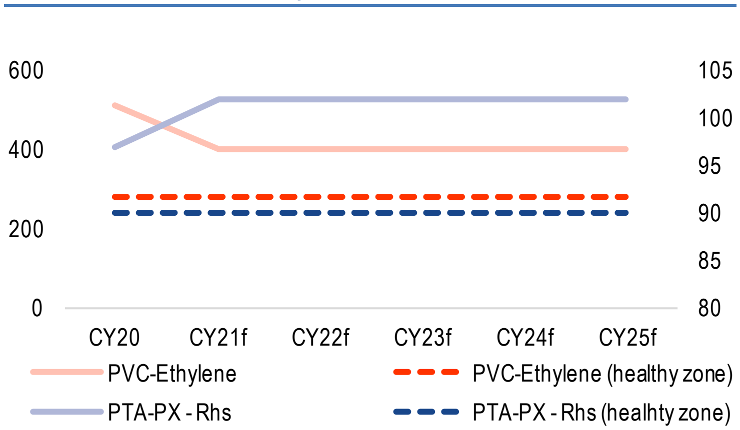
- **Demand from textile will be key:** Global polyester consumption dynamics and new PTA/PX capacities will define spreads for LOTCHEM, going forward. This will shape the earnings trajectory, where it will operate at maximum capacity utilization, in our view. We expect it to retain the earnings momentum at a medium-term spread outlook of US$90-100/ton. Caustic soda demand is also expected to grow; backed by strong textile export outlook (5M exports up 5% yoy); positive for ICI.

- **Soaring construction activities will propel demand:** The conventional use of PVC as pipes (c.60% of total demand) in the construction space, will aid in earnings expansion (5-yr earnings CAGR of 10%). PVC's application and acceptability over a wider range of products is gaining popularity, with a historical domestic demand CAGR of 10%. A mere increase of 0.1kg/capita indicates incremental demand of 20,000 tons/annum.

- **Reduced break-even levels:** Companies such as EPCL and LOTCHEM benefit from PKR depreciation. This will unlock further earnings potential on a normalized depreciation rate of 4-5%, going forward.

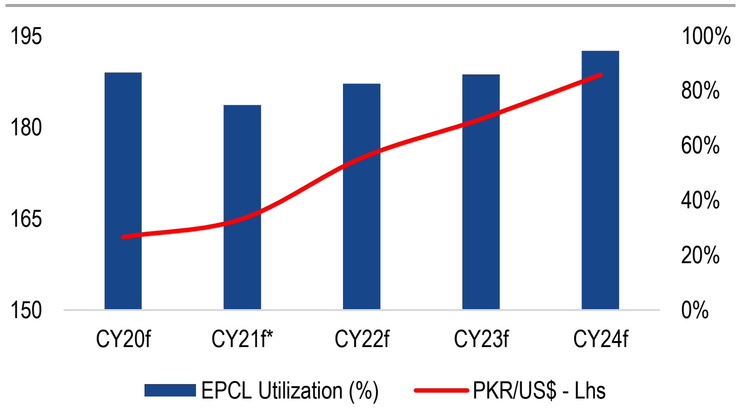
- **Risks:** (i) Major deterioration in international spreads, (ii) lower than anticipated PKR depreciation, (iii) removal or downward revision in duties, and (iv) rising number of Covid-19 cases that can warrant another lockdown and hamper sales growth.

Spreads to remain in the healthy zone…



Source: Bloomberg, IMS Research

…amidst higher utilization and PKR depreciation



Source: Company Account, IMS Research
**PVC expansion to come online*

Engro Polymer & Chemicals Ltd

Symbol: EPCL Rating: Buy TP: PKR57/sh

Expansion to drive growth momentum

Catalysts

- PVC expansion coming online in 1QCY21
- PKR depreciation, which will result in earnings expansion
- Core delta staying at elevated levels can lead to earnings upgrade

Risks

- Disruption in vaccine rollout can delay global economic recovery
- Core delta deteriorating below assumptions (LT: US$400/ton)
- Lower than expected PKR depreciation

Expansion to capture new and existing demand

We believe that the addition of 100,000 tons of new PVC capacity will allow EPCL to (i) capture captive domestic demand (c.260,000 tons), (ii) capitalize on the growth momentum spurred by the construction space, and (iii) benefit from PVC's expanding usage over a wider range of applications. This is catalyzed by a growing economy and changing consumer preferences, while the existing protection of 13% duty on PVC import will enable EPCL to ward off competition, enabling it to ramp up sales.

Healthy spreads amidst a US$ hedge

The core delta (PVC–Ethylene), is presently hovering at multi-year highs of more than US$700/ton and is likely to normalize in the near future. However, we expect it to settle in the healthy spot of US$400/ton in the medium term – close to the 10yr historical average of US$380/ton. Global PVC demand is expected to have a 5yr CAGR of 3.5%, in tandem with the slated capacity expansions. Even in the absence of a very high core delta, EPCL benefits from PKR depreciation courtesy import pricing parity.

Attractive valuation

EPCL currently trades at a forward P/E of 9.4x compared to a 4yr average P/E of 10.1x respectively. The sales and earnings are expected to grow at a CAGR of 14% and 10%, on the back of PVC/VCM expansion. This denotes the discount at which it is trading at and we see room for valuations to rerate.

EPCL - Valuation Snapshot

	CY19A	CY20f	CY21f	CY22f	CY23f
EPS (PKR)	4.07	4.94	5.21	5.71	6.18
EPS Growth (%)	-25%	21%	5%	10%	8%
P/E (x)	12.0	9.9	9.4	8.6	7.9
P/B (x)	2.5	2.5	2.1	1.8	1.5
DPS (PKR)	0.8	1.1	1.4	1.7	2.0
DY (%)	2%	2%	3%	3%	4%
ROE (%)	21%	25%	24%	22%	21%
EV/EBITDA (x)	8.0	6.7	6.6	5.5	4.8

Source: IMS Research

Engro Polymer & Chemicals Limited

Price (PKR)	48.84
Bloomberg / Reuters	EPCL PA/EPCL.KA
Mkt Cap (US$mn)	277
Upside (%)	17%
Fwd D/Y (%)	3%
Total Return (%)	19%
12m Hi-Low (PKR/sh)	49.17/22.47
6m Avg. D. Vol ('000 shrs)	4,176.84
6m Avg. Td Val (US$mn)	1.01

About the Company

Owned by Engro Corporation, EPCL is the only fully integrated Chlor-Vinyl chemical complex in Pakistan. It is the sole producer of PVC in the country, having a market share of c.80%. Apart from PVC, it manufactures and sells salt-based Chlor-alkali products such as caustic soda. A few by-products, namely, sodium hypochlorite and hydrochloric acid are also sold, but have a very small portion in the overall sales.

