Pakistan Investment Strategy 2018

Chance for a Home Run; Target 47,199

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Market Strategy

Synopsis

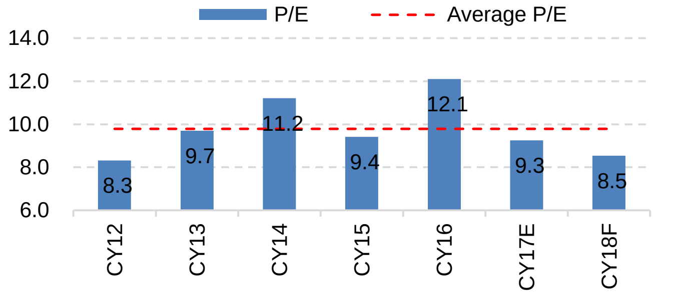
- **Total Return:** Pakistan equity market is expected to generate a total return of **20%** during 2018.
- **Attractive Valuations:** PSX is expected to provide strong returns in CY18 as KSE-100 is trading at a 5 year low PER of 8.5x, cheaper than its past 5 years' average of 10.3x. PSX is presently trading at a 46% discount to its regional peers as compared to an average of 36% during last 12 years.
- **Key Reasons for Upside:**
  - ✓ Diluting political noise
  - ✓ Commencement of a high Economic Growth period (FY18-20 average GDP growth expected at 6.0% compared to past 5 year average of 4.4%)
  - ✓ Low interest rates (FY18-20 average discount rate is expected at 6.75%, compared to past 5-yr average of 8.64%)
  - ✓ Attractive valuations compared to historic average and regional peers
  - ✓ Strong domestic liquidity
- **Index Target**: Based on index methodology of earnings growth, justified PER and target price mapping, we view the Dec'18 index target for KSE-100 index at 47,199 points, portraying an upside of 19.6%.
- **Sectoral Preference**
  - ✓ Banks: Betting on interest rate hike and loan growth
  - ✓ E&Ps: Rising oil prices, PKR depreciation and production growth to pose a rosy picture
  - ✓ Autos: Government priority to favor domestic industry and strict import controls deemed positive
  - ✓ Steel: Capacity accretion, diversification and pricing power remain key themes
  - ✓ Cements: Robust demand amid infrastructure expenditure to bode well
- **Favored Picks:** include HBL, UBL, OGDC, LUCK, DGKC, ENGRO, EFERT, HUBC, KAPCO, ASTL and MTL

Exhibit: KSE100 Index Target Estimates 2018

Valuation Basis	Target
Target Price Based	49,611
Earnings Growth	44,160
Justified PE	47,824
Average Target 2018	**47,199**
Index Closing 22-Dec-17	39,471
Expected Return 2018	**19.6%**

Source: AHL Research

Exhibit: KSE100 - Price to Earning Multiple



Source: PSX, AHL Research

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Politics

Political Outlook

Come election year; Dust to finally settle!

- **Turbulent Year for the Gov't:** As the year 2017 draws to a close, PML (N) will be breathing a desperately needed sigh of relief. Earlier this year the Supreme Court (SC) gave a verdict to form a JIT (Joint Investigation Team) to probe ex-PM Nawaz Sharif and his family. The investigation ended with the SC disqualifying the PM. More turbulence hit the party when non-bailable arrest warrants were issued for ex-Finance Minister Ishaq Dar in connection with a NAB reference against him relating to illegal accumulation of assets; he had to step down too. While towards the end of the year, in Nov-Dec'17 Islamabad faced a lockdown for almost two weeks when a group of right-wing activists staged a sit-in to protest the amendment in Khatm-e-Nabuwat oath. The army finally agreed to act as an intermediary in order to ensure a non-violent end to the demonstration. Some respite to the ruling party also came when the SC rejected NAB's appeal to reopen the Hudaibya Paper Mills Case.

- **Elections As Per Schedule:** The political outlook for 2018 has improved compared to last year with aid of recent developments including agreement on Delimitation of Constituencies and a briefing by the Chief of Army Staff to the Senate. These developments have reassured the public that the general elections in the country are likely to be held on time (~Aug'18).

- **Senate Elections – The First Goal Post for the PML (N):** . Winning the upcoming Senate Elections will be a major milestone for the PML (N) government, primarily to sustain a key role in future legislation. Subsequent to the Senate Elections, a care-taker government is expected to be installed from Jun'18 and General Elections should follow shortly (~Aug'18). The PML (N) and PTI appear more likely to emerge as main winners in the upcoming Senate Elections (Mar'18) while the PPP would possibly sustain some losses as their nominees from the 2013 elections retire.

Exhibit: Party Position in Senate

Party	Current	Expectation
PMl(N)	27	40
PPP	26	16
MQM	8	8
PTI	7	14
ANP	6	-
JUI	5	4
PML-Q	4	-
NP	3	6
PPMAP	3	6
BNP-A	2	-
BNP	1	2
JI	1	2
PML-F	1	-
IND	10	6
Total	**104**	**104**

Source: Senate Official Website, AHL Research

Political Outlook

Come election year; Dust to finally settle!

- **PML (N) Expected to Lead General Elections Outcome:** The results of the 2018 General Elections are expected to be mixed where no major party is projected to achieve a clear majority. We view the outcome would be a hung parliament which is negative for economic governance as coalition governments are unable to make tough economic decisions. We believe PML(N) would be able to achieve the highest number of seats and form a coalition government along with smaller parties.

- **Elections: Rejuvenation of Investor Sentiment:** We view that with a new government taking office in second half of the year, there will be an end to the long standing uncertainty in our political space and hence, we expect a major revival in the performance of the PSX. Empirical evidence supports our argument: if we consider the last 5 elections, the domestic equity bourse has generated an average of 31% return during the first year of government following general elections. This analysis includes 2008 which generated negative returns of 59% attributable to the global financial crisis. Therefore, we can safely conclude and hypothesize that with a new government taking charge, the equity market responds with positivity owing to jubilant investor sentiment as there is stability in the polity of the country.

Exhibit: Election Results

Year	Winning Party	Seats	Coalition	Opposition	Seats
Nov-88	PPP	94	MQM	IJI	55
Oct-90	IJI	111	MQM	PPP	44
Oct-93	PPP	89	MQM	PMLN	73
Feb-97	PML-N	137	MQM	PPP	18
Oct-02	PML-Q	126	MQM	PPP	81
Feb-08	PPP	119	MQM, JUI-F	PMLN	89
May-13	PML-N	188	JUI-F, PPMAP	PPP	42

Source: AHL Research

Exhibit: PSX Returns

Election Dates	Winning Party	Before 90 Days	Before 180 Days	Before 360 Days	After 90 Days	After 180 Days	After 360 Days
6-Oct-93	PPP	9%	22%	11%	59%	85%	65%
3-Feb-97	PML-N	1%	5%	-7%	-3%	21%	1%
10-Oct-02	PML-Q	18%	13%	70%	32%	35%	100%
18-Feb-08	PPP	8%	13%	25%	1%	-31%	-61%
11-May-13	PML-N	13%	23%	39%	17%	16%	44%
Average							
PPP		9%	17%	18%	30%	27%	2%
PML-N		7%	14%	16%	7%	19%	22%
PML-Q		18%	13%	70%	32%	35%	100%
Total		**10%**	**15%**	**28%**	**21%**	**25%**	**30%**

Source: Bloomberg, AHL Research

Economy of Pakistan

Economy Outlook

Entering a High Growth Era

- **3-yr Average GDP Growth to Clock-in at 6%:** We believe Pakistan will easily surpass the GDP growth target of 5.5% for 2018 as manufacturing sector makes a comeback on the back of a significant increase in power supply. Going forward, as major bottlenecks are expected to ease off, the economic growth is expected to increase to 6.0% – 6.5% by FY19 - FY20

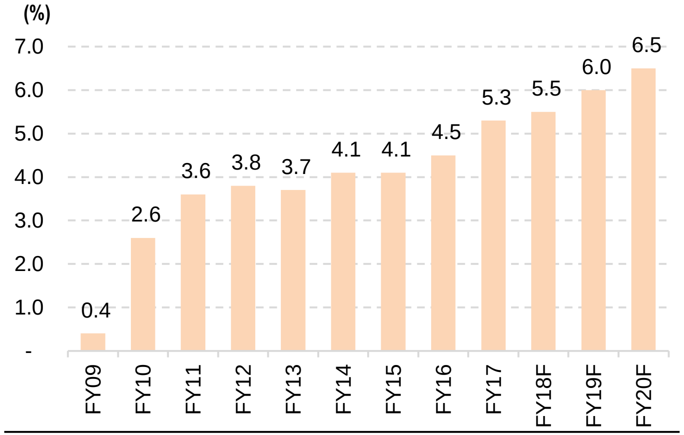
- **Inflation Expected to Remain Under Control:** Inflation during FY18 / CY18 is expected to remain around 4.6% / 5.8% as strengthening international prices for oil will have a direct and indirect impact on inflation.

- **Current Account Deficit to Remain High:** Current Account deficit is expected to widen to USD 15 billion due to higher investment requirements which will be financed through additional borrowing from various sources including multilateral institutions, commercial banks, bond issuances and project loans.

- **No Major Depreciation in Exchange Rate Expected:** We believe with the recent PKR losing 5.2% against the USD, depreciation of the local currency has largely been factored-in. However, the country needs to focus on cushioning its exports to regain competitiveness. Rebate has already been announced for exporters to promote exports. Additionally, govt. has imposed regulatory duty on imported goods including mobile phones, vehicles, auto mobile parts, cosmetics and some non-essential products to curb imports. We believe PKR will settle at PKR 112/USD during FY18 due to inflation differential with global economies.

- **Interest Rates Expected to Inch up:** Interest Rates are expected to remain stable till Mar'18, in our view. Going forward, there will be a slight increase in interest rates (~50bps) as inflation is anticipated to move up amid rising international commodity prices.

Exhibit: GDP Growth – Trend and Forecasted



Source: SBP, AHL Research

5.5% GDP Growth Expected

Various Triggers to Fuel Economy

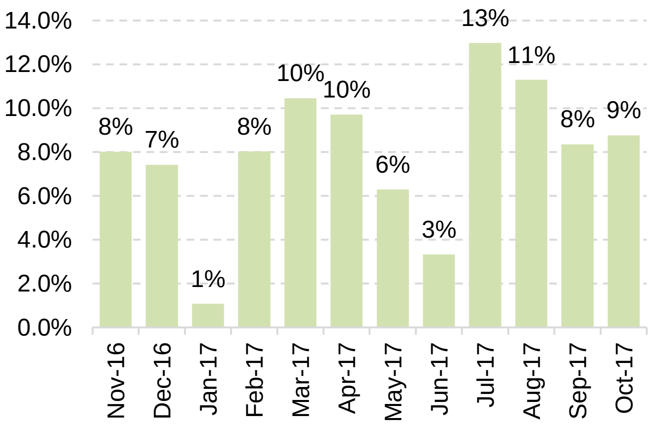
- **Light at the End of the Tunnel:** The outlook for Pakistan's economy remains bright given materialization and implementation of projects and initiatives undertaken by the government and under the umbrella of CPEC in sectors of energy and transportation / infrastructure. The GDP is expected to grow by 5.5% during FY18, as highlighted by the IMF[1] and the World Bank[2], on the back of reduction in power shortage and resultant improvement in the manufacturing sector. Hence, we view the industrial sector's contribution to GDP growth is set to increase to 1.4% in FY18 from 0.9% in FY17 while the service sector is expected to contribute 3.6%. The service sector is expected to grow 6.5% during FY18 compared to 5.9% during FY17 with the uptick in growth being charged by improved performance of the commodity producing sector.

- **Higher Credit Offtakes and Power Generation:** Significant improvement in leading economic indicators like Corporate Sector Credit Growth (+22% YoY) and growth in power generation (+16% YoY) adds to our conviction of stronger than expected GDP growth for FY18. Banking advances grew by 19.0% YoY in Oct'17 compared to last 5-year average of 9.9%. We believe there is still significant room available for expansion in private sector credit as advances to deposit ratio (ADR) is still low vis-à-vis historic levels. Monthly generation statistics show that power generation in Pakistan has reached an all-time high of 12,410 Gwh during Aug'17 after generation from new power plants. Per capital electricity consumption in Pakistan is one of the lowest as compared to middle income countries. It stands at 505 KWh in CY17 compared to 514 KWh in CY16.

- **Improved Governance:** As per the Global Competitiveness Report of 2017-18 issued by the World Economic Forum gauging production and prosperity, Pakistan improved its overall governance to achieve a rank of 115 (last year: 122nd) which hints at higher economic growth in upcoming years.

- **Higher LSM:** Growth in Large Scale Manufacturing reached a 15-month high in Jul'17, has been broad-based and includes increasing production of capital goods (like steel, cement, automobiles, glass), Food Products (Sugar, Ghee), Pharmaceuticals and Consumer Durables.

Exhibit: LSM Growth



Source: PBS, AHL Research

[1] http://www.imf.org/en/News/Articles/2017/12/14/pr17495-imf-staff-completes-mission-for-the-first-post-program-monitoring-to-pakistan?cid=em-COM-123-36336
[2] https://data.worldbank.org/country/pakistan?view=chart

Inflation Outlook

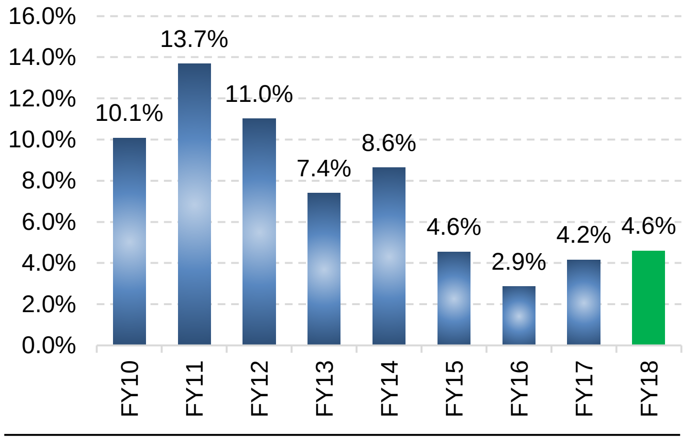
FY18 Inflation to Clock in at 4.6%

- **Outlook for FY18 / CY18:** During 5MFY18 headline inflation averaged at 3.59%. We revise upwards our FY18 estimates for inflation from 4.2% to 4.6%, accounting for increasing international commodity prices and depreciation impact, although minor. Pertinently, our estimates for FY18 are still below the government's target of 5.5-6.0%. Similarly, we have tweaked our estimates for CY18 to 5.8% compared to 5.0% previously. We also accentuate that a major impact in inflation will be observed from Feb'18 onwards, so we believe policy rate to increase in Mar'18 by 50bps against our previous hike target of May'18.

- **Depreciation – not to have major impact on Inflation:** Our inflation expectation takes account of the 5.2% PKR depreciation and 8.0% increase in oil prices. We believe the current round of depreciation will not have a significant impact on general inflation as commodities trading at a premium to international prices have a higher weight than commodities directly linked with the greenback. According to our calculations, 11.6% of the commodities in the CPI basket trade at a premium to international prices, while 10.1% of the commodities are directly linked to the USD which will witness a surge.

- In addition, three fourths of the index (76.4% of the commodities) is not linked with international prices and is majorly dependent on domestic demand-supply conditions; these will not be impacted by the PKR depreciation. For example, prices of house rent (21.8%), fresh and powdered milk products (7.43%), meat (2.43%), fresh fruits (1.86%), other fresh vegetables (1.71%), potatoes (0.46%), tomatoes (0.43%) etc. do not move in-line with the USD.

Exhibit: Historical CPI



Source: PBS, AHL Research

External Account Outlook

Pressure To Extend

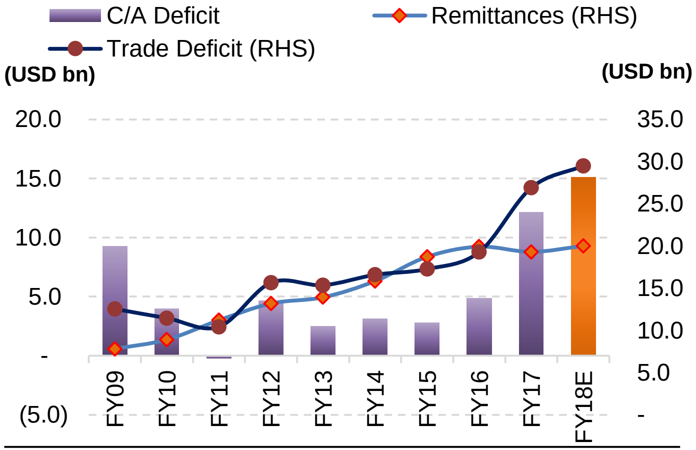
- **Ballooning CAD:** On the external front, we project the PKR to depreciate to PKR 112/USD by Jun ’18 in light of the widening current account deficit amid higher machinery and petroleum imports. To recall, CAD clocked-in at USD 12.1bn at the end of FY17 (~3.8% of GDP) and we project it to settle at USD 15.1bn by the end of FY18 (~4.5% of GDP). Increased investments and stagnant savings have also contributed to the broadening CAD; investments have increased from 16.1% in FY16 to 16.3% of GDP in FY17 while savings have augmented from ~15.3% of GDP in FY16 to ~15.8% in FY17.

- Contrary to the popular perception that a devaluation in the coming year will provide immediate relief to the inflating CAD, we argue that the diluting impact of the devaluation will surface with a lag – as part of the ‘J-curve effect”. Following depreciation of a currency, initial response of the trade balance is adverse as the higher exchange rate initially raises import bills. However, demand for cheaper, locally produced goods picks pace over time thereby becoming more competitive in the international markets against expensive imported goods (a positive for the trade balance).

- Imports during FY17 settled at USD 48.6bn and we project them to rise to USD 53.4bn during FY18. However, we view that the YoY increase in imports during FY18 will come down to ~10% as opposed to ~18% during FY17. Imports of petroleum products rose from 20% of total imports in FY16 to 22% in FY17 while machinery contributed 16% to FY17 imports (FY16: 17%). Total exports arrived at USD 21.7bn during FY17, which we expect to rise 10% YoY to USD 23.9bn by the end of FY18. Improvement in energy supply and growth in LSM is likely to fuel the exports growth. Textiles continue to dominate the country’s exports, contributing 57% in FY17, flattish compared to FY16. Furthermore, in an attempt to stimulate exports, the government announced an exports package worth PKR 180bn.

- Funding for the CAD is likely to be sourced from higher foreign direct investment, which we expect to cross USD 3bn, coupled with borrowings from commercial banks, multilateral institutions and bond/sukuk issuance (Pakistan recently issued Euro bond and Sukuk worth USD 2.5bn and investor participation amounted to USD 8.3bn which demonstrates Pakistan’s ability to borrow from global financial markets). During CY18 and ahead, we expect fuel savings to kick-in with the materialization of energy projects established independently, and as part of CPEC (China Pakistan Economic Corridor).

Exhibit: Historic statistics for Balance of Payments



Source: SBP, AHL Research

External Account Outlook

Pressure To Extend

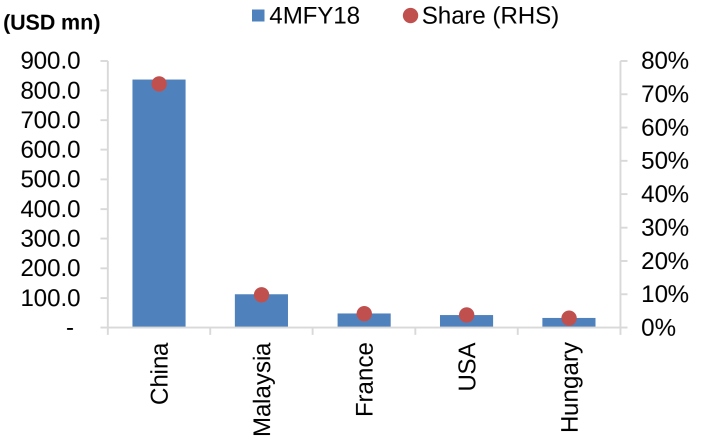
- **Decline in Remittances:** A decline in remittances during FY17 was witnessed attributable to the deteriorating economic landscape of the Middle East, which accounted for almost two thirds of our remittances. Remittances portrayed a downturn of 3.3% YoY, to settle at USD 19,304mn in FY17. These contributed ~7.1% to GDP in FY16 which reduced to ~6.4% in FY17 and we expect it to come down to ~6.0% in FY18.

- **Depreciation of PKR:** We expect the PKR/USD parity to depreciate by 3% YoY from FY18 onwards since we do not think that the government will opt for a sudden PKR depreciation which will restrict Pakistan's GDP growth, as has been witnessed in the past (during FY09, PKR depreciated by 25% against USD and GDP growth went down from 5% in FY08 to 0.4% in FY09). A sharp slowdown in GDP growth comes with a social (increase in unemployment) and political cost as well, which we do not think the government wants to bear.

- **Reserves:** Foreign Exchange Reserves lately came under pressure as inflows under Financial Account were lesser than the Current Account Deficit. SBP reserves stood at USD 16.1bn at the end of FY17 and are expected to rise to USD 16.2bn during FY18, while banks' reserves are expected to reach USD 5.0bn.

- **FDI:** Foreign Direct Investment is increasing as CPEC gains momentum and is evident through increase in share of China in total FDI. During 4MFY18, total net FDI clocked-in at USD 1,146mn, up by 57% YoY. FDI from China stands at USD 837mn (~73% of total FDI) compared to USD 217mn in same period last year.

