REP-300

Pakistan Strategy 2021

Realistic Optimism, Targeting 52,000

04-Dec-2020

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Best Corporate & Investment Bank: 2020

Best Domestic Equity House

Top 25 Companies

Corporate Finance House of the Year: 2020

Best Equity Research Analyst: 2020

Pakistan Investment Strategy 2021

Synopsis

- **Total return:** Led by strong earnings growth, economic growth, broadly stable external position, and cheap valuations, we expect the KSE-100 Index to generate a lucrative total return of 28% (USD-based: 23%) during CY21 taking index level to 52,000 by Dec'21 based on methodologies of earnings growth, target price mapping and justified P/E ratio.
- **Economic headwinds to subside:** We expect the economic activity to continue the robust pace it has showed over the last couple of months.
    - GDP growth is expected at 1.8% during FY21.
    - The Current Account, while swinging into a deficit, is expected to be manageable (-0.9% of GDP), attributable to Consumption driven, import-dependent GDP.
    - No significant depreciation of the currency on the cards (PKR/USD 168 expected by Dec'21) owing to orderly market conditions, continued robust inflows from remittances and improved exports.
    - Housing finance, construction package, TERF facility are some of the government's efforts to fuel investment activities in the country.
    - G20 debt relief facility and low interest rates to allay stress off debt servicing expenditure.
- **Attractive valuations:** Low interest rate regime highlights equities as the preferred asset class due to low fixed income yields
    - The KSE-100 Index trades at a P/E of 7.0x – 18% discount to historic 8.5x
    - The KSE-100 Index trades at a P/B of 1.0 – 46% discount to historic 1.9x
    - The KSE-100 Index trades at a 56% discount to regional markets, compared to historic discount of 36%.
- **Sectoral Outlook:**
    - **Cement:** Aggregate demand revival and government incentives for the construction industry should help propel dispatches growth.
    - **Automobile Assemblers:** Stability in the PKR/USD parity, and strong volumes growth amid demand revival and low interest rates should stimulate bottom-line of companies.
    - **Oil Marketing Companies:** Recovery in global oil prices will result in inventory gains. Volumetric growth and margins revision are likely to boost earnings further.
    - **Textile:** With re-opening of the global economy, export orders are likely to continue piling up, while government subsidies on utilities should keep margins upbeat.
    - **Fertilizers:** Stable offtake and pricing power will help profitability of the sector.
    - **Banks:** While lower interest rates are likely to compress NIMs and lead to lower earnings, we highlight that higher than expected recovery in credit demand, lower than expected NPL accretion, and dirt cheap valuations can fuel price performance of banking scrips.
    - **E&Ps:** A steady bottom-line of the E&P sector given stable oil price and PKR-USD outlook. Our oil price assumption for 2021 is USD 50/bbl.

- **Top Picks:** LUCK, DGKC, MLCF, HUBC, INDU, PSO, NML, ILP, ENGRO, FFC, HBL, MCB, OGDC, POL, and PPL.

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Global Politics

All eyes on Biden's chess board

- **Major policy shift expected:** Policies of the US towards Pakistan are always a subset of a larger geopolitical picture (war in Afghanistan or US-China relations, in the current context). In the broad geopolitical arena, efforts of the new presidency will be directed towards catching up with China, which has made gigantic economic leaps in recent years, and preventing it from becoming the global superpower. Biden's election has been welcomed with much fervor from across the world, particularly Europe as it anxiously awaits Biden's promises to re-enter the 2015 Iran nuclear deal and the 2015 Paris agreement on climate change. However, countries such as Saudi Arabia and China took their time to congratulate the President-elect (Russia is yet to do so). Biden has publicly referred to Russia as the country that "threatens the security" of the US the most, while he referred to China as the "biggest competitor". Saudi Arabia is on edge given Biden's vocal criticism of the powerful Crown Prince Muhammad Bin Salman. Biden has showed his intent clear about his desire to bring to task the conspirators behind the murder of journalist Jamal Khashoggi. On the journalist's second death anniversary, Biden publicly promised to "reassess" ties with the Kingdom.
- **China on the radar:** While criticizing Trump's policies on China, Biden himself has portrayed a similar confrontational tone. The President-elect has not committed towards scrapping tariffs (whilst describing trump's actions as "reckless") and has pitched a "Buy American" plan. Like Trump, Biden has been overwhelmingly critical of the growing influence of Chinese tech firms such as Huawei and the leaps it has made in 5G technology. China's rapid response and impressive control of the coronavirus followed by remarkable economic turnaround has aggravated pressure on the US, which continues to reel from continuous rise in COVID cases (more than 200k daily cases over the last 2 years). The US is likely to continue propping up anti-China forces in the region such as India (numerous trade and military level agreements have been signed recently) which is likely to force Pakistan to keep its eyes open.
- **India - The anti-China force:** Pakistan's relations with India are likely to remain cold, we view. LoC violations have only intensified while tension with China persists in the disputed Himalayan region of Ladakh. India's economic shambles are also a source of extreme pressure for the government (7.5% GDP contraction during 1QFY21), with the current woes pointing towards the severest recession since 1996. However, the US has increasingly built its cooperation and focus on India signing numerous defence and military deals recently. The US is focused upon strengthening India as a strong power in Asia to offer some threat to the rising Chinese influence**.**
- **Afghan exit in clear sight:** On the Afghan war front, Biden is expected to continue making concerted efforts towards an exit of the US forces post a peaceful and mutually acceptable political set-up in Afghanistan, as per the agreement signed in Doha earlier this year. Pakistan's cooperation and help in this regard is crucial. Military as well as civilian level contacts are likely to be strengthened to aid the smooth exit of the US forces and implement the deal between the Taliban and the US. Pursuant to his promises, President Trump announced (in November, after the elections) another round of exit of US soldiers from Afghanistan and Iraq, reducing

troop levels in both countries to 2,500. The President had tweeted in October his desire to pull out all troops from Afghanistan by Christmas.

- **Evolving Middle East dynamics**: Biden's promises to re-enter into the Iran nuclear deal has appeased Europe. However, that may not be an easy task as Iran is likely to ask for a high price such as immediate lifting of draconian sanctions imposed by President Trump, and possibly monetary compensation. Last week's murder of the leading scientist in charge of Iran's nuclear program, Mohsen Fakhrizadeh, has, however, complicated matters. The US and Israel have built a hard-hitting narrative against Iran's ambitions and have vociferously spoken against the threat it poses. Iranian President has publicly blamed Israel for the murder. To recall, Israeli PM Netanyahu had conducted a hard-hitting press conference in 2018 talking about the threats faced by Iran's nuclear proliferation. "Remember that name", Netanyahu had exclaimed, referring to Fakhrizadeh. Iran has vowed to avenge the murder and all these developments are likely to create a thorny road for the President-elect.
- While the UAE has formally recognized Israel, there were reports in the Israeli media about a meeting between the Saudi Crown Prince and the Israeli PM. PM Imran Khan has publicly talked about pressure from certain quarters regarding recognizing Israel but Pakistan's position remains unchanged and any recognition is off the cards until there is a "viable, independent, and contiguous" Palestinian state.

Domestic Politics

Government Stability – A Boon for Investment Climate

- **"One page" narrative:** In the domestic political arena we expect no major threat to the stability of the government. Brief jolts by the opposition may continue in the shape of rallies, but we do not expect any serious impediment to the continuity of the current democratic set-up. Exemplary relations between the government and the establishment is a big feather in the government's cap. Convergence of views on major policy issues, as has been witnessed in the PTI-led government's tenure so far, is crucial for investors' confidence in the markets.
- **PDM – A threat?** That said, we do highlight the "Pakistan Democratic Movement" (PDM) as a credible force of the opposition that can keep the government on the edge of its seat. The PDM is an alliance of opposition parties that seeks to oust the PTI from government. However, we think that the success of this alliance has clouds of uncertainty over it due to the cautious approach of parties such as the PPP which are ruling Sindh. Moreover, the rising COVID cases, may at some point force the opposition to suspend their public meetings, which however, has not happened so far. The political strength of the government is expected to solidify further in March when PTI is expected to emerge as the leading party in the Senate elections. The likelihood of that happening has increased following its victory in the Gilgit-Baltistan elections.
- **FATF Grey List exit is likely:** Furthermore, we think that an exit from the FATF grey list in February has become quite likely (discussed in detail in the Economy section). This would be a significant stimulant for confidence in the equity bourse.

COVID-19
The Black Swan

COVID-19

The Black Swan

- **Easing of the lockdown steepened the curve:** After showing initial resistance to imposing a lockdown, the federal government gave in to demands in early April from across the country to impose a nation-wide lockdown to curb the spread of the virus. Provinces such as Sindh had already gone into a strict lockdown towards the end of March. However, the PTI-led government had begun easing the lockdown across the country with various relaxations being announced in early May as the PM had continuously argued on national television against maintaining the nation-wide shutdown, citing the vast majority of the population's vulnerability to the resultant economic and financial hardships. Following the easing of the lockdown, the country witnessed a drastic surge in infections as well as the death toll. The month of June saw an average of 4,700 daily cases (May: 1,795), with the 14-Day MA touching a high of 5,865 on 13th June. Daily deaths also saw a marked rise – clocking-in at an average of 95 per day (May: 37). Infection ratio crept up to an average of 19% (May: 14%), touching a high of 26% on 27th May.

- **The miraculous turnaround:** However, July onwards, Pakistan saw a miraculous turnaround. The period mid-July to mid-October saw an average of 710 cases with infection rates plummeting significantly, touching a low of 0.7% on 9th Sep, while 14-Day MA touched a low of 1.6% on 12th Sep. The stark turnaround of the pandemic situation in Pakistan is nothing short of being miraculous. It has left health experts muddled, both across the country, as well as the world. Some cite Pakistan's young population (median age of 22) as an important reason, while others think the "BCG Vaccine" has been a contributing factor towards developing strong immunity. That said, most experts are confused and there is no plausible theory yet that explains the drastic decline in cases and deaths.

- **Global acclamation:** The remarkable turnaround in Pakistan's COVID situation while most of the large countries were still perilously far from a flattening curve, earned great acclamation from around the world. The WHO Director General included Pakistan amongst 7 countries from which the world can learn on dealing with the pandemic, accrediting Pakistan's deployment of the infrastructure it had built over the years to fight polio. In a separate statement, the WHO chief Tedros Adhanom also praised Pakistan's efforts to simultaneously support economic recovery as well as suppress the spread of the virus. Bill Gates in a telephonic conversation with PM Imran Khan also lauded the government's efforts to fight the virus as well as efforts for social protection.

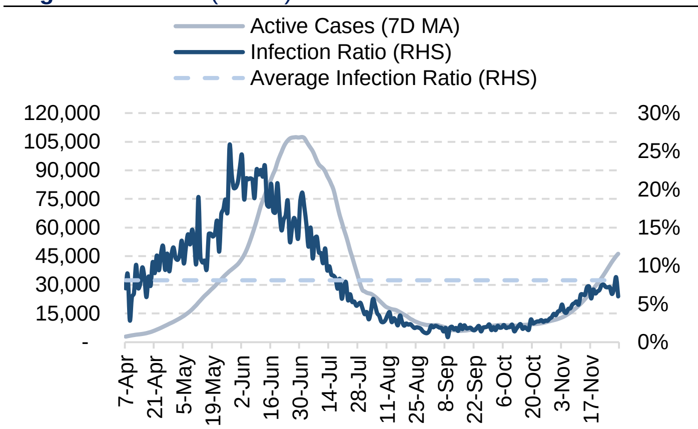
- **Second wave:** As the summer season started subsiding there was a marked rise in infections in Pakistan from mid-October onwards. Signs of a second wave became rapidly apparent as average daily cases went up to 683 in October and 1,730 in November, with infection creeping up to 8.5%. While no complete lockdown has been announced yet, certain SOP's have been enforced such as restriction of 300 people in marriage halls and closure of commercial activities by 10pm (8pm in Karachi).

- **Developments on the vaccine front:** On 9th November, the world breathed a much-awaited and much-needed deep sigh of relief when, drug makers Pfizer and BioNTech announced their trial results with an efficacy of 95% (90% reported earlier). Soon after, Moderna announced their results as well (efficacy: 95%), while Oxford/AstraZeneca announced their trial results with an efficacy of 62%-90%

depending on dosage regime. Pfizer/BioNTech and Moderna filed for approval from the FDA regulators on 20th and 30th November. The US government expects Pfizer and Moderna to provide 40mn dosages by the end of this year. However, European regulators have pushed back their assessment plans which could delay distribution in EU countries to early next year. While UK became the first country in the world to approve the Pfizzer/BioNTech vaccine on 2nd December 2020 (40mn doses ordered) with roll out of the vaccine expected within the next few days.

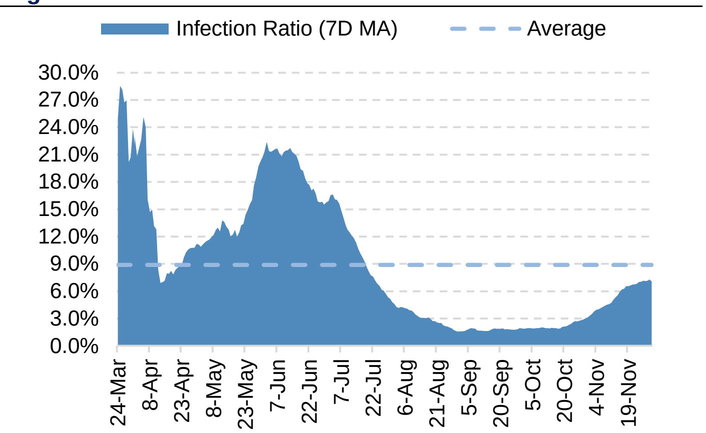
- PM Khan has approved an allocation of USD 100mn for vaccine procurement. Currently Pakistan is conducting phase-III trials of the vaccine developed by CanSinoBio – a Chinese pharmaceutical firm. News reports have suggested that Pakistani authorities are in touch with Oxford/AstraZeneca for timely vaccine procurement. In terms of pricing, Oxford/AstraZeneca have said they will sell their vaccine at cost (USD 4 - USD 5), while Moderna has said its vaccine will be charged at USD 32 - USD 37. Pfizer's vaccine is expected to cost USD 20 –USD 40.
- In terms of storage, Pfizer's vaccine is the most troublesome as it requires refrigeration at -70 degrees Celsius during shipment and storage, and has to be mixed with another liquid before administration. The Moderna vaccine can be stored in household refrigerators for up to 30 days, and at room temperature for up to 12 hours. It also does not require dilution before administering it. The Oxford/AstraZeneca vaccine is needed to be sent to vaccination centres in refrigerated vehicles and stored in a purpose-built vaccine refrigerator between 2 degrees Celsius and 8 degrees Celsius.

Fig: Active cases (7DMA) and Infection ratio



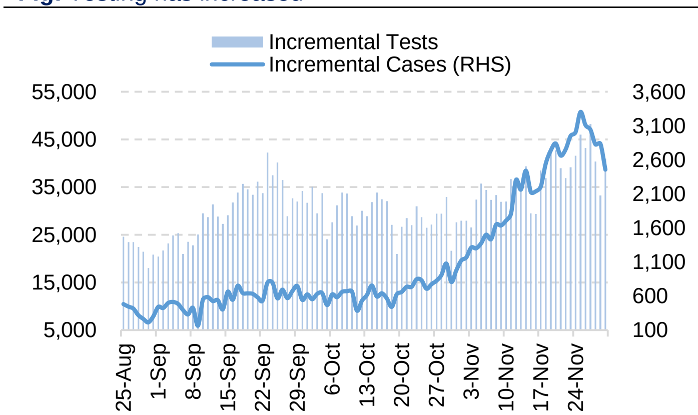
Source (s): Covid.gov.pk, AHL Research

Fig: Infection ratio 7DMA



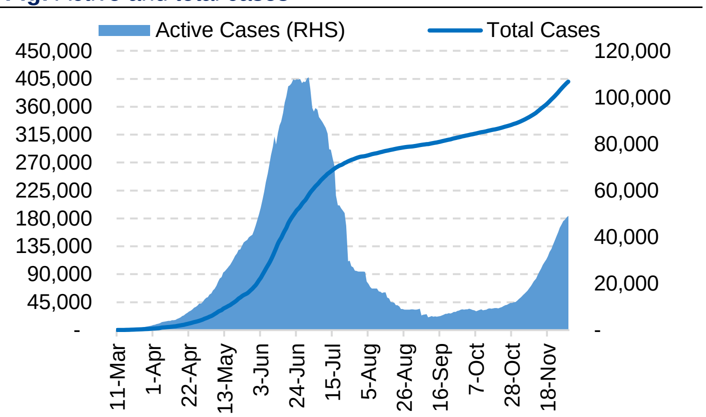
Source (s): Covid.gov.pk, AHL Research

Fig: Testing has increased



Source (s): Covid.gov.pk, AHL Research

Fig: Active and total cases



Source (s): Covid.gov.pk, AHL Research

The Economy and COVID-19

- **Improvement on the external front:** Paradoxically the pandemic has brought good tidings to the macro-economy of Pakistan. On the external front, the Current Account has progressively showed improving numbers supported by a robust momentum of workers' remittances, as discussed in the Economy section. Moreover, curtailed global activity has helped curtail imports significantly. Oil prices crash due to lackluster global demand helped curtail the import bill from the petroleum group by 25% YoY during 4MFY21 (oil prices). Current Account has posted a surplus in every month so far this fiscal year, with the surplus during 4MFY21 clocking-in at USD 1.2bn (deficit of USD 1.4bn SPLY).
- **Preemptive actions by the SBP:** To combat a sharp contraction in aggregate demand, the SBP, like most central banks around the world, resorted to a sharp contractionary monetary policy, slashing policy rate by 625bps. Moreover, the central bank's efforts to support the local economy through various relief measures were complemented by the strong balance sheets of commercial banks (CAR as at Sep'20: 19.5%). Relief measures such as principal deferment scheme and loan restructuring schemes, Rozgar Scheme (preventing workers' layoff through financing wages for 6 months), and facilities such as TERF (Temporary Economic Refinance Facility) to promote investments (fixed markup rate of 5% for 10 years), helped morph the economy into a sharp recovery phase.
- **Effects of second wave:** A resurgence of the virus is likely to jolt investor confidence in the markets. Business confidence is likely to suffer once again and if another lockdown is imposed, the "V-shaped recovery" may be forced to turn into a "W-shaped recovery". A serious resurgence of the virus followed by a lockdown could once again cause supply disruptions across the country, thereby leading inflationary readings northwards. While the SBP has emphasized the fact that temporary supply shocks are not considered in monetary policy deliberations by the MPC, any elongated impact on inflation could preempt a rate hike much earlier than expected. On the external front, we think that the healthy momentum of the current account may actually gain further momentum if the second wave prolongs as demand for imports is likely to plummet. Assuming global markets continue to remain open and export orders do not face delays, the surplus on the current account may witness further strengthening. Robust remittances should continue their trajectory as expatriate Pakistanis would look to support their families thereby giving more solid ground to the current account. All these developments should help maintain stability in the PKR/USD parity.