ICI Pakistan Ltd

Symbol: ICI Rating: Buy TP: PKR900/sh

Growing across all segments

Catalysts
- Soda ash capacity expansion
- Morinaga facility enters other segments
- Growth in Pharmaceutical segment
- Involvement in Astra Zeneca's Covid-19 vaccine

Risks
- PKR depreciation
- Competition in the PSF market from imports pushes the segment back into losses
- Slow growth and competition for Morinaga business

ICI Pakistan Limited	
Price (PKR)	751.98
Bloomberg / Reuters	ICI PA/ICI.KA
Mkt Cap (US$mn)	434
Upside (%)	20%
Fwd D/Y (%)	3%
Total Return (%)	22%
12m Hi-Low (PKR/sh)	795.48/495
6m Avg. D. Vol ('000 shrs)	28.54
6m Avg. Td Val (US$mn)	0.13

Unmatched growth potential
We expect ICI to maintain c.20% EPS CAGR, again backed by multifaceted projects as in the past. Consumer and Pharma will progressively take greater share in the company's EBITDA. Exports have been less than 5% of total revenues but many segments, including Chemicals and PSF, can generate growth through exports. Therefore, we think ICI deserves premium valuations.

Soda ash expansion milks growth elsewhere
Soda Ash's capacity expansion (by 30% to 550,000 tons pa) is driving the 3yr EBITDA CAGR of 8% for the largest segment and cash-cow of the company. ICI's recent acquisition of Cirin Pharma and assets from Wyeth and Pfizer will help it manufacture drugs and introduce new ones in future. Our estimates discount the potential involvement in distribution of Astra Zeneca's Covid-19 vaccine. ICI is the exclusive partner of the Pharmaceutical giant.

Morinaga has significant potential
ICI commissioned the first Morinaga manufacturing facility in December 2019, and is taking on Nestle Pakistan in the powder milk formula market. The company has plans to introduce other brands of the Japanese company alongside powdered dairy products. We also think it has the potential to enter export markets. This will be next leg of growth for the company.

ICI - Valuation Snapshot

	FY19A	FY20f	FY21f	FY22f	FY23f
EPS (PKR)	27.34	27.37	38.36	39.93	44.12
EPS Growth (%)	-23%	0%	40%	4%	10%
P/E (x)	27.5	27.5	19.6	18.8	17.0
P/B (x)	3.5	3.2	3.1	2.8	2.6
DPS (PKR)	9.0	16.0	19.0	20.0	22.0
DY (%)	1%	2%	3%	3%	3%
ROE (%)	13%	12%	16%	16%	16%
EV/EBITDA (x)	11.4	10.1	9.2	8.8	8.2

Source: IMS Research

About the Company
ICI is part of the Yunus Brothers Group (YBG) one of Pakistan's most dynamic and well run business groups that also owns Lucky Cement. ICI is engaged in the manufacture of polyester staple fiber, soda ash, pharmaceuticals and animal health products. ICI is also associated with the Japanese company Morinaga for local manufacturing of their products.

Marketweight

Yusra. B. Farhan
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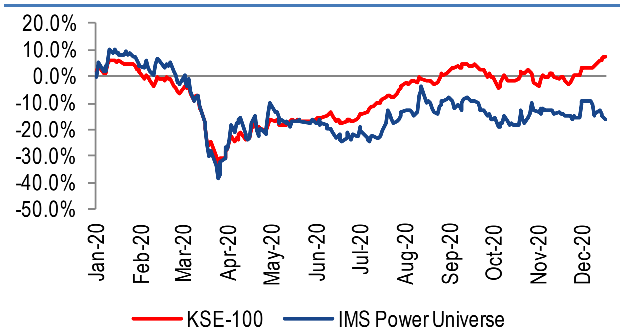
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY 21f
HUBC	Buy	125	59	3.2	2.5	0.8	5.1%