Exhibit: Foreign Direct Investment in Pakistan



Source: SBP, AHL Research

Fiscal Position Outlook

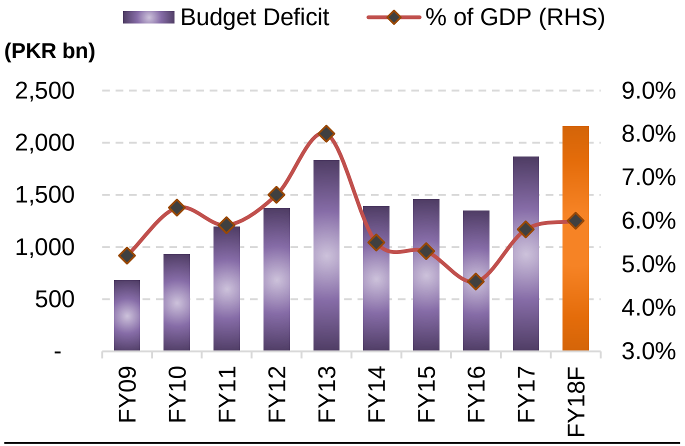
Year of Elections - Fiscal Deficit to Rise

- **Fiscal Deficit:** We expect the fiscal deficit during FY18 to settle at 5.5% of GDP compared to 5.8% in FY17. CY18 is an election year and the government will pursue an expansionary fiscal policy, we view. Secondly, as the government intends to support exports via clearance of refunds and provision of incentives in addition to currency devaluation, expenditure would remain high. Budget deficit is expected to clock-in at PKR 2,155bn by the end of FY18, showing a 15.6% uptick YoY.

- **Ambitious Revenue Targets Yet Again:** Strong growth in revenue has supported the overall fiscal balance. Pakistan's tax collection grew by an impressive 4-yr CAGR of 15% during 2013-17 on the back of strong growth in direct (16%) and indirect taxes (14%). Among indirect taxes, custom duty grew by a 20% 4-yr CAGR during 2013-17. Total revenue grew by a lesser quantum (+13%) as non tax revenue growth was slower (+5%). We project total revenue to settle at PKR 5,310bn at the end of FY18, set to portray an impressive 12% YoY improvement.

- **Hike in PSDP Expected As Elections Loom:** Total expenditure is expected at 21.3% of GDP in FY18, flattish from the preceding year. Total Expenditure has grown by a 4-yr CAGR of 9% as Development Expenditure grew by an average of 10% during the same period. According to our estimates, total expenditure is expected to rise by 13% YoY during FY18 to PKR 7,651bn. We view that the rise in total expenditure will come mostly on account of higher PSDP targeted towards extravagant infrastructure projects in a bid by the gov't to retain its voting populace.

Exhibit: Fiscal Deficit to Settled at 6% of GDP in FY18



Source: MoF, AHL Research

Improving energy situation

Power generation shows stellar improvement

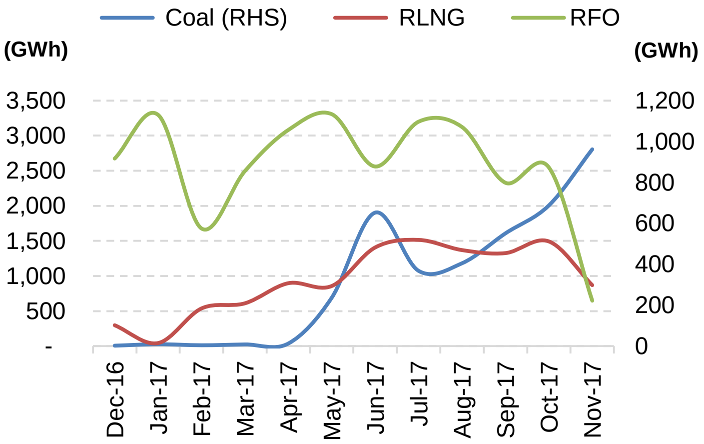
- **Economic Performance a Function of Power Generation:** Significant improvement is expected in the economic performance of Pakistan with reduction in power interruptions and shortages as the prevailing situation was far from ideal. Analyzing the situation of power supply in Pakistan compared to other countries, a World Bank report[3] stated that firms operating in Pakistan had to face far more power interruptions than their regional peers.

- **Introduction of More Efficient Sources of Generation:** Monthly power generation data shows that inclusion of efficient and cheaper sources of generation have phased out outdated and expensive power plants majorly based on Furnace Oil. Meanwhile, the share of RFO based generation has shrunk to 9.3% in Nov'17 from 19.7% in Nov'16. Coal based generation has increased by 40% MoM during Nov'17 to 962 GWh due to induction of Port Qasim Coal Power Plant (Load Factor: 44% for 660MW). Gas based generation also went up by 5.6% MoM, however hydel, FO, RLNG and Nuclear based generation dipped by 9.3%, 74.5%, 55.1% and 24.3%, respectively. With significant additions to the power generation capacity and reduction in power shortage, the government has achieved a state where it can opt for cheaper and more efficient power generation.

- **RLNG Replacing Furnace Oil:** Inclusion of RLNG into the energy mix has reduced the need for Furnace Oil in power generation and has thereby created a challenge for refineries operating in Pakistan producing this fuel. We have estimated that substitution of Furnace oil with RLNG and Coal will save PKR 156bn during FY19.

- **All-time High Generation:** The latest monthly power data has shown that the country's power generation reached its peak during Aug'17, clocking-in at 12,410 GWh. QATPL, Haveli Bahadur Shah, Balloki, Sahiwal Coal Power Plant and Chashma Nuclear IV) have been added to the national grid.

Exhibit: Source Wise Power Generation



Source: NEPRA, AHL Research

3 http://pubdocs.worldbank.org/en/444681490076354657/Electricity-Tariffs-Power-Outages-and-Firm-Performance.pdf

Challenges to the economy

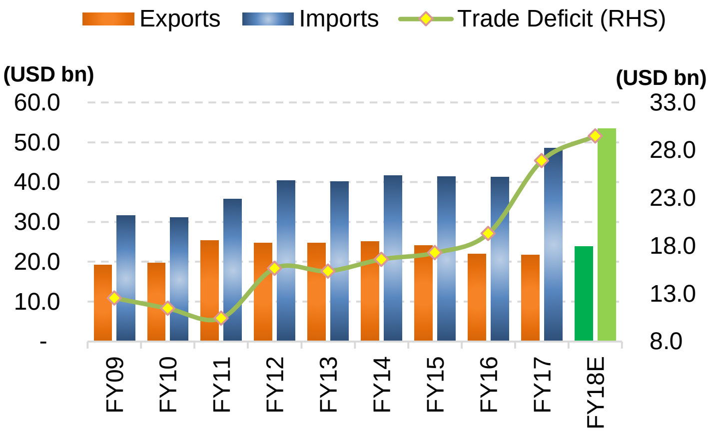
CAD and Currency to Play Vital Role

- **Absence of Support From Remittances:** Historically healthy support has been received from growing remittances almost covering the entire trade deficit (from FY11-16 remittances were 98% of trade deficit). This coverage declined to 72% in FY17, thereby increasing the Current Account Deficit.

- **Trade Deficit on the Rise:** Trade deficit during 5MFY18 grew by 26% YoY with imports up 19% YoY and exports up by 10% YoY in the said period. Higher imports under machinery and petroleum group were primarily responsible for the increase in trade deficit.

- **FX Reserves Under Pressure:** SBP had successfully managed to build up FX reserves to a record high of USD 24.03bn until Oct'16. However, a higher CAD, repayment and servicing of external debt has compressed the FX reserves, pushing them down to USD 20bn.

Exhibit: Trade Deficit is expected to clock in at USD 31bn



Source: PBS, AHL Research

Economic Indictors: Trend & Forecast

Key Economic Indicators

Exhibit: Key Indicators

	FY12A	FY13A	FY14A	FY15A	FY16A	FY17A	FY18E	FY19F	FY20F
Real									
GDP	3.8%	3.7%	4.0%	4.2%	4.7%	5.3%	5.5%	6.0%	6.5%
GDP (USD bn)	224.0	231.0	244.0	271.0	279.0	304.0	334.7	374.9	421.7
Prices									
CPI (YoY)	11.00%	7.40%	8.60%	4.60%	2.90%	4.15%	4.60%	6.00%	6.50%
Discount Rate - Period end	12.00%	9.00%	9.80%	8.80%	6.50%	5.75%	6.25%	6.75%	7.25%
External Sector (USD bn)									
Exports	24.7	24.8	25.1	22.9	22.0	21.7	22.5	24.0	25.5
Imports	40.5	40.2	41.8	41.3	41.2	48.5	53.4	56.1	58.9
Trade Deficit	15.8	15.4	16.7	18.4	19.2	26.8	30.9	32.1	33.4
Remittances	13.2	13.9	15.8	18.7	19.9	19.3	20.0	20.2	20.4
FX Reserves (Period End)	15.3	11.0	14.1	18.7	23.1	21.4	21.5	22.0	23.0
Exchange Rate (Period End)	94.6	99.7	98.8	101.8	104.8	104.9	112.0	115.4	118.8
PKR Depreciation (%)	10.0	5.4	(0.9)	3.1	2.9	0.1	6.8	3.0	3.0
Fiscal Accounts (% of GDP)									
Current Account Deficit	2.1%	1.1%	1.2%	1.0%	1.7%	4.0%	4.5%	4.3%	4.0%
Trade Deficit	7.1%	6.7%	6.8%	6.8%	6.9%	8.8%	8.8%	8.6%	7.9%
Fiscal Deficit	6.6%	8.0%	5.5%	5.3%	4.6%	5.8%	5.5%	5.0%	4.5%
External Debt	30.9%	27.0%	25.6%	24.2%	26.6%	27.3%	30.8%	30.8%	30.5%
Domestic Debt	38.2%	42.6%	44.0%	45.8%	47.4%	48.0%	47.8%	48.0%	47.4%

Source: SBP, PBS, AHL Research

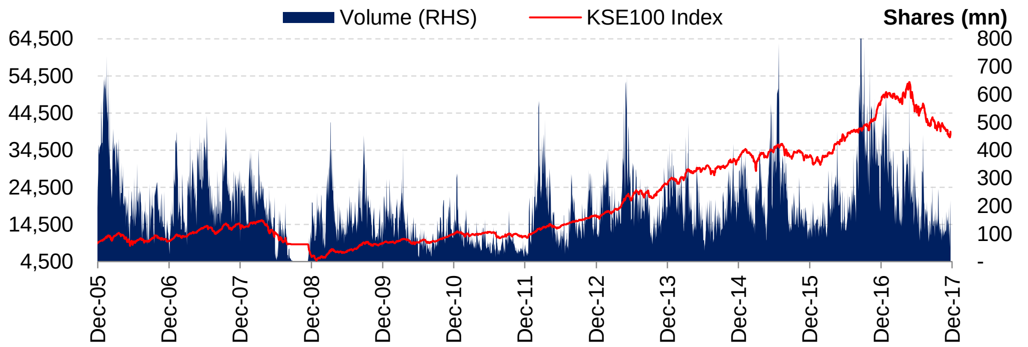
Capital Markets

Market Strategy

2017: A Reality Check

- **Irresistible Valuations :** PSX was trading at a PER of 12.1x in CY16. Currently, it is trading at a 4 year low PER of 9.3x in CY17E, cheaper than its past 5 years' average of 10.3x. We project a forward PER of 8.5x in CY18F. The last time our market was trading at such a cheap level was in CY12 (8.3x) when deplorable economic conditions (as indicated in the exhibit) despite healthy earnings growth had depressed investor confidence. We view that the decline in market performance was justified as earnings growth did not rationalize the buoyancy reflected by the market (primarily attributable to jubilation over MSCI EM inclusion) and the inflated bubble was bound to burst.

Exhibit: PSX Historical Performance



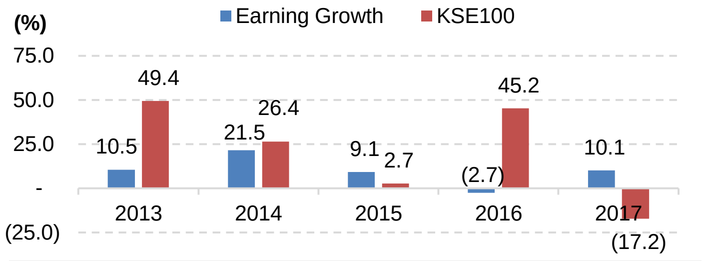
Source: AHL Research

Exhibit: Country Macros vis-à-vis KSE100 PE

Year	P/E	DR	EGrow	GDPg	C/A*	Fis. Def.*	Fx Res.	CPI
	x	%	%	%	%	%	USD bn	%
2012	8.3	11.2	18.1	3.8	(2.1)	6.6	13.8	9.7
2013	9.7	9.5	10.5	3.7	(1.1)	8.0	8.5	7.7
2014	11.2	9.9	21.5	4.1	(1.2)	5.5	14.9	7.2
2015	9.4	6.9	9.1	4.1	(1.0)	5.3	21.1	2.5
2016	12.1	5.8	-2.7	4.5	(1.7)	4.6	23.2	3.8
2017	9.3	5.8	10.1	5.3	(4.0)	5.8	20.4	4.2

Source: SBP, PBS, AHL Research, * % of GDP

Exhibit: KSE100 Performance vs KSE100 Earning Growth



Source: Bloomberg, AHL Research

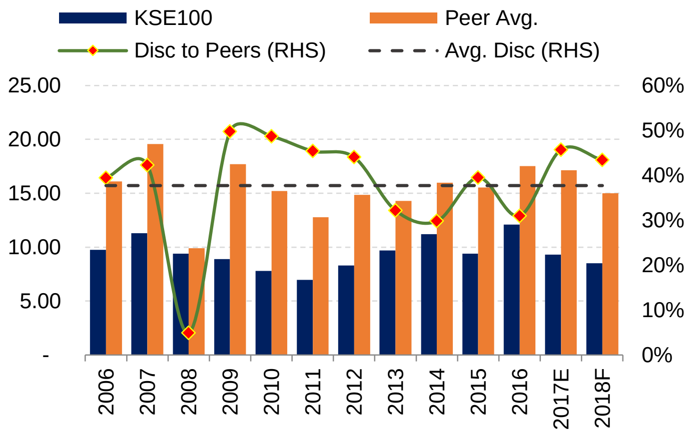
Market Strategy

Chance for a Home Run – Time to Buy

- **Attractive Valuations Compared to Regional Peers:** We view that the PSX is trading at attractive valuations compared to regional peers currently and presents a lucrative opportunity for investors. Regional peers including countries such as China (13.7x), India (17.3x) and Vietnam (16.4x) are trading at an average of 17.1x PER for CY18E, implying a ~43% discount for the PSX. Average discount of PSX against regional peers has remained ~36% for the past 12 years.

- **Lucrative Dividend Yields Compared to Region:** Dividend yield for the KSE-100 Index currently stands at 6.5% in CY17E and 7.2% in CY18F compared to regional averages of 2.2% and 2.4%, respectively. Historically, our equity market dividend yields have also fared well compared to the region, as the last 5 years DY average of 5.9% outperforms the regional average of 2.3%. We view that despite poor equity performance, lucrative dividend yields of the PSX make it an attractive investment destination.

Exhibit: Price to Earning - Regional Discount



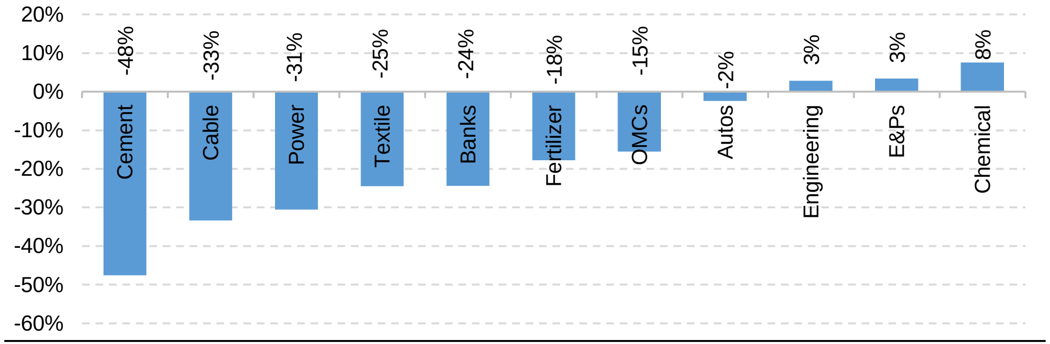
Source: Bloomberg, AHL Research

Market Strategy

E&P Sector to Pump Earnings During 2018

- **E&Ps to Lead Earnings Growth:** 2016 saw a negative earnings growth of 2.7% YoY while CY17E earnings growth stands at 10.1% YoY, led by a 30.7% YoY earnings growth in E&Ps while banks in CY17E are expected to portray a contraction in earnings of 2.0%. Surge in E&P profitability was on account of higher international oil prices (WTI, Brent and Arab Light prices up 16.6%, 22.4% and 28.7% YoY respectively) whereas banks' earnings retreated due to spreads compression and falling investment yields. We project an uptick in earnings of KSE-100 to a 4 year high of 11.9% in CY18F on account of 29.7% uptick in E&Ps and 12.1% uptick in Banks, which are the two highest weighted sectors in the PSX (15.2% and 23.5%, respectively). Our growth estimates for E&Ps is premised on the assumption of higher oil prices at an average of USD 58/barrel in FY18 and USD 60/barrel in FY19 while an expected 50bps hike in interest rates is forecasted to fuel banks' profitability.

Exhibit: KSE-100 Sector Performance During CY17TD*



Source: Bloomberg, AHL Research, *22-Dec-2017

Exhibit: Sector Earnings Growth: Trend & Forecast

(%)	2013	2014	2015	2016	2017E	5-Y Avg.	2018F
E&P	(3.2)	31.6	(29.4)	(33.3)	30.7	(0.7)	29.7
Banks	(6.2)	36.7	16.5	(1.2)	(2.0)	8.8	12.1
Fertilizer	43.8	0.4	78.3	(41.0)	6.3	17.6	10.5
Cement	79.5	15.2	15.3	20.8	(2.3)	25.7	3.4
OMCs	(50.5)	114.7	(75.7)	267.3	110.5	73.3	(8.1)
Autos	16.0	12.6	120.7	(1.4)	37.3	37.0	12.3
Power	34.7	15.9	60.8	9.0	1.2	24.3	2.0
Textiles	98.1	13.5)	(8.7)	23.3	(1.8)	19.5	6.1
Chemicals	(9.4)	49.1	28.0	30.2	15.7	22.8	10.0
Steel	184.5	(2.9)	13.6	105.4	65.6	73.3	11.6
Cable & Elec.	1,108.6	102.1	36.3	16.7	85.9	269.9	17.1
KSE100	**10.5**	**21.5**	**9.1**	**(2.7)**	**10.1**	**9.7**	**11.9**

Source: Company Financials, AHL Research

Market Strategy

Index Target of 47,199 points

- **Strike While the Iron is Hot:** We view the Dec'18 index target for the KSE-100 Index to clock-in at 47,199 points, portraying an upside of 19.6%. A variety of forces that we expect to come into play in CY18 are likely to propel the market.
- **Political Clarity to Awaken Local Investors' Confidence:** We forecast the rebirth of domestic investor confidence in the market as the political uncertainty is expected to clear out with a new government set to take charge post general elections. We also expect the elections to take place on time with the passing of the delimitation bill. The PM has also given statements reiterating that the general elections would take place on time. The process of dilution in political noise in the country has already begun with an announcement by the government that the senate elections would take place on 1st Mar'17. Moreover, briefing by the army chief to the senate which had a pro-democracy colour, has been received well by the investor circle and we expect this to further revive confidence in the equity market.
- As mentioned earlier, attractive valuations in the market are also likely to act as a catalyst for the domestic equity bourse. Pakistan's equity market is trading at a forward CY18F PER of 8.5x and a CY17E PER of 9.3x which is the lowest in 4 years.
- **Better Macros to Rejuvenate Foreign Interest:** Improving macroeconomic conditions of the country on the back of a forecasted decade high GDP growth rate (5.5% in FY18F) and materialization of CPEC projects is likely to attract foreign interest in the market. Moreover, depreciation of the currency will possibly drive earnings growth of various sectors, in addition to initiating a compression of the expanding current account deficit. Primarily, a PKR depreciation will have a direct healthy impact on the earnings of the second highest weighted sector – E&P (weight:15.2%) apart from positively impacting the profitability of textiles (weight: 2.3%) and IPPs (weight: 6.5%). Moreover, a reduction in the uncertainty regarding the value of PKR will also bode well for reviving foreign sentiment in the equity market.

Exhibit: KSE-100 Index Target Estimates 2018

Valuation Basis	Target
Target Price Based	49,611
Earnings Growth	44,160
Justified PE	47,824
Average Target 2018	**47,199**
Index Closing 22-Dec-17	39,471
Expected Return 2018	**19.6%**

Source: AHL Research

Market Strategy

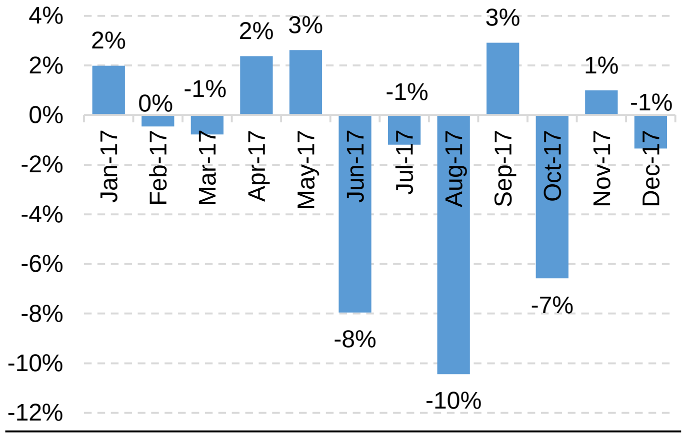
2018 to be Starkly Different from 2017

- **Mesmerized Story of Equity Market**: The domestic equity bourse sky rocketed to its highest ever level of 52,876 points on 24th May '17, a week before Pakistan formally entered the MSCI EM index. However, post upgrade of PSX, the index witnessed a terrible situation. The equity market has deteriorated ~25.4%TD since reaching its peak and is the worst performing emerging market in 2017. The market's fiasco this year is mostly attributable to i) Political uncertainty in the wake of ex-Prime Minister Nawaz Sharif's disqualification, ii) Deteriorating macroeconomic indicators with a ballooning CAD, iii) Foreign offloading, and iv) Lower than expected funds inflow post MSCI upgrade.

- **Abysmal Market Returns**: Market returns this year painted a dismal picture; with the index generating negative returns of ~24% in CYTD, PSX remains the only market in the Asia Pacific region to generate such high negative returns. Vietnam leads the way with ~43% return in CYTD, followed by South Korea (~35%) and India (~31%). The average return generated by the MSCI EM index stood at 30% in CYTD while the average MSCI World index clocked-in a return of ~20% in CYTD. However, if we solely take FY17 into consideration, Pakistan's equity bourse fared rather well, generating a return of 23.1%, second to only Indonesia (27.2%). PSX outperformed MSCI World during FY17 which generated 16.5% returns while returns for Vietnam, India and South Korea clocked-in at 20.5%, 19.7% and 22.2%, respectively.