Fig: Daily New Cases per million (as of 28th Nov, 2020)

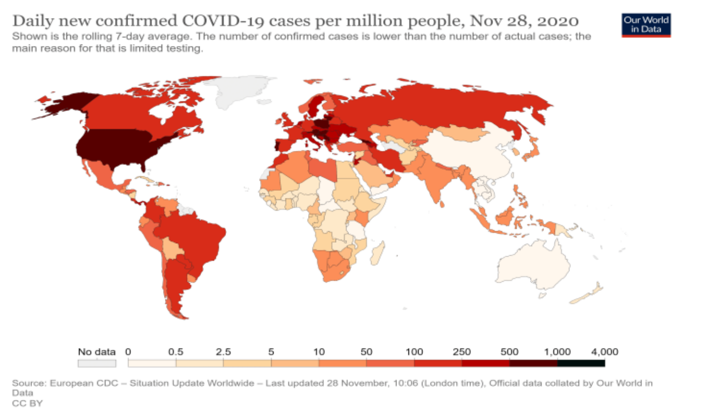


Fig: Daily New Deaths per million

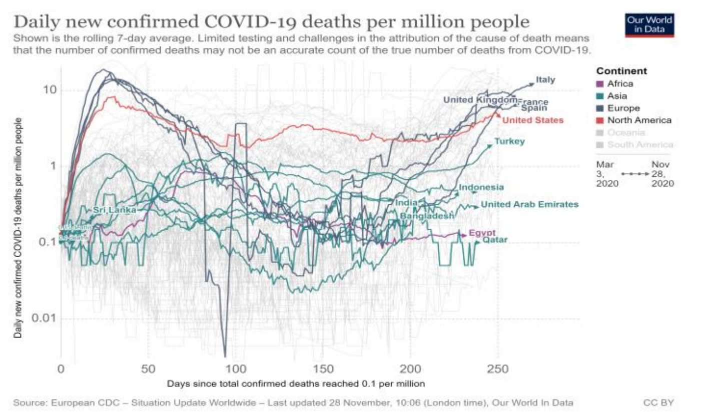


Fig: Fatality rate

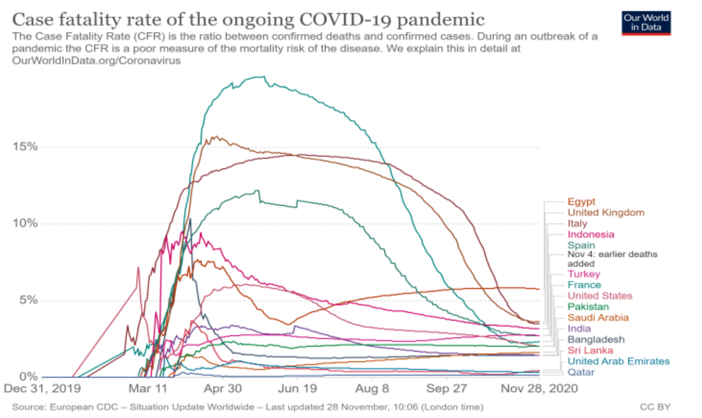


Fig: Daily new tests per 1,000 people

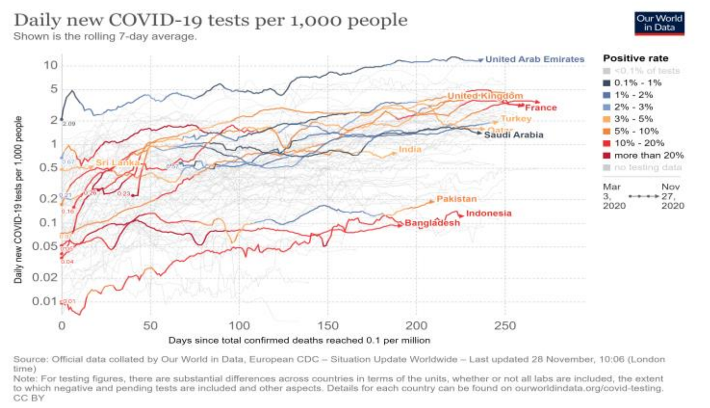


Fig: Testing policies

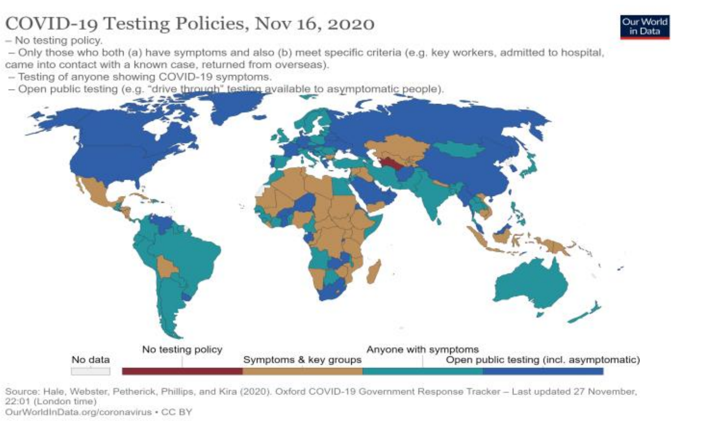


Fig: Contact tracing

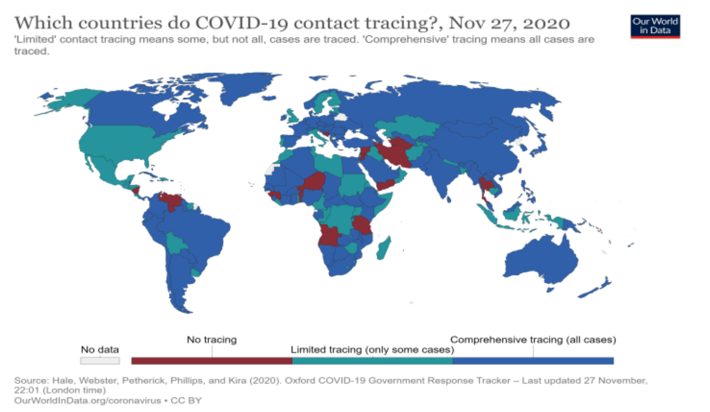


Fig: Government response

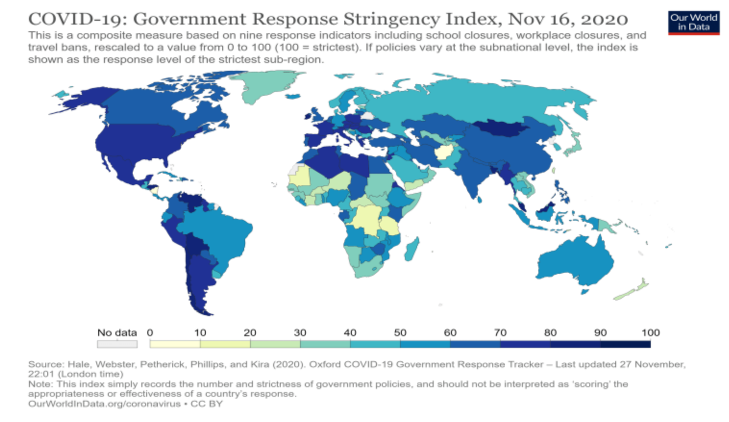


Fig: Deaths per million and GDP per capita

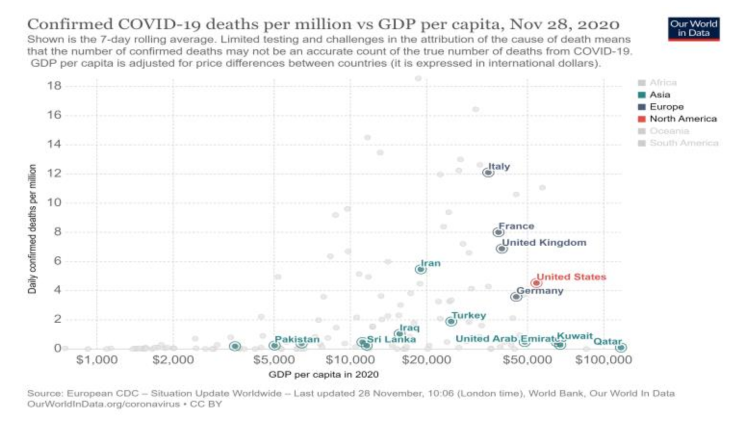


Fig: Debt or contract relief during COVID-19 (as of 16h Nov, 2020)

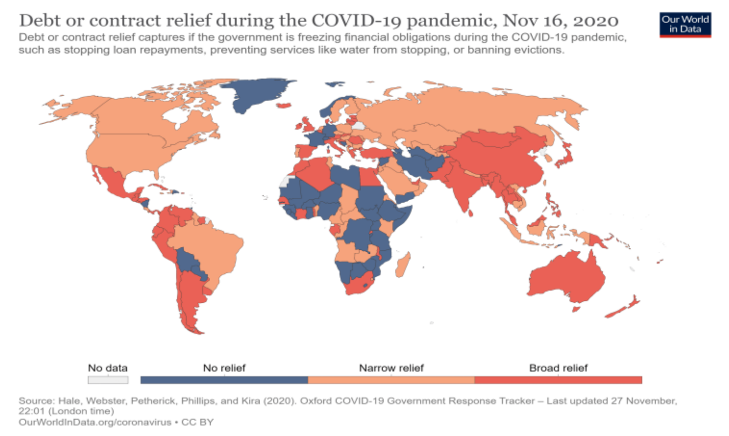


Fig: Income support (as of 16h Nov, 2020)

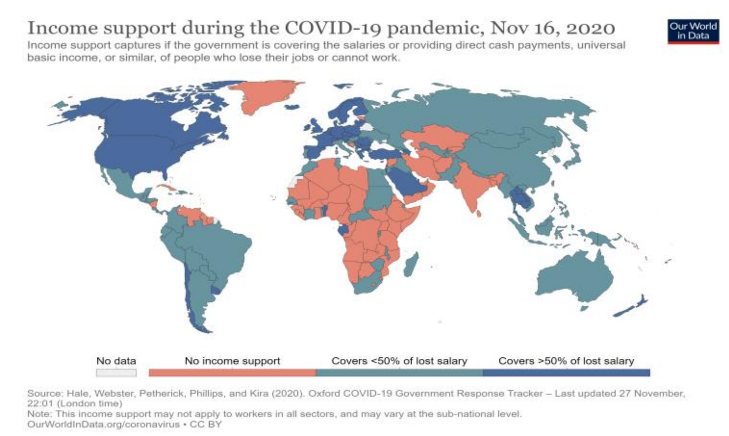


Fig: COVID-19 cases and GDP per capita

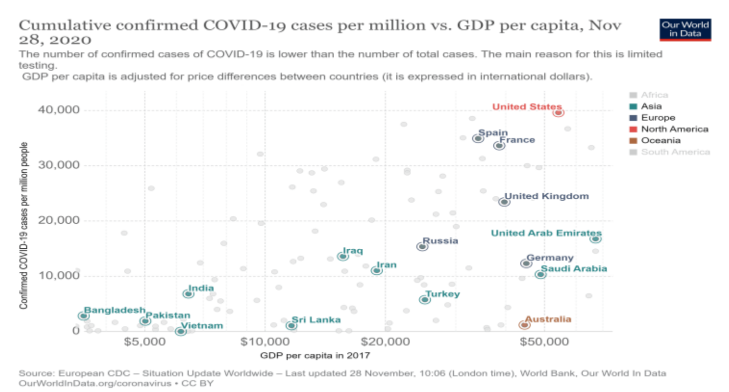
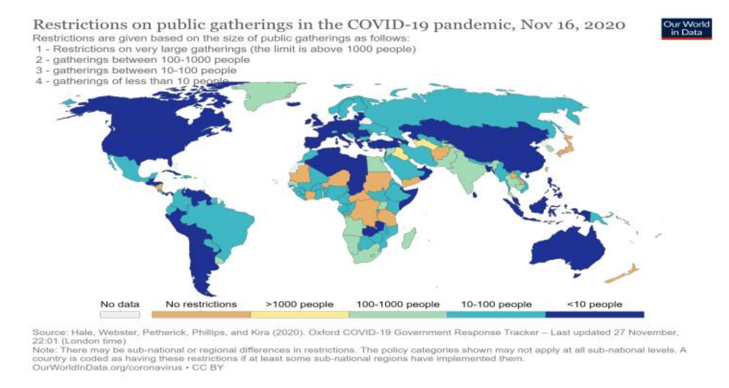
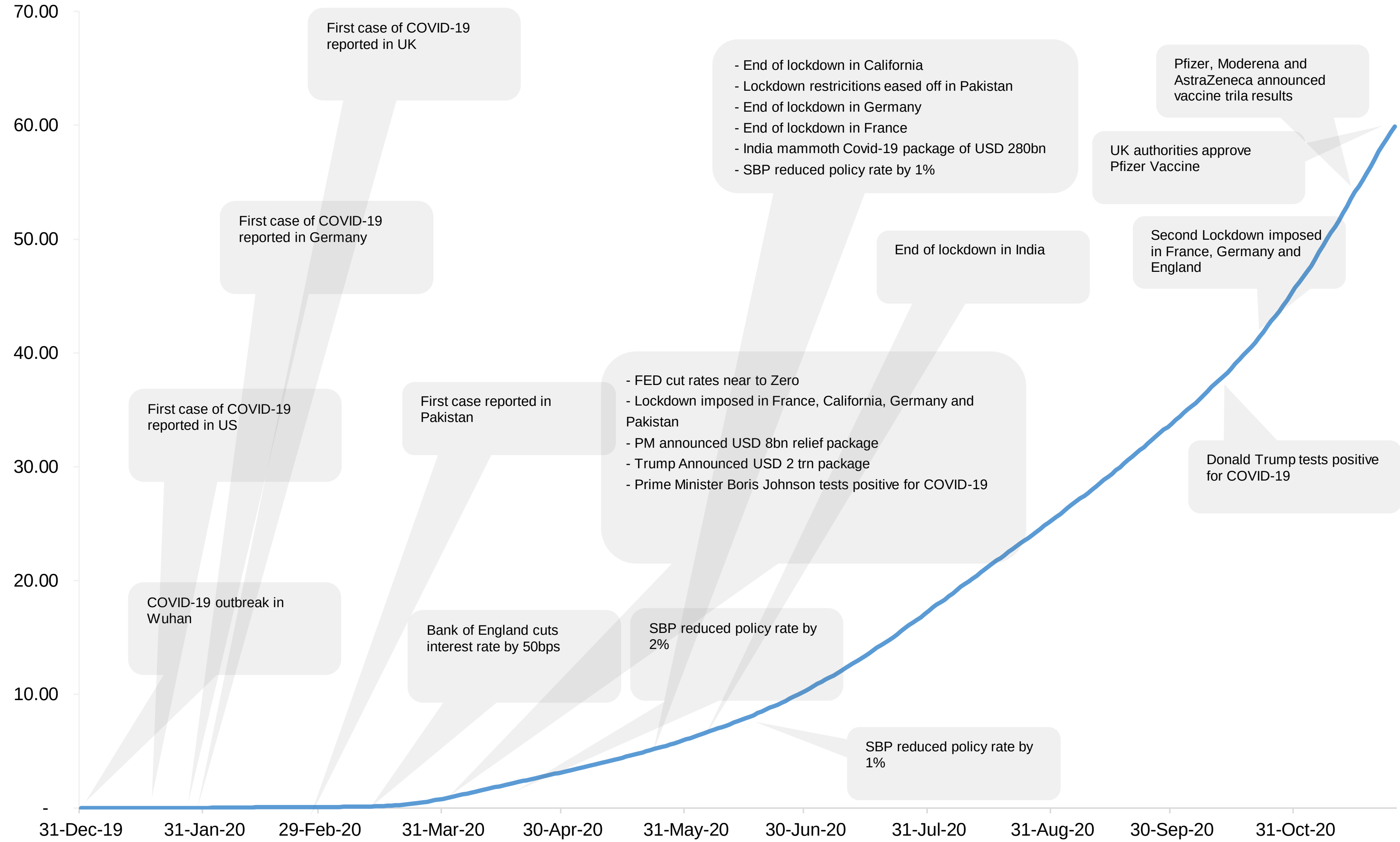


Fig: Public gathering restriction (as of 16h Nov, 2020)



COVID-19 Timeline



Economy
At an inflection point

Global Economies

A tale of divergence

COVID-19 changed the narrative in 2020! From growth, focus shifted to survival. We saw global economies coming up with stringent lockdown measures in the first half of 2020 to contain the coronavirus (COVID-19) pandemic and protect their people. It was earlier predicted that world would go into severe recession in 2020 however, as we fight this pandemic together, agencies like IMF and World Bank are now expecting a somewhat less severe recession than it predicted in June. However, with the arrival of the second wave, the world economies seem to be facing headwinds once again from rising domestic and external vulnerabilities. In its World Economic Outlook, IMF states that the global economy is still in deep recession and the risk of a worse outcome than in its new forecast is "sizable". It expects a negative 4.4% growth in world's real GDP in 2020, however projecting a strong come back in 2021 with real GDP jumping up to 5.2% (conditional upon availability of vaccine against COVID, we believe). Against the backdrop of the losses struck by the pandemic so far, which led to the shelter-in-place policies across some major economies, it is expected that same will continue in 2021 also. We have highlighted some of the key economies and their strategies post pandemic below:

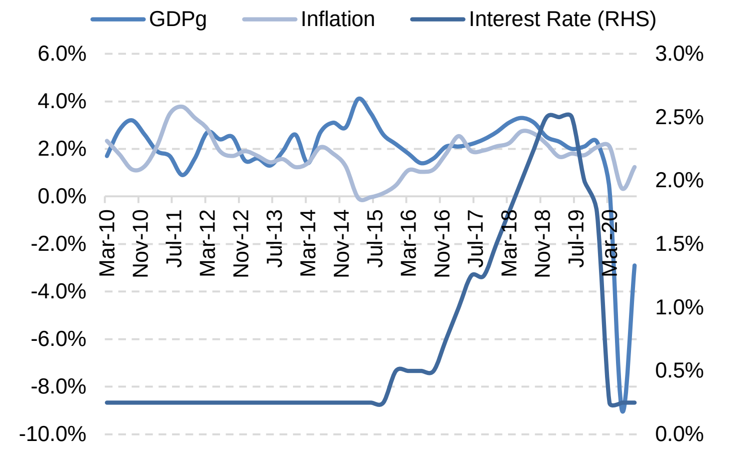
- **United States:** According to the Federal Open Market Committee (FOMC) meeting in September 2020, US GDP growth is expected to contract by 3.7% in 2020 before rebounding up to a 4.0% growth rate in 2021. Thereafter, growth is expected to slow down to 3.0% in 2022, and 2.5% in 2023. Moreover, the median core inflation rate (that strips out volatile gas and food prices) is predicted at 1.2% in 2020, 1.7% in 2021, 1.8% in 2022, and 2.0% in 2023. The Fed's target inflation rate is 2.0%. In November 2020, the Federal Reserve maintained its target for the federal funds rate at a range of 0% to 0.25%. Moreover, the Congressional Budget Office (CBO) predicts the third quarter will improve, but not enough to make up for earlier losses. While the economy may not return to its pre-pandemic level until 2022, under the current tax and spending laws. It is expected that the unemployment rate will average around 7.6% in 2020, falling down to 5.5% in 2021, 4.6% in 2022, and 4.0% in 2023.
- **United Kingdom:** Like all other economies, UK's economy was adversely affected by the pandemic too. It is expected that the disruption caused by EU exit will slow the pace of recovery relative to other countries and will delay fiscal re-balancing. The debt-to-GDP ratio is now expected to rise from 85% in 2019 to 112% by the end of this year and 113% by end-2021, according to the European Commission (EC). GDP contraction is forecast at 10.3% this year, followed by a very gradual recovery of 3.3% in 2021 and 2.1% in 2022. To recall, the Bank of England also responded by cutting Bank Rate by 65 basis points to 0.1% and announcing additional quantitative easing. Moreover, the average unemployment rate of 3.8% in 2019 is expected to increase to 5.0%, forecasts EC. Moreover, with Brexit on the horizon, a no-deal or weak-deal Brexit is likely to strain the value of the Sterling.
- **Eurozone:** European Central Bank (ECB) in its September 2020 statement highlighted that the unprecedented collapse in activity reflects the adverse impact of strict lockdown measures implemented in most euro area countries. However, Real-time high frequency indicators started to rebound in May. With this, ECB expects Real GDP to fall by 8.0% in 2020 only to rebound by 5.0% in 2021 and by 3.2% in 2022. Inflation is expected to increase from 0.3% in 2020 to 1.0% and 1.3% in 2021 and 2022, respectively. ECB in its September 2020 MPS decided to keep

its interest rates and coronavirus-stimulus program unchanged. The interest rate on the ECB's main refinancing operations, marginal lending facility and deposit facility remain at 0.00%, 0.25% and -0.50%, respectively. While the bank's Pandemic Emergency Purchase Programme remains at a total of 1.35 trillion euros (USD 1.6trn).

- **China:** In its recent (October 2020) report, World Bank highlighted that China is expected to grow by 2.0% in 2020 – boosted by government spending, strong exports, and a low rate of new COVID-19 infections since March, but kept in-check by slow domestic consumption. The People's Bank of China maintained its one-year loan prime rate for the fifth straight month in September, as the world's second-largest economy led the recovery in the region. Moreover, inflation is expected to remain stable for the next couple of years - at 2.7% - despite the outbreak of the COVID-19 pandemic. Public debt is a reason of concern in China. Although the official figure for 2019 was 52.6%, the real number is thought to be much higher and is expected to rise in coming years. Despite all this, on 29th October, China's top leadership finalized the blueprint of its 14th Five-Year Plan (2021—2025) and unveiled its "Vision 2035" program, which intends to catapult China to a "moderately developed economy" status in 15 years.
- **India:** S&P Global Ratings sharply revised its GDP outlook for India, projecting a deeper contraction for the current fiscal year due to subdued private spending and investment as a result of mounting COVID-19 cases. The rating agency expects the Indian economy to grow at -9% in fiscal 2020-2021 and 10% in fiscal 2021-2022. While in its recent meeting, RBI reiterated its resolve to revive growth impulses in the economy and mitigate the pandemic's impact, by extending its accommodative policy stance for the rest of this year as well as 2021-22, as it held key policy rates at 4%, unchanged in the face of high inflation.
- **Bangladesh:** The International Monetary Fund (IMF) in its October 2020 report highlighted that despite slow growth due to the coronavirus pandemic, Bangladesh overtook India as its per capita GDP in dollar terms is likely to expand by 4% in 2020 to $1,888. Its per capita GDP is growing at a rate faster than its GDP. For the next year, the IMF forecast 4.4% GDP growth for Bangladesh. Moreover, Inflation moderated to 5.7% in 2019 and is expected to remain stable in 2020 (5.5%) and in 2021 (5.6%). Furthermore, Bangladesh Bank (BB) announced an expansionary FY21 monetary policy at the end of July 2020 whereby the Bank Rate was cut to 4.00% from 5.00%.