Sector performance



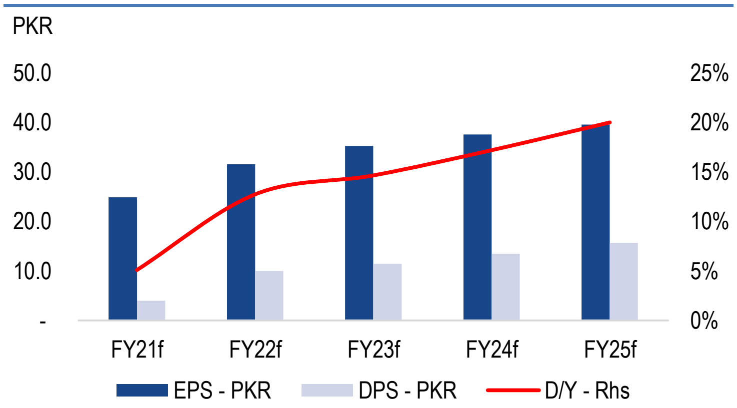
Source: IMS Research

Power

Meaningful reforms can drive sector tailwinds

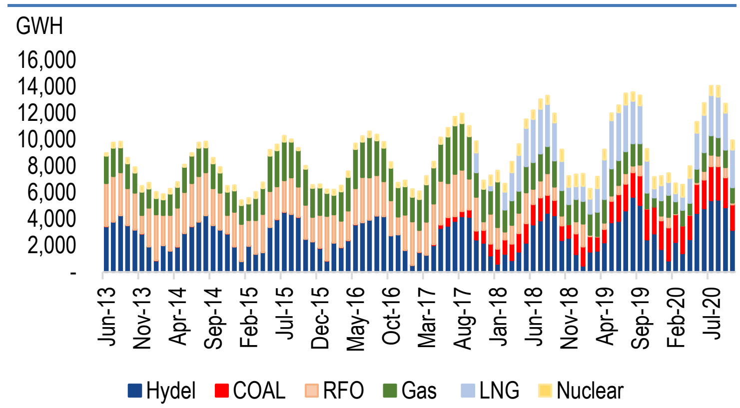
- **Contractual re-negotiations can ease the liquidity crunch:** In a bid to reduce future capacity payments (PKR675bn), the Government inked agreements with IPPs (on pre-2015 Power Policy) to reduce their tariffs in exchange for settling their outstanding receivables (c. PKR450bn). This should improve the ongoing liquidity crunch and lead to potential specie dividends. The payment mechanism is yet to be agreed upon where the GoP is reportedly eyeing 25-30% upfront payment and remaining in the subsequent two years. On a broader level however, this may not be enough to move the needle on capacity payments as bulk of the future capacity bill will arise from 2015 PP plants (CPEC). Negotiations with foreign investors are underway, and if fruitful, can lead to windfall savings.
- **IMF led power sector reforms – halfway there:** PM Khan has reportedly agreed to raise electricity tariffs by PKR3.34/kwh in Dec'20 (from PKR13.35/kwh to PKR16.69/kwh), in order to meet the IMF's conditions under the EFF program (electricity cost recovery). To this end, an additional c. PKR3/kwh rise is required, which may presumably occur in mid-CY21 alongside amendments to the NEPRA Act. While this is aimed at curbing circular debt build-up, it may also lead to lower recoveries. A prominent decline in circular debt (PKR2.3tn) may not emerge until T&D losses are resolved, subsidies done away, PP2015 contracts renegotiated and cost recovery sustained, in our view. However, outlook for cash payouts from the sector should still improve.
- **We like IPPs selectively:** Payment of overdue receivables should improve the cash flow situation for most IPPs where we hold a preference for HUBC – particularly after the GoP's offer to give cash in exchange for new projects and conversion of the base plant. We have a Buy rating on HUBC with a June 2021 TP of PKR125/sh.
- **Risks:** (i) Inconsistent payouts, (ii) continued shariah non-compliance, (iii) circular debt pile up, (iv) delay in project completion

HUBC – Medium-term D/Y is very high



Source: IMS Research

Energy mix has shifted towards coal & LNG, away from FO



Source: IMS Research

Hub Power Company Ltd

Symbol: HUBC Rating: Buy TP: PKR125/sh

Clarity on payouts is on the cards

Catalysts

- PKR depreciation leading to higher US$ denominated returns
- Successful receipt of overdue receivables which could improve cash flows
- Successful deployment of PKR65bn cash from GoP for new Karachi based projects

Risks

- Delayed capacity payments
- Greater than expected delays in dividend payouts
- Continued circular debt pile-up
- Delays in COD of new projects

GoP has offered a reasonable price for the base plant

HUBC has accepted the Government's proposal to convert two out of four units of its Base plant (2x330MW) from FO to Thar coal, and use the remaining funds to install a water desalination plant to provide 300mn gallons of water daily to Karachi. This is in exchange for PKR65bn upfront payment (equivalent to the remaining capacity payments of the base plant till 2027). The immediate payment would serve as an effective exit strategy for the Base plant, bearing in mind the uncertainty of its future cash-flows where cash influx could ensure minimal cuts in future dividends from HUBC's growth projects.

Payment of overdue receivables is awaited

It is uncertain what the GoP position would be on the outstanding receivables (PKR70.7bn as at Sep'20) of the base plant. If the aforementioned offer were to materialize. While HUBC has signed a MoU with the GoP to convert the plant to take-and-pay arrangement, settlement of receivables remains unfinished business.

Valuations are undeniably attractive

Earnings should continue to improve with rising share of profits from the CPHGC plant; however, cash flows may only improve sustainably through substantial capacity payoffs under recently agreed MoUs. Valuations are attractive where HUBC trades at a FY21f P/E of 3.2x. We maintain our liking for HUBC with a June'21 TP of PKR125/sh.

HUBC - Valuation Snapshot

	FY19A	FY20f	FY21f	FY22f	FY23f
EPS (PKR)	8.67	19.31	24.87	31.59	35.27
EPS Growth (%)	1.7%	122.8%	28.8%	27.0%	11.7%
P/E (x)	9.06	4.06	3.16	2.48	2.22
P/B (x)	1.77	1.21	0.84	0.65	0.50
DPS (PKR)	-	-	4.00	10.00	11.50
DY (%)	0.0%	0.0%	5.1%	12.7%	14.7%
ROE (%)	23.3%	35.4%	31.5%	29.6%	25.5%
EV/EBITDA (x)	8.95	6.61	10.09	8.28	6.92

Source: IMS Research

The Hub Power Company Limited

Price (PKR)	78.47
Bloomberg / Reuters	HUBC PA/HPWR.KA
Mkt Cap (US$mn)	636
Upside (%)	59%
Fwd D/Y (%)	5%
Total Return (%)	64%
12m Hi-Low (PKR/sh)	103.21/57.4
6m Avg. D. Vol ('000 shrs)	3,444.70
6m Avg. Td Val (US$mn)	1.70

About the Company

The Hub Power Company Limited (Hubco) is the first and largest IPP in the country with a combined installed power generation capacity of 2920MW. The IPP boasts under its wing a diversified group of IPPs providing FO, hydel and coal based electricity in Pakistan. HUBC is owned by Mega Conglomerate (MFG), a diversified conglomerate with business holdings.

Underweight

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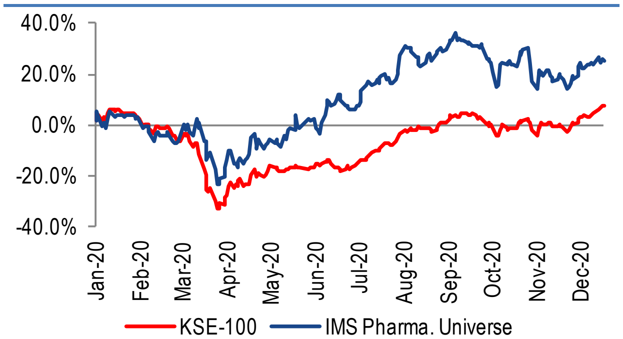
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY (%) 21f
AGP	Neutral	105	(7)	17.2	15.0	3.6	2.7%