- **CY18: Year of Reviving Sentiments:** CY17 depicts a sorry state of affairs for the domestic equity bourse. The latter half of the year (post MSCI EM inclusion) portrayed despondency with minimal foreign interest, lower than expected inflows from the MSCI EM Index and depressing volumes. We view CY18 to be a year of reviving investor sentiment in the equity market primarily on the back of diluting political uncertainty. With the passing of the delimitation bill, elections are likely to be conducted on time. Moreover, with the economy set to grow at a faster rate (~5.5%) than last year, we view foreign interest in the market is likely to recover. Furthermore, an expected interest rate hike this year is likely to uplift earnings of the banking sector which is the highest weighted sector (~23%) while PKR depreciation will be a catalyst to the second highest weighted sector – E&P's (~15.5%). Lastly, attractive valuations in the market are certain to attract the eyes of investors.

Exhibit: CY17: Monthly Returns



Source: PBS, AHL Research

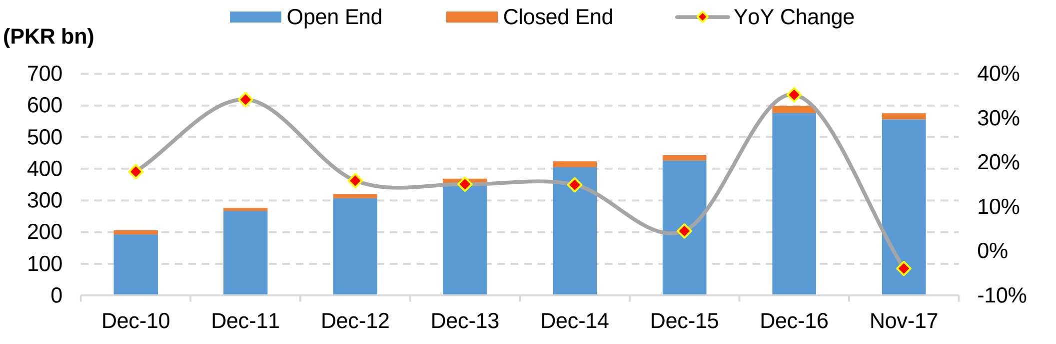
Market Strategy

Domestic Liquidity

- **Locals Absorbed the Foreign Selling:** Pakistan equity market observed foreign outflows of USD 497mn during CY17TD which was mainly absorbed by i) Mutual Funds (net buy: USD 201mn), ii) Insurance Companies (net buy: USD 182mn), and iii) Companies (net buy: USD 131mn).

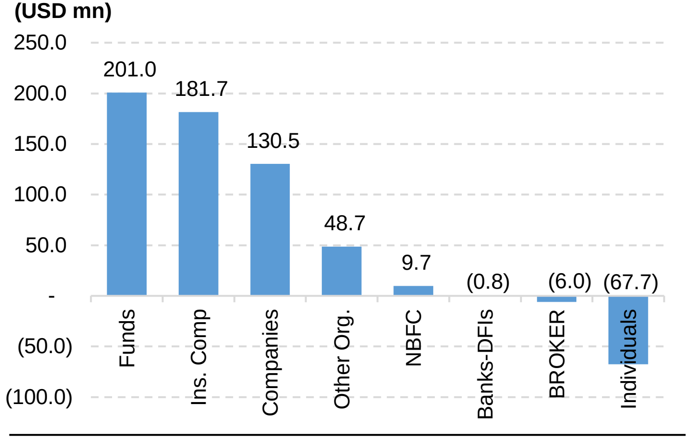
- Moreover, as per latest available data, mutual funds have invested up to ~84% of total AUM's in the equity market. We view that with the clarity and dilution of noise on the political front, mutual funds are expected to chip in ~ PKR 15 - 20bn into the equity market.

Exhibit: Assets Under Management have increased at 17% CAGR during last 8-years



Source: MUFAP, AHL Research

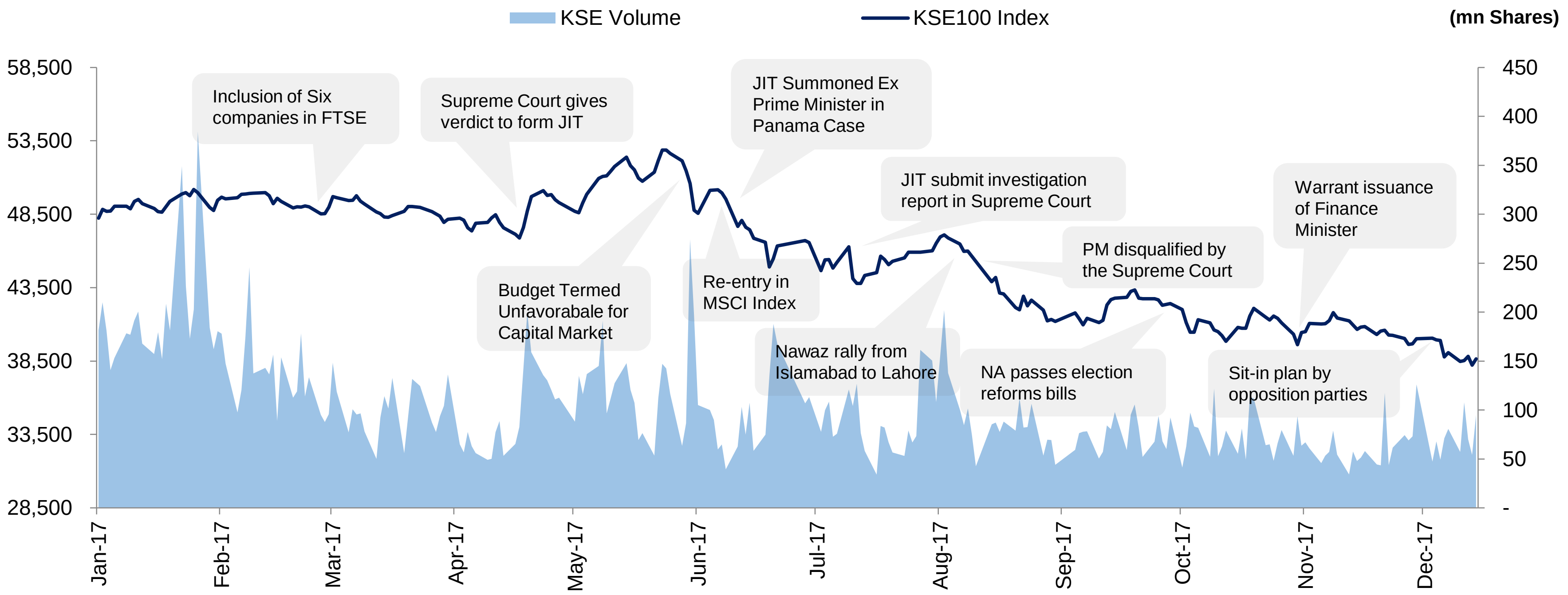
Exhibit: Net Buy / (Sell) by Local Investors in CY17TD*



Source: Bloomberg, AHL Research, *22-Dec-2017

Market Strategy

KSE100 Index Performance (CY17TD)

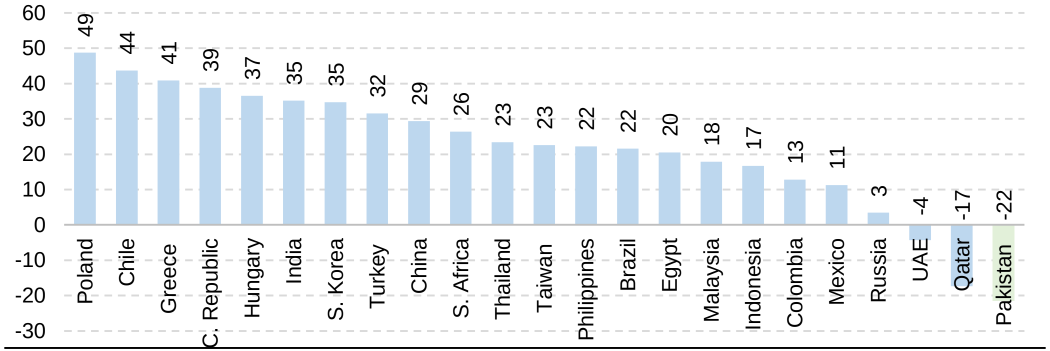


Market Strategy

2017 – A Roller Coaster Ride

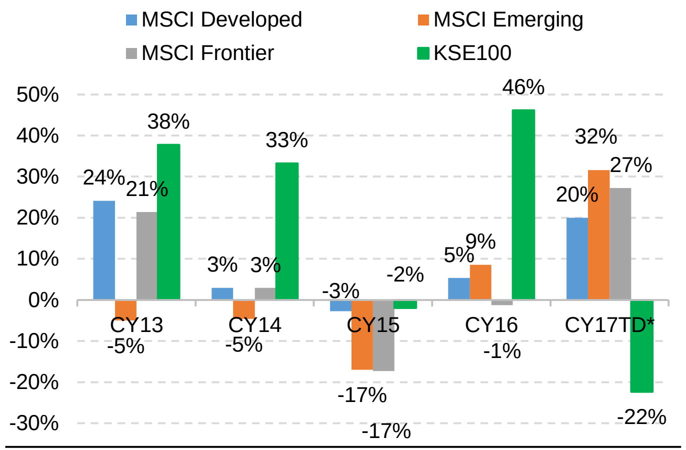
- **The MSCI surprise:** The PSX has dwindled ~25.4%TD since reaching its highest level in May'17. The bloodbath at the equity bourse has been surprising for some, but expected by others. During the first half of CY17, the market elevated to its highest ever level of 52,876 points on 24th May'17 as investors celebrated Pakistan's inclusion into the MSCI EM Index. However, political uncertainty in the aftermath of ex-PM Nawaz Sharif's disqualification, deteriorating macroeconomic landscape of the country particularly on account of increasing pressure on the external account and weak foreign interest contrary to expectations have all contributed to the downfall in the market. During CY17TD, the market has given a negative return for the second time during past nine (9) years and first time during past six (6) years. Average return for past nine (9) years has remained 26% p.a.

Exhibit: MSCI Emerging Countries Return in CY17TD*



Source: Bloomberg, AHL Research, *22-Dec-2017, *USD based Returns (%)*

Exhibit: KSE100 Relative Performance with MSCI



Source: Bloomberg, MSCI, AHL Research, *22-Dec-2017
USD based Returns

2017: Foreign Portfolio Investment

Running Out of Steam

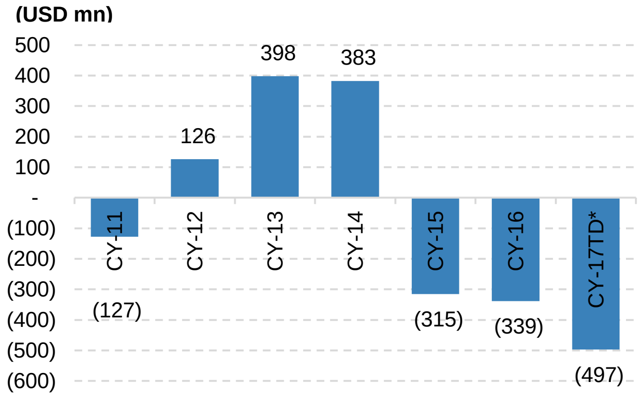
- **Highest Ever Divestment since 2009:** The benchmark KSE-100 index was unable to attract foreign investment with net sell during CY17TD at USD 497mn compared to USD 339mn in CY16. Majority of the foreign residue was absorbed by Mutual Funds, Insurance Companies and Companies worth USD 201mn, USD 181mn and USD 130mn, respectively. Portfolio divestment widely seen during first half of CY17 was largely attributable to transition from MSCI Frontier Market Index to Emerging Market Index. This transition generated more than 60% of selling in 1HCY17 (USD 333mn).

- **Sector-wise Offloading**: Selling was largely concentrated in i) Cements (USD 176mn) given rising input cost and decline in cement prices denting gross margins, ii) Other sectors (USD 121mn), iii) Commercial Banks (USD 100mn) as unchanged interest rates, spreads compression, imposition of super tax in CY17 and HBL's penalty worth USD 225mn eroded profitability, iv) Power Generation and Distribution (USD 51mn), and v) Exploration and Production (USD 44mn).

- **Comparison of Flows with Asia-Pac:** Data for Asia-Pac region reveals that outflows were witnessed in other markets as well like Indonesia recorded total outflows of USD 2,958mn and Thailand USD 848mn while simulating the same trend, Pakistan also noticed total outflow of USD 495mn. However, China and India managed to attract massive foreign inflows of USD 61,774mn and USD 7,710mn, respectively.

- **Outlook:** The wait for PKR depreciation is largely over as local currency has depreciated by 5.2% to PKR 111/USD. We expect foreign investors to start accumulating shares as KSE-100 index is currently trading at an attractive PER of 9.3x (2017) compared to regional (Asia-Pac) average of 17.1x, while offering DY of ~6.5% versus ~2.2% offered by the region.

Exhibit: Highest Ever Divestment in CY17



Source: NCCPL, AHL Research, *22-Dec-2017

Equities: Sluggish Trading

Depressed Sentiments, Depressed Volumes

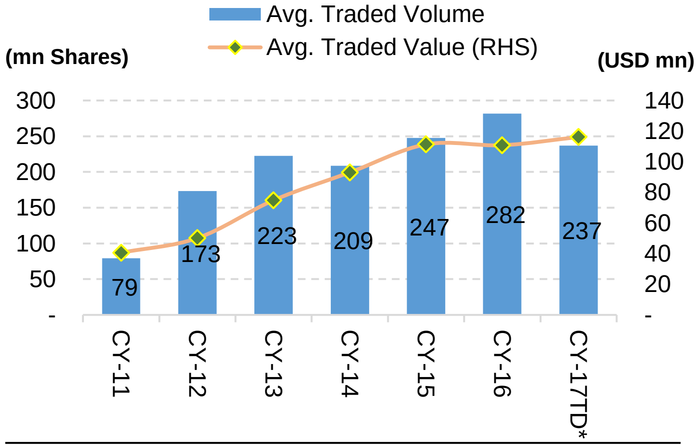
- **High and Low Volumes:** This year volumes made an intraday high of 607mn shares in May’17 compared to 903mn in Sep’16 (this level was last observed in Mar’05). On the other hand, this year the market witnessed its lowest volumes at 50mn shares (similar levels were last seen in Jun’12). The excitement over up gradation of equity market kept the volumes higher during first six months while a downturn was witnessed in the second half on the back of lower than expected inflows from MSCI EM Index.

- **Sectors-wise Volume Details:** Sectors that remained in the spotlight (volume leaders) during the year were Banks, Engineering, Technology & Communication, Power and Cements, registering average volumes of 29.4mn , 24.1mn, 22.5mn, 21.6mn and 18.9mn, respectively. The scrip-wise volumes chart was led by KEL (16.3mn) followed by TRG (12.3mn) and ASL (10.5mn).

- **2017: A Year of Dull Volumes**: CY17 was a year dictated by a lackluster volumes. Average volumes in CYTD clocked-in at 237mn shares, deteriorating 15.6% YoY (average volumes during CY16: 282mn shares). However, volumes during 1HCY17 depicted a healthy trend as the hype regarding Pakistan’s reclassification was building up, settling in at 315mn; these declined by ~50% to 157mn during 2HCY17TD. However, value traded depicted an improvement on account of Pakistan’s reclassification - average value traded in CY17TD settled at USD 158mn, registering a 13% YoY improvement.

- **Index Contribution:** Laggards dominating the trend of contributions to the index included Cements (2,652pts, 32% of total decline) followed by Banks (2,347pts, 28% of total decline), Power (866pts, 10% of total decline), Fertilizer (693pts, 8% of total decline), Pharmaceuticals (521pts, 6% of total decline), Oil & Gas Marketing Companies (431pts, 5% of total decline) and Telecom (265pts, 3% of total decline). Meanwhile top scrip wise contributions to the downside were by HBL (-1,340pts, 16% of total decline) primarily attributable to the payment of the settlement fine in the wake of investigations into its NY branch and LUCK (-967pts, 12% of total decline) owing to decline in cement prices and rising input cost.

Exhibit: Average Traded Volume Decreased by 16% YoY



Source: PSX, AHL Research, *22-Dec-2017

Commercial Banks

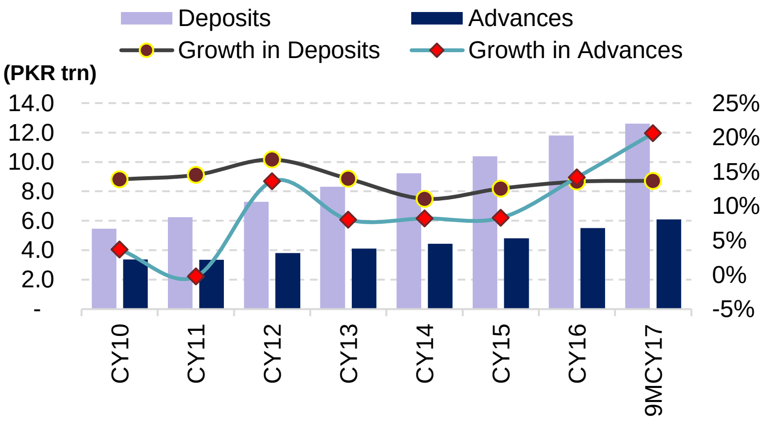
Commercial Banks

Asset Quality: The Cutting Edge

Key Investment Theme

- **Infection spiraling downwards:** Improving asset quality continues to fuel earnings growth for the banking sector. Net NPLs (Non-Performing Loans) of the banking system have declined YoY by a staggering 18% during 9MCY17, clocking-in at PKR 90bn (9MCY16: PKR 109bn). Gross NPLs have clocked-in at PKR 612bn compared to PKR 631bn SPLY. The infection ratio of the industry has improved from 11.3% in 9MCY16 to 9.2% in 9MCY17. The improvement in asset quality has kept the provisioning charges in-check, arriving at PKR 3bn in 9MCY17, portraying a drastic decrease of 70.2% YoY. Coverage ratio of the sector showed an uptick, clocking in at 85.3% in 9MCY17, compared to 82.7% SPLY.
- **Changing composition of the balance sheets:** Interest expense of the sector has sky rocketed, depicting a 53% uptick QoQ and 6.1% YoY during 9MCY17. Equity's contribution to total assets has been on a downwards trajectory, coming down from 10% in CY14 to 7.7% currently. Growth in liabilities YTD has outpaced the growth in assets, clocking-in at 12% and 10.9%, respectively. SPLY the ratio stood at 8.8%. The trend implies that borrowings have increasingly funded the growth in assets. However, cost of deposits of the sector has been brought down to 3.1% at the end of CY16 compared to 4.9% in CY13. This has come on the back of a rise in low cost deposits and strengthening CASA. Average CASA for our AHL universe currently stands at 81.5% compared to 77.1% in CY12-CY16, depicting a phenomenal growth. Going forward, we expect average CASA for the universe to settle at 82% for the period CY17-CY19.
- **Interest rate uptick to lift NIMs:** Consistent interest rate slashing has compressed NIMs (Net Interest Margins) of the sector substantially. NIMs of the AHL universe have narrowed from an average of 4.9% in CY12 to ~3.8% in 9MCY17. We believe the compression phase has bottomed-out and expect interest rate uptick from CY18 onwards to fuel NIMs going forward.

Exhibit: Sector Growth of Deposits & Advances



Source: SBP, AHL Research

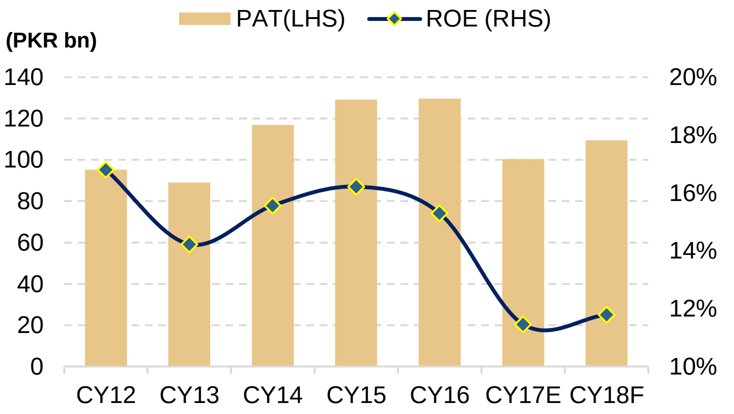
Commercial Banks

Asset Quality: The Cutting Edge

Key Investment Theme

- **Stellar growth in advances:** Advances clocked-in at PKR 6.1trn in Oct'17, recording a staggering growth of 19% YoY. With PIB maturities coming in and investment yields falling, banks have shifted their focus in favor of advances, depicted by the ADR which was set at 52.2% in Oct'17 compared to 49.4% in SPLY.
- **Profitability:** With 9M results in, so far the total listed banking sector has depicted a downturn of 21% in YTD earnings, primarily attributable to the USD 225mn settlement fine paid by HBL. If we look at the earnings ex-settlement fine, a decrease of 3.1% in earnings of the banking sector in YTD was seen. With a month to go for year end we see a decline of 4.5% in CY17E (HBL penalty adjusted). While we view CY18 to be brighter based on i) interest rate hike, ii) higher liquidity available with PIB maturities set to continue, iii) further improvement in asset quality, and iv) bullish outlook on fee income growth, earnings should see an increase of 12.9% in CY18F.

Exhibit: AHL Universe Profitability & ROE



Source: SBP, AHL Research

Key Risks

- Aggressive credit offtake can lead to NPL accretion.
- Advances growth can be curtailed by capital restraints of large banks due to regulatory requirements.
- Rising interest expense as a consequence of changing composition of balance sheets.

United Bank Limited

Fundamentals Intact; Game. Set. Match.