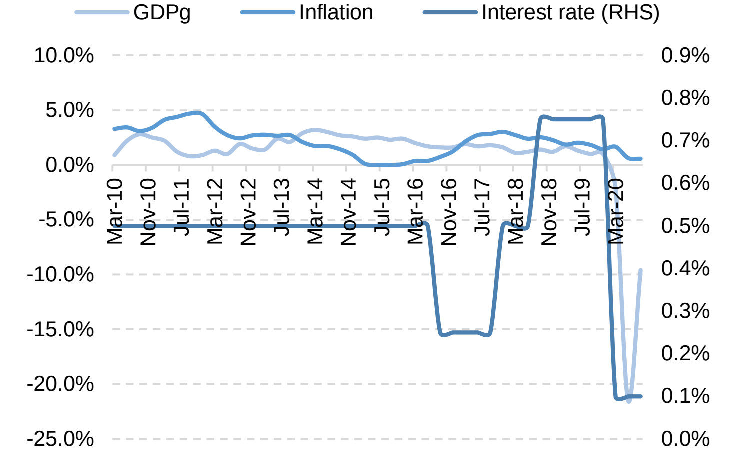
Focus charts

Fig: Interest rate, GDP and Inflation of US



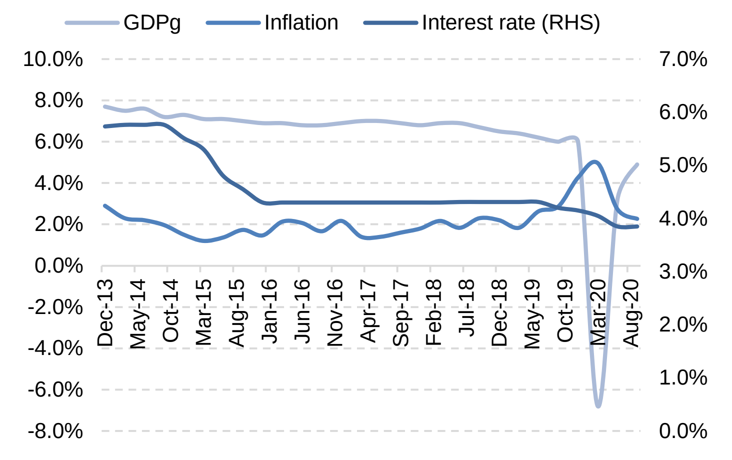
Source (s): Bloomberg, AHL Research

Fig: Interest rate, GDP and Inflation of UK



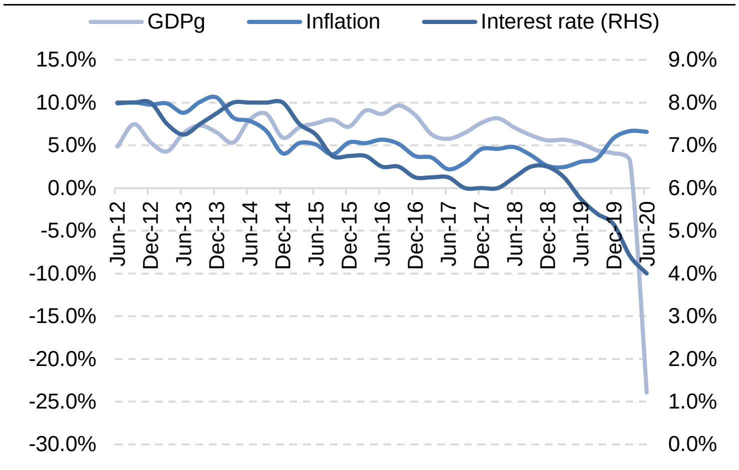
Source (s): Bloomberg, AHL Research

Fig: Interest rate, GDP and Inflation of China



Source (s): Bloomberg, AHL Research

Fig: Interest rate, GDP and Inflation of India



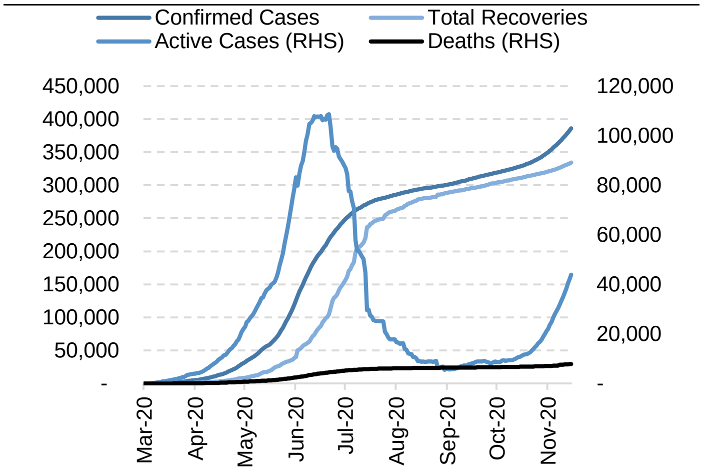
Source (s): Bloomberg, AHL Research

Economic Growth

Pakistan's economic journey: from surviving to thriving

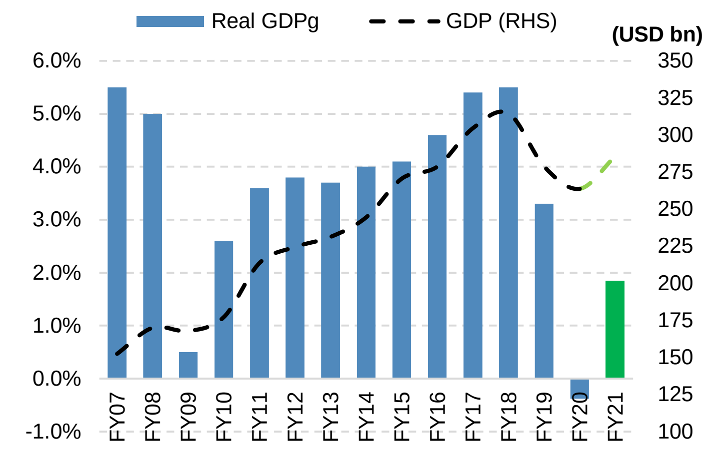
- Against the backdrop of the socio-economic damage done so far by the pandemic, we were unsurprised that Pakistan's GDP growth turned negative to -0.4% during FY20 after almost 68 years. When the pandemic hit Pakistan in February/March, the country moved relatively quickly and effectively towards a lockdown in the first phase of the crisis. After months of strict control and lockdown, the government lifted much part of the restrictions in 1QFY21, which gradually improved economic momentum. However, as we write, the country is experiencing a second Covid-19 spell, which threatens the early stage recovery.

Fig: COVID-19 Cases in Pakistan



Source (s): Covid.gov.pk, AHL Research

Fig: Pakistan GDP Growth – Trend and Forecast



Source (s): MoF, AHL Research

- Real GDP is estimated to grow by 1.84% this year, which is considerable for a country which has shown negative growth last year. This recovery in economic growth should take us closer (somewhat) to levels witnessed prior to pandemic and is relatively rapid compared to many other countries, supported by pent-up domestic demand. Therefore, we hold a Positive outlook for FY21 with the following key sectoral projections:
- **Industrial sector to take the lead:** Contributing 21% to the GDP, we expect industrial sector to outperform, growing at a rapid 2.3% YoY in FY21, led predominantly by construction and large-scale manufacturing (LSM). We saw LSM registering a growth of 4.81% YoY in the 1QFY21 as compared to SPLY. Factors like low interest rate, construction package announced by the government and uptick in exports are expected to drive this growth. We also foresee heavyweight sectors such as textile and food having weights of 21% and 12%, respectively in LSMI to lead as COVID-19 related lockdowns and mobility restrictions eased off towards the beginning of 1QFY21 which had affected supply chains. However, another lockdown followed by 'second wave' could be a major threat to our assumption. Moreover, output of automobiles would also continue its upwards momentum given expectation of a slight devaluation in PKR, going forward (any cost increase to be passed on to consumers).

- **Agricultural sector to provide support:** Further boost to the overall economic growth is expected from the agriculture sector which, we believe, will grow by 2.1% YoY. Despite the destruction caused by unprecedented monsoon rains and locust attack, we expect the agriculture sector to recover in the coming months. Improved production of important crops and livestock are anticipated to lead the overall growth of agriculture sector which we expect to jump by 1.3% and 2.8% YoY in FY21, respectively. The cotton output is likely to display a dip of 3%, while sugarcane crop is also expected to shrink. It is expected that Punjab and Sindh will start sugarcane crushing from December with penalties to be imposed to discourage delay in timely production.

- **Services contraction eased:** On the back of improved growth in agriculture and industry, together with an expected recovery in domestic demand, services should also contribute to the economic growth. We forecast growth in the services sector to be around 1.6% in FY21. In the services sector, wholesale and retail trade is likely to show moderation as a consequence of reduction in imports owing to steps undertaken by the government to control foreign exchange outflow.

Fig: Industrial Sector

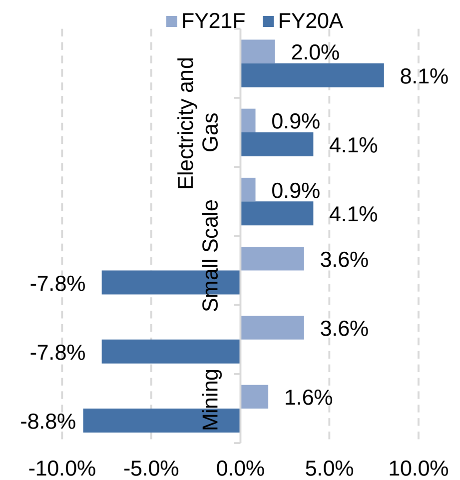


Fig: Agricultural Sector

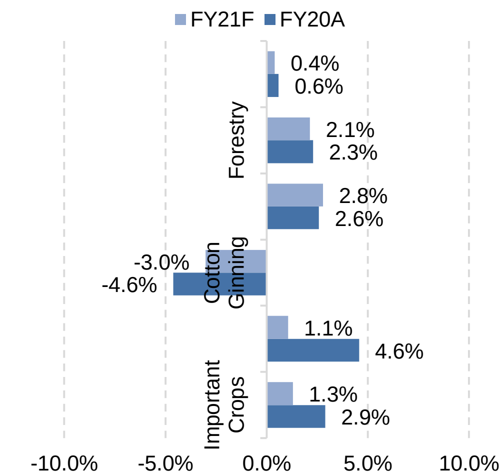
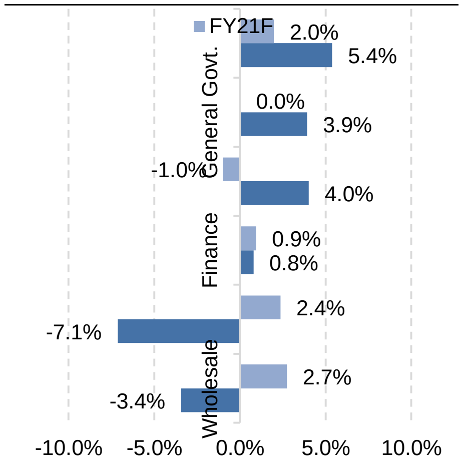
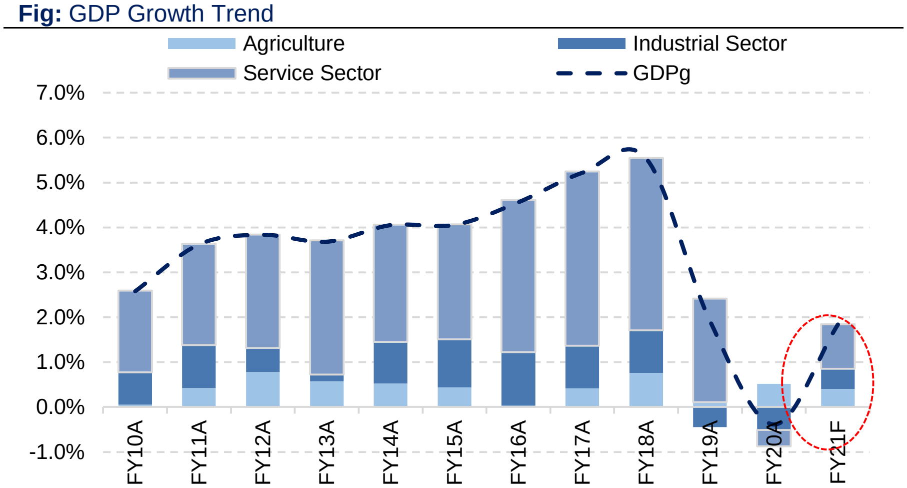


Fig: Services Sector



Source (s): SBP, AHL Research

Fig: GDP Growth Trend



Source (s): SBP, AHL Research

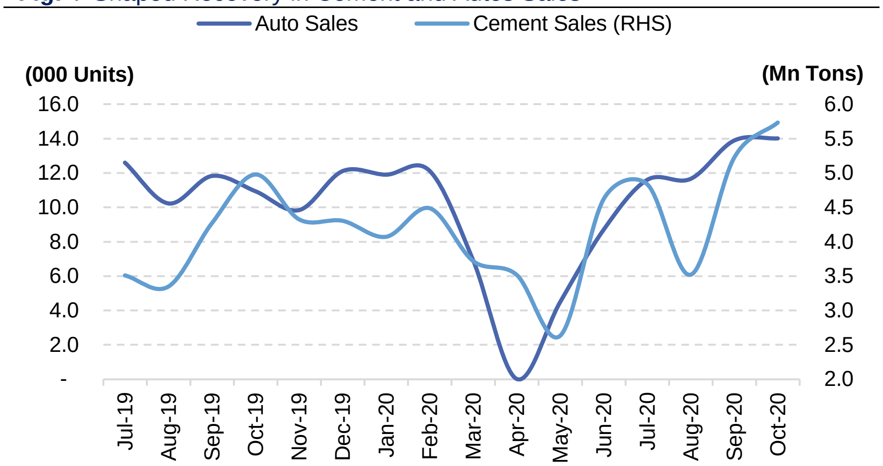
The Corona Toll

State Bank of Pakistan – The Messiah

Following the outbreak of the pandemic, central banks around the world were grappled with concerns about despondent economic activity and a drastic fall in GDP. Like much of the world, Pakistan too, initiated an aggressive round of monetary easing, slashing the policy rate by c. 625bps within 3 months. The SBP through its monetary policy statements and other communication made it clear that inflation targeting will take a back seat while growth revival would primarily influence monetary policy deliberations.

- **Resilience and recovery, supported by a proactive central bank:** The stark turnaround in economic activity has largely been contributed by the monetary and fiscal stimulus that the SBP injected into the economy. While overall credit to private sector remained subdued (-0.9% YTD) as banks portrayed risk aversion, the SBP stepped up with various facilities to promote growth and investment which have borne substantial fruit. The SBP introduced a TERF (Temporary Economic Refinance Facility) facility to promote investments and economic activity which provided a fixed mark-up facility (initially at 7% and now reduced further to 5%) for 10 years. Moreover, a "SBP Rozgar Scheme" was introduced to prevent workers' layoff through financing wages for 6 months. To avert a suppression of cash cycles, the SBP introduced a principal deferment facility for one year and loan restructuring schemes as well.
- **V-Shaped cyclical recovery:** Numbers posted by cyclical sectors post lifting of lockdown in the wake of various SBP relief measures for industries and incentives to promote growth and investment, have been impressive. Following easing of the lockdown, Jun'20 saw a massive 69% MoM jump in total cement dispatches and the robust momentum continued for the following months – 4MFY21 total domestic dispatches showed an 18% YoY jump while exports recorded an impressive 29% YoY jump. Similarly, auto sales have also been supported by a recovery in consumption patterns, rising 13% YoY during 4MFY21.

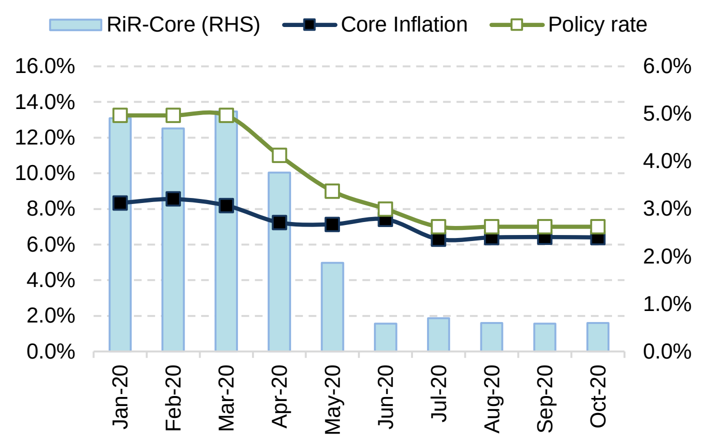
Fig: V-Shaped Recovery in Cement and Autos Sales



Source (s): PAMA, APCMA, AHL Research

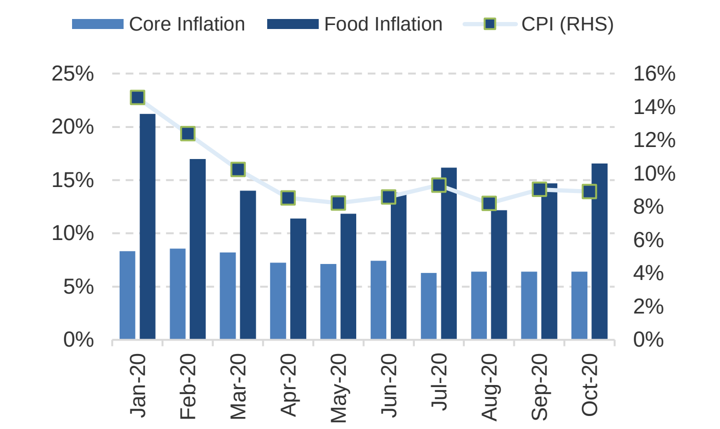
- **Core inflation in smooth waters:** The SBP has maintained in its most recent MPS (Nov'20) that overall financial conditions in the country are stable and inflationary risks are balanced. Recent surge in inflationary readings have been fueled by uptick in selected food items, which was attributable to supply shocks from monsoon rains and locust attacks. Shortage in wheat and sugar was also seen owing to premature export of said commodities. However, the government has intervened and took measures such as increasing the Minimum Support Price (MSP) for wheat while also importing commodities. While food inflation has seen a surge, core inflation has remained stable primarily attributable to subdued demand in the economy. While CPI started its ascent from Jun'20 onwards, core inflation has remained moderately stable at an average of 6.4% during 5MFY21 compared to average CPI of 8.8% during the same period. Real interest rates during this fiscal year (5MFY21) have hovered around -1.8%, but around +0.6% when accounting for core inflation. The SBP has on multiple occasions stated that supply shocks which are causing inflationary readings to go up are seen as temporary and transitory and thereby do not influence monetary policy deliberations.

Fig: Core-Inflation adjusted interest rates are moderate



Source (s): PBS, AHL Research

Fig: Food Inflation Driving CPI

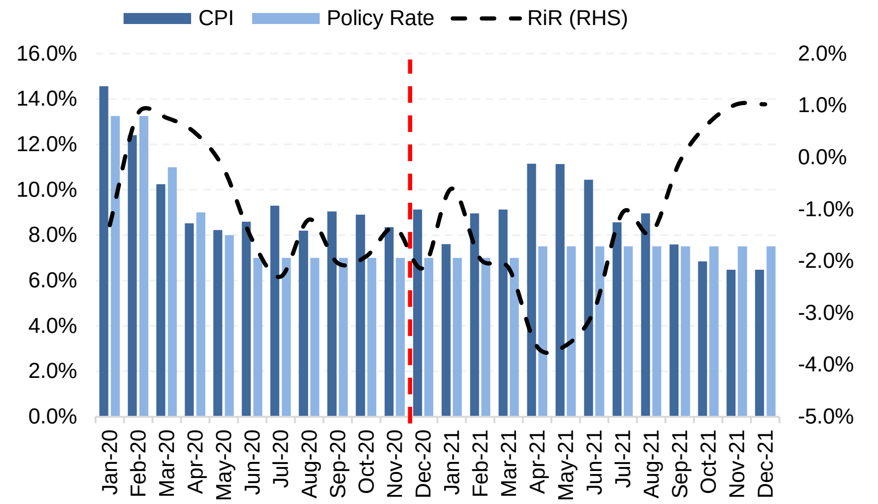


Source (s): PBS, AHL Research

- **Monetary tightening to initiate in 4QFY21:** Going forward, we view the inflation and monetary outlook as being highly contingent on the COVID situation which has seen a recent deterioration. While the rest of the world is reeling from a perilous scenario, Pakistan's second wave is still far from being deadly as the first wave. Successful trials of efficacy of close to 95% have been announced by Pfixer/BioNtech and Moderna, while Oxford-AstraZeneca have also announced their vaccine trials results of 62-90% (dependent on dosage). The vaccine rollout is expected in late Dec'20 or early 2021 - a major stimulant for domestic as well as international investment sentiment. We project aggregate demand to witness an uptick, as consumption patterns are likely to revive significantly, which may push inflationary readings northwards. Moreover, the vaccine rollout is likely to stimulate global demand as well and as the COVID situation sees respite, global travel is likely to start recovering with the world economy entering into a recovery phase. Subsequently, we expect oil prices to pick up in CY21 – another driver for domestic inflationary readings. Seasonality impact of the Ramazan month is also likely to drive inflation. Whereas the impact of house rent adjustments (Jan'21 and Apr'21) is also likely to translate into inflationary pressure.

- **50bps hike expected in 4QFY21, avg. inflation for FY21 at 9.26%:** Premised on the aforementioned reasons, we project average inflation during 2HFY21 to settle at 9.74% against 8.78% during 1HFY21. Average CPI during 4QFY21 is expected to clock-in at 10.47%. Our projections for FY21 average CPI are set at 9.26% and we expect an interest rate hike of 50bps in 4QFY21. We anticipate growth deliberations to continue being on the radar of the central bank and hence, a very hawkish approach towards the monetary policy may not be on the cards yet.

Fig: Real Interest Rate: Trend and Forecast



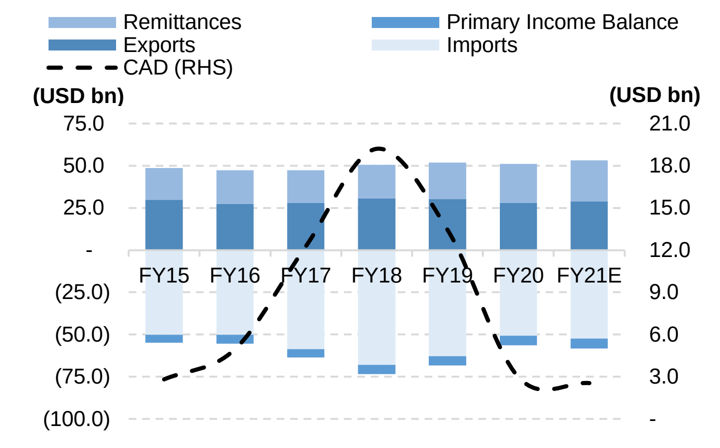
Source (s): SBP, PBS, AHL Research

External Sector

A feather in the government's cap

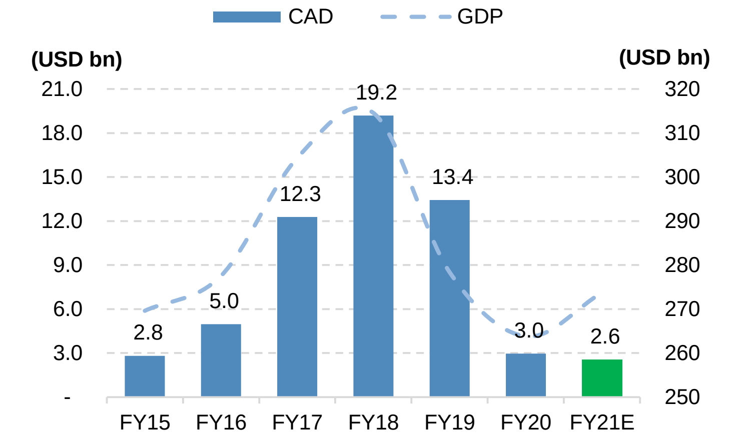
Amidst global headwinds, the Current Account Balance remained impressive over the first four months of FY21, although exports were slower relative to 2020. For a shred of evidence, Pakistan posted a quarterly Current Account Surplus of USD 1,160mn during 4MFY21 against a deficit of USD 1,419mn recorded in the same period last year. The quarterly surplus during 1QFY21 came after a gap of more than five years (3QFY15: USD 514mn). Based on historical data, we saw that this is the highest surplus after 1QFY04 (USD 1.1bn) - almost 17 years. The primary factors that drove the surplus during 4MFY21 were: a 27% YoY rise in remittances along with a 4% YoY decline in total imports, while closure of major global economies owing to the pandemic, dealt a blow to exports which saw a 10% YoY downturn during the said period**.** Our estimate for the Current Account Deficit is set at USD 2.5bn (0.9% of GDP) during FY21.