Sector performance



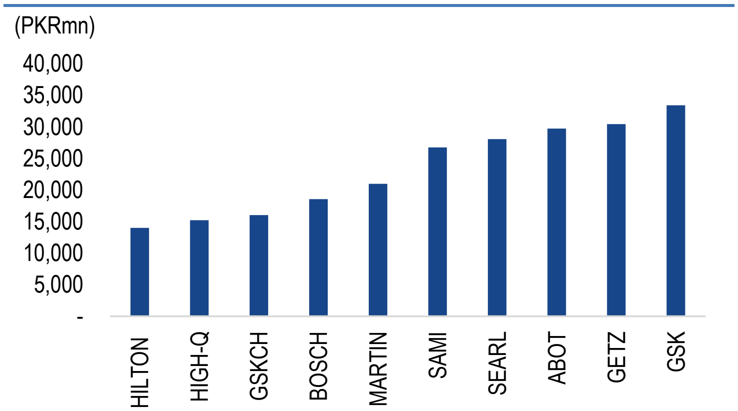
Source: IMS Research

Pharma

Local players taking the lead

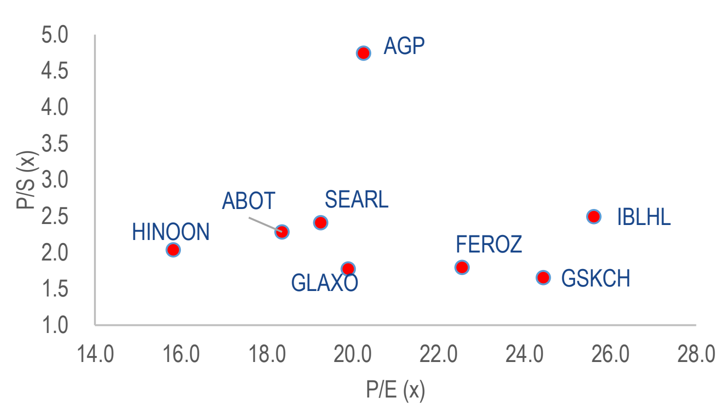
- **Sales momentum is unlikely to lose steam in 2021:** In the wake of the Covid-19 pandemic, pharmaceuticals witnessed a broad based rise in demand (c. +13%yoy in 9MCY20) for Covid-related treatment drugs and OTC products. We expect this to continue in CY21f – albeit at a more normalized pace. This is premised on an apparently more lethal second wave of Covid-19 (currently underway) and priority based roll out of the vaccine next year (c. March 2021 onwards). The vaccine will not be a game changer for importing companies, in our view and will follow a plug-and-play (trading) business model with minimal profits.
- **Margins may remain stable:** The PKR has appreciated c. 5% vs. the US$ in August 2020. This should provide relief to pharmaceutical importers over the next few months, but is likely to reverse as Pakistan begins to fulfill its debt obligations. We think GMs within the listed sector should remain largely stable in 2021 (vs. 35% in 2020).
- **Local players becoming increasingly agile:** Within the span of a decade, local pharmaceutical players have outpaced MNCs in terms of growth and market share. Local pharmaceuticals contribute c. 60% in the top 10 (in value terms) where SEARL, Getz, Sami and High-Q are some of the leading names. We expect local companies to continue to gain greater share in 2021 (SEARL is now the second largest in volume terms). We also expect a rapid increase in the share of top ten products within the sales mix due to increasing brand loyalty.
- **Valuations are beginning to peak:** The pharmaceutical sector has rallied 34%CYTD, substantially outperforming the KSE-100 and, leading valuations (forward P/E of 18.2x and P/S of 2.1x) towards peak 2017 levels (P/E: 22.0x). This rounds up our UW stance on the sector.
- **Risks:** (i) Sharp PKR devaluation, (ii) negative changes in the Drug Pricing Policy 2018, (iii) trade disruptions.

Local players are growing faster (Sep'20)



Source: IMS Research

Pharma Sector P/E & P/S (9MCY20 annualized)



Source: IMS Research

Marketweight

Zain Rizvi
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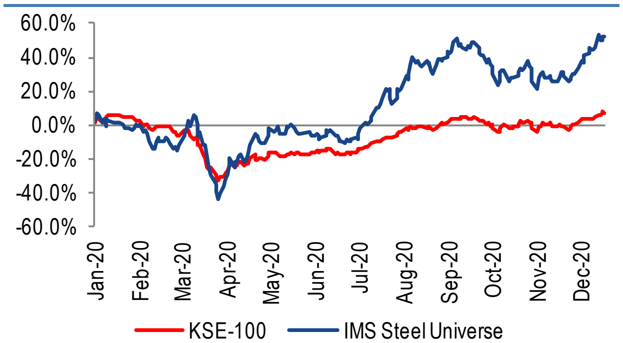
Sym	Rating	TP (PKR)	Upside (%)	PE (x) 21f	PE (x) 22f	PB (x) 21f	DY (%) 21f
MUGHAL	Neutral	73	8	12.7	9.1	1.9	1.5%
ASTL	Neutral	49	6	29.5	15.7	1.2	0.5%
ISL	Neutral	89	(3)	11.2	9.1	2.8	2.2%