Key Investment Theme

- **Industry leader in domestic Current Accounts:** UBL leads the industry in accumulating the highest proportion of domestic current accounts - ~41% (compared to 38.7% in SPLY). Current Accounts of the bank have grown at a 5 year CAGR of 16.4%. Non-remunerative current accounts recorded a 13.1% YoY growth in 9MCY17 and are expected to grow at an average of 16% in the CY18-CY22 period.
- **Mighty deposit generation:** Aggressive deposit growth of the bank has fueled balance sheet expansion. The bank has outperformed industry growth in deposit base expansion, registering an average growth of 15% during CY12-CY16 against industry growth of 13.8% in the same period. Icing on the cake comes from growth being sourced from low cost deposits. This translates into higher liquidity as well as lower cost of deposits, which currently stands at 2.6% vis-à-vis an average of 3.4% in the CY12-CY16 period. We expect this to settle at 2.8% in CY17E and 3.1% in CY18F.
- **Shining asset quality:** The bank's asset quality had deteriorated to an alarming level when the infection ratio had rocketed to 13.6% in CY12. However, increased and consistent focus on effective credit risk management has reduced infection to 7.7% in 9MCY17. Going forward, we expect infection to settle at an average of 6.9% in the CY18-CY22 period.
- **Investment mix:** The bank operates the largest PIB portfolio in the industry alongside a high average maturity age (~2.5 years) as well. Investment yields are hovering above a respectable level of 7%, with PIB average yields at around 8.8%. The IDR of the bank has currently settled at a sky high level of 84.4% compared to 73% in SPLY.

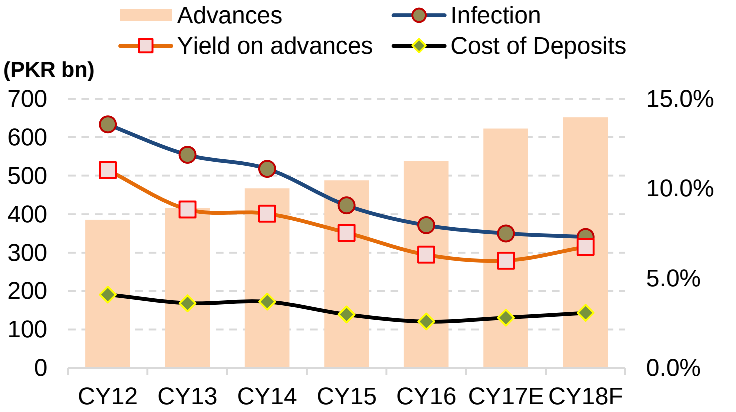
Key Risks

- Weak asset quality on the UAE loan book where economic conditions are deteriorating. Infection hovers above ~10% on the UAE loan book.
- The bank operates the largest PIB portfolio and a possible interest rate uptick can lead to higher marked-to-market unrealized losses

BUY

Target Price	PKR	223.4
Market Price	PKR	182.8
Upside	%	22.2
PSX Code		UBL

Exhibit: Lending machine stands strong



Source: SBP, AHL Research

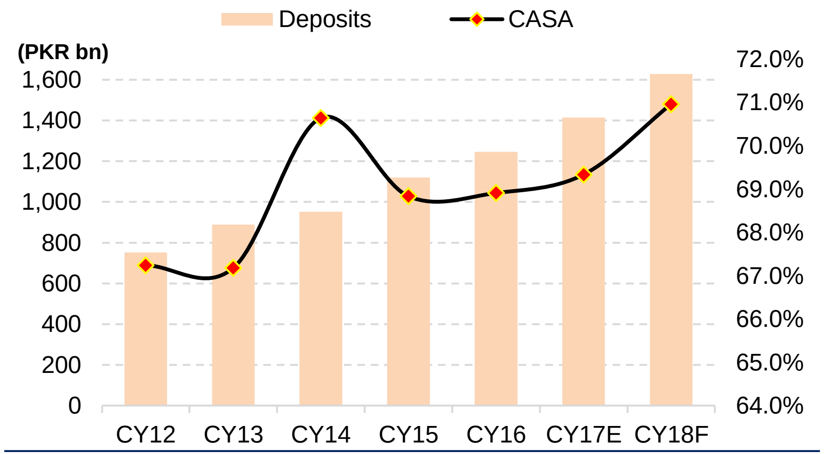
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2016A	2017E	2018F
Income Statement			
Mark-up Income	101,755	106,156	124,018
Non-Mark-up Income	25,134	23,993	25,153
Total Income	85,013	80,290	88,568
OPEX	36,253	38,249	40,998
Post Tax Profit	28,002	24,907	27,210
Balance Sheet			
Advances	537,782	623,163	651,798
Deposits	1,245,792	1,414,690	1,627,596
Investments	838,262	1,037,861	1,161,130
Borrowings	205,865	220,614	261,387
Total Equity TIER - II	163,729	174,198	184,815
Revaluation Surplus	35,706	34,779	33,758

Source: Company Financials, AHL Research

Exhibit: Qualitative & Quantitative deposit base expansion



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2016A	2017E	2018F
Price to Earning	x	10.5	9.2	8.4
Price to Book	x	1.8	1.3	1.2
ADR	%	46.5	47.2	42.9
IDR	%	65.7	72.6	70.5
NIMs	%	4.2	3.5	3.4
ROE	%	17.4	14.4	14.9
ROA	%	1.8	1.4	1.4

Source: Company Financials, AHL Research

Habib Bank Limited

Re-emerging From The Shadows

Key Investment Theme

- **Overpowering the turbulence:** The bank continues to stand strong in face of the turmoil caused post NYSDFS penalty. Advances showed a staggering growth of 26% YoY (average growth of top 5 banks: 18.4%) while deposits portrayed an 18% YoY uptick (average growth of top 5 banks: 16.9%) during 9MCY17. The management emphasizes that the domestic franchise have not been impacted as a result of the NY branch fiasco. With industry average deposit growth in CY12-CY16 at 13.8%, the bank has outperformed the industry which portrayed growth of 15.4% during the same period.
- **Qualitative and quantitative deposit base expansion:** Together with the quantitative growth, the bank has increased the quality of its deposit base with an increased focus on low cost deposits. The CASA ratio for the bank currently stands at a robust level of 84.1%, outperforming top 5 banks' average level which hovers around 75%, and is expected to settle at an average of ~82% in CY18-CY20. Current accounts make up 37% of the bank's total deposits as per 9MCY17 results, compared to an average of 33.5% in the CY12-CY16 period. Growth in current accounts during the said period was observed at a CAGR of ~19%. Moreover, fixed deposits' proportion of the total deposits has also come down to 16% from an average of 23% in the CY12-CY16 period.
- **Rebounding Asset Quality:** The bank has been consistently improving it asset quality substantially, with infection coming down from 12.7% in CY13 to 8.2% at present. Going forward, we expect infection to settle at an average of 8% in the CY18-CY22 period. In conjunction with the decline in infection, the bank has considerably raised its coverage ratio as well, clocking-in at 91.4% in 9MCY17 compared to an average of 85% in the CY12-CY16 period.

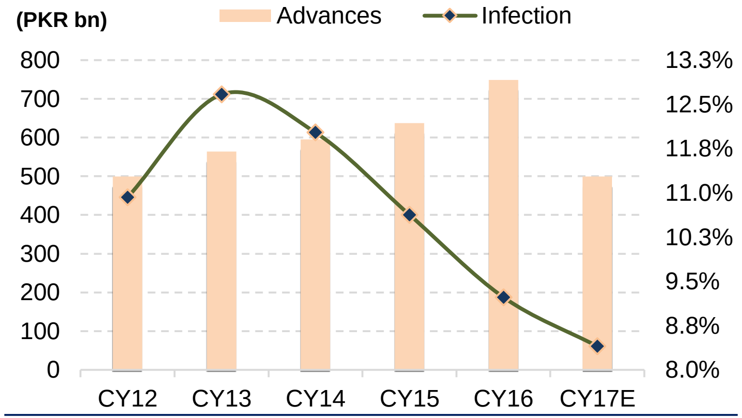
Key Risks

- Concerns over the bank's capital adequacy exist in the aftermath of the NYSDFS penalty. CAR has come down from 15.5% in CY16 to 13.6% currently. As of now, the bank has curtailed its dividend but has not announced any capital raising strategy. We view an adverse impact on growth in advances going forward.
- Aggressive advances growth could lead to NPL accretion. The bank's exposure in textiles is high which is one of the highest infected sectors, with an infection of ~22% currently.

BUY

Target Price	PKR	223.4
Market Price	PKR	170.1
Upside	%	31.3
PSX Code		HBL

Exhibit: Quality Lending



Source: Company Financials, AHL Research

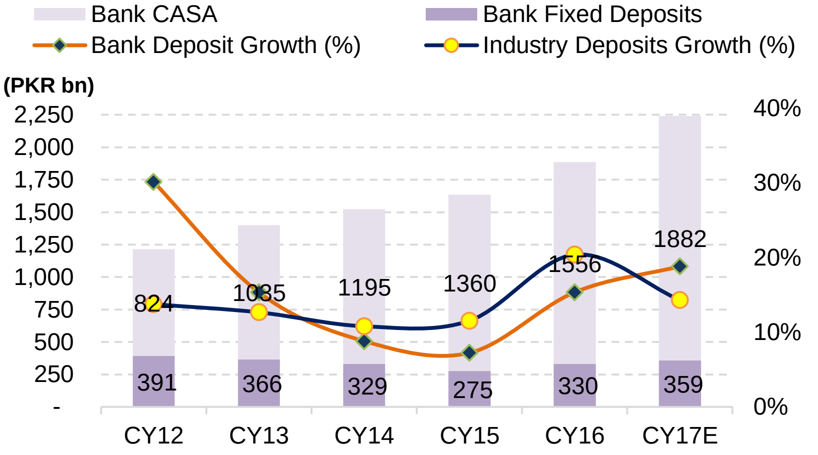
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2016A	2017E	2018F
Income Statement			
Mark-up Income	81,951	79,400	90,631
Non-Mark-up Income	31,062	34,531	37,164
Total Income	113,013	113,931	127,794
OPEX	55,771	59,869	65,470
Post Tax Profit	34,070	8,220	37,473
Balance Sheet			
Advances	748,466	889,343	912,758
Deposits	1,885,959	2,240,984	2,478,021
Investments	1,344,405	1,617,180	1,688,726
Borrowings	332,823	380,967	396,483
Total Equity TIER - II	195,010	181,290	210,780
Revaluation Surplus	22,805	14,569	18,319

Source: Company Financials, AHL Research

Exhibit: Focus on low cost deposits intact



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2016A	2017E	2018F
Price to Earning	x	11.8	30.3	6.7
Price to Book	x	2.1	1.4	1.2
ADR	%	39.7	39.7	36.8
IDR	%	71.3	72.2	68.1
NIMs	%	4.0	3.3	3.4
ROE	%	18.0	4.4	19.1
ROA	%	1.4	0.3	1.2

Source: Company Financials, AHL Research

E&Ps

Exploration and Production

Equilibrage Glut

Key Investment Theme

- **OPEC Production cut to continue in 2018:** During 173rd OPEC meeting in Nov'17, the conference decided to continue its production cuts (1.8mn bbl/day) for CY18, in-line with the decisions taken during last two meetings. Additionally, prices of Brent and WTI surged by 16.8% and 8.8% to USD 64.7/bbl and USD 58.5/bbl during CY17TD. Additionally, the producers will review the deal again at the next OPEC meeting scheduled to be held in Jun'18.

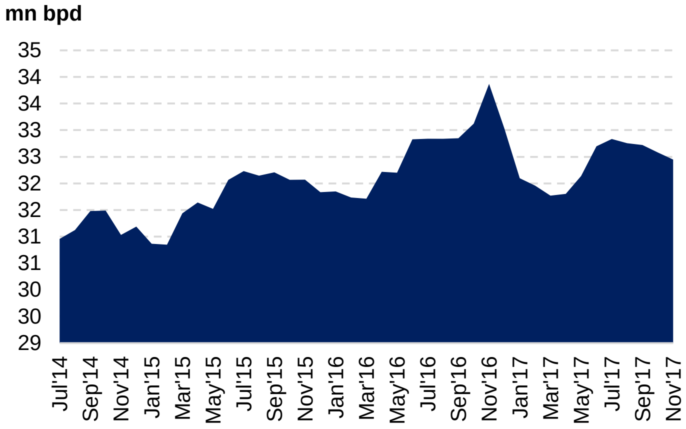
- **Demand Outlook:** As per the estimates of US Energy Information Agency (EIA) report, it is expected that growth in the global oil demand will be 1.51 mb/d to 98.9 mb/d, which is a little higher compared to 2018's initial demand of 1.26mb/d. The prime rationale behind this growth includes firm economic growth, lending support to industrial and construction fuels in both OECD and non-OECD along with expansion in the transportation sector. Moreover, growth in petrochemical demand is projected to be one of the fastest-growing contributors in US, China, South Korea and the Middle East.

- **Oil Assumption for AHL E&P Universe:** In the wake of stability in the oil prices, we have revised upwards our oil price assumption to USD 58/bbl in FY18, USD 60/bbl in FY19 and USD 65/bbl in FY20 onwards.

Key Risks

- Subdued oil demand from major oil consuming economies.
- Slow down in the imports by US leading towards supply imbalance despite production cuts.

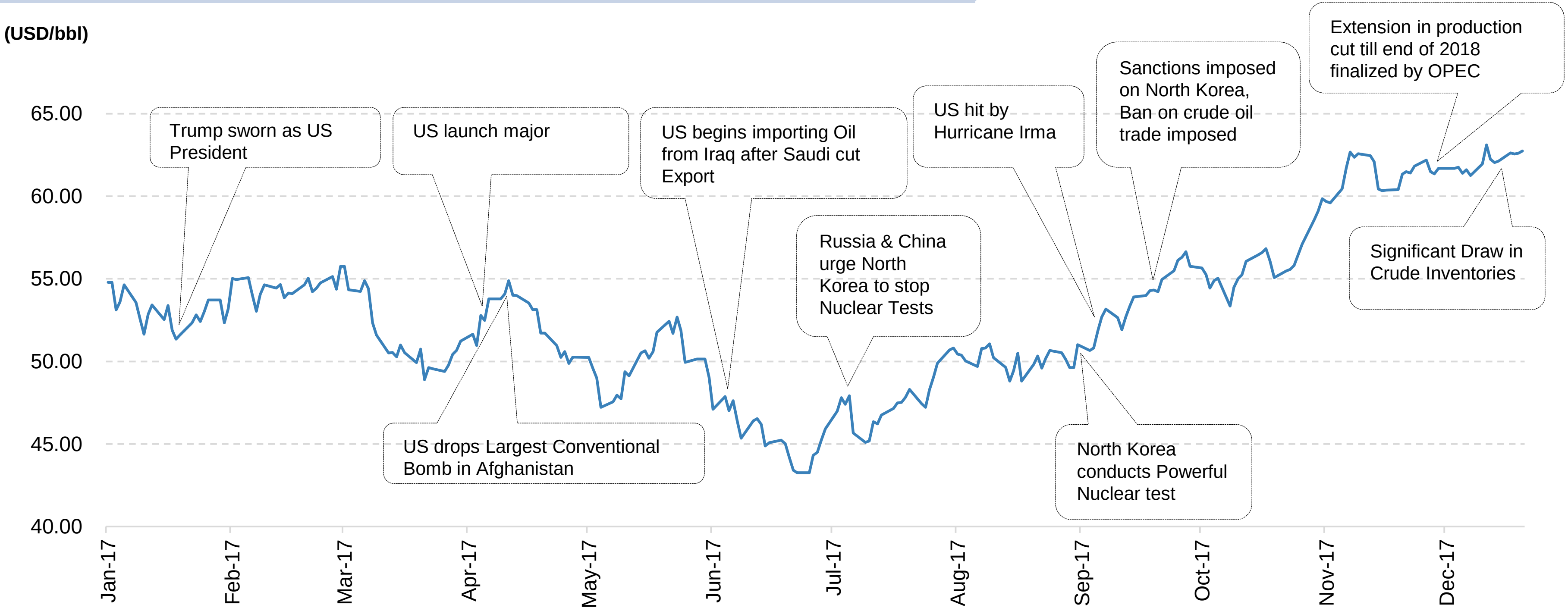
Exhibit: OPEC Crude Oil Production



Source: OPEC, AHL Research

Exploration and Production

Arab Light Price Chart (CY17TD)



Exploration and Production

Highlights of 2017

Key Investment Theme

- **Production summary:** Oil Production during FY17 increased by 2% YoY to 32.2mn bbl from 31.5mn bbls in FY16. However, gas production dropped slightly by 1% YoY from 4,058 mmcfd to 4,031 mmcfd. We estimate flows and production addition in FY18 from Makori Deep, TAY, Jhandial, Kunnar West, Kunnar South, Pasakhi East.

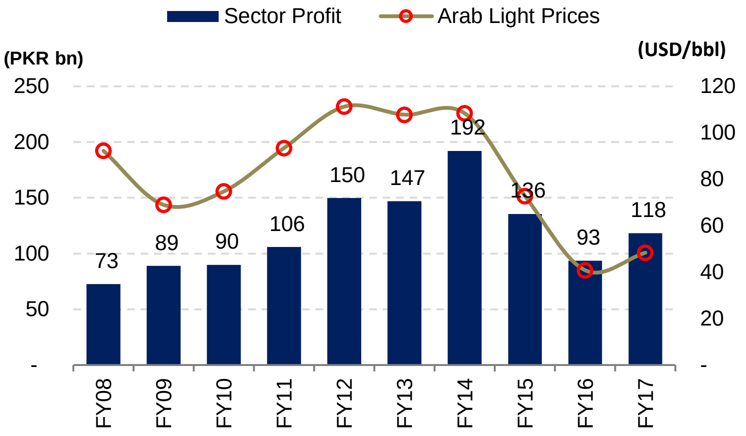
- **Exploration Momentum to Continue:** The local E&Ps spudded 93% of targeted wells in FY17 (82% in FY16) which includes 36 exploratory and 48 development / appraisal wells. For AHL E&P universe, OGDC spudded 22 wells (11 Exploratory and 11 Developmental Wells), PPL 26 wells (10 exploratory and 16 Developmental), POL 6 wells (3 Exploratory and 3 Developmental) and MARI 8 wells (5 Exploratory, 2 Appraisal and 1 developmental). Moreover, E&Ps made 15 new discoveries during FY17. We expect this momentum to continue amid stable law and order situation along with the incentives and returns provided by the gov't for exploration activities.

- **Oil price + PKR depreciation**: Revenues of E&P companies are dependent on oil prices along with PKR depreciating against greenback as a result of which the sector's profitability moves in tandem with oil prices and PKR depreciation. Additionally, based on FY19 expected earnings, E&P sector is trading at attractive PER of 8.5x along with 5.5% dividend yield.

Key Risks

- Exploration and Drilling risk including inability to find commercial quantities of hydrocarbons.
- Oil prices volatility and PKR appreciation risk.
- Delay in production coming online.
- Due to prevailing situation of FO, oil production specially from TAL block & Nashpa could be hurt.

Exhibit: Sector Profitability & Oil Prices Trend



Source: Company Financials, AHL Research

Oil & Gas Development Company

Exploring its way Forward

Key Investment Theme

- **Production growth:** The company contributed largest market share of around 48% and 28% in country's total oil and natural gas production, respectively. During FY17, major oil production growth was witnessed from Kunnar, Makori East and Rajian while, UCH, Nashpa, Adhi and Makori East contributed towards gas production growth. The company completed KPD-TAY and Uch-II projects in FY17 and is currently conducting developmental activities at Nashpa and Soghri fields.

- **Trading at lowest PER**: The stock is currently trading at implied oil prices of USD 50/bbl along with an attractive FY19 PE multiple of 7.68x as compared to E&P sector multiple of 8.50x. We expect the company to post solid earnings growth of 26% and 13% in FY18 and FY19, respectively.

- **Operational activities:** During the year the company spudded 22 wells which includes 11 exploratory and development wells each. The company also signed MoU with a foreign E&O company for mutual cooperation, technological and equipment advancement. Furthermore, the company also seeks to materialize the shale gas/oil and tight gas/oil study results in the business operated blocks.

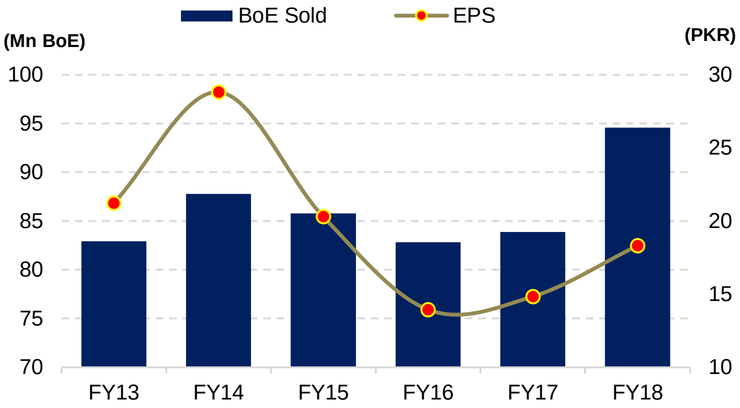
Key Risks

- Delay in expected commencement of production and one-off expenses i.e. impairment and drywells.
- Oil price volatility and PKR appreciation.
- Production cut from Nashpa and TAL block amid prevailing FO situation, we estimate 3 month production decline would have a negative impact of PKR 0.46/share on OGDC's bottom-line.