Fig: Current Account Break-up



Source (s): SBP, AHL Research

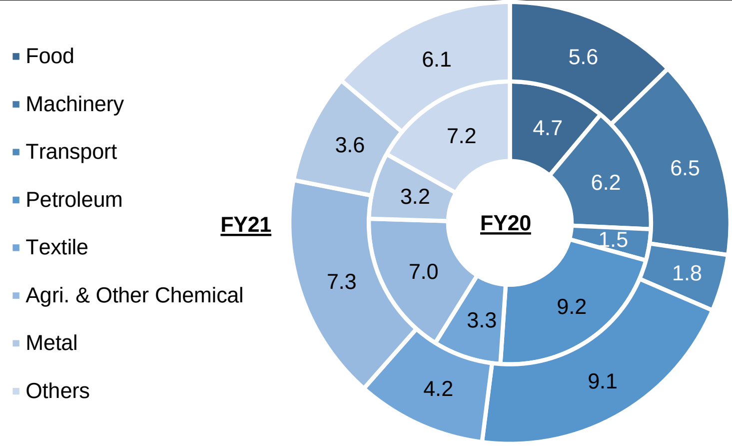
Fig: Current Account Deficit vs GDP



Source (s): SBP, AHL Research

- **Consumption-led, import dependent GDP growth:** Bullish economic activity in Pakistan has typically been a double-edged sword for Pakistan as it usually translates into broad external and fiscal deficits. Pakistan being a consumption-driven economy and one whose import bill is dominated by oil imports, tends to suffer from broad deficits on its external account when economic activity is rampant. We expect the import bill to surge during 2HFY21 primarily led by higher oil prices as global economies enter into recovery mode, consequently swinging the current account balance to a deficit. We expect the volumetric growth in petroleum imports to partially offset the savings from lower average oil prices (FY21 average prices assumed at USD 45/bbl vis-à-vis USD 54/bbl in FY20) following a drastic slump in the advent of the COVID-19 outbreak. With economic activity expected to pick further pace, import growth is likely to outpace export growth. Imports in the Food category are expected to register a 13% YoY jump (wheat and sugar shortages met through imports) while we foresee Machinery imports to post a 9% YoY jump with resumption in CPEC-led demand and higher economic activity. That said, we project imports to clock-in at USD 52.3bn (up 3% YoY).

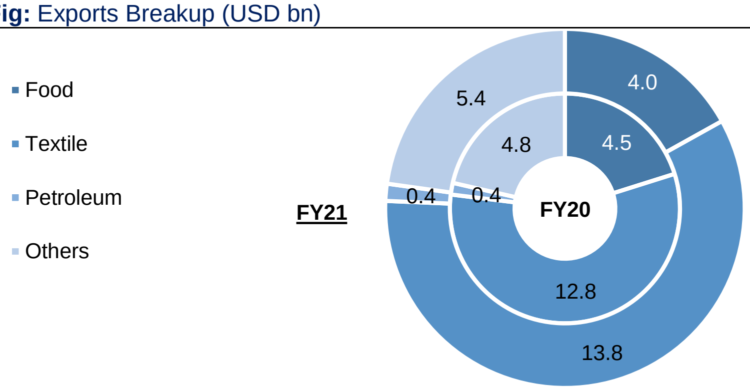
Fig: Imports Breakup (USD bn)



Source (s): SBP, AHL Research

- **Diluting impact of COVID-19 to stimulate exports:** In order to help prevent the export industry from falling into deep trouble with the onset of COVID-19, SBP announced some proactive measures in Mar'20 which included: reducing performance requirement to avail cheaper credit under Export Financing Scheme (EFS) from 2 to 1.5 times, extension till Dec'20 to perform under EFS, relaxation in conditions for Long Term Financing Facility, etc. SBP's incentives reflected buoyancy in export markets with total exports registering a 20%, 17% and 29% MoM acceleration in Jun'20, Jul'20, and Sep'20 respectively. With the rollout of vaccines expected at the end of December or early next year we can expect global economies to start opening up once again following lockdown in major trading partners, which should provide healthy momentum to exports. Earlier the textile industry was grappled with bottlenecks due to constraints in importing major raw materials such as dyes and chemicals from China, where there was a slowdown in manufacturing in the wake of the pandemic. It is worth mentioning that major textile players in the country are operating at close to 100% utilization levels and have spoken of pre-booked orders till June'21. As the US-China trade war is unlikely to cease any time soon given President-elect Biden's plans of "Buy American" and the fact that he has not committed publicly to ending the trade war, Pakistan is likely to continue being a beneficiary. Pakistan can cash in from the opening up of the gap in export markets in US, particularly for Textile. We expect the textile category (55% of total exports) to post a 6% YoY jump, while we forecast total exports to settle at USD 28.9bn (up 3% YoY).

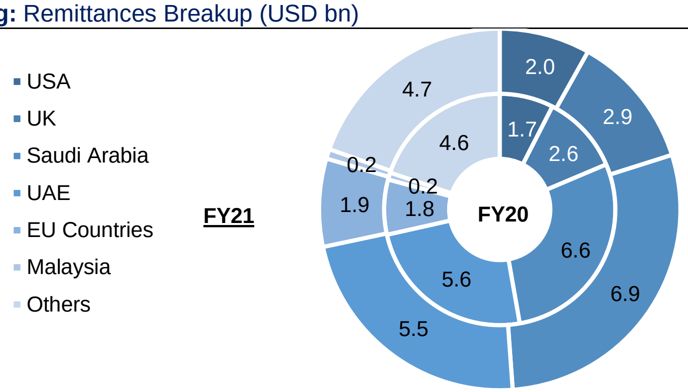
Fig: Exports Breakup (USD bn)



Source (s): SBP, AHL Research

- **Robust remittances:** Remittances are expected to continue lending crucial support to the C/A balance, accredited to curb on unofficial channels and government's efforts under the Pakistan Remittance Initiative, as well as stable conditions in the money market following advent of a market-determined exchange rate. In addition to this, government is also putting in efforts to attract more foreign investment by offering products like Roshan Digit Account, and lucrative rates on government securities, to name a few. While we remain positive on the outlook for remittances, we do highlight that the ongoing rapidly changing political dynamics in the Middle East do pose a downside risk. Pressure on Pakistani diaspora in terms of employment in the Middle Eastern countries can severely strain the remittances inflows. However, political uncertainty in the Middle East can also have adverse effects on global oil prices which can compress the import bill. We expect remittances to settle at USD 23.8bn, up 3% YoY.

Fig: Remittances Breakup (USD bn)



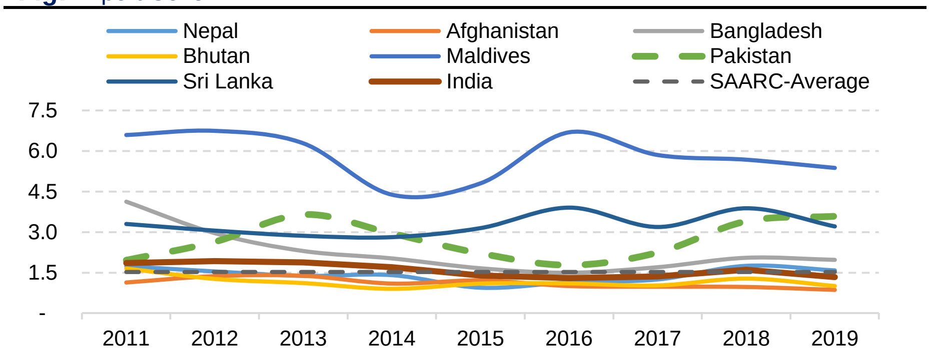
Source (s): SBP, AHL Research

- **Hot money inflows expected:** The Financial Account is expected to show improvement on account of hot money flowing into the debt markets. Debt moratorium by G20 countries till Dec'20 (recently extended up to Jun'21 for which Pakistan will apply) has provided a relief to the reserves of the country. The Cabinet approved suspension of bilateral loan repayments (USD 2.7bn) in Nov'20. We expect Pakistan to be able to maintain the reserves level at USD 21bn by FY21.

Adequate reserves to buffer depreciation pressures

Pakistan's international forex reserves rose to USD 20.6bn in Nov'20 from USD 17.9bn at the end of Dec'19. At almost 2.9 months of imports coverage, Pakistan's foreign reserves are slightly below the IMF's minimum 3 months' threshold. Compared to regional players, Pakistan stands well above the average Import cover of the countries graphically illustrated in figure below.

Fig: Import Cover



Source (s): SBP, World Bank, AHL Research

- Moreover, an increase of PKR 248bn in Net Foreign Assets (NFA) of Pakistan's banking system in 1QFY21 is also reflected in Foreign Exchange Reserves. Causes of this increase in Net Foreign Assets was a Current Account Surplus along with deferment of some repayments of foreign loans which helped ease off pressure from foreign exchange reserves of the country. Another important external account related indicator i.e. Net Domestic Assets (NDA) to NFA ratio, turned negative as NDAs of the banking system turned negative. The Net Foreign Assets of the banking system witnessed an inflow of PKR 992bn during FY20. With the current level of reserves, Pakistan faces increasing external debt servicing pressures as the amount due in FY21 is USD 10.3bn. As per Economic Affairs Division's Monthly Bulletin (Sep'20), Pakistan received USD 2.7bn in 2MFY21 from multiple sources, break-up of which is as follows:
    - USD 1.3bn as program/budgetary support assistance to restructure the economy,
    - Commercial borrowing to repay maturing Sukuk and foreign commercial loans USD 149mn
    - Assistance for development of the economy USD 317mn
    - Safe deposits USD 1bn

  On the other hand, so far USD 798mn has been repaid in the first two months of FY21 and the remaining amount (over USD 9.5bn) is to be paid in the next 10 months.

Table: External Position (Inflows vs. Outflows) - FY21E

Outflows (USD mn)			**(12,057)**	**Inflows (USD mn)**	**13,604**
External Public Debt Servicing				IMF	904
	Estimates	**Actual**		Multilateral-ADB/WB	2,100
Bilateral	(2,142)	(102)	(2,040)	Commercial	4,000
Multilateral	(2,114)	(493)	(1,621)	Received from Multiple Sources in 2MFY21	2,700
Commercial	(4,353)	(204)	(4,149)	Net FDI	1,600
Eurobond | SUKUK	(440)	-	(440)	Eurobond | SUKUK	1,500
IDB (Short-term)	(1,194)	-	(1,194)	Others*	800
IMF	(120)	-	(120)	**Expected Increase in FX reserves- as at Jun'21**	**1,547**
Total			**(9,564)**	**Actual Reserves- SBP (As at Jun'20)**	**12,132**
Current Account Balance			**(2,493)**	**Expected Reserves- SBP (As at Jun'21)**	**13,679**

Source (s): SBP, AHL Research, *RDA, Hot Money and SBP Purchases

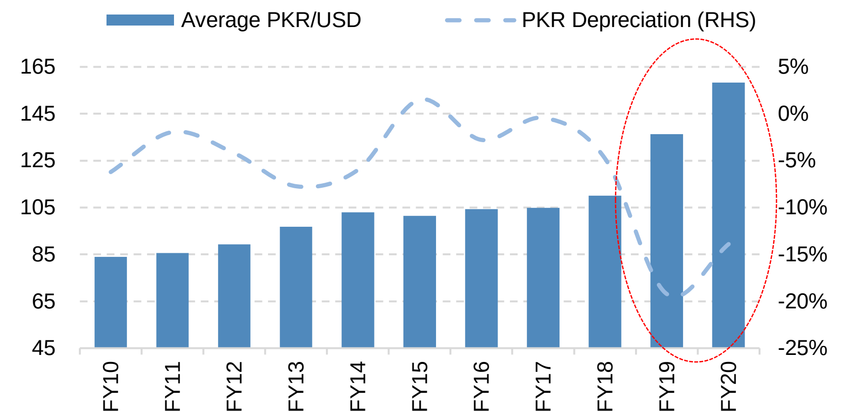
- Pakistan will be relying on financing from IMF and other bilateral partners to meet its external debt requirements in FY21. We have assumed that the net increase in FX reserves during FY21 would amount to USD 1.5bn.
    - The Government is likely to raise USD 1.5bn from Euro bonds and Sukuk; USD 200-300mn Panda Bonds inclusive.
    - Continuation of the IMF EFF (Extended Financing Facility): USD 904mn expected.
    - Other multilateral inflows including ADB and World Bank worth USD 3-3.5bn.
    - Others including, Roshan Digital Accounts/Naya Pakistan Certificates, Hot money and SBP purchase: expected amount USD 800mn.
    - Commercial Borrowings expected around USD 4-5bn (USD 2.5bn rolled over amount- China)

- Heightened debt proportions are often and mostly seen with very critical and glaring eyes in Pakistan. However, major developed economies across the world are highly indebted. Japan, Singapore, US, and Canada have debt/GDP ratios much higher than that of Pakistan: 237%, 126%, 107% and 90% respectively (as at Dec'19).

Days of extreme volatility in the currency are over

The PKR/USD parity has seen recent appreciation of 5% FYTD. This is mostly attributable to the solidifying position of our external account while the fall in the value of the USD against most global currencies owing to uncertainty regarding outcome of the US Presidential elections also contributed to the appreciation. Moreover, sentiment in the currency market gained traction following the deferment of debt repayment to G20 till Jun'21, and expected improvement in inflows with the launch of Roshan Digital Account.

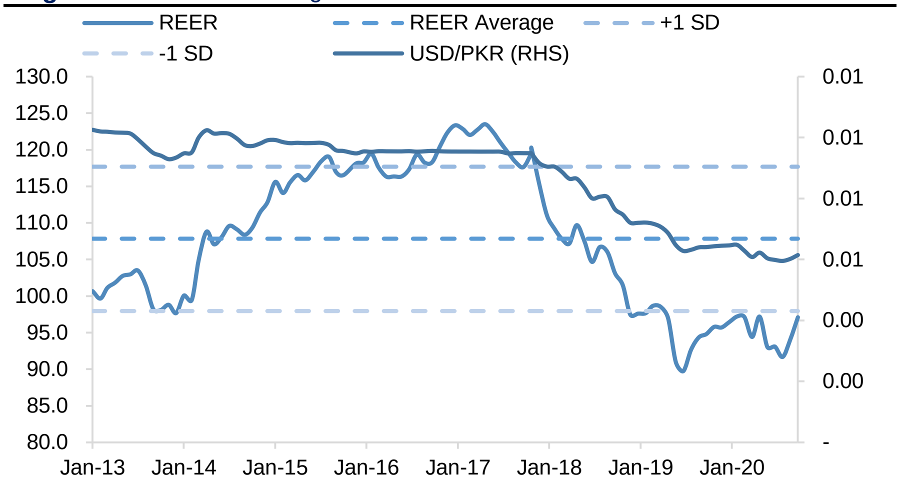
Fig: Average PKR/USD - Trend



Source (s): SBP, World Bank, AHL Research

- **REER approaching fair value:** The Real Effective Exchange Rate (REER) has come down this year, from 97.2 in Feb'20 to 91.8 in Aug'20. As per the provisional data for Oct'20, REER stands at 97, as the currency saw appreciation of 5.4% FYTD. We believe there is room for the PKR to depreciate very slightly in order for it to be closer to its fair value. The REER is currently below the lower standard deviation band (implying that it is undervalued). We expect the PKR/USD parity to settle at 161 at Dec'20 and 165 by Jun'20, as we expect the current account to swing into deficit during 2HFY21 with the import bill resurging. We expect SBP to adopt greater flexibility in the short term, allowing PKR to appreciate, but still accumulate more reserves. While in the short-term SBP may sterilize excess liquidity by selling government securities to ward-off a further flaring up of the headline CPI inflation, an enduring solution could be to use the inflow of capital for real investments and capacity creation, thereby managing growth, inflation and financial conditions consistently and positively. In the longer term, there are a few key considerations such as i) addressing the speculations on heavy external borrowing by GoP, ii) repayments scheduled from 2HFY21 onwards, and iii) widening CAD which will put some pressure on the PKR/USD parity.

Fig: Real Effective Exchange Rate



Source (s): SBP, AHL Research

- As per economic theory, interest rate differentials between two countries affects the currency parity between the two countries. Higher interest rates in one country will attract foreign capital thereby appreciating its currency. If we compare the rate differential between KIBOR and LIBOR with the annual depreciation witnessed in the PKR/USD parity, we see that on average the differential is 7.5% while average depreciation is 5.5%. At present, there is a ~6.9% average interest rate differential during FY21 between KIBOR and LIBOR. Since LIBOR tends to stay more stable on average, as opposed to the KIBOR, a higher differential means that the KIBOR has increased.

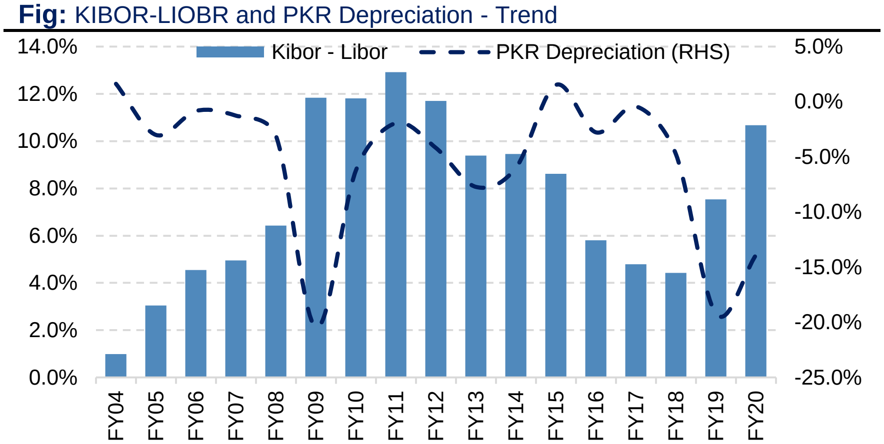
- Running a regression with the annual depreciation of the PKR against the USD as the dependent variable on the KIBOR-LIBOR differential as the independent variable, we find an inverse relationship with a coefficient of -0.85. This implies that for every 0.85% **reduction** in the interest rate differential, there is a 1% depreciation in the PKR/USD parity. We do highlight that the regression gives a p-value of 0.06 and R-squared of 22%, at a confidence interval of 95%. Our data-set runs from FY04 to FY20. The low R-squared can be explained by the high variance in Pakistan's interest rates and annual depreciation. Volatile economic fundamentals explain the high variance in policy rate changes and currency fundamentals.

Fig: Regression Statistics

Multiple R	0.46
R Square	0.22
Adjusted R Square	0.16
Coefficient	(0.86)
p-Value	0.06
Standard Error	0.06
Observations	17.00

Source (s): AHL Research

Fig: KIBOR-LIOBR and PKR Depreciation - Trend



Source (s): SBP, AHL Research

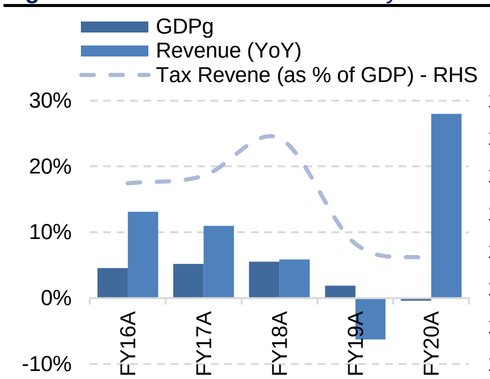
Public Finance

Govt. to Reflate the Economy with an Ambitious Budget

As with the last several years, government plans to sustain its expansionary fiscal policy thrust in FY21 with a budgeted outlay of PKR 7,231bn, although down by 11% compared to FY20 estimates of PKR 8,135bn. This year, the outbreak of COVID-19 has magnified the existing vulnerability in Pakistan's public finance. The pandemic can be associated primarily with (1) a decline in tax revenue, and (2) low spending on development if 'second wave' hits us hard. However, we expect fiscal stimulus to remain at the same level as we saw during Budget. For FY21, the government refrained from introducing any new taxation measures in the budget and only undertook a variety of measures for tariff rationalization in order to revive the stalled economic activity. With this, we expect fiscal deficit to clock-in at 7.5% in FY21 against the government's target of 7%. This large budget is understandably so since the outbreak of COVID-19, which disrupted economic activities, and essentially forced the government to play a leading role in salvaging the economy from the ruins of recession.