Sector performance



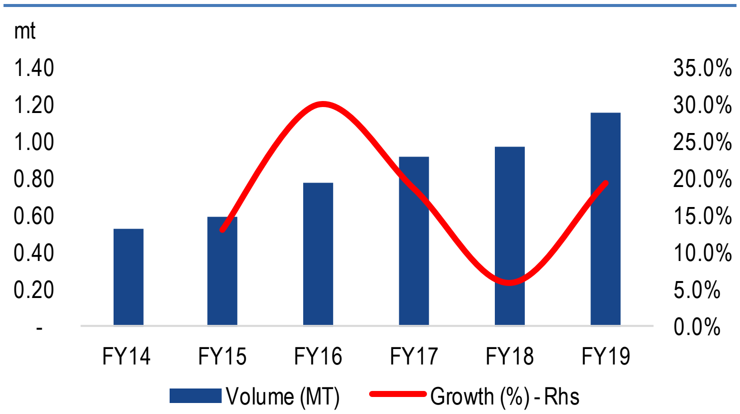
Source: IMS Research

Steel

Positives have exceeded expectations

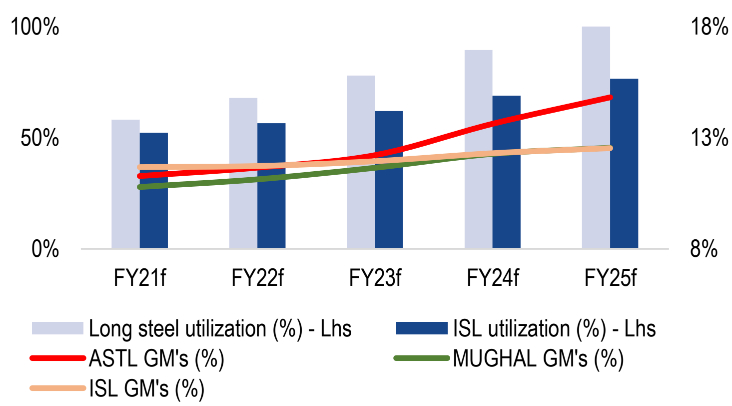
- **Positives abound, but priced in:** Backed by sheer optimism, the long steel stocks in our coverage (MUGHAL, ASTL) have rallied 56% FYTD. The rally has primarily been led by (i) lifting of Covid-19 lockdowns, (ii) government incentives for construction sector, (iii) sharp reversal in interest rates (reduced by 625 bps to 7%), (iv) deferment in loan principal payments and (v) reduction in power tariffs on incremental consumption. Due to the cyclicality of the sector and rapid convergence towards future earnings multiples, we believe majority of the positives have been built into the price.
- **Prospects improved in light of normalcy:** Going forward, the government has ruled out a full-fledged lockdown, unlike in the first wave. This has unlocked strong growth momentum in long-steel, propelled by the immense activity in the construction space. Robust sales growth post easing of lockdowns and 5MFY20 cement dispatches up 2x yoy, solidifies our stance. However, the recent rise in scrap/HRC prices (driven majorly by high iron ore demand in China) has led to local steel players to pass on costs through several price increments which can dampen sales if persistent. We expect prices to normalize once demand in China for iron ore supply from Brazil returns to normalcy.
- **History implies more room:** As witnessed in the last construction up-cycle, from FY14-17, our steel universe share prices grew by a staggering 1.2x. Going by this, there could be room for price performance, particularly if the steel sector moves in lockstep with cement sector performance.
- **Rising demand from 2/3 wheelers, white goods:** The flat steel company under our coverage (ISL) has rallied 77% FYTD backed by an anticipated rebound in demand in FY21f (25%). Demand is on the rise as the pandemic eases and demand for 2/3 wheelers & appliances booms.
- **Risks:** (i) Rise in HRC/Scrap prices and deterioration in spreads, (ii) second wave can hamper sales growth, (iii) higher than anticipated PKR depreciation, and (iv) upward revision in interest rates.

IMS steel volumetric growth witnessed in the last construction upcycle…



Source: Company accounts, IMS Research

…is likely to repeat with higher utilization and margin expansion



Source: IMS Research

Picks outside Coverage

Aisha Steel Mills Limited	
Price (PKR)	21.35
Shares (mn)	765.53
Mkt Cap (US$mn)	102.09
12m Hi-Low (PKR/sh)	21.35/6.96
6m Avg. D. Vol ('000 shrs)	7,427.74
6m Avg. Td Val (US$mn)	0.70

Aisha Steel Ltd

About the Company

Aisha Steel Limited (ASL) was incorporated in 2005 and started its commercial operations in 2012. It is one of the largest manufacturer of Flat Rolled Steel (CRC and HDGC) and located in Port Qasim, Karachi- the most suitable plant location for export market. It is a state-of-the-art Cold Rolling and Hot dipped Galvanized Rolling Complex with a CRC capacity of 700,000 metric tons per year. ASL is one of the largest private sector investments in the value added flat-rolled steel industry in Pakistan.

Investment Thesis

ASL is an attractive scrip with decent growth potential, where it has observed a 5yr revenue CAGR of 26%, alongside a well-managed product mix in the flat steel segment. ASL primarily supplies to two/three wheelers segment, white goods and the construction space. The excess capacity, post expansion in FY19 and aggressive penetration, with the company targeting c.400,000 tons in sales v.s c.200,000 tons historically, will allow ASL to capture greater market share. The cut in interest rates from 13.25% to 7% have provided a much needed breather to profitability through substantial reduction in finance costs as shown by the 1QFY21 interest expense (down 42% qoq). Deleveraging on its books will further elevate earnings (interest-bearing debt at c.PKR19.3bn - end of FY20 v.s at c.PKR14.7bn - end of 1QFY21).

On the pricing front, ASL is well positioned (prices in tandem with ISL) and Anti-dumping duties on CRC/ HDGC also protect it against imports.

Risks:1)Volatility in International CRC-HRC prices, 2) Interest rate hikes, and 3) Slower than expected growth on account of 2nd wave.

International Industries Limited	
Price (PKR)	167.95
Shares (mn)	131.88
Mkt Cap (US$mn)	138.36
12m Hi-Low (PKR/sh)	167.95/64.55
6m Avg. D. Vol ('000 shrs)	1,235.85
6m Avg. Td Val (US$mn)	1.02

International Industries Ltd

About the Company

International Industries Limited (IIL) is Pakistan's largest manufacturer & exporter of steel tubes, stainless steel pipes and polymer pipes with an annual manufacturing capacity of 817,000 tons. It is the parent company of International Steels (ISL) with 56% ownership and also has a 17% share in Pakistan Cables (PCAL).

Investment Thesis

Alongside being the largest domestic producer of pipes/tubes, it also has a strong global presence, which will enable INIL to penetrate further into the export market (c.16% of total revenue). On the domestic front, the influx in infrastructural activity will greatly benefit INIL, with greater spending by the government a key trigger. The acceptance of polymer pipes by SNGPL and SSGC to be used for the installation of gas pipelines also trigger further growth and profitability. Growth in real estate segment through Naya Pakistan Housing Scheme and other private projects will also be positive, as INIL makes pipes for gas and water supplies. The upsurge in 2/3 wheeler demand (5MFY21 sales up 18% yoy), is another volume driver. INIL is currently trading at a slight discount to its portfolio value (ISL and PCAL contributing PKR175/sh compared to INIL's market price of PKR168/sh, with no value given to core business). The core business emerged from losses in 1QFY21, with further improvements expected going forward.

Risks: 1) Failure to secure major GoP contracts, 2) sharp increase in raw material prices and 3) Changes in taxes/duties.

Power Cement Ltd

Power Cement Limited	
Price (PKR)	9.66
Shares (mn)	1,063.41
Mkt Cap (US$mn)	64.17
12m Hi-Low (PKR/sh)	10.85/4.63
6m Avg. D. Vol ('000 shrs)	12,270.11
6m Avg. Td Val (US$mn)	0.71

About the Company

Power Cement was previously known as Al-Abbas Cement Limited until its acquisition in 2010 by the Arif Habib Group, a financial and industrial conglomerate. It is the third largest cement plant in the South market with a total capacity of 3.4mn ton after completing recent expansion of 2.5mn tons.