BUY

Target Price	PKR	190.1
Market Price	PKR	162.1
Upside	%	17.2
PSX Code		OGDC

Exhibit: Production and Profitability



Source: Company Financials, AHL Research

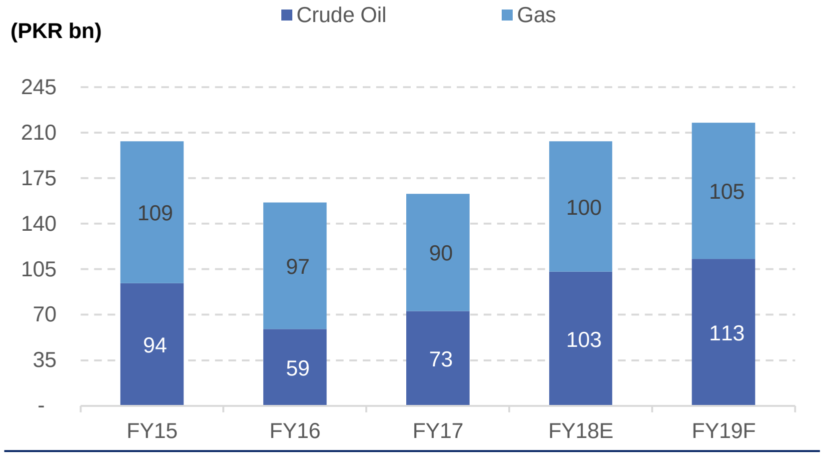
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	171,829	214,373	230,624
Gross Profit	95,004	123,531	134,336
Operating Profit	77,496	104,628	114,034
Finance Cost	1,515	2,335	2,627
Post Tax Profit	89,137	109,641	125,504
Balance Sheet			
Shareholder's Equity	512,984	570,577	624,763
Interest Bearing Liabilities	-	-	-
Total Liabilities	114,304	150,135	163,136
Current Assets	342,460	390,783	408,579
Non-Current Assets	234,492	279,593	328,984
Total Assets	627,288	720,712	787,899

Source: Company Financials, AHL Research

Exhibit: OGDC – Crude Oil & Gas Revenue



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	14.8	18.3	20.6
Dividend per share	PKR	7.5	8.3	8.3
Book Value per share	PKR	119.3	132.7	145.3
Price to Earning	x	7.9	8.9	7.9
Price to Book	x	1.0	1.2	1.1
Net Margins	%	55.3	57.6	58.3
Dividend Yield	%	6.4	5.1	5.1

Source: Company Financials, AHL Research

Fertlizers

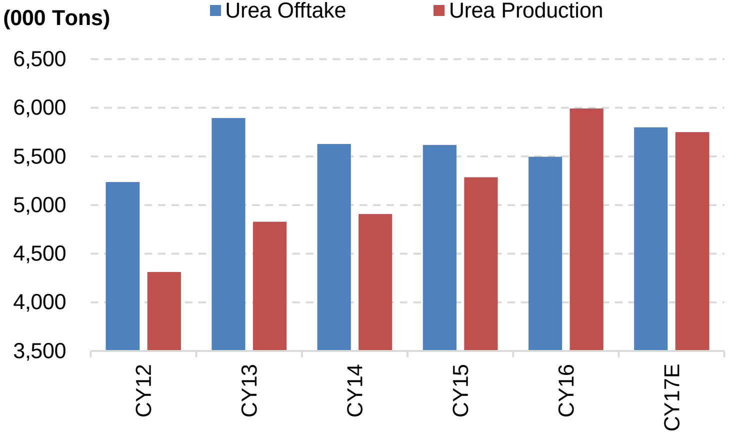
Fertilizer

Seed Today, Yield Tomorrow

Key Investment Theme

- **Better Agriculture Sector Performance:** The sector contribution in the GDP improved by 3.5% YoY in FY17 as compared to 0.3% YoY in FY16 and cumulative weight in GDP clocked-in at 0.69% during FY17 as compared to 0.06% a year back. This was mainly due to better offtake, gov't policy to maintain urea prices at a comfortable level along with subsidy offered on different products. Over the past 10 years, fertilizer sector offtake has grown at an average rate of 2%. Furthermore, average demand for urea is around 5.6mn tons while production is ~5.1mn tons.
- **Strong offtake leading to lower inventory levels:** To recall, urea offtake in the prior year clocked-in at 5.5mn tons while inventory levels by year end were set at 1.0mn tons (75% held by local players). We estimate urea offtake in CY17 at ~5.8mn tons, leaving inventory levels at a reasonable ~0.25mn tons by Dec'17 (all held by domestic manufacturers).
- **International Pricing:** Urea prices during FY18TD recovered sharply to USD 280/ton, a jump of 30%, while further hike is probable on account of a major Indian tender expected to float by end of Dec'17. Major uptick in urea prices is owed to higher coal prices tagged with supply cuts from China. With rising international urea prices, we expect pricing pressure to ease off in the local market.
- **Inventory levels to increase again with the end of current season:** We view that seasonality with respect to inventory levels is expected to set in again given continued operation of fertilizer plant on RLNG. Moreover, we cannot rule out the possibility of another export grant in case of excess inventory buildup.

Exhibit: Urea Offtake & Production



Source: NFDC, AHL Research

Key Risks

- Gas tariff/GIDC increase and failure to pass on the same to end consumer.
- Volatility in international prices.
- Floods / Earthquake.

Engro Fertilizer Limited

Lucrative Dividend Yield

Key Investment Theme

- **Inventory Levels to come down:** We believe urea inventory is expected to smoothen out by Dec'17 as demand stemming from the Rabi sowing season peaks.

- **Trading Synergies**: The company is expected to import 550k tons of DAP annually, leading to an improvement in annualized after-tax earnings by PKR 2,203mn (EPS: PKR 1.65). Moreover, current annual demand for DAP in Pakistan is around 2.0mn tons out of which FFBL is expected to cater to 0.75mn tons, while the rest will be shared between EFERT and other private importers.

- **Relatively Better-off amid concessionary gas**: The company remains immune to gas tariff hikes given availability of concessionary gas at USD 70/mmbtu for 10 years. This makes EFERT less sensitive to any potential decline in urea prices going forward.

- **Lower Multiple Compared to Peers**: The stock is currently trading at CY18F PE of 8.3x compared with industry PER of 9.5x along with highest dividend yield of 12.1% in fertilizer sector.

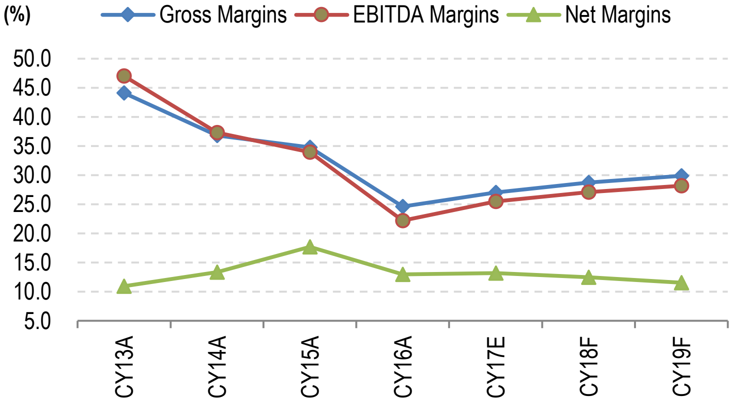
Key Risks

- For every PKR 50/bag reduction in urea prices, bottom-line is eroded by PKR 0.9/share.
- Gas tariff hike in feed stock / fuel stock.

BUY

Target Price	PKR	77.1
Market Price	PKR	66.2
Upside	%	16.5
PSX Code		EFERT

Exhibit: EEFRT Margins



Source: Company Financials, AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2016A	2017E	2018F
Income Statement			
Net Sales	69,519	74,320	85,805
Gross Profit	17,111	20,099	24,669
Other Income	8,135	5,511	3,242
Finance Cost	8,135	5,511	3,242
Post Tax Profit	9,025	9,807	10,690
Balance Sheet			
Shareholder's Equity	41,283	41,773	41,816
Interest Bearing Liabilities	36,461	28,893	28,375
Total Liabilities	61,145	49,613	47,990
Current Assets	27,128	18,138	17,759
Non-Current Assets	75,300	73,247	72,047
Total Assets	102,428	91,386	89,806

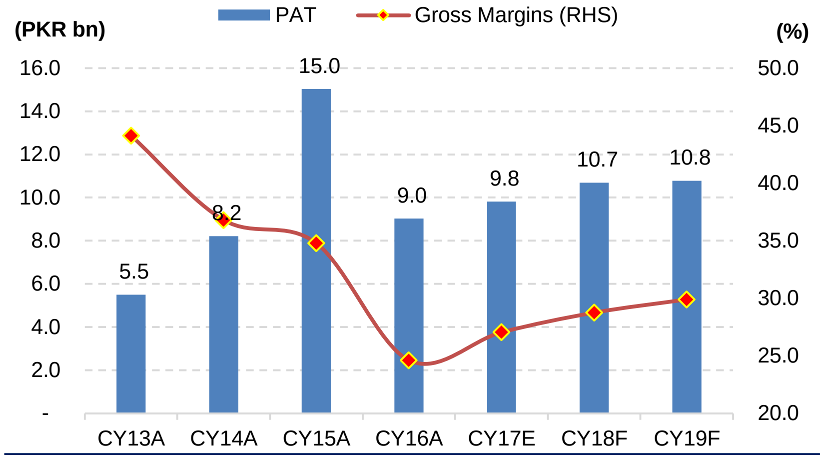
Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2016A	2017E	2018F
Earnings per share	PKR	6.8	7.4	8.0
Dividend per share	PKR	7.0	8.0	8.0
Book Value per share	PKR	31.0	31.4	31.4
Price to Earning	x	10.0	9.0	8.2
Price to Book	x	2.2	2.1	2.1
Net Margins	%	24.6	27.0	28.8
Dividend Yield	%	10.3	12.1	12.1

Source: Company Financials, AHL Research

Exhibit: PAT and Gross Margins



Source: Company Financials, AHL Research

Engro Corporation Limited

Giant to Become Gigantic

Key Investment Theme

- **5-yr profitability CAGR of 21%:** We expect the company to post a 5-year profitability CAGR of 21%. The expected growth is primarily driven by 1) EFERT, where concessionary gas along with synergies from DAP trading business, 2) Stable business operation from Elengy terminal 3) Power business, which is likely to remain stable amid secure gas supply, 4) Volumetric growth leading towards higher profitability amid debottlenecking of PVC plant and 5) Future power projects of ~USD 2bn.
- **Black Diamond**: Power projects worth ~USD 2bn include SECMC mining project amounting to USD 800mn and Engro Powergen Thar Power Limited (EPTPL) mine-mouth 330MWx2 coal power plant, with a ticket size of USD 1,200mn. These projects are expected to materialize by Jun'19. Pertinently, we estimate EPTPL will contribute PKR 62.3/share to our target price and PKR 9.40/share to ENGRO's profitability assuming a stake of 50%. Likewise, upside from SECMC mining project will be PKR 10.7/share in our target price and PKR 1.55/share in earnings assuming a 12% stake.
- **Massive Cash Position**: The company sits on a massive cash pile at present, amounting to PKR 61.3bn as at Sep'17, which could be utilized for future growth projects including RLNG terminal, RLNG based power plant, Naptha cracking facility and extension of mine mouth power plant (to 660 MW) to name a few.

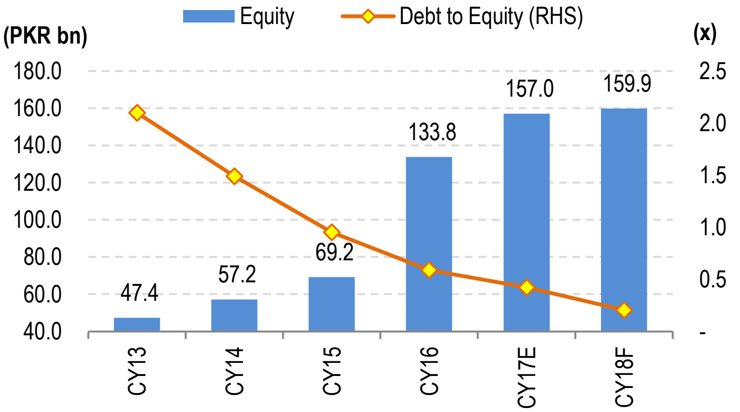
Key Risks

- Gas price hike for fertilizer sector.
- Volumetric and margin decline in dairy segment.
- Delay in thar coal power plant
- Inability to reinvest cash proceeds

BUY

Target Price	PKR	328.9
Market Price	PKR	277.4
Upside	%	18.6
PSX Code		ENGRO

Exhibit: Declining Debt to Equity



Source: Company Financials, AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2016A	2017E	2018F
Income Statement			
Net Sales	157,208	118,982	133,847
Gross Profit	35,843	29,279	35,653
Other Income	68,838	6,586	4,429
Finance Cost	6,038	3,902	3,605
Post Tax Profit	69,107	10,440	12,953
Balance Sheet			
Shareholder's Equity	169,091	168,773	175,432
Interest Bearing Liabilities	78,654	64,749	32,310
Total Liabilities	121,243	120,966	86,534
Current Assets	113,597	109,789	111,468
Non-Current Assets	176,736	179,951	150,498
Total Assets	290,333	289,739	261,966

Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2016A	2017E	2018F
Earnings per share	PKR	131.94	19.93	24.73
Dividend per share	PKR	24.00	24.00	16.00
Book Value per share	PKR	322.82	318.57	333.81
Price to Earning	x	2.40	13.91	11.22
Price to Book	x	0.98	0.87	0.83
Net Margins	%	22.80	24.61	26.64
Dividend Yield	%	7.59	8.65	5.77

Source: Company Financials, AHL Research

Exhibit: SoTP Valuation

Company	PV of Cash flows	Stake	Adjusted	TP*
Engro Fertilizer	102,562	57%	58,464	111.6
Engro Foods	63,862	40%	25,545	48.8
Engro Polymer	29,856	56%	16,776	32.0
Engro Eximp Agri porducts	57	100%	57	0.1
Engro Powergen	11,567	69%	7,981	15.2
Engro Vopak	3,818	50%	1,909	3.6
Engro Elengy Terminal	10,864	80%	8,691	16.6
Engro Powergen Thar Ltd	65,302	50%	32,651	62.3
SECMC	46,559	12%	5,587	10.7
After portfolio Discount (30%)				210.7
Cash	61,924			118.2
Total	**396,371**		**157,661**	**328.9**

Source: AHL Research, *Target prices on ENGRO's paid up capital

Cements

Cements

Cementing the Future

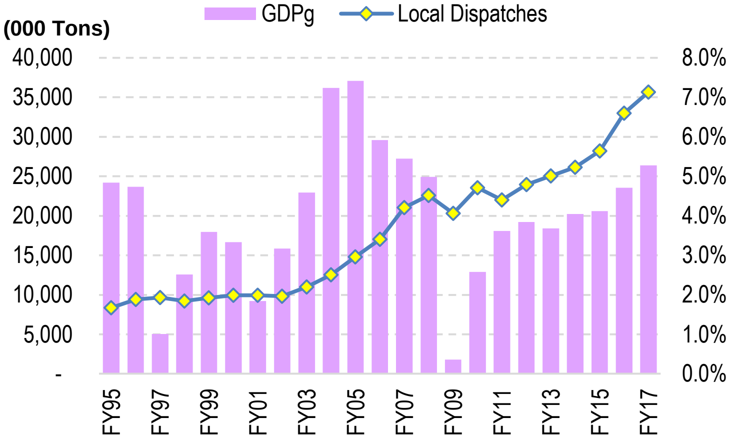
Key Investment Theme

- **Key Demand Triggers:** Key demand drivers for the cement sector remain 1) handsome demand for housing units (private), 2) builders procuring cement amid fast-paced progress on new/existing prominent housing schemes and high rises, 3) need for infrastructure on account of up trending economic growth together with gov'ts strategic projects, and 4) CPEC-led demand.

- **Exports to Rise Eventually:** Pakistan's cement exports declined for a consecutive 8th year to 4.7mn tons in FY17. Major reasons for decline include 1) replacement of exports to Afghanistan by Iranian cement, 2) anti-dumping duty imposed on exports to South Africa and 3) un-competitiveness in the export market attributable to higher prices in the local market. We believe decline in exports was eclipsed by robust demand in the local market leading to higher retention prices which eventually compelled local players to withdraw from low priced markets. Moreover, with scheduled capacities coming online in the following 1-3 years, local manufacturers will once again begin focusing on exports, even in low price markets.

- **Utilization Levels to Come Down Gradually:** With the forthcoming capacity additions of ~26.04mn tons (18.39mn tons in north and 7.65mn tons in south) by FY21, Pakistan's installed cement capacity will take off to 72.98mn tons compared to 46.94mn tons at present, depicting a massive jump of ~55%. However, as per our analysis, the drop in utilization levels will be gradual rather than sudden given capacities are set to achieve COD as per assorted timelines along with an agreed ratio of addition at the time of commencement.

Exhibit: Industry Growth Parallel to GDP Growth



Source: APCMA, AHL Research

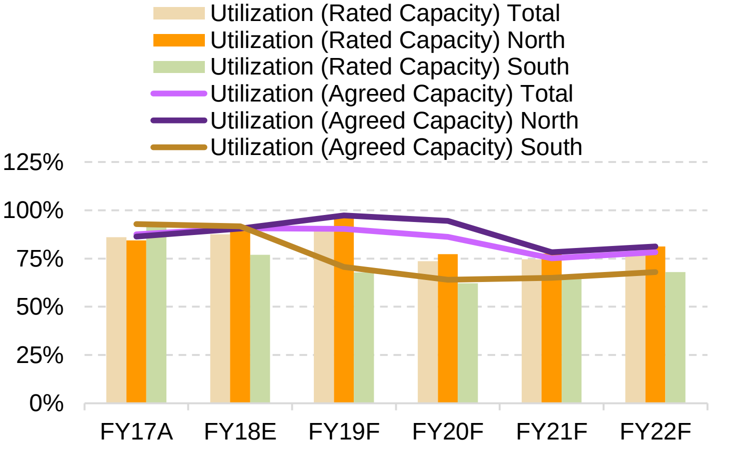
Cements

Cementing the Future

Key Investment Theme

- **Pricing Outlook:** Recent episodes of price decline in the northern region weakened the investors' confidence as cement prices waned by ~PKR 45/bag since Jul'17. We view that additional capacity addition of ~55% to 26.04mn tons by FY21, will incite pressure in both regions but we expect it not to be drastic in the Northern region from current levels. Further to this, we may see a PKR 25-30/bag price decline in the Southern region by the end of FY18.
- **Demand to Grow at a CAGR of 8.6% by FY20:** Given the strong infrastructure-led economic performance, we foresee total industry demand to grow at a CAGR of 8.6% by FY20 mainly on account of greater PSDP utilization, realization of energy projects, urban housing schemes and revival of the private sector credit offtake. This will be fueled by strong housing finance disbursement amid rising demand for housing and low interest rates.

Exhibit: Capacity Utilization Analysis



Source: AHL Research

Key Risks

- Ascent in coal prices and/or downwards pressure on cement prices.
- Price war post materialization of additional capacities.
- Loss of sales on the export front.
- Electricity and gas tariff hikes.

Cements

Cementing the Future

- Attached below is a snapshot of the industry. While current capacity is around 46.94mn tons (8.59mn tons in South and 38.35mn tons in North), announced expansions are set to take installed capacity of the sector to 72.98mn tons (16.24mn tons in South and 38.35mn tons in North). Pertinently, BWCL will be the first player in North to conclude its expansion, followed by MLCF.

Exhibit: Announced Capacities

Company	Type of expansion	Capacity (mn/ton)		Timeline	Comments
		South	North		
ACPL	Brownfield	1.20		1HFY18	COD expected by Dec'17
LUCK	Brownfield	1.25		1HFY18	COD achieved
POWER	Brownfield	2.50		2HFY19	On-track
DGKC	Greenfield	2.70		1HFY19	On-track
CHCC	Brownfield		2.10	1HFY21	On-track
LUCK	Greenfield		2.30	2HFY20	Mining license issues
KOHC	Brownfield		2.30	2HFY19	Awaiting financial close
GWLC	Brownfield		2.40	2HFY19	Delayed
PIOC	Brownfield		2.50	2HFY19	On-track
DGKC	Brownfield		2.20	2HFY21	Delayed
MLCF	Brownfield		2.19	2HFY19	On-track
BWCL	Brownfield		1.80	1HFY19	On-track
FLYING	Brownfield		0.60	2HFY20	Delayed
Total		**7.65**	**18.39**		
Current capacity		8.59	38.35		
Post expansion capacity		**16.24**	**56.74**		

Source: PSX announcements, AHL Research

Lucky Cement Company Limited

On to Imperative Diversification

Key Investment Theme

- **Hard to Overlook the Reigning Leader:** Lucky Cement Limited (LUCK), now the largest player in the cement industry has an installed capacity of 8.64mn tons. With its plants strategically located at Pezu and Karachi, the company enjoys freight advantage over its competitors on exports, rendering it to be the most cost-efficient cement manufacturer. In FYTD, the company has attained the 2nd largest market share in export and domestic market of 19% and 17%, respectively.
- **Omnipresent Amid Diversification:** LUCK has been a torchbearer in the domestic corporate world with its fixity of purpose apparent in massive investment plans underway to diversify its portfolio; i) 1.25mn tons greenfield expansion at Karachi plant has achieved COD recently, ii) greenfield cement plant located in Northern Region with nameplate capacity of 2.30mn tons awaits necessary regulatory approvals, iii) first unit of brownfield expansion at Iraq cement grinding mill has come online (0.44mn tons), iv) targeted financial close of the 660MW coal-based power plant scheduled by Jun’18, v) PKR 12bn investment set aside for assembly of Kia vehicles under greenfield status of Auto Policy, and vi) proposed equity investment of PKR 720mn in a 50MW Wind Farm (not incorporated yet). Investment outlay during the next few years for said projects amounts to ~PKR 55bn. Moreover, our solid earnings outlook implies a 12% CAGR over FY17-22F.
- **SoTP-based TP at PKR 681:** With upwards sticky cement prices observed during the past few months, LUCK’s stock price has come down significantly in FYTD, flaring up the upside to 53%.

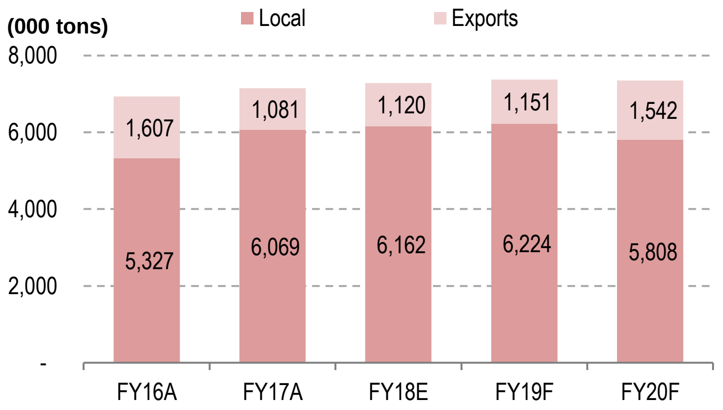
Key Risks

- Cement prices tapering off; every PKR 5.00/bag decline will erode EPS by PKR 1.10/share (3%).
- Drastic ascent in coal prices; bottom-line should retreat by PKR 1.08/share (3%) on every USD 5.00/ton uptick in average coal prices.
- Postponement in materialization of key investment projects.