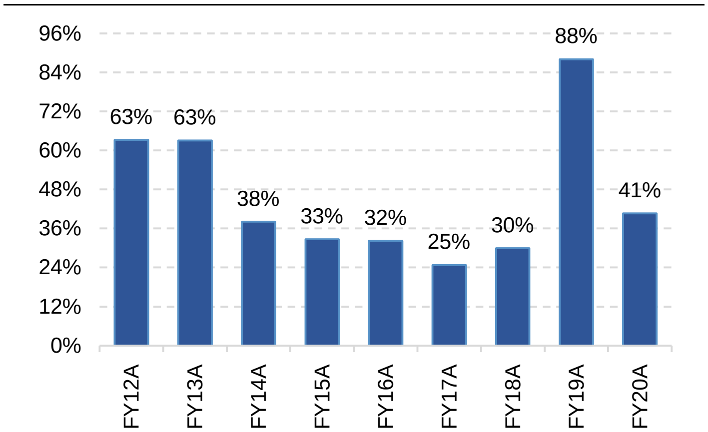
- **Revenue assumption remains aggressive:** Being in the IMF program means stringent revenue collection targets. With the on-going challenging times, business community had demanded major relaxation in taxation measures in Budget FY21 in order to stir up economic activity in the country. IMF had earlier shown reluctance to alter its PKR 5.1trn target for the next year, but FBR tax target announcement for FY21 showed that the government was successful in negotiating the target and bringing it down to PKR 4.9trn. Given the mammoth target, the FBR will have to work on administrative improvement and anchor all its resources towards attaining this huge amount. Government has estimated total revenue at PKR 6,573bn (28% growth expected in indirect tax and 26% in direct taxes), 19% higher than the FY20R target of PKR 5,504bn. However, we expect the total tax collection for FY21 around PKR 5,453bn, in line with the government's target of PKR 5,464bn. On the other hand, we expect the Non-Tax revenue to post a jump of 22% YoY to PKR 1,858bn mainly on the back of Markup Income and Petroleum Levy. With this, our projection for total revenue is to settle at PKR 7,311bn at the end of FY21, portraying an impressive 16% YoY improvement. If we look at 1Q numbers of FY21, so far total revenue collected stands at PKR 1.5trn with tax collection clocking in at PKR 1.1trn and remaining PKR 356bn collected under non-tax.

Fig: Revenue and Economic Activity



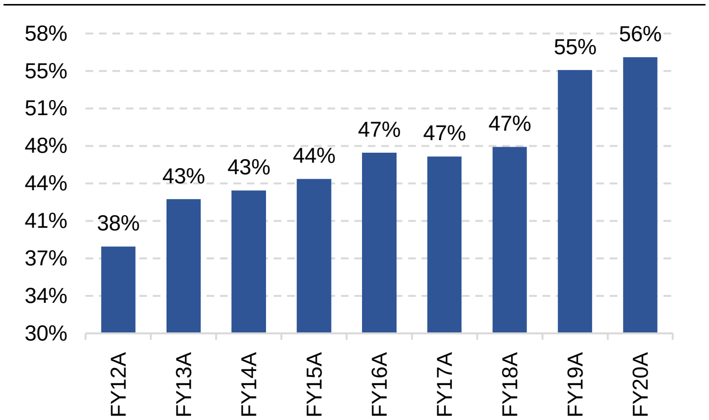
Source (s): MoF, AHL Research

Fig: Debt* to Revenue - Trend



Source (s): SBP, MoF, AHL Research, * Incremental Debt

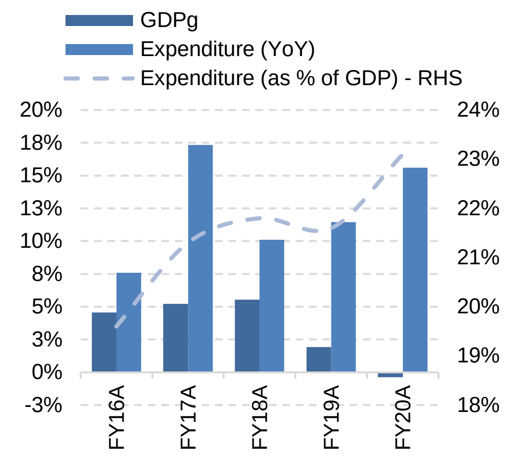
Fig: Debt to GDP - Trend



Source (s): SBP, MoF, AHL Research

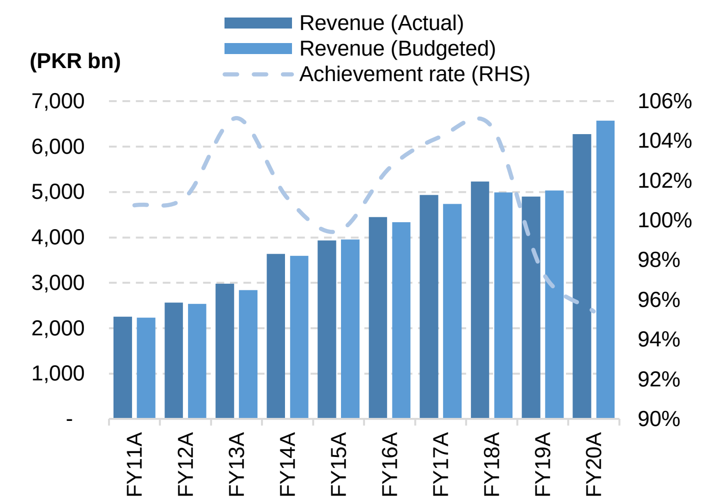
- **Lower Current Expenditure to provide respite:** On the expenditures side, which increased 16% YoY in FY20, the government has kept total expenditure outlay at PKR 8,786bn (5% higher YoY than FY20R of PKR 8,345bn) in the Budget FY21. Current Expenditure is budgeted to contribute 87% (last year: 88%) while the Development Expenditure is budgeted to contribute 11% (last year: 12%) to the total budgeted expenditure. However, we expect total expenditure to be around 18% of GDP in FY21, 13% YoY down from the preceding year. We view that the decline in total expenditure will come mostly on account of lower current expenditure (-14% YoY). On the other hand, we expect PSDP to increase 8% YoY, targeted towards infrastructural development projects. Moreover, as the government intends to support exports via clearance of refunds and provision of incentives in addition to currency devaluation, overall expenditure would remain under pressure. Subsidies are set to contribute 3% in FY21 current expenditure vis-à-vis 4% in FY20R. Power subsidies (WAPDA/PEPCO and KEL) budgeted at PKR 150bn are set to witness a decline of 43% YoY from FY20R. While energy prices have come down slightly, we believe the government is assuming electricity tariff hikes. Grants and Transfers will decline by 23% YoY yet contribute 14% in FY21 (11% last year). Albeit, a cut will be seen in certain key heads such as relief for daily wagers at PKR 75bn last year has not been earmarked at all in FY21B while provision to BISP has been slashed from PKR 234bn to PKR 200bn.

Fig: Expenditure and Economic Activity



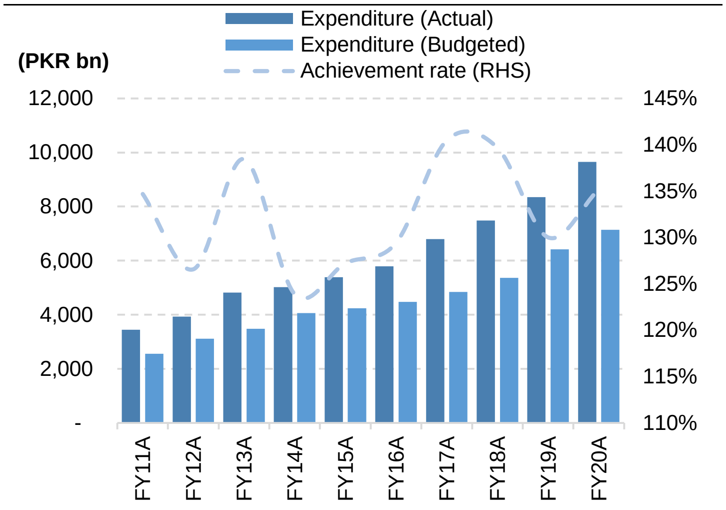
Source (s): MoF, AHL Research

Fig: Budgeted and Actual Revenue - Trend



Source (s): MoF, AHL Research

Fig: Budgeted and Actual Expenditure - Trend



Source (s): SBP, MoF, AHL Research

Circular Debt

An overarching problem

Circular debt is a vicious cycle where a stakeholder of the energy sector supply chain owes dues to the other stakeholder. It may also be defined as an unpaid amount by the government for not passing on the actual cost of generation to the customers which results in accumulation of debt to distribution companies. These distribution companies (DISCOs) thus, are unable to pay to the power generation companies leading to inability of these power producing companies to pay dues to the Oil Marketing Companies (OMCs). All this leads to these cash trapped OMCs finding it difficult to pay for oil purchase (import). Another factor contributing to the menace is Transmission and Distribution losses (T&D) and overdue bills resulting in higher liquidity burden on distribution companies. This is the reason why Pakistan's energy sector has been in the state of jeopardy, with liquidity crunch in form of circular debt bloating to PKR 2.2trn as at June'20. To recall, the circular debt accumulation picked up pace from 2014 onwards when new capacities added into the system while demand of energy did not increase in line with the capacity addition, worsening the overall power sector woes.

How to address the Circular Debt Problem?

- Control or reduce Transmission and Distribution Losses
- Improve system of overdue bills collection
- Timely tariff determination
- Pass on the actual cost of generation to customers

The five primary reasons contributing to the overall circular debt are;

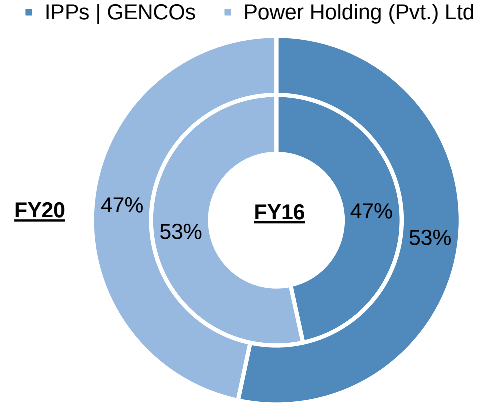
- Poor sector governance due to political considerations, commercial decision-making often overshadowed and overstaffing in DISCOs and lack of transparency in procurement.
- Delay in tariff determination and notification as it takes time due to political considerations.
- Delay in Fuel Price Adjustment (FPA)
- Poor revenue recovery from government and private consumers (Revenue collection in some DISCOs is poor which leads to rise in circular debt and Govt. allocated amount remained insufficient for tariff differential subsidy).
- Excessive T&D losses (difference between allowed and actual). Total system losses are ~32% (T:3%, D:21% and R:11%) compared to allowed losses of 16%.

What Govt. has done to resolve the CD...

- Govt. issued Pakistan Energy SUKUK-I of worth PKR 200bn in Mar'19 and Energy SUKUK-II of worth PKR 200bn in Jun'20.

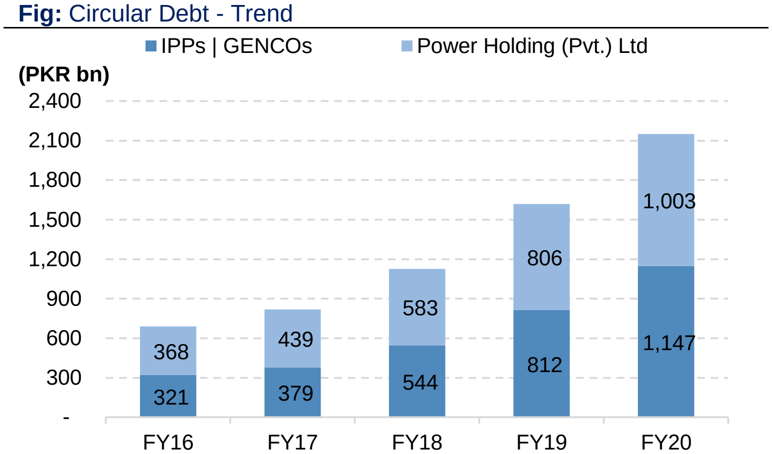
Circular Debt Management Plan: In July 2019, Circular Debt (CD) Management Plan 2019 was laid out with IMF, aimed at reducing growth in CD from above PKR 490bn (in FY19) to PKR ~130bn (FY20) and sequentially to PKR 80bn (FY21). However, due to COVID19 situation, PKR 532bn were added during FY20 in the stock of CD and has reached to PKR 2.2trn.

Fig: Breakup of Circular Debt



Source (s): State of industry Report, AHL Research

Fig: Circular Debt - Trend



Source (s): State of industry Report, AHL Research

Circular Debt

Receivables and payables position of listed energy chain companies

Fig: Receivables and Payables Position of Listed Energy Chain Companies

PKR mn	Receivables	Payables	Short term Borrowings	Net Receivables	Net Receivables/Share	Overdue Receivables	% of Total Receivables	Govt Holdings
KAPCO	125,386	21,468	39,750	64,168	72.9	106,831	85.2%	45.7%
NPL**	19,620	1,062	5,345	13,213	37.3	14,787	75.4%	0.0%
PKGP	22,327	1,084	9,047	12,196	32.8	14,182	63.5%	0.0%
NCPL	20,770	987	10,293	9,489	25.8	14,260	68.7%	0.0%
KOHE	7,730	38	4,788	2,904	17.1	6,021	77.9%	6.0%
LPL	20,073	1,034	12,147	6,891	18.1	12,417	61.9%	0.0%
EPQL	13,483	8,791	3,254	1,437	4.4	7,640	56.7%	0.0%
HUBC*	122,512	79,865	38,553	4,094	3.2	92,104	75.2%	7.0%
OGDC	342,872	66,206	-	276,665	64.3	286,087	83.4%	85.0%
PPL	329,180	116,101	-	213,079	78.3	289,679	88.0%	74.9%
MARI****	32,049	39,711	-	(7,662)	(57.4)	n/a	n/a	38.4%
PSO*****	215,959	177,490	42,196	(3,727)	(7.9)	156,621	72.5%	43.3%
APL	13,943	29,060	-	(15,118)	(151.9)	7,689	55.1%	0.0%
SNGP***	490,912	462,492	25,701	2,719	4.3	339,891	69%	54%

Source(s): Company Financials, AHL Research, *Consolidated, ** as of Sep'20, *** as of Jun'19, ****receivables from SSGC, SNGP and CPGC, Payables ex GIDC, *****excluding LPS

International Monetary Fund (IMF)

Talks resumed, second review expected to conclude soon

- On July 3, 2019, the Executive Board of the IMF program approved a 39-month arrangement under the Extended Fund Facility (EFF) for an amount of USD 6 billion to support the Government of Pakistan's economic reform program. Major highlights of the program include:
  - Sustainable and balanced growth.
  - Increased per capita income.
  - Fiscal consolidation to reduce public debt, expansion of social spending and safety net for the most vulnerable segments of the society.
- The fund's immediate disbursement was USD 1 billion, with another ~USD 453mn expected after second review that was scheduled for Feb'20 (we had successfully completed our first review last year in December). During the meeting in Feb'20, Pakistan and the IMF agreed that the fund's executive board would approve the second review for the release of a third loan tranche of USD 453 million subject to fulfilling of all the conditions by the Pakistan government. However, following the outbreak of pandemic, review was temporarily halted and IMF's priority shifted to another facility namely 'Rapid Financing Instrument' (RFI) so as to provide rapid financial assistance to all member countries facing an urgent balance of payments need. Therefore, in addition to the tranches received from IMF last year under EFF facility, IMF also provided Pakistan with USD 1.4bn 'Rapid Financing Instrument' (RFI) in April'20 to cope with the pandemic.

- Recently, IMF and Pakistan resumed talks and for the same purpose, IMF's team is expected to visit Pakistan to take the discussion further. In the recent post MPS analyst briefing, the Governor SBP updating about the development in this regard pointed towards possibility of a 'good news' in the near future. He emphasized that the technical level discussions are going on between SBP and IMF these days and they are hopeful of successfully concluding these talks soon. SBP mentioned that the areas key to the on-going discussion were:

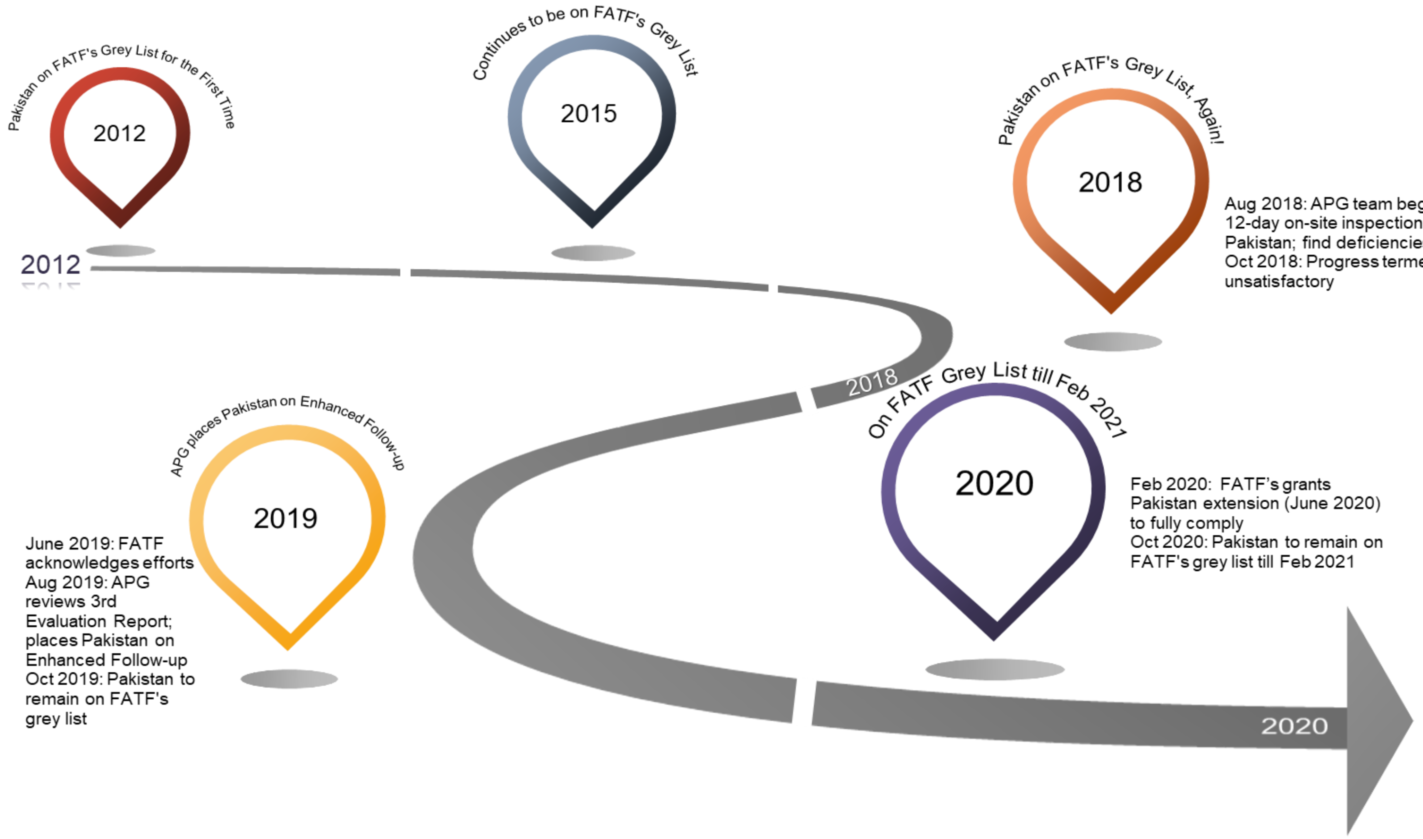
  (i) **Power Sector reforms** such as power tariff adjustments as well as amendments in National Electric Power Regulatory Authority (NEPRA), Circular Debt Resolution. To reiterate, the NEPRA Act was introduced in the National Assembly, which was introduced by the government to pass on the cost of inefficiency and power theft to electricity consumers through the imposition of surcharges. However, the bill was not approved. Moreover, the Circular Debt now stands at a whopping PKR 2.2trn with PKR 243bn increase in 1HCY2020, whereas around PKR 294bn raise expected in the 2HCY20 (as per news sources).

  (ii) **Mobilization of taxes.** With regard to revenue collection, IMF also seeks clarity on how Pakistan plans to improve its revenue in FY21. In Budget FY21, government had set a revenue target of PKR 4,963bn for FY21.

- In the end, the Governor SBP further stated that only the timings of execution need to be agreed upon by the two parties, otherwise talks are in the final stages. To recall, during the second review meeting, before COVID, IMF seemed quite satisfied with the performance of Pakistan so far.

Financial Action Task Force (FATF)

Likely to be promoted to 'White List' in Feb'21



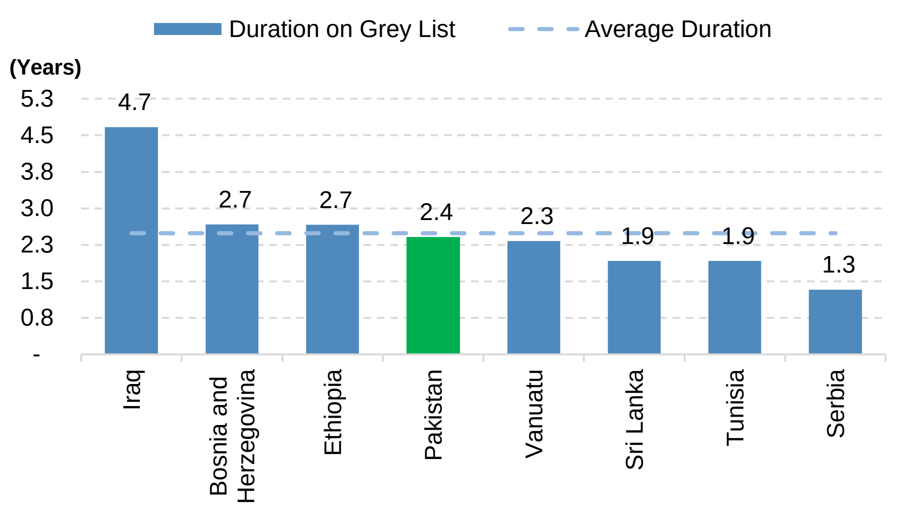
Source (s):AHL Research

- In Oct'20, the FATF (Financial Action Task Force) handed out another extension to Pakistan, maintaining its status on the grey list until Feb'21. Asia Pacific Group (APG) - a regional affiliate body for the Asia-Pacific region of the FATF – in its first Follow-Up Report (FUR) on Mutual Evaluation of Pakistan reported that Pakistan's progress so far was:
  - Partially compliant on twenty five counts;
  - Largely compliant on nine recommendations; and
  - Non-compliant on four counts
- Moreover, the report stated that Pakistan successfully complied with 21 out of 27 points of action, however, it should continue to work on implementing its action plan to address its strategic deficiencies, by:
  1. Demonstrating that law enforcement agencies are identifying and investigating the widest range of TF activity and that TF investigations and prosecutions target designated persons and entities, and those acting on behalf or at the direction of the designated persons or entities
  2. Demonstrating that TF prosecutions result in effective, proportionate and dissuasive sanctions
  3. Demonstrating effective implementation of targeted financial sanctions against all 1267 and 1373 designated terrorists and those acting for or on their behalf, preventing the raising and moving of funds including in relation to NPOs, identifying and freezing assets (movable and immovable), and prohibiting access to funds and financial services, and

4. Demonstrating enforcement against TFS violations, including in relation to NPOs, of administrative and criminal penalties and provincial and federal authorities cooperating on enforcement cases.