Investment Thesis

POWER's new expansion will reduce variable costs considerably, as the new plant is much more efficient and consumes less power and fuel to produce cement. Additionally, with recent increase in cement demand, POWER managed to cater to 22% of the total South demand in 4QFY21 as compared to their prescribed share of 20.5%. In the later part of FY21, we expect an increase in local cement demand will help POWER to sell more and maximize their earnings by selling at higher prices (PKR10/bag rise in retention prices will boost POWER EPS by PKR0.26). Moreover, the recent decline in interest rates will also support the company's bottom-line. We believe that POWER will post EPS of PKR1.33/2.96 in FY21/FY22f and the total utilization will be 77%/86% in the same period.

Risks: 1) Increase in interest rates, 2) lower than expected demand, 3) Increase in local and export prices, and 4) dilution of market share

The Bank of Punjab

The Bank of Punjab	
Price (PKR)	9.31
Shares (mn)	2,643.69
Mkt Cap (US$mn)	153.74
12m Hi-Low (PKR/sh)	14.13/7.01
6m Avg. D. Vol ('000 shrs)	7,481.84
6m Avg. Td Val (US$mn)	0.44

About the Company

The Bank of Punjab is the 8th largest bank (by deposits) in Pakistan with a network of 624 branches and assets in excess of PKR1tn. BOP is owned 57.5% by the Govt. of Punjab.

Investment Thesis

BOP has undergone significant de-risking with RWA density (RWA to total assets) having dropped to 30% in Sep'20 (vs. 77%-93% in 2007-08). This compares well to the banks in our coverage space (29% ABL, 36% HBL), where BOP is no longer constrained for capital (CAR has risen to 16.97%). This should lead to a consistent cash payout going forward. BOP has made strides in improving its asset quality, with coverage at 86% (vs. 99% for IMS coverage Banks). While NPLs appear much higher vs. peers (3QCY20 NPL ratio: 13.75% vs. 7% for coverage banks), this is due to legacy NPLs not written off but fully provided for. BOP has immense room to improve its deposit mix (47% savings and 18% current deposits) which can significantly lower cost of funds. BOP is relatively shielded against Single Treasury Account implementation due to its application on a Federal level for now. BOP trades at undemanding valuations while offering sector beating ROEs (CY20f: 15.3% vs. 14.6% for our coverage space). BOP trades at a CY20f annualized P/B of 0.5x, vs. IMS Banks Median CY20f: P/B of 0.9x).

Risks: 1) Sharp deterioration in asset quality, 2) implementation of Treasury Single Account leading to erosion of deposit base, 3) inability to optimize deposit mix.

Century Paper & Board Mills Ltd

Century Paper & Board Mills Limited	
Price (PKR)	118.41
Shares (mn)	176.42
Mkt Cap (US$mn)	130.49
12m Hi-Low (PKR/sh)	118.41/35.84
6m Avg. D. Vol ('000 shrs)	504.87
6m Avg. Td Val (US$mn)	0.31

About the Company

Established in 1984, CEPB is a flagship Company of the Lakson Group of Companies in Pakistan. The Company started commercial production in 1990 and has attained leadership position in Packaging Boards and is a sought after supplier in the Printing and Packaging Industry. The company is also engaged in manufacturing of Corrugated Cartons.

Investment Thesis

The profitability of the company is set to revive on the back of reduced wood pulp and waste paper prices internationally, which is a major raw material cost for the company. CEPB will also benefit from reduced international coal prices, as 70% of the total energy requirement is fulfilled through coal based CPP. Therefore, we believe the company will be able to post EPS of PKR15.20/18.75 in FY21/FY22f and the gross margins during the same period will be around 20%/21%. Additionally, CEPB has also done debottlenecking on its existing plant, which has increased its existing plant capacity by c.15%. This expansion will help the company to substitute imports and maximize utilization levels. Management has initially planned to come out with a mega expansion strategy, but this has been put on hold due to economic stress this year. This project can however, serve as a key catalyst for profitability.

Risks:1) Increase in prices of imported raw material, 2) Shift of existing customers to cheaper imported packaging and 3) Further devaluation of PKR against USD

Waves Singer Pakistan Ltd

Waves Singer Pakistan Limited	
Price (PKR)	29.08
Shares (mn)	187.60
Mkt Cap (US$mn)	34.08
12m Hi-Low (PKR/sh)	31.17/15
6m Avg. D. Vol ('000 shrs)	1,768.23
6m Avg. Td Val (US$mn)	0.29

About the Company

WAVES is one of the largest producers and suppliers of consumer appliances such as split air conditioners, microwave ovens, refrigerators, deep freezers, sewing machines, as well as other light engineering products, with over 140 retail outlets spread all over Pakistan. In 2018, Singer Pakistan merged with Cool Industries (parent company of Waves).

Investment Thesis

Waves holds roughly 30% of the deep freezer and sewing machines markets, where competition is faced from the likes of PAEL, Haier and Dawlance (among others). The pickup in business activities in the country is likely to lead to an increase in demand for consumer appliances (especially from the food and restaurant sectors), while the reduction in interest rates is likely to improve the bottom-line. The planned entrance into the real estate sector provides a hedge against consumer items, where rental income may be indexed with inflation, in our view. The potential synergies from the merger in 2018, may be realized further due to robust revenue growth (5year CAGR of 54%), and increasing by c.60% on average in the 2018/19 period. WAVES trades at P/S of 0.64x and P/B of 0.67x

Risks: 1) Volatility in exchange rate, 2) higher inflation, 3) aggressive competition from peers, and 4) slower economic recovery due to second wave

Unity Foods Ltd

Unity Foods Limited	
Price (PKR)	28.06
Shares (mn)	994.05
Mkt Cap (US$mn)	174.23
12m Hi-Low (PKR/sh)	28.61/7.32
6m Avg. D. Vol ('000 shrs)	25,895.41
6m Avg. Td Val (US$mn)	3.01

About the Company

Unity Foods Ltd (UNITY), formerly known as Taha Spinning, is primarily engaged in the production and sale of edible oil, industrial fats and animal feed. Its subsidiary (more than 69% holding), is engaged in the production and sale of flour. The edible oils are sold under the brand names of Dastak, Ehtimam (both mid-tier segment) and Zauqeen (discounted), which contribute 17% of revenues (bulk oil sales generate c.50%).