BUY

Target Price	PKR	680.5
Market Price	PKR	475.2
Upside	%	43.2
PSX Code		LUCK

Exhibit: Battle for Market Share to Continue



Source: Company Financials, AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Sales	45,687	50,005	52,102
Gross Profit	21,298	18,648	18,649
Other Income	1,993	3,525	5,048
Other Charges	1,788	1,611	1,679
Post Tax Profit	13,692	13,216	14,208
Balance Sheet			
Shareholder's Equity	79,785	89,121	98,155
Current Liabilities	10,344	10,352	10,741
Trade and other payables	9,270	9,278	9,667
Non-Current Liabilities	7,209	7,351	7,424
Current Assets	46,368	44,426	42,155
Non-Current Assets	50,969	62,397	74,165

Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings	PKR	42.3	40.9	43.9
Dividend	PKR	12.0	16.0	18.0
Book value	PKR	246.7	275.6	303.5
Price to Earning	x	19.8	11.6	10.8
Price to Book	x	3.4	1.7	1.6
Gross Margins	%	46.6	37.3	35.8
Dividend Yield	%	1.4	3.4	3.8

Source: Company Financials, AHL Research

Exhibit: Target Price Methodology

Sum of the Parts	Value	Per share	Discount	TP
Core	110,465	342.0	-	342.0
ICI	40,055	124.0	30%	86.8
Iraq Project	12,830	39.7	-	39.7
Congo Project	17,059	52.8	-	52.8
660 MW Coal Power Plant	51,723	160.1	30%	112.1
Wind Power	3,035	9.4	-	9.4
KIA motors	12,162	37.7	-	37.7
	247,327	**766**	**60%**	**680.48**
			MP	***445.8***
			Upside	***53%***

Source: Company Financials, AHL Research

DG Khan Cement Company

Domestic Spending to Bolster Growth

Key Investment Theme

- **Secure Position:** DGKC has upheld its 3rd spot in top cement manufacturers by capacity in FYTD. The company has an 11% share in the local market and a 10% share in total exports.
- **Expansion Almost Palpable:** With upcoming expansion in twin regions (+2.80mn tons in South by 1HFY19; +2.20mn tons in North by FY21), the company is set to extend its wings in the market. As stimulants to the likes of robust PSDP disbursement, strong private sector credit offtake and housing need tagged with CPEC-led scope for growth generate demand, DGKC remains poised to excel.
- **Investment Portfolio Unlocks Further Value:** The company's investment portfolio comprises of noticeable names like NML, NCL, MCB and AICL. While translating into a marked to market value of ~PKR 25.73bn, we apply a 30% discount and value the portfolio at PKR 18.01bn (PKR 41.44/share).
- **Healthy Earnings Upswing:** We anticipate DGKC's profitability to grow at a 5-year CAGR of 9% to FY22 supported by capacity additions.
- **SoTP Valuations:** Our Dec'18 SoTP-based target price of PKR 167.1/share comprises of core and portfolio value of PKR 126.0/share and PKR 41.1/share, respectively.

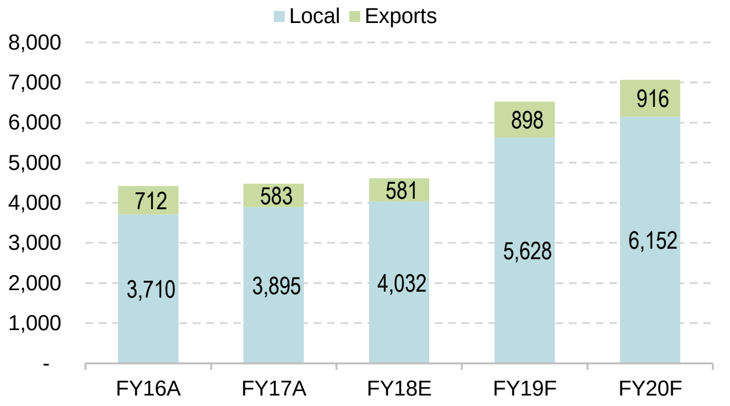
Key Risks

- Cement prices tapering off; every PKR 5.00/bag decline will erode EPS by PKR 0.54/share (2%).
- Unusual ascent in coal prices; bottom-line should retreat by PKR 0.58/share (3%) on every USD 5.0/ton uptick in average coal prices.

BUY

Target Price	PKR	167.1
Market Price	PKR	121.2
Upside	%	37.9
PSX Code		DGKC

Exhibit: Sales Breakup



Source: Company Financials, AHL Research

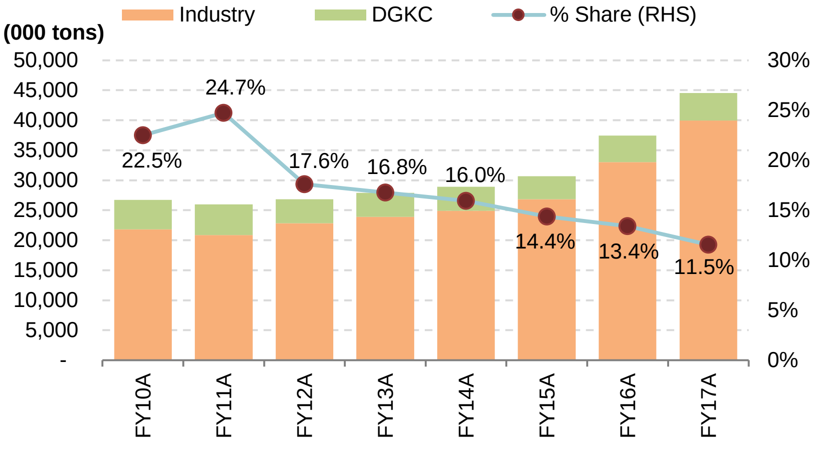
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Sales	30,136	31,137	43,697
Gross Profit	11,845	10,416	16,786
Other Income	11,845	10,416	16,786
Finance Cost	383	695	1,355
Post Tax Profit	7,975	9,903	10,218
Balance Sheet			
Shareholder's Equity	74,869	80,829	86,885
Current Liabilities	14,850	15,824	23,556
Trade and other payables	5,454	4,934	6,925
Non-Current Liabilities	18,653	26,743	21,253
Current Assets	27,301	26,633	28,758
Non-Current Assets	81,071	96,763	102,936

Source: Company Financials, AHL Research

Exhibit: Market Share



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings	PKR	18.2	22.6	23.3
Dividend	PKR	7.5	9.0	9.5
Book value	PKR	170.9	184.5	198.3
Price to Earning	x	11.7	5.4	5.2
Price to Book	x	1.2	0.7	0.6
Dividend Yield	%	3.5	7.4	7.8
Gross Margins	%	39.3	33.5	38.4

Source: Company Financials, AHL Research

Power Generation

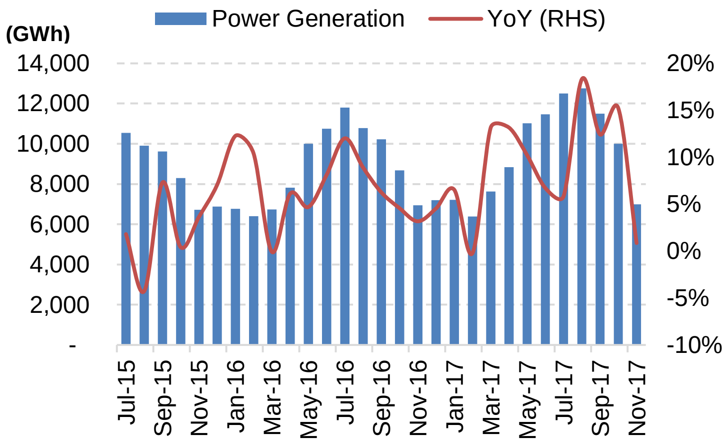
Power Generation & Distribution

En Route Low Cost Era

Key Investment Theme

- **Robust Growth Ahead:** Power generation has witnessed a growth of 11.0% YoY in 5MFY18 and is expected to grow by 10% YoY in FY19 due to capacity additions in the system.
- **Power Mix to Tilt Towards Low Cost Based Plants:** As of Novt'17, RLNG and coal have 9.7% and 10.7% share in energy mix, respectively. However, the share of FO has declined to 7.2% from 19.7% last year. As per our calculations, by the end of Jun'19 the share of coal will increase to 11%, while the share of RLNG at 14% due to induction of hydel power plants in the system.
- **Dividend Yield Plus USD Based Return:** IPPs are offering a lucrative dividend yield of 11.0%. In addition to this, the return of IPPs is guaranteed and hedged against US dollar. PKR depreciation against US dollar should increase the return of IPPs, we view.
- **CPEC Materializing:** USD ~33.7bn were allocated for the power sector under CPEC. Two coal based power plants (Sahiwal coal plant and Port Qasim) were established under the umbrella of CPEC. Sahiwal coal power plant is running at 79% load factor (Nov'17) while one unit of Port Qasim (660 MW) has also started to generate electricity (44% load factor in Nov'17). The second unit of Port Qasim is expected to generate electricity from Mar'18.

Exhibit: Power Generation up by 9.7% YoY in 10MCY17



Source: NEPRA, AHL Research

Key Risks

- Strengthening of PKR against US dollar
- Piling up of Circular debt

Hub Power Company

Growth Intact; BUY!

Key Investment Theme

- **China Power Hub Generation Company (CPHGC):** As per the management all financing documents are signed and approvals have been received for the 1,320MW imported coal fired plant. Currently, the management is in the process of meeting CPs (Conditions Precedent) for the financial closure; USD 1.5bn debt has been secured for the project. While commenting on the mix of debt between Chinese and Pakistani banks, the management informed us that Pakistani banks have virtually no exposure in the project's debt financing as HUBC is leveraging its own balance sheet to inject equity into the project. Our estimates suggest that the project will have a target price impact of PKR 23.8/share.
- **Thar Energy Limited:** Thar Energy Limited will setup a mine mouth coal-fired plant (330 MW) at a cost of ~USD 500mn. Currently, HUBC has 60% share in this project, while the Fauji group has a stake of 30% and the remainder (10%) is owned by China Machinery and Engineering Corporation (CMEC). Financial closure is expected in Mar'18 and the project is likely to commence operations by Jun'20. The project adds PKR 9.2/share to our target price.

Key Risks

- Strengthening of PKR against US dollar
- Piling up of Circular debt.
- Delay in Coal Projects

BUY

Target Price	PKR	122.5
Market Price	PKR	91.4
Total Return	%	41.1
PSX Code		HUBC

Exhibit: Sum of the Parts Valuation (PKR/Share)

Current Projects	87.0
1,320 Coal Plant	23.8
330 Coal Plant	9.2
SECMC	2.5
Total	**122.5**

Source: AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	101,188	77,263	60,876
Gross Profit	17,260	19,334	21,885
Other Income	156	129	140
Finance Cost	4,081	4,841	5,134
Post Tax Profit	11,348	12,165	14,629
Balance Sheet			
Shareholder's Equity	34,999	40,884	50,013
Interest Bearing Liabilities	54,829	61,669	51,629
Total Liabilities	124,621	84,643	85,012
Current Assets	103,448	74,341	87,344
Non-Current Assets	56,168	51,186	47,681
Total Assets	159,620	125,527	135,025

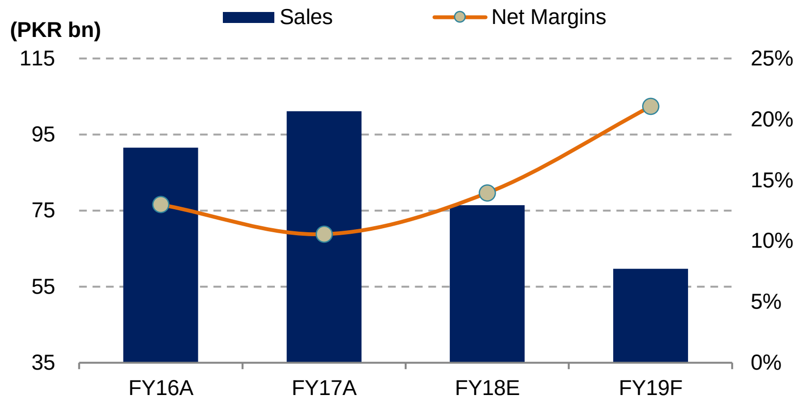
Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	9.2	9.4	11.3
Dividend per share	PKR	7.5	6.5	6.5
Book Value per share	PKR	30.3	35.3	43.2
Price to Earning	x	12.7	9.7	8.1
Price to Book	x	3.9	2.6	2.1
Net Margins	%	17.1	25.0	36.0
Dividend Yield	%	6.4	7.1	7.1

Source: Company Financials, AHL Research

Exhibit: Sales & Net Margins



Source: Company Financials, AHL Research

Exhibit: Hub Power Investments Requirement

USD mn	Total Investment	Equity Requirement	HUBC Stake	HUBC Investment	HUBC Investment*
1,320 Coal Plant	1,914	479	46.0%	220	23,222
330 Coal Plant	498	124	60.0%	75	7,876
SECMC	800	200	8.0%	16	1,688
Total	**3,212**	**803**		**311**	**32,786**

Source: Company Financials, AHL Research, * PKR mn

Kot Addu Power Company

Multi-fired Power Plant; BUY!

Key Investment Theme

- **FO plants shutdown, no impact on KAPCO:** KAPCO's flexibility to operate on RLNG and FO will provide the company a competitive edge and with a changing energy mix, we have assumed that the plant will only be operated on RLNG rather than RFO (FO-based generation during FY17: 63%). Moreover, our discussion with KAPCO's management suggests that 200mmcfd of RLNG has already been allocated to the company which would be sufficient enough to produce ~1,000 MW.
- **Merit Order; KAPCO is favourite:** As per NTDC's latest merit order, three RLNG blocks of KAPCO are at 37th, 42nd and 51st position, respectively. Therefore, for the generation of 14.8k MW (cumulative capacity of 24k MW at an average load factor 62% including generation from all sources plus renewables), all blocks of the company (operating on RLNG) are expected to contribute to the country's power generation.
- **PPA Extension:** With favorable multi fuel fired engines coupled with expected remaining useful life of the plant (11 years beyond 2021), we cannot rule out the possibility of extension in the PPA beyond FY21. However, due to changing gov't priorities to cheaper sources of generation, we have not assumed extension in the PPA for the company into our valuations.

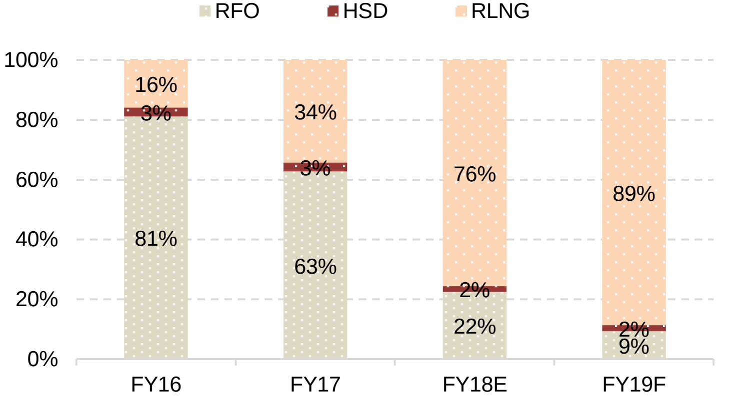
Key Risks

- Strengthening of PKR against US dollar
- Piling up of Circular debt.

BUY

Target Price	PKR	63.6
Market Price	PKR	54.0
Total Return	%	35.5
PSX Code		KAPCO

Exhibit: RLNG to dominate in fuel mix of KAPCO going forward



Source: Company Financial, AHL Research

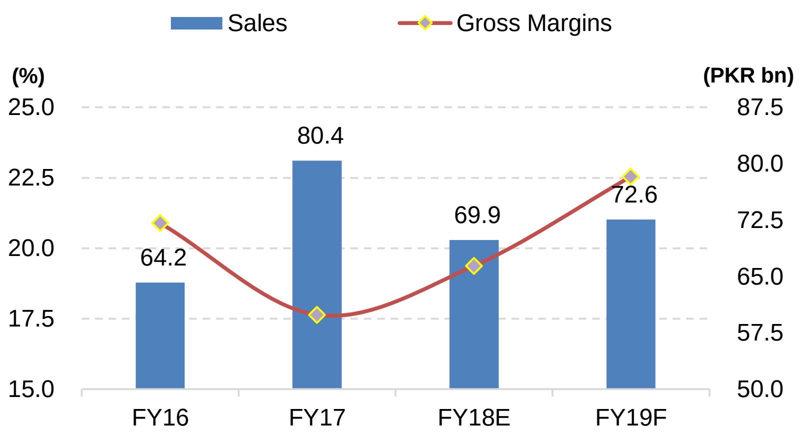
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	80,390	69,864	72,554
Gross Profit	14,180	13,536	16,356
Other Income	4,991	5,595	2,947
Finance Cost	4,425	5,095	2,011
Post Tax Profit	9,447	9,181	11,711
Balance Sheet			
Shareholder's Equity	32,503	33,321	35,790
Interest Bearing Liabilities	46,609	22,812	18,021
Total Liabilities	83,497	59,307	49,495
Current Assets	104,953	84,016	77,973
Non-Current Assets	11,047	8,613	7,312
Total Assets	116,001	92,629	85,285

Source: Company Financials, AHL Research

Exhibit: Sales & Gross Margins



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	10.7	10.4	13.3
Dividend per share	PKR	9.1	9.5	10.5
Book Value per share	PKR	36.9	37.9	40.7
Price to Earning	x	6.7	5.2	4.1
Price to Book	x	2.0	1.4	1.3
Net Margins	%	17.6	19.4	22.5
Dividend Yield	%	12.6	17.6	19.5

Source: Company Financials, AHL Research

Oil & Gas Marketing

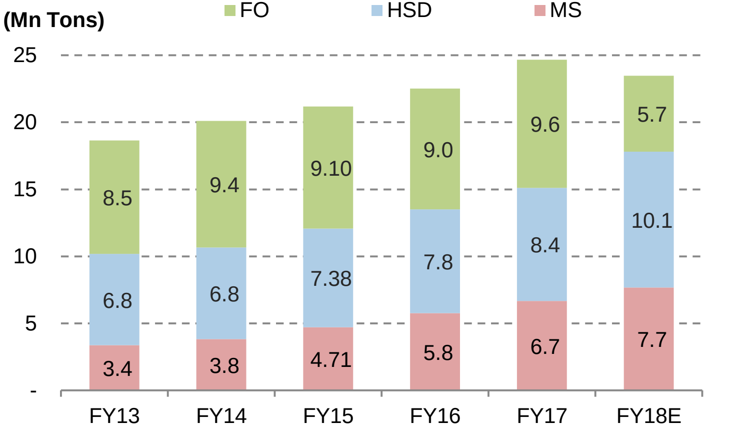
Oil & Gas Marketing Companies

Furnace Oil Leading to Volumetric Decline

Key Investment Theme

- **Changing Fortunes:** In FY17, Mogas , HSD and FO industry volumes grew by 16.4%, 9.4% and 6.6%, respectively. During 5MFY18, Mogas and HSD sales volumes witnessed growth of 12.8% and 12.2% on the back of decade high GDP growth above 5.5%, improving law and order situation, control on dumped oil from Iran, higher auto demand which grew by 29% YoY.
- **Nosedive in Consumption of Furnace Oil:** With the change in power mix due to availability of power generation plants based on Hydel, Nuclear, Coal and RLNG, demand for FO is expected to decline significantly. Since furnace oil-based plants are less efficient and expensive compared to RLNG and coal based, we forecast industry demand for FO to fall by 40% YoY to 5.8mn tons in FY18, 1.9mn tons in FY19 and 1.4mn tons in FY20 compared to 9.56mn tons in FY16. PSO's black oil market share is currently above 73%.
- **Inventory Gains:** After recent agreement between OPEC countries to extend production cut for FY18, an uptick in international oil price is expected. Oil marketing companies may enjoy inventory gains as impact of rising international oil prices will increase ex-refinery prices of petroleum products.
- **Margins Revision and Deregulation:** Government of Pakistan took positive step for oil marketing companies to increase margins on Mogas by 5.81% to PKR 2.55 per liter for FY18 while announced deregulation of HSD margins applicable from Jan'18 which will allow company to pass on the impact of rising import cost easily. Improving volumes along with margins is supporting growth of sector. We expect slight uptick in inflation due to PKR depreciation will be beneficial for OMCs as there margins increase in line with inflation.

Exhibit: Sales Volume of POL Products



Source: OCAC, AHL Research

Key Risks

- Rise in product prices might dent volumetric growth.
- Lack of storage capacity to curb volumetric growth.
- A depreciation in the value of PKR against USD can lead to exchange losses.

Pakistan State Oil

LNG Partly Substituting Furnace Oil

Key Investment Theme

- **LNG substitutes FO demand:** LNG contribution in PSO's profitability is set to elevate going forward amid increase in imports from 600 mmcfd to 1200 mmcfd resulting in improved sales and profitability. However, new RLNG based power plants is expected to cut demand of furnace oil. We assume LNG will contribute in FY18 EPS of PKR 4.20/share while FO demand will go down to 4.2mn tons during the year. In FY17, LNG contributed PKR 491mn (Profit after tax) translating into EPS of PKR 1.51.
- **Profitability supported by rising volumes:** We expect company bottom-line to clock in at PKR 15,714mn which will translate to an earning of PKR 48.2/share. We expect PSO volumes of petroleum products will fall down by 11% YoY given diminishing demand of furnace oil which will fall by 40% YoY to 4.2mn tons compare to 7.01mn tons in SPLY.
- **Less Exposed to PKR Depreciation:** PSO has foreign exchange loans of USD 706.5mn as of FY17, The Government of Pakistan committed to writing any extra cost related to PKR depreciation will be provided by GoP. Currently, PSO has unrealized exchange gain of PKR 2.4bn arising from foreign exchange loans.
- **Intensity of Circular Debt to ease off:** Majority of the debt belongs to the power sector. We believe circular debt issue to ease off as we expect FO sales to power sector will decline drastically which will keep the intensity of circular debt at ease. As of 22nd Oct'17 circular debts stand at PKR 303bn including late payment surcharge.
- **Spot Retained:** PSO being the largest oil marketing company having an approximate market share of 55% in FY17. During 1QFY18, PSO market share stands at 56% and the company is planning to increase market share by making investment in storage capacity and retail outlets.
- **Largest OMC at Cheapest Multiple:** The stock is currently trading at forward price earning multiple of 6.0x compared to previous 6 year average of 8.2x, while average multiple of the sector is at 7.7x.