- To recall, Pakistan was placed on FATF's Grey List in Jun'18 whereby it was found non-compliant with recommendations of the FATF which targeted areas of risk assessment, national cooperation, targeted sanctions, preventative measures, due diligence, internal and third party controls, law enforcement, regulation and supervision for money laundering and terror financing, amongst others. Thereafter, the incumbent government made a commitment to combat such risks to the financial system of the country and adhere to 40 key recommendations of the FATF. We view that the government has been proactive in addressing the major concerns of the FATF in an attempt to combat money laundering and terrorist financing. For example, so far the joint session of the parliament amended about 15 laws to upgrade its legal system matching international standards as required by the FATF. Pakistan Government recently fulfilled one more condition of the Financial Action Task Force (FATF) and increased powers of Federal Investigation Agency (FIA) to curb money laundering. KYC and AML regulations have seen stringently strengthened in the country and Pakistan fares well when compared to many countries that are not on the grey list. With the efforts put in by the government, we view that blacklisting is a highly improbable scenario and Pakistan should be able to make it the 'White List' in Feb'21.

Fig: Duration on Grey List



Source (s): AHL Research

Key Economic Indicators

Table: Key Indicators

	FY12A	FY13A	FY14A	FY15A	FY16A	FY17A	FY18A	FY19A	FY20A	FY21F
Real										
GDP	3.8%	3.7%	4.0%	4.2%	4.7%	5.3%	5.5%	1.9%	-0.4%	1.8%
GDP (USD bn)	231.0	236.4	246.7	269.6	277.5	304.4	314.6	278.4	263.8	278.3
Prices										
CPI (% YoY average)	11.1%	7.4%	8.6%	4.6%	2.9%	4.2%	3.9%	7.3%	10.8%	9.3%
Policy Rate - Period end	12.00%	9.00%	10.00%	7.00%	5.75%	5.75%	6.50%	12.25%	7.00%	7.50%
External Sector (USD bn)										
Exports	24.7	24.8	25.1	24.1	22.0	22.0	24.8	24.3	22.5	23.6
Imports	40.4	40.2	41.7	41.4	41.3	48.7	55.7	51.9	42.4	44.3
Trade Deficit	15.7	15.4	16.6	17.3	19.3	26.7	30.9	27.6	19.9	20.6
Remittances	13.2	13.9	15.8	18.7	19.9	19.4	19.9	21.7	23.1	24.2
FX Reserves (Period End)	15.3	11.0	14.1	18.7	23.1	21.4	16.4	14.5	18.9	20.8
Exchange Rate (Period End)	94.6	99.7	98.8	101.8	104.8	104.9	121.5	160.1	168.1	165.0
PKR Parity Change (%)	(9.1)	(5.1)	0.9	(3.0)	(2.8)	(0.1)	(13.7)	(24.1)	(4.8)	1.8
% of GDP										
Current Account Deficit	2.0%	1.1%	1.3%	1.0%	1.7%	4.1%	6.3%	4.9%	1.1%	0.9%
Trade Deficit	6.8%	6.5%	6.7%	6.4%	6.8%	8.8%	9.8%	9.7%	7.6%	7.4%
Fiscal Deficit	6.6%	8.0%	5.5%	5.3%	4.6%	5.8%	6.6%	8.9%	8.1%	7.5%
External Debt	30.9%	27.0%	25.6%	24.2%	26.6%	27.4%	33.4%	45.7%	45.5%	45.2%
Domestic Debt	38.1%	42.5%	43.3%	44.4%	46.9%	46.5%	47.4%	54.6%	55.8%	55.5%

Source (s): SBP, PBS, MoF, AHL Research

AHL Strategy Poll

What our survey suggests

- A survey comprising of seven questions was conducted by AHL as part of our market research, to determine the expectations of stakeholders of market regarding some of the key macroeconomic indicators for the year 2021. As always, deep gratitude is owed to all the respondents who participated in our survey.
- **About the poll:** The survey was designed in a way that is bifurcated into two main areas: (i) economic expectations and, (ii) stock Market expectation. For the former part we had questions pertaining to economic growth, inflation, interest rate, parity and twin deficits whilst, the latter part of the survey focused on KSE-100 target expectation.
- **Our Respondents:** Our respondents included:
    - Financial services: Banks, AMCs, Insurance, and DFIs
    - Non-Financial Services/Manufacturing: E&Ps, Cements, Fertilizers, Steel, Textiles and Pharmaceuticals.
- **What our survey suggests:** Broadly speaking, our respondent's expectation is in line with the government's and SBP's expectation. We have enlisted below the responses below indicator wise.

(i) GDP Growth:

- 58% of the total respondents are of the view that Pakistan's GDP growth will fall in the range of 0-2%.
- 39% of the total respondents expect growth above 2%
- Only 3% of the respondents expect negative growth.

(ii) Average Inflation:

- 64% of the total respondents expect inflation to remain between 8-9%.
- 19% of the respondents expect below 8% inflation.
- Remaining 17% expect inflation above 9%

(iii) Interest Rate:

- 58% respondents anticipate an interest rate hike in FY21, of which 3% expect hike of 25-50bps, 29% expect 50-100bps hike and 26% expect more than 100bps
- 16% respondents anticipate an interest rate cut in FY21, of which 6% expect cut of 25-50bps, 6% 50-100bps cut and 3% expect more than 100bps cut
- 26% expect status quo i.e. policy rate unchanged at 7%

(iv) PKRUSD Parity:

- **Dec'20:** 71% of the respondents expect parity to remain below PKR 160 level. Remaining 29% foresee it in the range of PKR 160-165/ USD.
- **Jun'21:** 55% expect parity to hover in the range of PKR 160-165/ USD, 29% expect it below PKR 160/ USD and 16% expect it between PKR 166-170/USD.
- **Dec'21:** 43% anticipate parity to remain between PKR 166-170/ USD, 32% expect parity to hover in the range of PKR 160-165/ USD,16% expect it above PKR 170/USD level, and 9% expect it below PKR 160/ USD.

(iv) Current Account Balance:

- Surplus: 6% expect a current account surplus of less than USD 1bn while all other respondents expect a deficit.
- Deficit: 69% expect a current account deficit of more than USD 2bn while 25% respondents expect a deficit between USD 1-2 bn.

(v) Fiscal Deficit:

- 45% of the responses show expectation of deficit as a % of GDP following in the range of 7-8%,
- 30% expect deficit to be above 8%, and
- Remaining 25% expecting less than 7% deficit.

(vi) KSE-100 Dec'21Target:

- 55% of the responses expect KSE-100 index to remain in the range of 45,000-50,000 points,
- 29% expect index to cross 50,000 level,
- Remaining 16% expecting less than 45,000 points.

Fig: GDP growth expectation for Fiscal Year 2021

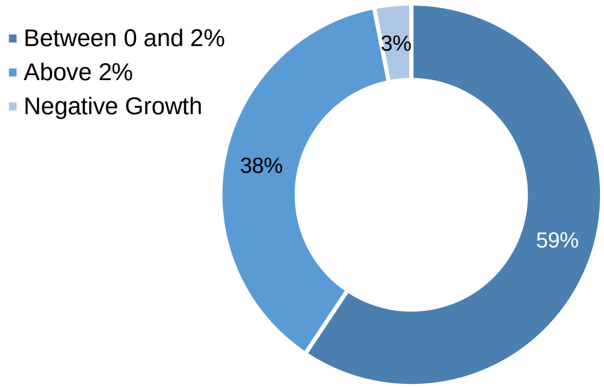


Fig: Average inflation for Fiscal Year 2021

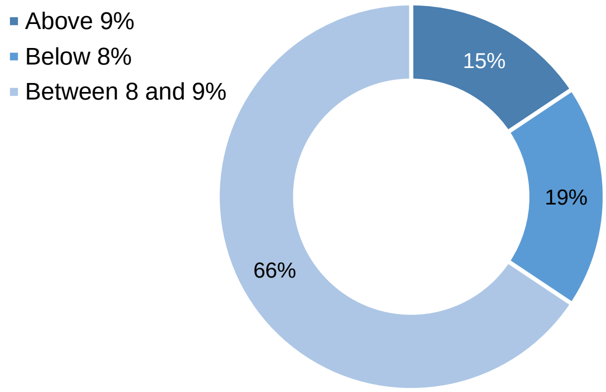


Fig: Interest rates during Calendar Year 2021

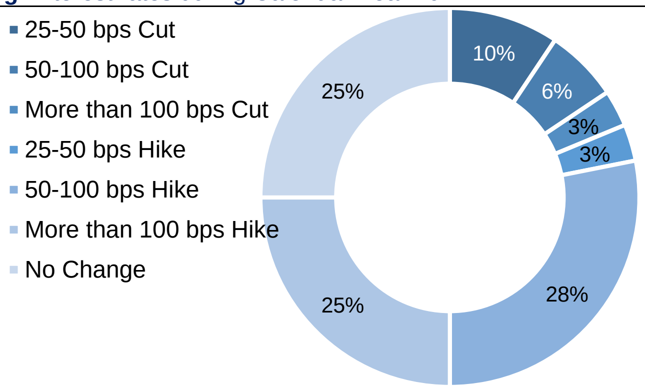


Fig: Fiscal Deficit during Fiscal Year 2021 (% of GDP)

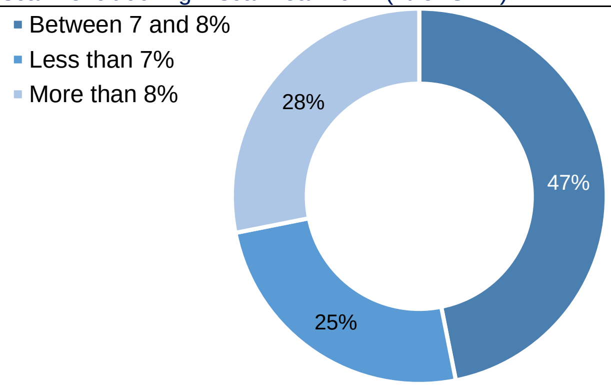


Fig: Outlook on Currency (Jun'21 end)

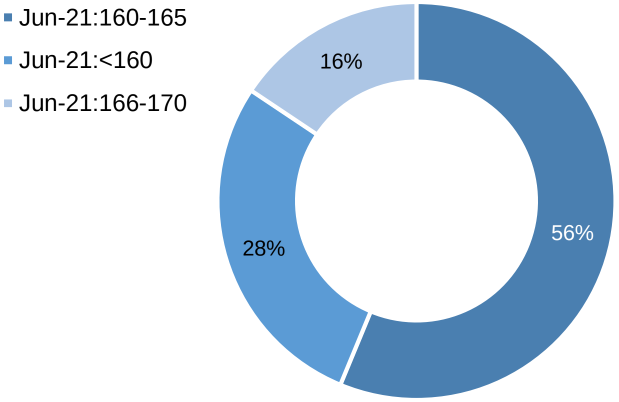


Fig: Outlook on Currency (Dec'21 end)

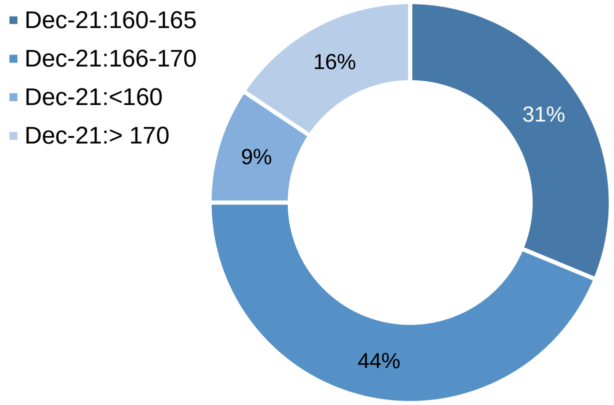


Fig: Current Account Deficit during Fiscal Year 2021

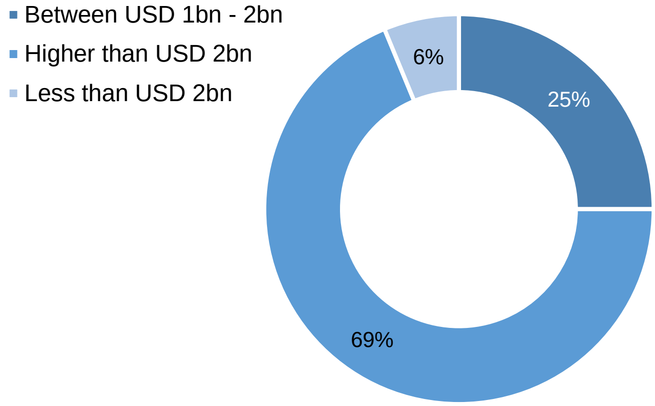
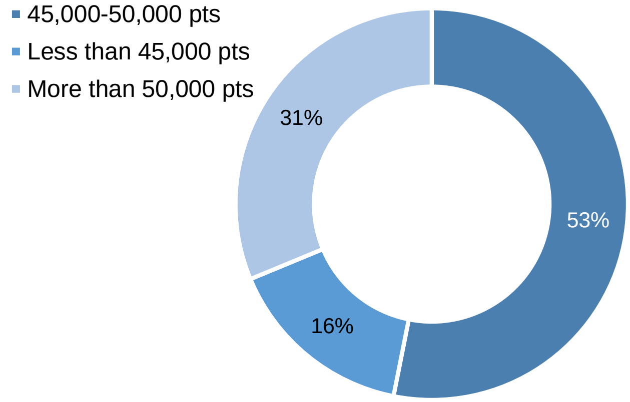


Fig: KSE-100 Index level by December 2021



Pakistan Equity Market

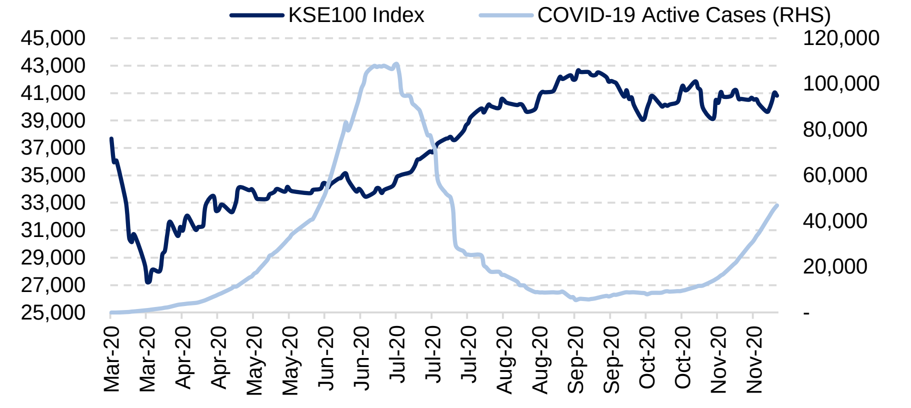
2021: The great reset

CY20 Equity Market

A pendulum swing

- **Equity market dysfunction during COVID:** The equity market during CY20 has been nothing short of being volatile. The market has seen a V-shaped recovery after a severe hammering following the outbreak of COVID-19, which saw its first case in Pakistan being reported on 26th February, 2020. With a rapid rise in global infections, investors across the world foresaw a drastic slump in the economic activity and concerns of a global recession, triggering an aggressive sell-off from global equities. Dow Jones touched a low of 18,592 points (~4-Yr low) on 23rd March (-35% since 30th Dec'19) while FTSE 100 touched its low of 4,994 points (~8-Yr low) on the same day (-34% since 31st Dec'19).

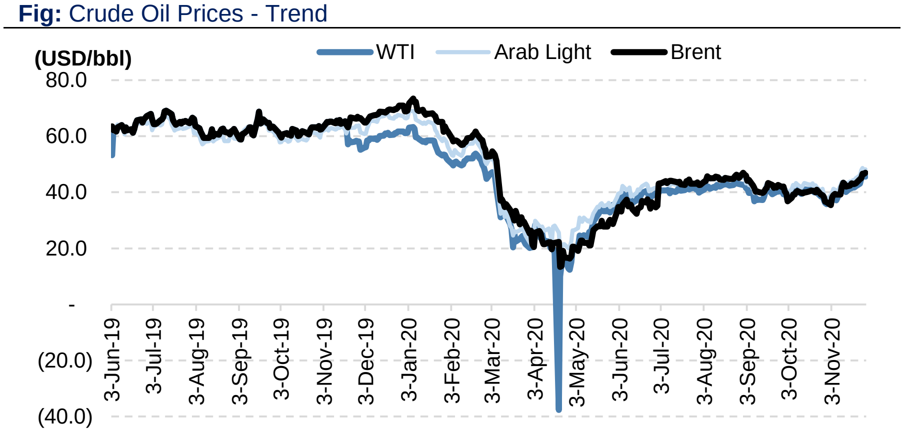
Fig: KSE100 Index and COVID19 Cases - Trend



Source (s): Covid.gov.pk, PSX, AHL Research

- **Oil prices in jeopardy:** Moreover, with a drastic slowdown in economic activity came a subsequent pressure on oil prices, apart from a massive contraction in air travel. Oil prices were on a declining trend since the onset of the new calendar year, but the severe downslide was aggravated from Feb'20 onwards. Russia and Saudi Arabia engaged in a tense price war following failure of agreement between OPEC and Russia on production cuts. Brent crashed to a low of USD 19.33/bbl on 21st April while WTI futures traded in negative territory (USD -37.63/bbl) on 20th April, as storage capacities reached maximum potential and producers would pay traders to offload oil from them (WTI futures contracts require physical delivery).

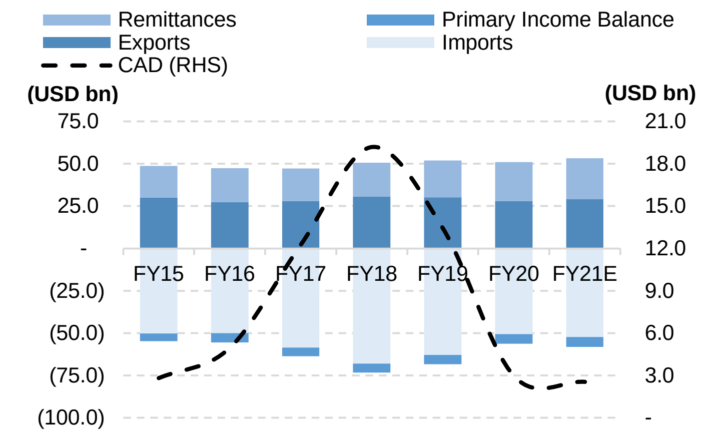
Fig: Crude Oil Prices - Trend



Source (s): Bloomberg, AHL Research

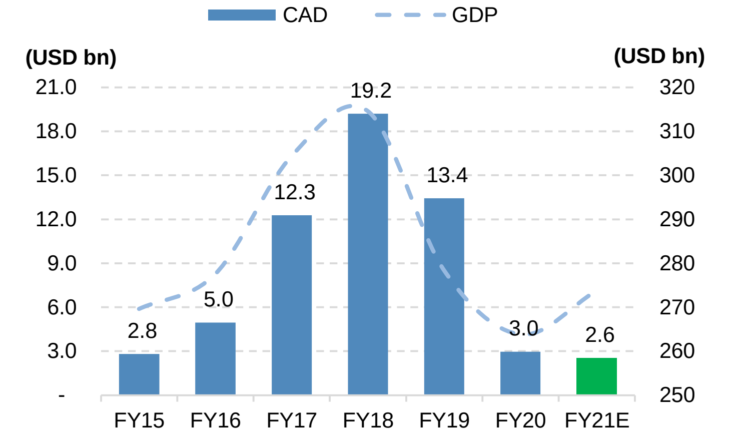
- **Equities shine while debt market loses its sheen:** The onslaught in the domestic equity bourse gained significant pace post reporting of the first COVID case. Imposition of lockdown in March triggered an aggressive sell-off. Oil scrips and Banks faced the most hammering (45% and 35% during the period Dec'19 to Mar'20, respectively) due to crash in oil prices and with SBP resorting to monetary easing (625 bps cut in policy rate between March and June). The domestic bourse touched its low of 27,228 points on 25th March. GoP and SBP played a proactive role in supporting the economic revival through announcing various schemes and facilities for credit and fiscal stimulus which helped sentiment to recover in the bourse. Moreover, the country was lent USD 1.4bn from the IMF as a Rapid Financing Instrument (RFI), USD 500mn from the ADB, and USD 200mn from the World Bank, as funds to deal with the economic fallout from the pandemic. The government made a concerted effort to revive the economic activity in the country through a particular focus on the construction industry. Announcement of a construction package, mortgage financing and low interest rates fueled sentiment in cyclical sectors such as Cement, Steel and Automobiles (87%, 96% and 71% during the period Mar'20 to Nov'20, respectively). The low interest rates once again highlighted equities as a preferred asset class, as fixed income instruments saw a suppression in yields (up to ~350 bps decline in 10Y PIB yields).
- **Heading in the right direction:** While the pandemic brought misery to the domestic economy, the external account of Pakistan continued to strengthen, posting a surplus in Mar'20 and May'20 (USD 57mn and USD 344mn, respectively), as imports faced severe contraction following closure of global markets as well as slump in oil prices. The momentum gained traction as remittances inflow June'20 onwards witnessed flows north of USD 2bn continuously. The Current Account has posted a surplus each month this fiscal year, closing 4MFY21 with a surplus of USD 1.2bn, longest ever consecutive surplus. While the external account continued its consolidation, supply side constraints owing to monsoon rain etc. fueled food inflation leading to upward pressure on CPI readings, which once again kept investment climate in the local bourse wary.