Investment Thesis

The rise in international palm oil to c.US$850 is likely to lead to an increase in profitability (vs. low of US$450/ton during the lockdown). The increasing brand awareness through the Utility Store Corporation has led to an increase in 1QFY21 revenues, which is likely to be sustained in our view. An increase in branded oils is likely to increase margins further, as they fetch higher prices than bulk oil sales, while greater contribution from Sunridge (flour) may increase overall margins, as it fetches c.25% margins. The multiple aggressive expansion plans in the oil refinery, flour mill capacity, chemical plant and margarine plant (FY22), may increase topline further (topline rose by 2.8x yoy in 1Q). The reduction in interest rates will support the bottom line, as the company also plans on issuing a sukuk (PKR2-3bn). Unity trades at a TTM P/E of 24x but this is balanced by a quick growth trajectory.

Risks:1) Significant decline in palm oil prices, 2) sharp PKR depreciation and 3) unforeseen delays in expansion projects

Ghani Global Glass Ltd

Ghani Global Glass Limited	
Price (PKR)	14.39
Shares (mn)	100.00
Mkt Cap (US$mn)	8.99
12m Hi-Low (PKR/sh)	17.82/7.15
6m Avg. D. Vol ('000 shrs)	875.16
6m Avg. Td Val (US$mn)	0.08

About the Company

GGGL is in the business of manufacturing glass tubes and has also started the value added production of vials and ampules from tubes. It is the first company to introduce premium European tubing glass manufacturing plant with a production capacity of 20 tons/day. The company has a mix of 22 Ampoules machines and 4 vial manufacturing machines. It is a subsidiary of Ghani Global Holding (GGL), with a shareholding of 50.1%.

Investment Thesis

GGGL aims to cater to the domestic demand currently being served by imports from Europe and China, where 90% of the Chinese tube market and 20% of the European tube market in Pakistan has been captured. Alongside, it has also started exporting to various countries such as Bangladesh, Argentina and Egypt. The plant is running at optimum utilization, with plans to expand by adding a 2nd glass tube furnace, which will be financed through 140% right issue. Out of the PKR1.4bn raised through rights, PKR800mn will be used for expansion, whereas the remaining PKR600mn will be used to retire debt. GGGL was able to achieve profits for the first time in FY20, since inception of its sales in 2016 and has continued the momentum into 1QFY21. The management firmly believes that it will continue the upward trajectory as witnessed by its 4-yr topline CAGR of 110%. We believe it has passed its initial years as a new company and is set to flourish, with high growth prospects.

Risks: 1) Competition from imports, 2) Global risk of Covid-19 2nd wave can hurt exports, 3) Gas shortage in winters.

Systems Ltd

Systems Limited

Price (PKR)	401.23
Shares (mn)	123.43
Mkt Cap (US$mn)	309.36
12m Hi-Low (PKR/sh)	402.51/93.19
6m Avg. D. Vol ('000 shrs)	296.46
6m Avg. Td Val (US$mn)	0.52

About the Company

Systems Limited (SYS) is involved in IT service sales including Business Process Outsourcing, Enterprise Resource Planning, Management Consultancy and System Re-engineering services to Retail, Banking, Pharmaceuticals and E-Commerce businesses. The founder and directors own 33.5%, with general public holding 32.5% and 24% being held by mutual funds and foreign investors, cumulatively.

Investment Thesis

Systems Ltd (SYS) is one of the largest IT exporters in Pakistan (c.80% of revenue from exports – denominated in foreign currency). It provides long-term services with 90% of revenue recurring in nature and serving over 400 customers globally. Covid-19 has provided multiple growth opportunities for SYS due to changing market dynamics, where companies globally are striving to optimize costs through greater digitization. Apart from its core business, SYS has also diversified into Fintech (since 2015) under the banner of One-load (EP systems Pakistan) – providing financial solutions to retailers. The management believes that Pakistan can double its IT exports in the next 2 years, where SYS will be the biggest beneficiary. Moreover, the domestic IT export sector enjoys corporate tax exemption until 2025 and naturally benefits from PKR depreciation. Despite the handsome rally lately, there is still room for upside, as SYS boasts massive growth potential, with a 5-yr revenue and net profit CAGR of 31%. The gross and net margins have hovered in the range of 31% and 20%, respectively. Note, SYS is comparable to other global IT companies due to its foreign source of revenue (c.80%) and is valued as a tech stock based on high growth multiples, completely indifferent of index multiples. The scrip currently trades at a trailing P/E of 27x.

We think the stock deserves to trade above 20x P/E being a unique exposure in Pakistan market, superb track record and promising growth plans.

Risks: 1) Disruption in global vaccine rollout, 2) Lower than anticipated PKR depreciation, and 3) Slower than expected growth on account of 2nd wave