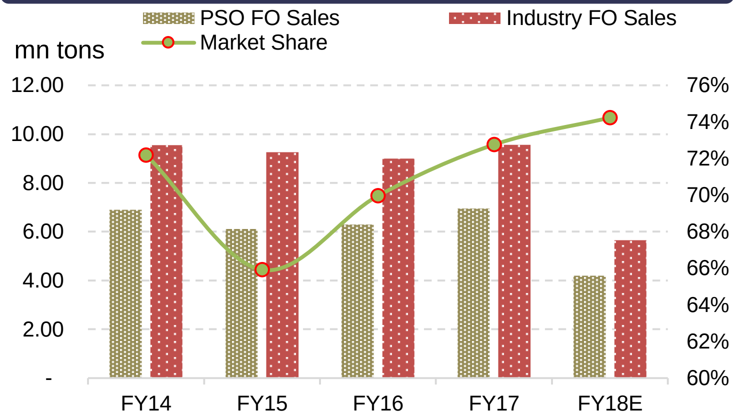
Key Risks

- Transfer of LNG business from PSO to Government holding private limited.
- Dumping of furnace oil inventory below cost price.
- Imposition of any regulatory duties on imports of POL products

BUY

Target Price	PKR	374.4
Market Price	PKR	289.8
Upside	%	29.2
PSX Code		PSO

Exhibit: FO Volumes & Market Share



Source: Company Financials, AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	878,147	936,768	981,935
Gross Profit	37,199	38,990	40,689
Other Income	10,745	7,475	7,640
Finance Cost	5,923	5,083	3,804
Post Tax Profit	18,226	15,714	15,926
Balance Sheet			
Shareholder's Equity	102,850	112,043	121,449
Interest Bearing Liabilities	131,765	87,785	87,760
Total Liabilities	289,593	255,699	263,389
Current Assets	368,560	340,451	353,887
Non-Current Assets	23,883	27,291	30,951
Total Assets	392,443	367,743	384,838

Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	55.9	48.2	48.8
Dividend per share	PKR	25.0	20.0	20.0
Book Value per share	PKR	315.5	343.7	372.5
Price to Earning	x	6.9	6.0	5.9
Price to Book	x	1.2	0.8	0.8
Net Margins	%	2.1	1.7	1.6
Dividend Yield	%	6.5	6.9	6.9

Source: Company Financials, AHL Research

Exhibit: PSO Receivable Position

	22-Oct-17	30-Sep-17	30-Jun-17
Power Sector Receivables	197.5	188.3	176.1
SNGPL for LNG	5.7	4.0	14.0
PIA	13.3	13.1	13.3
POC	9.6	9.6	9.6
Total	**226.1**	**215.0**	**213.0**
LPS	76.4	76.40	73.70
Total (Including LPS)	**302.5**	**291.4**	**286.7**

Source: Company Financials, AHL Research

Automobiles

Automobile Assembler

New Players to Challenge Dominating Giants

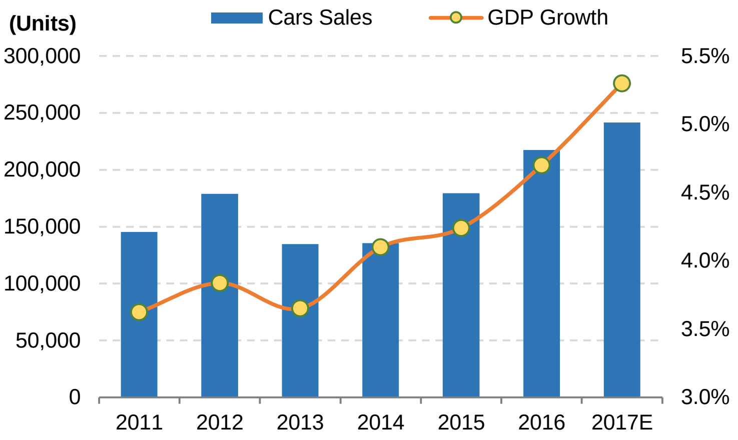
Key Investment Theme

- **Autos Portraying True Picture Of Developing County:** During 2018, we expect auto assemblers to record highest ever sales attributable to i) Economic growth (GDP growth of 5.5% for FY18 which is 10 year high), ii) Rising auto financing to PKR 168bn iii) Improving Law and Order situation and iv) Infrastructure development on account of CPEC related projects of roads from Kashgar to Gwadar,. During 5MFY18, total car sales units crossed 100k mark to 104.9K units, up 29% YoY mainly due to existing players announcing influx of new models with the same features as per global standards. INDU recently launched the minorly changed flagship Corolla, while HCAR launched BR-V (first locally assembled SUV). Likewise, Pak Suzuki introduced Cultus to maintain its market share.
- **Old Giants, Strategy Primed:** The domestic auto assemblers are trading at almost full capacity which indicates robust auto demand while volumes would remain capped unless new capacities or debottlenecking takes place. The large players strategized to compete against new entrants like Hyundai, KIA and Renault. Status of the Japanese oligopoly stands to swing in coming years; i) Hyundai is set to commence local assembly by Dec'19 with project outlay of USD 200-250mn investment, and ii) South Korean KIA Motors with Lucky Cement is expected to commence operation in 3QCY19. This shall keep demand appetite buoyant in the forthcoming years, we view.
- **Effects of Sharp Currency Movement:** With domestic auto assemblers exposed to fluctuations in USD and JPY, the latest episode of Rupee devaluation against the greenback (5.2%) remains a key phobia of industry participants. While pricing power at present allows local players to pass on the impact, sudden and drastic movement prohibits such opportunity and hence, erodes margins and bottom-line. We view the PKR / USD parity to stabilize around 112 by the end of the year (currently at 111 / USD).

Key Risks

- Volatility in USD and JPY.
- Unexpected movement in steel & commodity prices.
- Delay in introduction of new cars.
- New players grabbing market share of current assemblers.

Exhibit: Car Sales & GDP Growth



Source: PAMA, SBP, AHL Research

Honda Atlas Car

Demand to Lift Earnings

Key Investment Theme

- **Noticeable Volumetric Growth:** By March End (ME17), HCAR sales were recorded at ~35K units, up by 37% YoY compared to ~26K units in ME16. This improved the market share from 12% to 19% given overwhelming response to 10th generation civic which faced less competition since its launch. During ME18TD, total sales clocked-in at 33K units compared to 21K units, up by 55% YoY.
- **Proactive Approach for Capturing Marketing**: HCAR's capacity utilization by the end of the year is expected to exceed the 90% mark (total double-shift capacity of 50,000 units per annum) compared to 52% in SPLY. We believe the company is making the most of the ongoing demand cycle by aggressively launching new car models namely 10th generation Civic, BR-V (launched in Mar'17) and facelift of Honda City (7th Generation). We expect that in order to capture market and to remain competitive against new players, the company may plan to launch New City and CBUs (Honda Brio).
- **Margin Stability Key to Bottom-line:** Margins are anticipated to remain stable around 14% in ME18 and onwards as HCAR's utilization levels approach 100%. A key risk to company margins remains the volatile FX movement. We do accentuate HCAR's reliance on the USD which amounts to a massive 70% of imported costs while the remaining 30% is exposed to variation in the JPY. With that said, with solid footprints in the domestic automobile market, high demand (case in point: pre-booking orders) and considerably less competition (before the advent of new players) in '1300cc and above category', the company retains pricing power to pass on any significant cost jumps.

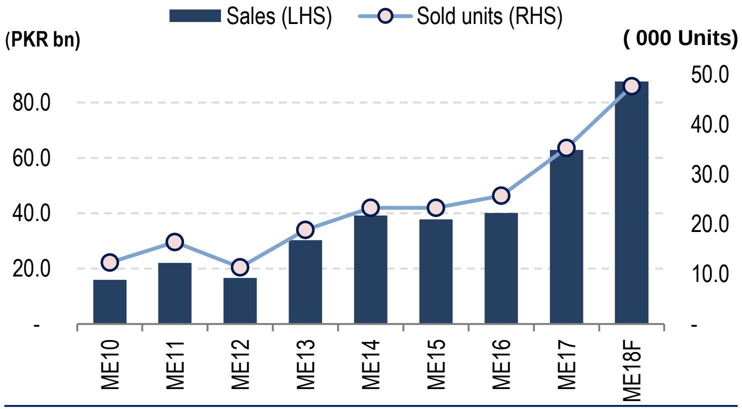
Key Risks

- Depreciation of PKR / USD and PKR / JPY.
- Arrival of new players will dilute market share.
- Sharp volatility in steel prices will significantly impact the company's bottom-line.

BUY

Target Price	PKR	671.6
Market Price	PKR	507.9
Upside	%	32.2
PSX Code		HCAR

Exhibit: HCAR – Sales & Volumes



Source: Company Financials, AHL Research

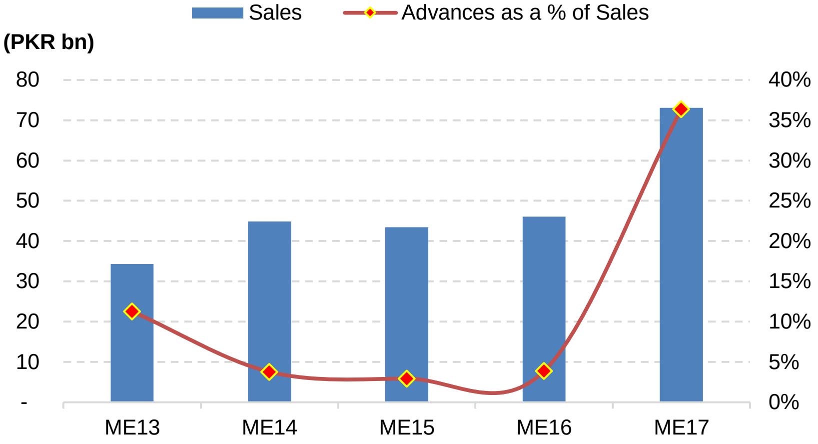
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	62,803	87,601	93,251
Gross Profit	9,122	10,354	11,651
Other Income	1,115	1,327	1,270
Finance Cost	23	44	55
Post Tax Profit	6,135	6,541	7,547
Balance Sheet			
Shareholder's Equity	13,065	17,036	21,584
Trade and Other Payables	37,637	38,020	37,375
Total Liabilities	38,401	38,766	38,098
Current Assets	46,380	47,267	50,727
Non-Current Assets	5,086	8,535	8,954
Total Assets	51,465	55,802	59,682

Source: Company Financials, AHL Research

Exhibit: Growth in Advances from Customers



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	43.0	45.8	52.8
Dividend per share	PKR	13.0	18.0	21.0
Book Value per share	PKR	91.5	119.3	151.1
Price to Earning	x	17.5	11.1	9.6
Price to Book	x	8.2	4.3	3.4
Net Margins	%	0.1	0.1	0.1
Dividend Yield	%	6.4	6.9	6.9

Source: Company Financials, AHL Research

Millat Tractors Limited

Agri-Growth: Tractors Glare of Publicity

Key Investment Theme

- **Market Capitalization:** Millat Tractors Limited (MTL) secured highest market share in the tractor industry averaging around 60% over the past many years and maintaining this share due to premium quality and reliability of the tractors keeping the demand intact. In 5MFY18, MTL sold 16,421 units, up 55% YoY amid uptick in demand.
- **High Margins on Export:** Exports sales constitute 2% of total topline of the company. **I**n FY17, MTL managed to export approximately ~310 units and now management's main focus is to increase exports given high margins available and expand its footprints in the international market. This year, we expect exports to increase by 10% to ~350 units.
- **Higher Localization - a competitive edge:** Management traditionally aims to depend on locally manufactured components for tractors and create in-house plant facilities for equipment. Some models of the company have localization around 90% which has kept the margins stable for the company in recent years and has provided competitive edge against peers.
- **Economic Growth Ticking Sales Upwards:** In FY17, sales grew by 63% YoY mainly on the back of decade high GDP growth of 5.3%, increased demand of high horse power tractors for CPEC related projects, increasing consumer financing and improvement in agricultural output.
- **Diversification:** Management is planning to diversify from tractors business to passenger car manufacturing business, a consortium led by Nishat group to manufacture Hyundai cars. MTL's stake in the venture is ~18% and expected to act as a key catalyst for the scrip going forward.

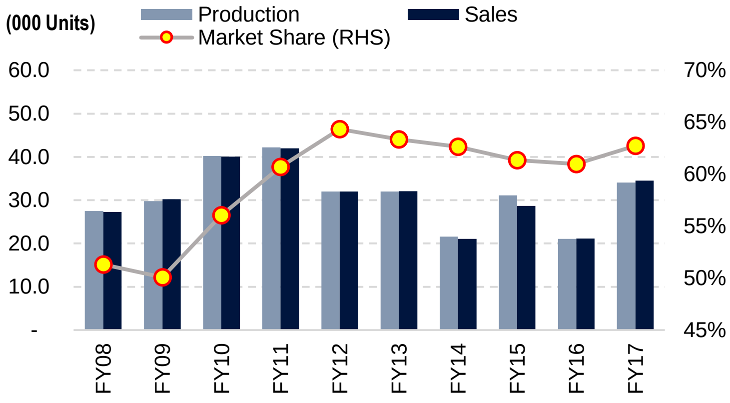
Key Risks

- Hike in GST on Tractors.
- Unfavorable Budget Policies and Sharp recovery in commodity prices.
- Adverse currency movement in USD, EURO and GBP.

BUY

Target Price	PKR	1,470.0
Market Price	PKR	1,146.2
Upside	%	28.2
PSX Code		MTL

Exhibit: Production & Market Share



Source: Company Financials, AHL Research

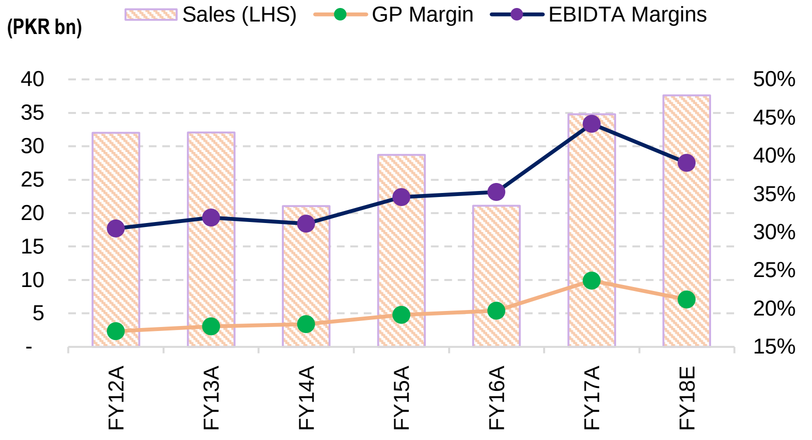
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	30,014	32,791	31,298
Gross Profit	7,097	6,949	6,160
Other Income	816	813	777
Other Expenses	455	469	410
Post Tax Profit	4,258	4,283	3,782
Balance Sheet			
Shareholder's Equity	5,750	6,175	6,583
Trade and Other Payables	11,255	11,676	11,245
Total Liabilities	11,381	11,799	11,364
Current Assets	15,622	16,456	16,422
Non-Current Assets	1,508	1,519	1,524
Total Assets	17,131	17,974	17,946

Source: Company Financials, AHL Research

Exhibit: Correlation Between Sales and Margins



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	96.1	98.6	87.2
Dividend per share	PKR	95.0	89.0	78.0
Book Value per share	PKR	129.8	139.4	148.6
Price to Earning	x	14.3	11.2	12.6
Price to Book	x	10.6	7.9	7.4
Net Margins	%	14.2	13.3	12.3
Dividend Yield	%	6.9	8.1	7.1

Source: Company Financials, AHL Research

Textile Composite

Textile Composite

All Eyes on Rebate and PKR Depreciation

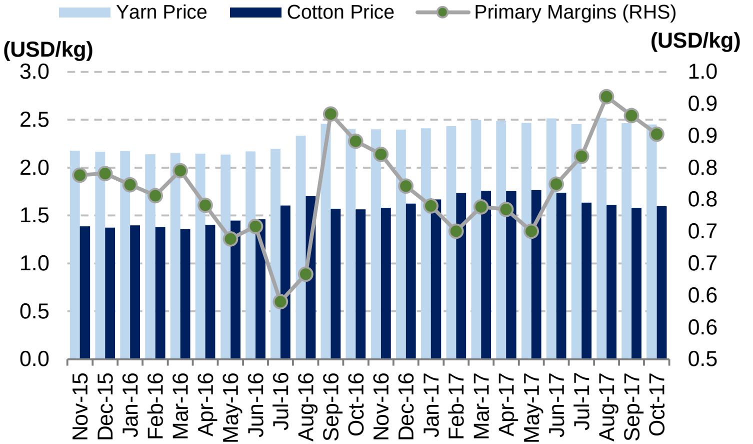
Key Investment Theme

- **Massive export incentive package announced by incumbent government:** The second phase of export incentive package announced by the government to provide relief includes: i) Export rebate on Yarn: 4%, Weaving: 5%, Home textile: 6% and Garments: 7% , ii) zero rated tax regime, iii) releasing pending tax refunds, iv) removal of sales tax on import of machinery. However, government is further planning to provide relief in form of revision in electricity and gas tariff. This package improved textile exports of Pakistan as exports of textile group increased by 8% to USD 5,511mn during 5MFY18.
- **Recovery in textile exports:** During 5MFY18, textile exporters managed to boost textile exports by 8% to meet the government target of 10%. We observe that prices of cotton yarn, cotton cloth, knitwear and bed wear will remain under pressure whereas ready-made garments witnessed a surge in prices by an average 3% due to increased demand from international buyers.
- **PKR Depreciation to Encourage Exporters**: Textile exports constitutes more than 60% of total Pakistan's exports and currently PKR has depreciated 5.2% against USD which will have significant impact on sector margins and improve competitive position of the country's textile exports.
- **Bright future ahead:** The government is focused on pursuing a strategy to enhance exports by providing maximum benefits to exporters such as subsidies, incentive packages and low rate of taxation compared to other sectors.

Key Risks

- Higher cotton prices.
- Delay in refund payments.
- Appreciation of PKR against USD.
- Discontinuation of GSP+ status.

Exhibit: Yarn Margins



Source: PBS, AHL Research

Nishat Mills Limited

Hyundai Investment; A Catalyst

Key Investment Theme

- **Improving Demand of Ready-made Garments:** The contribution in sales from ready-made garments is increasing amid rising demand of garments from Europe resulting in increase in prices. In FY17, garments sales swelled by 10% to PKR 4.5bn from PKR 4.1bn in SPLY.
- **Diversification in Auto Industry:** NML has recently shown interest to enter the Automobile industry in collaboration with Hyundai. A new subsidiary "Hyundai Nishat Motors Private Limited' has been formed to primarily engage in manufacturing of Hyundai vehicles in Pakistan. As per initial impressions, total project outlay will be ~USD 200-250mn. This project will add PKR 27-32/share to the target price on 42% stake.
- **Portfolio Value:** NML being one of the largest, well diversified conglomerates of Pakistan, has vast investments in group companies and other businesses. NML has investments in diversified sector such as Power, Cements, Banks, Construction, Textile, Insurance, Dairy, and Healthcare. Portfolio contribution towards fair value stands at PKR 104/share.
- **Swelling Non-core Income:** Majority of NML's earnings stem from dividend income and hence, company's profitability remains highly sensitive to non-core income Albeit, as dividend income from other concerns remains robust, non-core contribution to total earnings would be set around 72% in FY18E vis-à-vis last four years average of above 60%.
- **Continuation of Export Package:** Government exports incentive package will continue in the upcoming year which will add PKR 796mn to the topline translating into EPS of PKR 2.26.

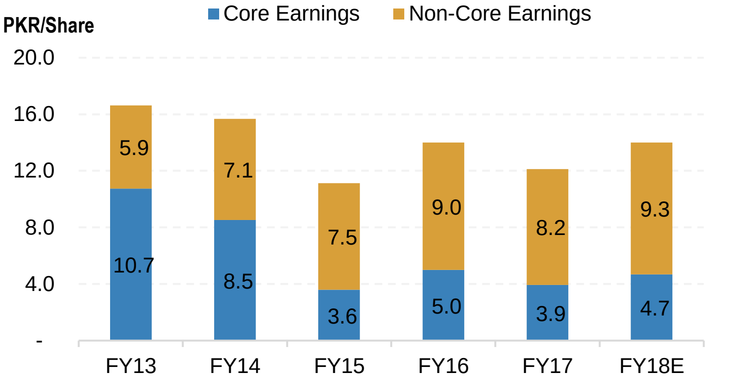
Key Risks

- Cessation of Export Incentive Package.
- PKR appreciation against regional currencies.
- Delay in Refund Payment Orders.
- Withdrawal of Zero Rated Tax Status.