Fig: Current Account Break-up



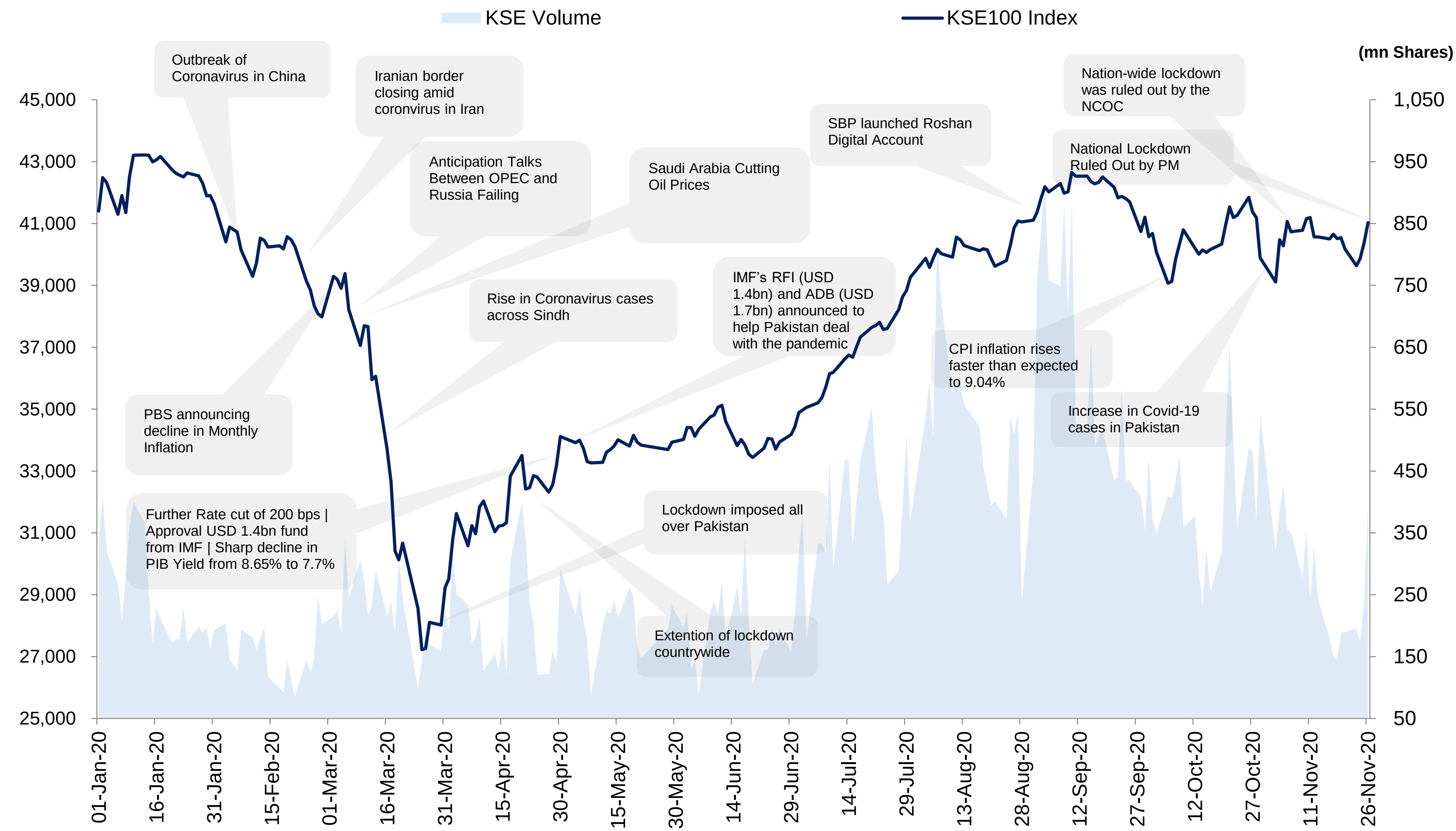
Source (s): SBP, AHL Research

Fig: Current Account Deficit vs GDP



Source (s): SBP, AHL Research

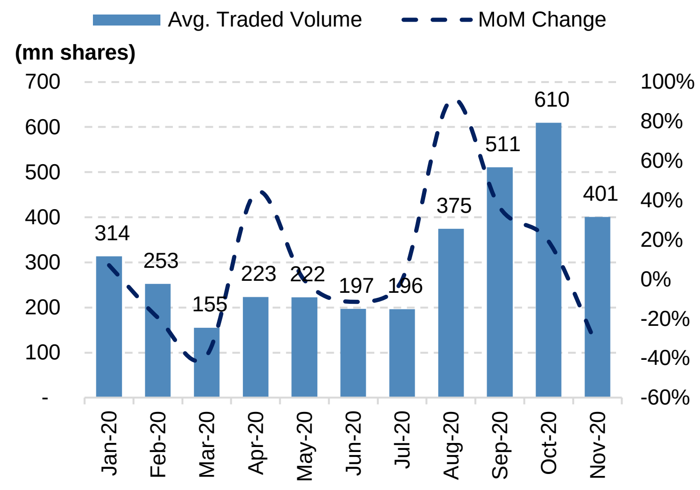
KSE100 Event Graph (2020)



Drastic improvement in volumes as equites become preferred asset class

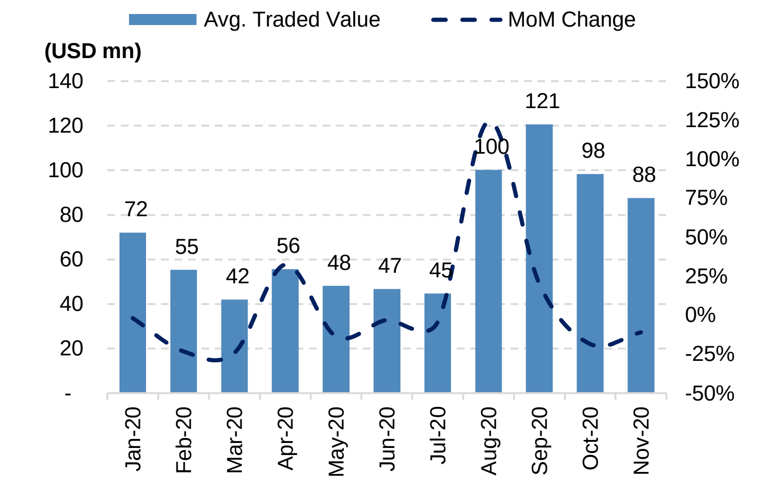
- **A tale of two halves:** The initial performance of KSE-100 at the beginning of CY20 was encouraging due to improving macro-economic situation of the country and business friendly policies that well-supported the overall market. However, this upbeat performance remained short lived amid spread of novel coronavirus that gripped the entire world fiercely including all developed and undeveloped economies. As a result, KSE-100 bore the brunt and nosedived by 12,153 points in a span of 13 trading days (6th Mar'20 to 25th Mar'20) to 27,228 points (lowest 6-year level) due to nationwide lockdown announced together with closure of industries. To revive the falling demand, incumbent government announced gigantic stimulus package of USD 8bn (PKR 1.2 trn) along with reduction in policy rate (625bps) to increase the money flow in the economy. In addition to this, the government also granted a subsidized loans facility to support industries which helped improve sentiments and resulted in V shape recovery in the index performance. This became more evident in second half with average volume and value for CYTD settling at 314mn shares (posting a 15-year high intraday volume of 919mn shares on 3rd Sep'20) and USD 69.9mn, up by 98% and 77% YoY, respectively.
- **Strong comeback in 2H:** As they say, numbers speak volumes! During 2HCY20, volumes so far have skyrocketed as average volume has increased by 2.1x to 439mn shares compared to 207mn shares in 1HCY20 amid easing lockdown situation and drastically increased corporate sector earnings which revived investors' confidence. Likewise, value also went up by 2.0x to PKR 15.5bn in 2H compared to PKR 7.9bn in 1HCY20.

Fig: Monthly Average Traded Volume



Source (s): PSX, AHL Research

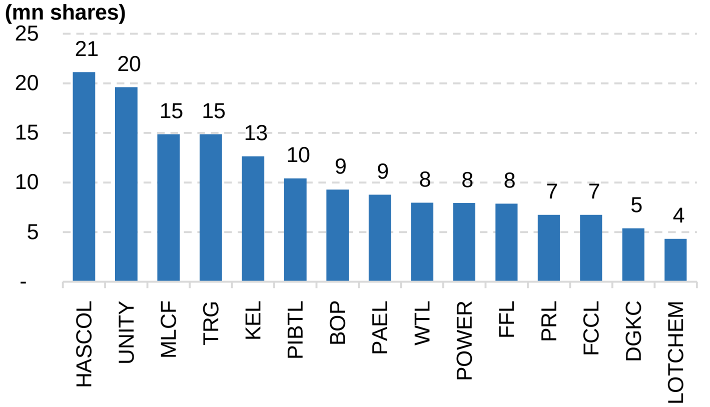
Fig: Monthly Average Traded Value



Source (s): PSX, AHL Research h

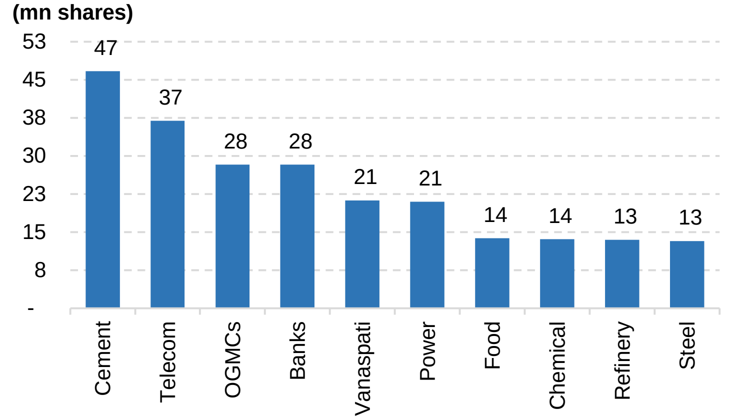
- **Volume leaders during CY20TD**: Sectors that attracted the most activity during the period were Cements, Technology & Communication, Oil and Gas Marketing Companies, Commercial Banks and Vanaspatti & Allied Industries registering average volumes of 47mn, 37mn, 28mn, 28mn and 21mn, respectively. Whereas on a scrip-wise basis, volumes were led by HASCOL (21mn), UNITY (20mn) and MLCF (15mn).

Fig: Top Volume Leaders (CY20TD*)



Source (s): PSX, AHL Research, * 27-Nov-20

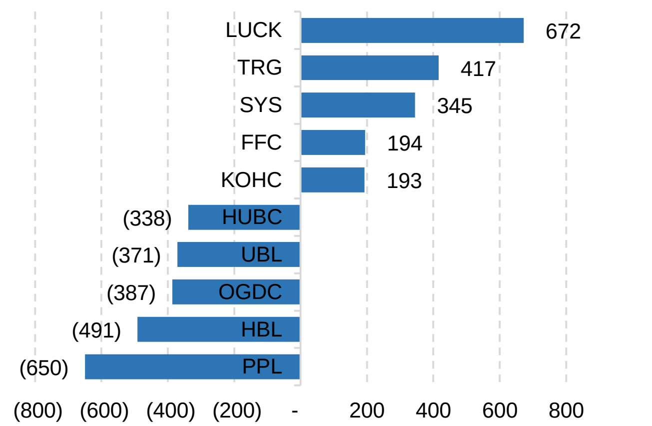
Fig: Top Volume Leaders (CY20TD*)



Source (s): PSX, AHL Research, * 27-Nov-20

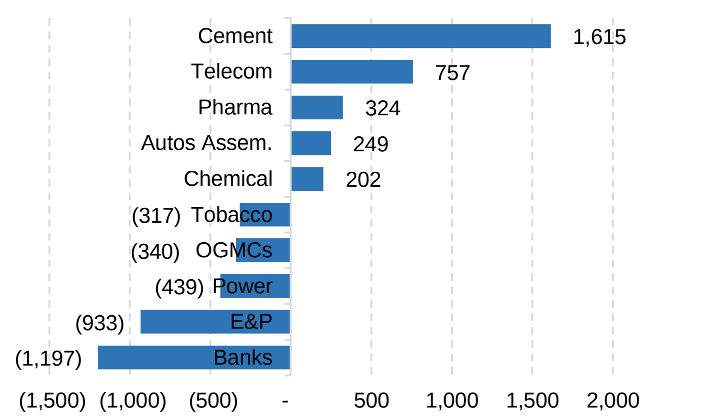
- **Index contribution (gainers vs. losers):** Gainers dominating the index contributions included Cements (1,615pts) followed by Technology & Communication (757pts), Pharmaceuticals (324pts), Automobile Assemblers (249pts), and Chemicals (202pts). Whereas, negative index contribution came from Commercial Banks (1,197pts), Oil and Gas Exploration (933pts) and Power Generation and Distribution (439pts). Meanwhile, scrip wise top contributions to the upside were led by LUCK (672pts, 42% of total cement sector contribution) mainly due to revival in cement dispatches and better retention prices, TRG (417pts, 55% of total Tech sector contribution) on the back of outstanding quarterly results, and SYS (345pts) owing to re-rating of tech scrips. Scrip wise negative contributors were i) PPL (-650pts) due to lower international oil prices on a YoY basis, ii) HBL (-491pts) on account of decline in policy rate to 7% from 13.25% in same period last year, and iii) OGDC (-387pts) due to pilling up of circular debt which will cause liquidity problems.

Fig: Top Index Contributors (CY20TD*)



Source (s): PSX, AHL Research, * 27-Nov-20

Fig: Top Index Contributors (CY20TD*)



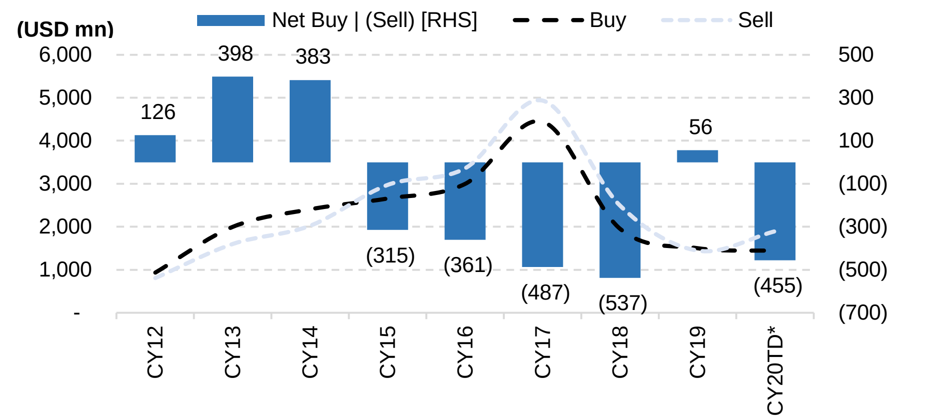
Source (s): PSX, AHL Research, * 27-Nov-20

Foreign Investors' Portfolio Investment

COVID19 triggered sell-off

- **Foreigners' sentiments plunge amid Coronavirus:** As healthcare systems world over collapsed amid rapid spread of the novel Coronavirus and economies came to a standstill, global equities witnessed a rout in the outgoing year. Pertinently, offloading was particularly sharp in the Emerging Markets and Pakistan was no exception; net outflows at the local bourse during CY20 arrived at USD 455mn compared to net inflows of USD 56mn last year, when turnaround in the economy had just started appearing palpable. Optimism, however, was cut short as despite imposition of lockdown and travel restrictions worldwide, COVID-19 became a global pandemic. Although brief spells of buying were witnessed as the local economy opened up and earnings revival stunned investors during 3QCY20, second-wave concerns kept the annual tally negative.

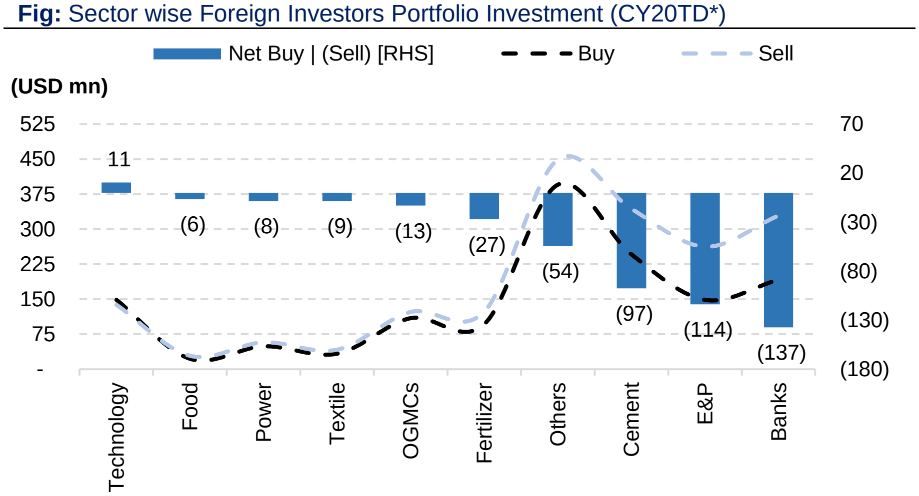
Fig: Foreign Investors Portfolio Investment - Trend



Source (s): NCCPL, AHL Research, * 27-Nov-20

- **Sector-wise offloading:** Major selling was witnessed in i) Commercial Banks (USD 137mn) given sharp cut in interest rates and its potential impact on NIMs as well as augmented provisioning to account for any fallout from COVID-19, ii) Oil and Gas Exploration companies (USD 114mn) as oil prices tanked amid rift between Saudi and Russia and global demand crash in the wake of corona, and ii) Cements (USD 97mn) with the sector bearing losses during 1HCY20 as plants were shut down during lockdown.

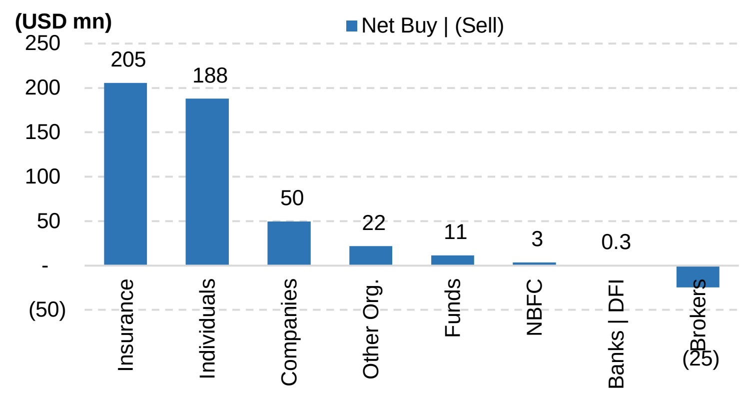
Fig: Sector wise Foreign Investors Portfolio Investment (CY20TD*)



Source (s): NCCPL, AHL Research, * 27-Nov-20

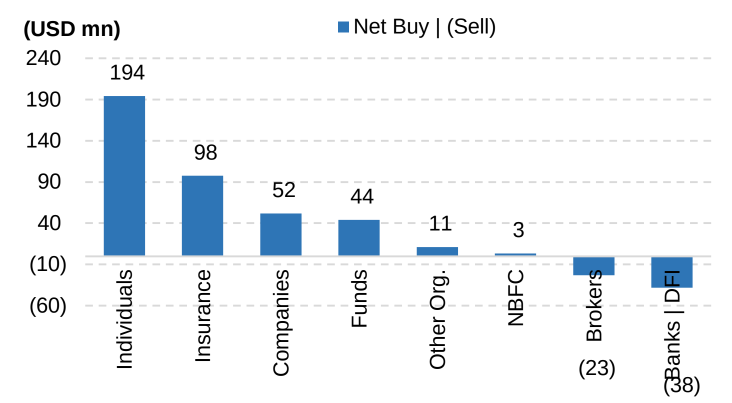
- **Locals absorb foreign selling:** On the domestic front, foreign offloading was absorbed by Insurance companies (USD 205mn) and Individuals (USD 188mn) in CY20. Following this, Companies and Other Organizations were the largest accumulators with net buying set at USD 50mn and USD 22mn, respectively. We also highlight that since the market touched its low in Mar'20, individuals have been the largest buyers at USD 194mn.