IMS Universe

As of	December 18, 2020					EPS (PKR)			PER (x)		PBV (x)		DY (%)		ROE (%)	
	Mkt Cap (US$Bn)	Price (PKR)	TP (PKR)	Upside (%)	Stance	21f	22f	23f	21f	22f	21f	22f	21f	22f	21f	22f
E&P									**5.7**	**4.9**	**0.7**	**0.7**	**7%**	**9%**	**13%**	**14%**
OGDC	2.96	110	150	36%	Buy	20.69	24.22	25.38	5.3	4.6	0.6	0.6	7%	9%	12%	13%
PPL	1.62	95	140	47%	Buy	16.47	19.25	19.21	5.8	5.0	0.7	0.6	4%	6%	12%	13%
POL	0.74	419	475	13%	Buy	56.64	62.30	58.93	7.4	6.7	2.8	2.7	11%	11%	39%	41%
Banks									**6.9**	**6.0**	**0.9**	**0.9**	**8%**	**9%**	**13%**	**15%**
ABL	0.60	84	110	31%	Buy	15.02	16.16	17.89	5.6	5.2	0.7	0.7	11%	11%	13%	13%
MCB	1.37	185	235	27%	Buy	25.05	26.13	29.05	7.4	7.1	1.2	1.1	11%	11%	16%	17%
HBL	1.25	137	175	28%	Buy	22.14	25.73	29.29	6.2	5.3	0.7	0.7	6%	7%	12%	14%
UBL	0.99	130	155	20%	Buy	18.06	22.65	25.15	7.2	5.7	0.8	0.7	8%	9%	11%	13%
BAFL	0.39	35	45	28%	Buy	6.32	7.11	8.11	5.6	4.9	0.6	0.6	9%	10%	12%	12%
MEBL	0.94	106	120	13%	Buy	11.81	14.35	15.78	9.0	7.4	1.8	1.6	5%	5%	21%	23%
Cement									**11.6**	**5.8**	**1.5**	**1.4**	**1%**	**4%**	**13%**	**24%**
DGKC	0.30	109	155	42%	Buy	10.02	24.86	27.23	10.9	4.4	0.7	0.6	0%	5%	6%	14%
LUCK	1.38	684	841	23%	Buy	54.77	127.38	145.93	12.5	5.4	2.1	1.9	1%	4%	17%	37%
MLCF	0.28	41	48	16%	Buy	4.09	5.43	5.51	10.1	7.6	1.3	1.2	0%	0%	14%	16%
CHCC	0.16	134	150	12%	Buy	11.18	19.74	23.28	11.9	6.8	2.1	1.6	0%	3%	19%	27%
FCCL	0.18	21	27	28%	Buy	2.02	3.02	3.28	10.4	7.0	1.4	1.3	0%	7%	14%	19%
KOHC	0.27	214	235	10%	Buy	19.86	27.24	30.00	10.8	7.9	2.0	1.7	1%	4%	20%	24%
PIOC	0.14	96	130	36%	Buy	7.60	17.25	20.62	12.6	5.5	1.8	1.4	0%	4%	15%	28%
Fertilizer									**7.0**	**7.5**	**1.1**	**1.0**	**10%**	**10%**	**16%**	**14%**
FFC	0.86	108	136	26%	Buy	13.94	14.56	14.81	7.8	7.4	3.2	2.9	10%	11%	43%	41%
EFERT	0.53	64	75	18%	Buy	10.08	7.36	7.33	6.3	8.6	1.8	1.8	15%	11%	29%	21%
FFBL	0.19	23	22	-5%	Neutral	3.22	3.26	3.33	7.2	7.1	1.7	1.5	3%	6%	26%	22%
FATIMA	0.39	30	30	1%	Neutral	4.32	3.99	3.83	6.8	7.4	0.7	0.7	4%	3%	11%	9%
ENGRO	1.12	312	380	22%	Buy	46.21	42.92	44.67	6.8	7.3	0.7	0.7	10%	11%	11%	9%
OMCs									**6.7**	**6.2**	**1.0**	**0.9**	**4%**	**6%**	**15%**	**15%**
PSO	0.63	213	300	41%	Buy	40.07	42.00	45.03	5.3	5.1	0.8	0.7	3%	5%	15%	14%
APL	0.21	337	400	19%	Buy	38.36	46.26	53.73	8.8	7.3	1.7	1.6	5%	9%	20%	23%
SHEL	0.17	251	215	-14%	Sell	12.60	16.70	23.33	20.0	15.1	4.5	4.0	3%	4%	23%	28%
Engineering									**13.2**	**9.9**	**2.1**	**1.8**	**2%**	**3%**	**16%**	**18%**
ASTL	0.09	46	49	6%	Neutral	1.57	2.94	5.25	29.5	15.7	1.2	1.1	1%	2%	4%	7%
MUGHAL	0.11	67	73	8%	Neutral	5.31	7.41	10.25	12.7	9.1	1.9	1.7	1%	2%	16%	20%
ISL	0.25	92	89	-3%	Neutral	8.18	10.08	12.14	11.2	9.1	2.8	2.4	2%	4%	28%	28%
Power									**3.2**	**2.5**	**0.8**	**0.7**	**5%**	**13%**	**27%**	**26%**
HUBC	0.64	78	125	59%	Buy	24.87	31.59	35.27	3.2	2.5	0.8	0.7	5%	13%	32%	30%
Autos									**14.2**	**10.8**	**1.8**	**1.7**	**3%**	**6%**	**13%**	**16%**
PSMC	0.12	225	235	5%	Neutral	(3.24)	6.56	2.57	n.m	34.3	0.8	0.8	0%	0%	-1%	2%
HCAR	0.29	327	365	12%	Neutral	17.21	33.59	40.65	19.0	9.7	2.5	2.2	2%	3%	14%	24%
INDU	0.59	1,205	1,458	21%	Buy	115.53	120.12	150.32	10.4	10.0	2.1	2.0	5%	8%	21%	20%
Tractors									**11.4**	**9.9**	**9.2**	**8.8**	**8%**	**10%**	**80%**	**89%**
MTL	0.34	1,100	1,330	21%	Buy	96.71	112.06	122.08	11.4	9.8	9.2	9.0	8%	10%	83%	93%
AGTL	0.14	375	455	21%	Buy	32.31	37.18	38.66	11.6	10.1	9.2	8.4	8%	9%	82%	87%
Pharma									**17.0**	**13.9**	**3.6**	**3.2**	**3%**	**4%**	**21%**	**23%**
AGP	0.20	113	105	-7%	Neutral	6.54	7.54	8.48	17.2	15.0	3.6	3.2	3%	4%	22%	23%
Food																
FCEPL	0.41	85	65	-24%	Sell	2.10	3.59	5.05	40.5	23.7	6.5	5.6	1%	2%	17%	25%
Chemical									**13.5**	**12.7**	**2.2**	**2.0**	**2%**	**3%**	**16%**	**16%**
ICI	0.4	752	900	20%	Buy	38.36	39.93	44.12	19.6	18.8	3.1	2.8	3%	3%	16%	16%
LOTCHEM	0.1	16	15	-3%	Neutral	1.28	1.30	1.49	12.2	12.0	1.3	1.2	1%	2%	11%	10%
EPCL	0.3	49	57	17%	Buy	5.21	5.71	6.18	9.4	8.6	2.1	1.8	3%	3%	24%	22%
Textiles									**8.7**	**7.2**	**1.0**	**0.9**	**5%**	**6%**	**11%**	**12%**
NML	0.2	99	132	33%	Buy	11.88	13.73	15.20	8.4	7.2	0.5	0.5	5%	6%	6%	6%
GATM	0.1	37	50	37%	Buy	5.50	6.95	7.17	6.6	5.3	0.9	0.8	7%	8%	14%	17%
ILP	0.3	64	80	24%	Buy	6.53	7.99	8.19	9.9	8.1	2.9	2.5	5%	6%	32%	33%
IMS-Universe									**7.3**	**6.1**	**1.0**	**1.0**	**6%**	**7%**	**14%**	**16%**

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Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
Neutral	Total return expectation of > -5% or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: Please see page 18

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