BUY

Target Price	PKR	163.6
Market Price	PKR	146.4
Upside	%	11.8
PSX Code		NML

Exhibit: NML Earnings Breakup



Source: Company Financials, AHL Research

Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	49,248	51,780	55,093
Gross Profit	5,380	6,214	6,153
Other Income	4,260	4,236	4,879
Finance Cost	915	951	959
Post Tax Profit	4,262	4,919	5,148
Balance Sheet			
Shareholder's Equity	88,763	83,162	86,376
Interest Bearing Liabilities	22,036	20,946	21,048
Total Liabilities	29,963	29,672	30,239
Current Assets	30,194	32,772	36,774
Non-Current Assets	88,532	80,061	79,841
Total Assets	118,726	112,834	116,615

Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	12.1	14.0	14.6
Dividend per share	PKR	5.0	6.0	7.0
Book Value per share	PKR	252.5	236.5	245.7
Price to Earning	x	13.1	10.5	10.0
Price to Book	x	0.6	0.6	0.6
Net Margins	%	8.7	9.5	9.3
Dividend Yield	%	3.2	4.1	4.8

Source: Company Financials, AHL Research

Exhibit: NML – Portfolio Value

	Nov-17		Jun-17
Companies	Holdings	Portfolio Value	Portfolio Value
Nishat Power	51.0%	5,984	8,533
DG Khan Cement	31.4%	18,555	29,325
MCB	7.6%	17,632	18,240
Pakgen Power	27.6%	2,317	2,073
Nishat Chunian	13.6%	1,516	1,678
Adamjee Insurance	0.03%	5	7
Lalpir Power	28.8%	2,422	2,245
Others		3,825	3,763
Total Value of Investments		52,256	65,865
Total Value of Investments - PKR/Share		149	187
Discount Applied		30%	30%
Contribution towards fair value - PKR/Share		**104.0**	**131.1**

Source: Company Financials, PSX, AHL Research

Engineering (Steel)

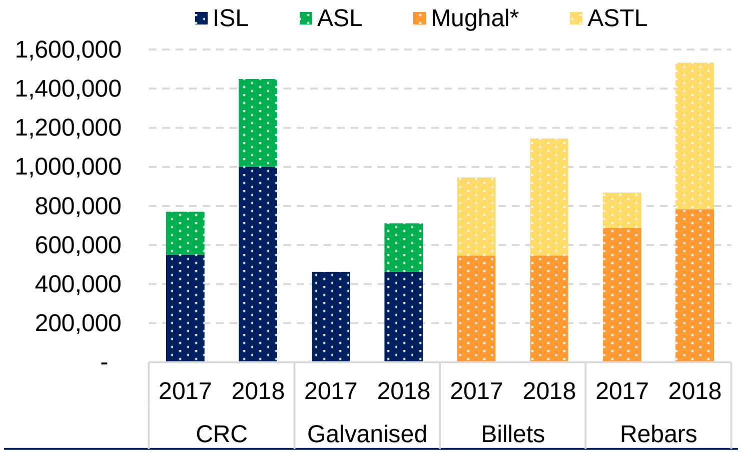
Engineering (Steel)

Opportunity For All

Key Investment Theme

- **Energy Focus A Key Growth Harbinger:** Although indigenous steel demand depicts a rosy picture on its own, development on the energy front (construction of damns, RLNG pipelines etc.) remains a key driver going forward.
- **Protectionist Duties Set to Replace Imports:** While imposition of fresh import level duties safeguards local players from international dumping, it also leaves room for greater pricing flexibility. In particular, anti-dumping duty on billets, rebars, CRC and galvanized sheets protects both, the long as well as flat steel industry.
- **Expansion Spree:** With that said, the domestic steel industry is undergoing an expansionary phase currently with stakes to retain / recuperate market share higher than ever; ASTL, Mughal, ISL and ASL are key listed players adding capacity in upcoming years.
- **Interest in Equity Market Yet to Die Down:** Having been a popular means of raising capital for expansion in the preceding few years, we may witness more IPO's in the sector with a potential to further unlock value.

Exhibit: Industry Growth Outlook



Source: Company Financials, AHL Research
*Mughal's available capacity remains much lower than its installed capacity amid electricity shortage

Key Risks

- **Margins Exposed to International Volatility:** With multiple countries and market dynamics instigating volatile swings in prices of scrap and other raw materials of steel, margins remain rocky.
- **New Players to Tap Market:** New players / capacities inundating the industry in the next two years could potentially trigger a price war, chopping off profitability of key players.

Amreli Steels Limited

Channeling Astounding Market Presence

Key Investment Theme

- **Demand Appears Buoyant:** Growth in homegrown steel rebar demand should witness no obstacles we view, given drivers such as preference for quality rebars on the rise, boom in the housing / construction space, CPEC led urbanization and a massive federal PSDP allocation at PKR 1,001mn (+40% YoY).
- **Import Rivals Ousted = Mighty Pricing Power:** Whereas a favorable duty structure put in place to curb dumped imports, widens the discount domestic rebars retail at vis-à-vis international rebars. Hinting at a greater flexibility to pass on costs, ASTL enjoys mighty pricing power at present.
- **2018; Year of Good Omen:** Commencement of commercial operations at Dhabeji remains a key catalyst for the company in 2018. Whereas planned expansion in ASTL's melting and re-rolling capacity to 600k and 750k, respectively by FY20 should significantly propel top-line.
- Having incorporated the above, we arrived at a DCF-based **Dec'18 target price of PKR 136/share**, offering an upside of 56% based on current levels.
- We also accentuate further potential for upside as i) a recent notice disseminated to the stock exchange revealed the company's plan to step into the **Electric Transmission / Tower** business with an equity stake of 65% (PKR 1,040mn) alongside a Chinese partner, and ii) claim to **tax credits** may also provide added impetus to earnings.

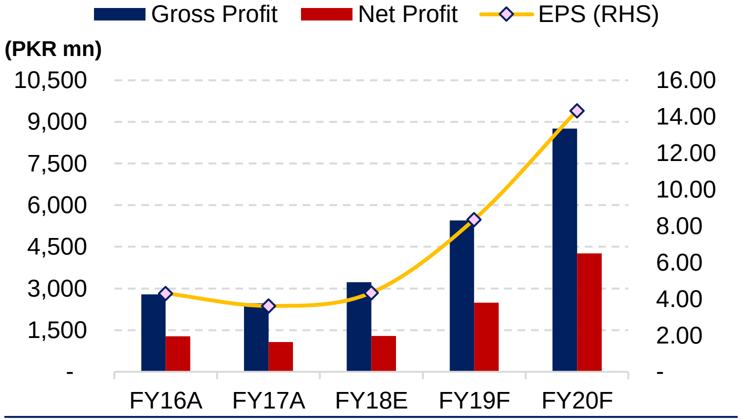
Key Risks

- **Delay in Expansion Blueprint:** While we have already assumed a lag in some of the expansion plans, any postponement beyond our expected timeline would alter the company's bottom-line.
- **Market Penetration:** With several new players expected to enter the market in the next 2 years (~1.3mn TPA), pressure on margins can build up as pricing power derails.

BUY

Target Price	PKR	136.1
Market Price	PKR	87.2
Total Return	%	56.0
PSX Code		ASTL

Exhibit: Stunning Profitability Growth In Years to come



Source: Company Financial, AHL Research

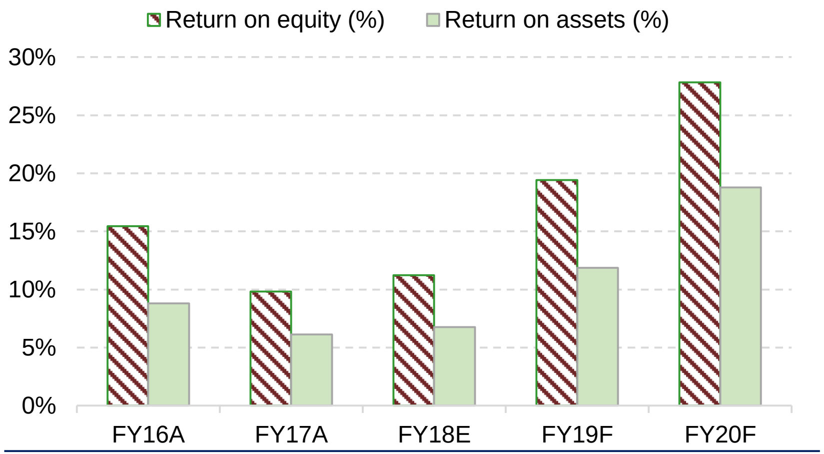
Financial Snapshot

Exhibit: Financial Highlights

PKR mn	2017A	2018E	2019F
Income Statement			
Net Sales	13,284	17,607	29,074
Gross Profit	2,468	3,220	5,448
Distribution expenses	337	409	637
Administration expenses	325	393	492
Post Tax Profit	1,074	1,290	2,483
Balance Sheet			
Shareholder's Equity	11,146	11,842	13,731
Interest Bearing Liabilities	4,650	5,660	5,610
Total Liabilities	7,063	8,026	8,277
Current Assets	5,791	6,366	7,714
Non-Current Assets	12,418	13,503	14,294
Total Assets	18,209	19,869	22,008

Source: Company Financials, AHL Research

Exhibit: Robust Returns



Source: Company Financials, AHL Research

Exhibit: Ratio Analysis

Ratio Analysis	Unit	2017A	2018E	2019F
Earnings per share	PKR	3.6	4.3	8.4
Dividend per share	PKR	2.0	2.0	3.8
Book Value per share	PKR	37.5	39.9	46.3
Price to Earning	x	34.0	20.1	10.4
Price to Book	x	3.3	2.2	1.9
Net Margins	%	8.1	7.3	8.5
Dividend Yield	%	1.6	2.3	4.3

Source: Company Financials, AHL Research

Recommendation Summary

Code	Company	Price	TP	Upside (%)	Stance	EPS (PKR)			DPS (PKR)			P/E (x)		Div. Yield (%)		P/B (x)		ROE (%)	
		22-Dec-17	Dec-2018			2016	2017	2018	2016	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
Exploration & Production																			
PPL	Pakistan Petroleum Ltd.	198.4	232.2	17.0	Buy	8.7	18.1	21.2	5.75	9.00	10.50	11.0	9.4	4.5	5.3	1.8	1.6	17.5	18.4
OGDC	Oil and Gas Dev Co.	162.1	190.1	17.2	Buy	13.9	14.8	18.3	5.20	6.00	7.50	10.9	8.9	3.7	4.6	1.4	1.2	12.9	14.8
POL	Pakistan Oilfields Ltd.	588.2	667.5	13.5	Buy	30.6	40.9	60.6	35.00	40.00	55.00	14.4	9.7	6.8	9.4	4.4	4.2	31.4	44.2
MARI	Mari Petroleum Ltd	1,423.2	2,130.2	49.7	Buy	54.9	82.9	152.8	5.10	5.20	5.50	17.2	9.3	0.4	0.4	6.1	3.8	43.0	50.0
Commercial Banks																			
UBL	United Bank Ltd.**	182.8	223.4	22.2	Buy	22.7	19.9	21.8	13.00	12.00	13.00	9.2	8.4	6.6	7.1	1.3	1.2	14.4	14.9
MCB	MCB Bank Ltd.**	202.5	228.5	12.9	Buy	18.6	21.1	22.0	16.00	16.00	17.00	9.6	9.2	7.9	8.4	1.5	1.4	16.3	15.8
HBL	Habib Bank Ltd.**	170.1	223.4	31.3	Buy	23.2	5.6	25.5	14.00	7.00	8.00	30.3	6.7	4.1	4.7	1.4	1.2	4.4	19.1
ABL	Allied Bank Ltd.**	81.5	110.0	35.0	Buy	12.8	10.6	12.8	7.00	7.00	8.00	7.7	6.4	8.6	9.8	0.9	0.8	11.6	13.0
NBP	National Bank of Pakistan.**	46.7	60.4	29.3	Buy	10.8	9.7	(3.2)	7.50	6.00	-	4.8	(14.7)	12.8	-	0.5	0.6	11.4	(3.8)
Fertilizer																			
ENGRO	Engro Corporation**	277.4	328.9	18.6	Buy	131.9	19.9	24.7	24.00	24.00	16.00	13.9	11.2	8.7	5.8	0.9	0.8	6.2	7.6
FFBL	Fauji Fert. Bin Qasim	34.2	40.9	19.4	Buy	1.4	2.9	3.2	0.50	2.00	2.00	12.0	10.8	5.8	5.8	2.4	2.2	20.3	21.0
EFERT	Engro Fertilizer	66.2	77.1	16.5	Buy	6.8	7.4	8.0	7.00	8.00	8.00	9.0	8.2	12.1	12.1	2.1	2.1	23.6	25.6
FFC	Fauji Fertilizer Co.	76.9	88.0	14.5	Buy	9.3	7.8	8.2	7.90	7.00	7.00	9.9	9.4	9.1	9.1	3.4	3.2	34.4	34.8
FATIMA	Fatima Fertilizer Co.*	30.2	NC	na	na	4.7	na	na	3.25	na	na	na	na	na	na	na	na	na	na
AHCL	Arif Habib Corp. Ltd.*	35.6	NC	na	na	2.8	5.3	na	2.50	3.00	na	6.7	na	8.4	na	0.5	na	na	na
Cement																			
LUCK	Lucky Cement Ltd.	475.2	680.5	43.2	Buy	46.0	42.3	40.9	10.00	12.00	16.00	11.2	11.6	2.5	3.4	1.9	1.7	18.4	15.6
FCCL	Fauji Cement Company	22.6	25.1	11.3	Buy	3.9	1.9	2.9	2.75	0.90	2.00	11.9	7.7	4.0	8.9	1.6	1.5	13.7	19.9
ACPL	Attock Cement Ltd.	170.3	195.4	14.8	Buy	25.2	26.5	20.4	12.50	13.50	11.00	6.4	8.3	7.9	6.5	1.6	1.5	27.1	18.8
DGKC	D.G. Khan Cement Co.	121.2	167.1	37.9	Buy	20.1	18.2	22.6	6.00	7.50	9.00	6.7	5.4	6.2	7.4	0.7	0.7	11.3	12.7
KOHC	Kohat Cement Company	122.1	169.4	38.8	Buy	28.5	22.9	20.3	6.00	14.00	8.00	5.3	6.0	11.5	6.6	1.2	1.1	24.4	19.3
MLCF	Maple Leaf Cement	68.8	81.5	18.5	Buy	9.3	9.1	8.1	4.00	3.75	3.50	7.6	8.4	5.5	5.1	1.9	1.4	26.4	19.0
POWER	Power Cement*	8.7	NC	na	na	0.5	0.5	na	-	-	na	na	na	-	na	1.0	na	na	na
Oil & Gas Marketing																			
PSO	Pakistan State Oil	289.8	374.4	29.2	Buy	31.5	55.9	48.2	12.50	25.00	20.00	5.2	6.0	8.6	6.9	0.9	0.8	18.7	14.6
APL	Attock Petroleum Ltd.	499.3	714.5	43.1	Buy	46.2	63.9	53.1	40.00	42.50	42.50	7.8	9.4	8.5	8.5	2.5	2.4	34.6	26.3
Automobile Assembler																			
PSMC	Pak Suzuki Motor Co.	482.2	704.8	46.2	Buy	33.7	46.2	66.8	5.50	19.00	27.00	10.4	7.2	3.9	5.6	1.4	1.3	13.9	18.3
INDU	Indus Motor Company	1,680.5	2,113.4	25.8	Buy	145.7	165.4	178.6	100.00	115.00	125.00	10.2	9.4	6.8	7.4	4.2	3.7	44.2	42.3
HCAR	Honda Atlas Cars (Pak) Ltd.	507.9	671.6	32.2	Buy	24.9	43.0	45.8	7.00	13.00	18.00	11.8	11.1	2.6	3.5	5.6	4.3	58.4	43.5
MTL	Millat Tractors Ltd.	1,146.2	1,470.0	28.2	Buy	39.5	96.1	96.7	50.00	95.00	87.00	11.9	11.9	8.3	7.6	8.8	8.2	86.1	71.8
Power Generation & Distribution																			
HUBC	Hub Power Company***	91.4	122.5	41.1	Buy	10.3	9.2	9.4	11.00	7.50	6.50	9.9	9.7	8.2	7.1	3.0	2.6	31.3	28.6
NCPL	Nishat Chu. Power Ltd.***	29.1	32.9	31.9	Buy	7.5	8.2	8.9	7.25	2.50	4.50	3.6	3.3	8.6	15.5	1.2	1.0	36.4	32.6
NPL	Nishat Power Limited***	30.1	39.1	49.2	Buy	8.1	8.2	8.5	6.00	4.00	4.50	3.7	3.5	13.3	15.0	0.8	0.7	22.1	20.6
KAPCO	Kot Addu Power Co. ***	54.0	63.6	35.5	Buy	10.3	10.7	10.4	9.00	9.05	9.50	5.0	5.2	16.8	17.6	1.5	1.4	29.8	27.9
Textile Composite																			
NML	Nishat Mills Ltd.	146.4	163.6	11.8	Buy	14.0	12.1	14.0	5.00	5.00	6.00	12.1	10.5	3.4	4.1	0.6	0.6	5.0	5.7
NCL	Nishat (Chunian) Ltd.	46.5	57.2	23.1	Buy	5.5	6.7	5.13	2.50	2.75	2.75	6.9	9.0	5.9	5.9	0.9	0.9	14.1	10.0
Chemicals																			
LOTCHEM	Lotte Chemical Pak Ltd.	6.7	11.0	62.8	Buy	0.21	0.62	0.84	-	-	-	10.9	8.0	-	-	0.9	0.8	8.7	10.7
EPCL	Engro Polymer & Chem.	29.7	48.4	63.0	Buy	0.99	3.43	4.47	-	0.45	1.75	8.7	6.6	1.5	5.9	2.5	2.0	32.7	33.5
Cable & Electrical Goods																			
PAEL	Pak Elektron Ltd.	47.5	92.8	95.3	Buy	7.37	7.29	8.53	3.00	3.00	3.00	6.5	5.6	6.3	6.3	0.8	0.7	16.6	17.4
Pharmaceuticals																			
SEARL	The Searle Co. Ltd	300.4	505.0	68.1	Buy	11.31	14.29	15.81	5.00	10.00	11.00	21.0	19.0	3.3	3.7	5.6	4.9	29.1	27.5
Engineering																			
ASTL	Amreli Steels Ltd.	87.2	136.1	56.0	Buy	4.31	3.62	4.34	2.00	2.00	2.00	24.1	20.1	2.3	2.3	2.3	2.2	9.8	11.2

Source: Bloomberg, AHL Research, * Group Company: No estimates are given, **Earning Consolidated Basis, *** Upside is Total Return

List of Abbreviations

1H	First Half	FM	Frontier Markets	NIR	Net International Reserve
1Q	First Quarter	FMCGs	Fast Moving Consumer Goods	NPL	Non Performaning Loans
9M	9 months	FO	Furnace Oil	NYSDFS	New York State Department of Financial Services
ADB	Asian Development Bank	FTSE	Financial Times Stock Exchange	O&M	Operations & Maintance
ADIP	Auto Industry Development Policy	FX	Foreign Exchange Reserves	OMCs	Oil Marketing Companies
ADR	Advances Deposit Ratio	FYTD	Fiscal year to date	OMO	Open Market Operation
AHL	Arif Habib Limited	FY	Fiscal Year	OPEC	Oil Producing and Exporting Countries
APCMA	All Pakistan Cement Manufacturers Association	GBP	Great Britian Pound	p.a.	Per annum
bn	Billion	GDPg	GDP growth	PAT	Profit After Tax
bbl	Barrel	GDP	Gross Domestic Product	PBS	Pakistan Bureau of Statistic
BEER	Bond Equity Equivalent Ratio	GENCOs	Power Generation Companies	PBV	Price to Book Value
BoE	Barrels of Oil Equivalent	GIDC	Gas Infrastructure Development Cess	PE	Price Earning
bpd	barrels per day	Gov't	Government	PER	Price Earning Ratio
CAC	Cotton Crop Assesment Committee	GSP	Generalised Scheme of Preferences	PIB	Pakistan Investment Bonds
CAGR	Compounded Annual Growth Rate	GST	General Sales Tax	PKR	Pakistan Rupee
CAR	Capital Adequacy Ratio	HSD	High Speed Diesel	POL	Petroleum Products Prices
CASA	Current Account Saving Account	ICH	International Clearing House	PP	Petroleum Policy
CG	Central Government	ICT	Information & Communications Technology	PPA	Power Purchase Agreement
CKD	Complete Knock Down	IDR	Investment Deposit Ratio	PR	Policy Rate
CNG	Compressed Natural Gas	IFC	International Finance Corporation	PSDP	Public Sector Development Program
CNY	Chinese Yuan	IMF	International Monetary Fund	PSX	Pakistan Stock Exchange
COD	Commercial Operations Date	IPPs	Independent Power Producers	RDs	Regulatory Duties
CPEC	China Pakistan Economic Corridor	JIT	Joint Investigation Team	REER	Real Effective Exchange Rate
CPI	Consumer Price Index	JPY	Japanese Yen	RFO	Residue Fuel Oil
CSF	Coalition Support Fund	KO	Kerosene Oil	RGDP	Real Gross Domestic Product
CYTD	Calendar year to date	KSE	Karachi Stock Exchange	RHS	Right hand side
CY	Calendar Year	LHS	Left hand side	RLNG	Regassified Liquified Natural Gas
DAP	Di-ammonium Phosphate	LNG	Liquified Natural Gas	ROA	Return on Assets
DCF	Discounted Cash Flow	LPS	Loss Per Share	ROE	Return on Equity
DPS	Dividend Per Share	LSM	Large Scale Manufacturing	SBP	State Bank of Pakistan
DR	Discount rate	LTFF	Long Term Financing Facility	SECMC	Sindh Engro Coal Mining Company
DY	Dividend Yield	mn	Million	SME	Small Medium Enterprises
E&P	Exploration & Production	mb/d	Million barrels per day	SoTP	Sum of the parts
EBITDA	Earning Before Interest, Taxes & Amortization	ME	March End	SPLY	Same period last year
ECC	Economic Coordination Committee	mmbtu	Metric Million British Thermal Unit	TD	To Date
EFF	Extended Fund Facility	mmcfd	Million Cubic Feet Per Day	T&D	Transmission & Distribution
EGrow	Earning Growth	MPC	Monetary Policy Committee	TPA	Tonnes Per Annum
EM	Emerging Markets	MS	Motor Spirit	USD	US Dollar
EPS	Earrings Per Share	MSCI	Morgan Stanley Composite Index	VSS	Voluntary Separation Scheme
EU	European Union	MW	Mega Watts	WAPDA	Water & Power Development Authority
EV	Enterprise Value	NCCPL	National Clearing Company of Pakistan Limited	YTD	Year-to-date
Ex	Excluding	NFA	Net Domestic Assets	YoY	Year-on-Year
FIPI	Foreign Investor Portfolio Investment	NIM	Net Interest Margins		

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec'18 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +10% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -10% from last closing of market price(s)

* Upside for Power Generation Companies (Ex. KEL) is upside plus dividend yield.

Equity Valuation Methodology

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

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

Risks

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

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

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Disclosure required under Research Analyst Regulations, 2015:
In order to avoid any conflict of interest, we hereby disclose that; Arif Habib Limited (AHL) has shareholding in NBP, FFC, DGKC, PSO.

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