Fig: Local Investors Portfolio Investment (CY20TD*)



Source (s): NCCPL, AHL Research, * 27-Nov-20

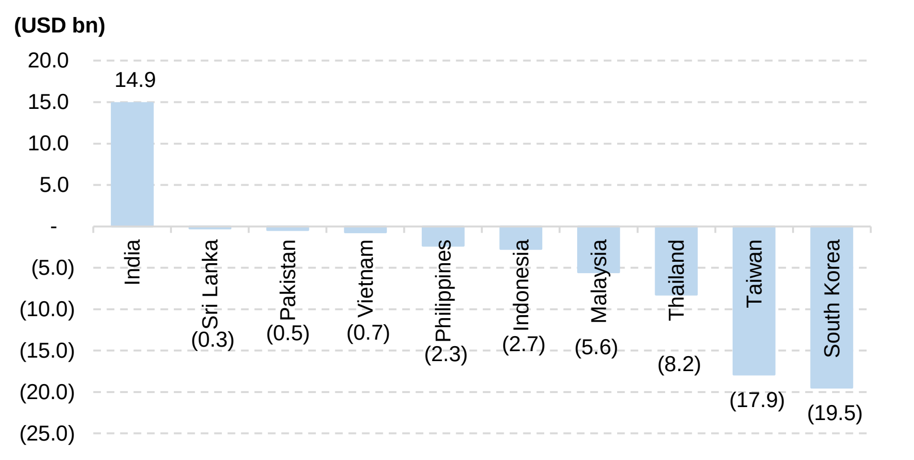
Fig: Local Investors Portfolio Investment (Market Low to date*)



Source (s): NCCPL, AHL Research, *25-Mar-20 to 27-Nov-20

- **Region sees massive outflows, India being the only exception:** The Asia-Pac region saw hefty off-loading from equities amid despondency in global investment climate. However, India was the only exception, attracting inflows of USD 14.9bn CYTD. FDI policy reforms and other investment promotion policies helped stimulate the inflows in India. Hefty outflows of USD 19.5bn and USD 17.9bn were witnessed in South Korea and Taiwan respectively, while Thailand, Malaysia, and Indonesia each saw outflows of USD 8.2bn, USD 5.6bn and USD 2.7bn respectively.

Fig: Regional Foreign Investors Portfolio Investment (CY20TD*)

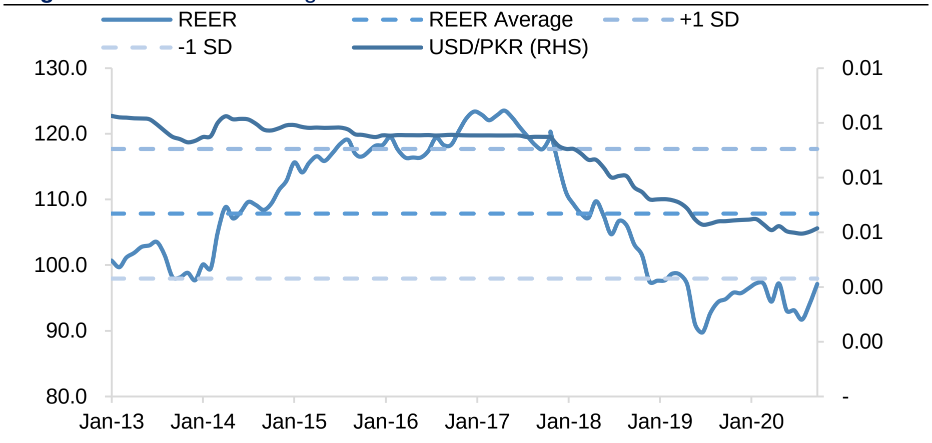


Source (s): Bloomberg, NCCPL, AHL Research, * 27-Nov-20

- **Outlook:** We expect foreigners to become net buyers in the upcoming year. This is backed by the REER index, which stood at 97 as at Oct'20, implying that the Pak Rupee may not witnesses any major volatility while improvement on the external account and the State Bank's continued assurance of comfortably meeting all debt obligations, should also keep the currency stable. In addition, we expect the Emerging Markets to attract inflows as major stimulus by governments in the West and policy rate decisions that are dovish in nature, will force value hunters to invest in debt and equity markets of EM countries, translating into foreign buying in the local bourse.

  The KSE-100 index is currently trading at an attractive PE of 7.0x (2021) compared to regional (Asia-Pac) average of 15.8x, while offering DY of ~6.5% versus~2.2% offered by the region.

Fig: Real Effective Exchange Rate



Source (s): SBP, AHL Research

Pakistan Equity Market outlook

Back to being the preferred asset class

- **Index target:** The KSE100 index is expected to generate a total return of **28%** during 2021. We expect the local bourse to reach **52,062** points by Dec'21. Our index target is based on target price mapping, justified P/E multiples and earnings growth. Our justified P/E for CY21 comes out to 8.4x which is close to last 10-Yr P/E of 8.5x, while earnings growth is expected at **17.6%.**

- **Strong earnings growth of 17.6% in 2021:** Entering 2021, we expect earnings growth to register a healthy jump in 2021, even better than the last 5-year average of 4.5%, which is expected to be largely triggered by the revival of aggregate demand post COVID-19 and lower interest rates. We expect the key sectors i.e. Cements, Textiles, Steel, and OMCs, to lead the earnings growth chart. While the economy could not catch up with its underlying potential amid COVID-19 fallout, a turnaround likelihood is tangible as we expect that the government's seriousness to address structural issues, energy sector issues, and inflationary pressure will bear fruit.

Table: KSE100 Index Target Estimates 2021

Valuation Basis	Weight	Target
Target Price Based	20%	60,588
Earnings Growth	40%	50,642
Justified PE	40%	49,220
Average Target 2021	**100.0%**	**52,062**
Index Closing 27-Nov-20		40,807
Expected Return 2021		**27.6%**

Source (s): AHL Research

Table: Corporate sector KSE100 earnings growth: Trend & Forecast

(%)	2015A	2016A	2017A	2018A	2019A	5-Y Avg.	2020E	2021F
E&P	(29.4)	(33.3)	30.7	27.8	46.3	8.4	(10.9)	(7.1)
Banks	16.5	0.8	(21.6)	5.3	20.2	4.2	40.4	(3.8)
Fertilizer	39.8	72.0	(57.7)	38.3	(4.4)	17.6	25.7	1.8
Cement	19.7	16.1	(7.0)	(4.5)	(37.4)	(2.6)	nm	nm
OMCs	(52.3)	80.0	65.4	(14.6)	nm	19.6	nm	nm
Autos	120.7	(1.4)	37.4	8.4	(36.0)	25.8	nm	136.0
Power	60.9	(11.0)	(2.4)	8.7	13.3	13.9	82.9	10.1
Textiles	(2.6)	39.1	(14.4)	15.7	51.9	17.9	(62.6)	122.3
Chemicals	95.3	35.4	28.8	64.0	(2.4)	44.2	(15.9)	31.1
Steel	(21.8)	110.8	148.7	21.7	(28.7)	46.1	nm	nm
KSE100	**11.1**	**7.6**	**(11.7)**	**10.7**	**4.89**	**4.5**	**(0.5)**	**17.6**

Source (s): Company Financials, AHL Research

- **Fundamental improvement across the sectors:** The Cement and Steel sector should reap benefits from the robust demand uptick, firm product prices, low interest rate scenario, relatively higher amount of PSDP to support the revival of the economy and government's focus on the housing industry. The Textile sector will be triggered by incremental exports on account of piled up orders post pandemic alongside low interest rates. Capacity expansion and low base of the Chemical sector will propel the earnings jump in 2021. Whereas improving offtake and stable fertilizer prices should support Fertilizer sector's earnings and payouts, while stable oil prices (relative to the COVID period) alongside better volumes should restrict the profitability slide in the E&P sector. In addition to this, resolution of Circular Debt is expected through issuance of PIB/TFC/Equity Swap, which should translate into better cash payouts from government owned entities i.e. PPL, OGDC, PSO, HUBC and KAPCO. This should attract a large portion of the dividend luring investors to equities. We also highlight heavy-weight Banks, despite such a steep cut in interest rates, we do not see a major decline in earnings amid drastic decline in provisioning.

- **Risks mitigated:** The index target appears sufficient to counterbalance perceived risks of i) Reversal in inflation and thus interest rates (2QCY21 by 50bps), ii) Lower than pre-COVID GDP growth rate, and iii) Political risks.

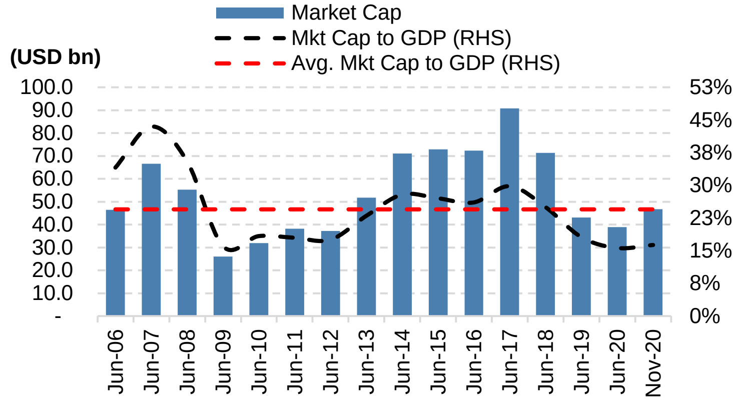
- **Mean reversion of Market Cap to GDP, IPO's to boost volumes in 2021**: Many peer countries including India, China, Vietnam, Bangladesh and Indonesia stand above average with regards to their market capitalization to GDP size and growth (as equities incorporate future economic growth as well). Pakistan's equity market has the greatest room for expansion of its market capitalization to GDP ratio, currently at 16%, which is lower by 9ppts to historical average market capitalization to GDP. This suggests that potential reversion to the mean ratio would result in incremental market cap of PKR 492bn, implying an upside potential of 9% from current levels. This is expected to significantly improve IPOs in 2021, as lower interest rates with marked improvement in market liquidity should provide a reason for companies to raise funds through equities with lower liquidity premium. For 2021, we are expecting total eight (8) new IPOs with in Auto Parts, Leather, Transport, Glass and Ceramics, Consumers and Oil Marketing sector with estimated capital raising ~20bn.

Fig: 2020 and 2021 IPOs

2020 IPOs	2021E IPOs*
The Organic Meat Co. Ltd.	Panther Tyre Ltd.
TPL Trakker Ltd.	Service Global Footwear Ltd.
Agha Steel Industries Ltd.	Airlink Logistics
Engro Polymer Preference	Gas and Oil Ltd. (GO)
	Sadaqat Ltd.

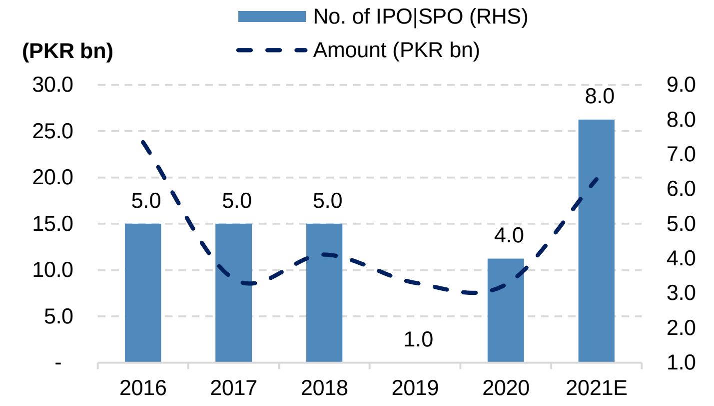
Source (s): PSX, AHL Research. *amongst others

Fig: Market Cap to GDP - Trend



Source (s): MoF, PSX, AHL Research

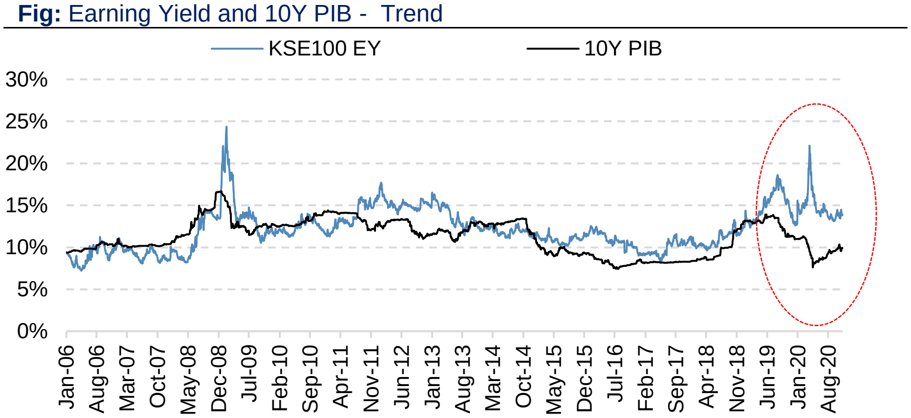
Fig: IPO and SPO – Trend



Source (s): PSX, AHL Research

- **Widening gap of earnings yield and 10-Yr PIB:** Since earnings growth is the prime factor to account for by investors above all, as it is an integral part of the emerging markets' fundamentals, KSE100's earnings growth is expected to post robust growth, competing with most of the peers with better economic growth i.e. China, India, Sri Lanka, Taiwan and South Korea. Therefore, we expect KSE100's re-rating whereby prevailing market discounts may substantially narrow to their historical averages. Moreover, analyzing earning yields suggests that the last 5-Yr earnings yield of KSE-100 Index was 12% as compared to current earnings yield of 15%, implying a 20% run-up assuming earnings yield reverts to last 5-Yr average. Additionally, the gap between earnings yield and 10-year PIB has widened to 4% as compared to historical average of 1%.

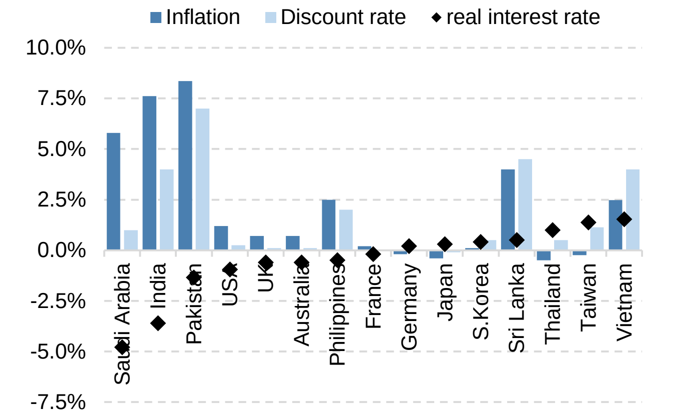
Fig: Earning Yield and 10Y PIB - Trend



Source (s): SBP, AHL Research

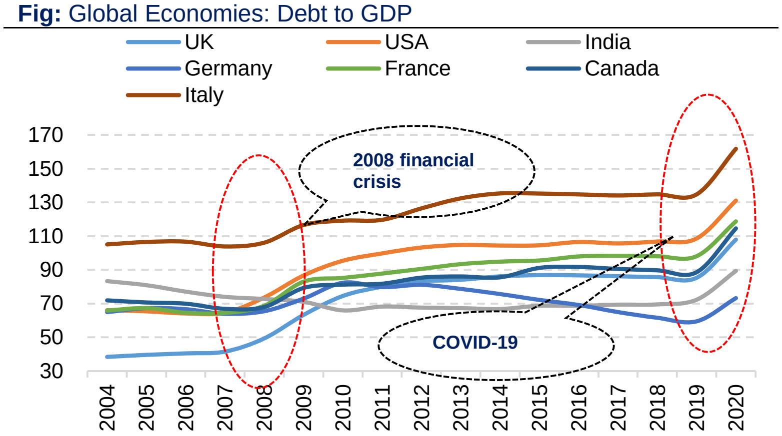
- **Financial repression in 2021 and hot money?** After the financial crisis of 2008 and World War II, the world, especially western countries, witnessed massive financial repression. Real interest rates turned negative i.e. savers earned returns below the rate of inflation in order to allow banks to provide cheap loans to companies and governments, reducing the burden of repayments. Given current dynamics post COVID-19 pandemic, and analyzing the world debt to GDP ratio, the system could face the same financial repression due to high debt to GDP ratio mostly across the globe post announcement of a variety of fiscal and external stimulus by the government and central banks to ease off the burden of the pandemic. With this scenario, majority of the capital flows from Western/Developed and in particular US markets, could pour into emerging markets. Having said that, we are expecting a good inflow of foreign investment in our equity and debt markets in 2021. The domestic equity bourse has significant regional discounts as global equities are on the rise. The KSE-100 index's deep discount to regional peers remains 56% on PE, 41% on EV/EBITDA, 43% on PEG, 47% on PBV, while a substantial 67% on dividend yield and a hefty 21% on ROE. On the debt market side, going forward we expect hot money to flush in in 2021 as foreigners can safely benefit from carry trades in the range of 3-5% returns. Global fixed income yields are likely to remain low and Pakistan can benefit by capitalizing on the spreads.

Fig: Real Interest Rate



Source (s): World Bank, PBS, SBP, AHL Research

Fig: Global Economies: Debt to GDP



Source (s): World Bank, AHL Research

Table: 2021 Forward Multiples

Country	Earning Growth	DY	ROE	PE	PBV	PEG	EV / EBITDA
Indonesia	32.0%	2.0%	14.2%	15.3	1.9	0.5	10.1
India	30.9%	1.5%	13.7%	19.9	2.8	0.6	14.6
Vietnam	19.1%	1.7%	16.3%	13.0	2.0	0.7	9.9
Philippines	27.5%	1.6%	8.9%	17.9	1.6	0.7	11.7
Sri Lanka	19.1%	2.7%	7.4%	13.6	0.9	0.7	6.5
Thailand	14.1%	2.7%	7.0%	18.3	1.6	1.3	11.6
China	15.5%	2.1%	10.4%	14.5	1.9	0.9	12.8
Taiwan	13.3%	3.4%	14.6%	16.6	2.1	1.3	10.6
S.Korea	25.5%	1.8%	11.4%	13.0	1.0	0.5	8.3
Peer Avg	***21.9%***	***2.2%***	***11.5%***	***15.8***	***1.7***	***0.8***	***10.7***
Pakistan	17.6%	6.5%	14.7%	7.0	1.0	0.4	6.3
Prem/(Disc)	4.3%	-66.6%	-21.4%	-56%	-43%	-50%	-41%

Source (s): Bloomberg, AHL Research

Pakistan Equity Market

Earnings growth expected at 6-yr high

- **Power to Lead the Earnings Chart in 2020:** Earnings decline of the KSE-100 index in 2020 is expected to arrive at 0.5%. Sectors such as Cement, OMCs, steel and Autos posted losses whereas Textile, Chemicals and E&P displayed a profitability decline of 62.6%, 15.9% and 10.9%, respectively. At the other end of the spectrum, Power Generation sector led the earnings jump, depicting a stunning growth of 82.9% in lieu of recognition of profit from coal-based power plants, higher dollar indexation and other income. Following this, index-heavy Commercial Banks (23% weight) are set to post the second largest growth in bottom-line of 40.4% due to healthy capital gains on fixed income securities and initial expansion in NIMs with immediate downwards repricing in liabilities (there is lag between asset and liability repricing). Finally, we project the Fertilizer sector to unveil a profitability growth of 25.7% attributable to higher urea offtake and lower effective gas prices (abolition of GIDC), translating into improved margins.
- With that said, we project earnings growth of the benchmark index in the upcoming year at a **6-yr high of 17.6%.** Top performing sectors are listed below.
    1. **OMC's:** The sector posted losses in 2020 due to recognition of hefty inventory losses amid massive oil price volatility, albeit, as the oil price outlook appears stable-to-improved, OMCs are expected to churn out profits.
    2. **Cements:** Solid earnings growth estimated in Cements during 2021 compared to losses booked in 2020 on account of pricing discipline amid end of outgoing expansionary cycle, coupled with vigorous dispatches growth expected on the back of incentives given to the construction sector and relatively higher PSDP allocation to support revival of economy, while low interest rates should also reduce financial risk.
    3. **Textile:** Textile sector should reap benefits of robust recovery in export orders, piled up during pandemic and as Pakistan fares better than other countries on the COVID front, alongside government support making textile sector competitive against regional peers.
    4. **Automobile Assemblers:** We cite V-shaped recovery in the economy and cut in the benchmark interest rate to aid auto demand whereas stability in the Pak Rupee should also cushion margins.
    5. **Chemical**: Low base effect from last year alongside commercial operations of new capacities is set to generate a 31% earning surge in Chemicals.
    6. **Fertilizers:** We cite stable offtake alongside pricing power of local manufacturers to translate to stable profitability of fertilizer companies in 2020.
    7. **Commercial Banks:** We do highlight that heavy-weight Commercial banks will remain a laggard in 2021, with a minor decline in earnings due to decline in NIIs.
    8. **E&Ps:** Whereas a steady bottom-line of the E&P sector is hinged upon a stable oil price and PKR-USD outlook.

Commercial Banks

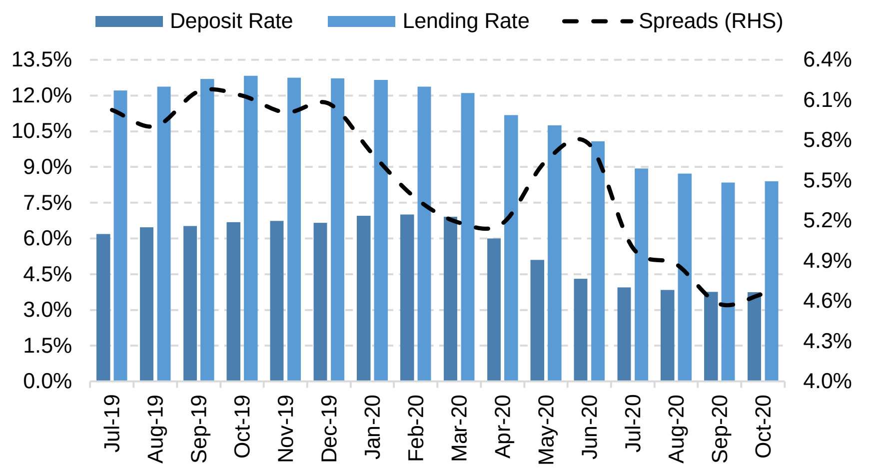
Strong Balance Sheets to Mitigate COVID Risks

Commercial Banks

Strong balance sheets to mitigate COVID risks

- **Monetary easing stressed banking spreads:** As a counter measure to contain the ill-effects of the pandemic, SBP reverted to an easy monetary policy stance (reducing policy rate by a cumulative 625bp in CY20) that kept rupee-lending rates under pressure throughout CY20. As a consequence, weighted average lending rate on fresh loans and advances, and weighted average deposit rates slipped down to 8.0% and 2.9% as at October 2020 (against 13.7% and 7.8% as at October 2019), respectively. The profitability of commercial banks witnessed substantial improvement during CY20 which was primarily supported by reduced interest expense and exceptional capital gains. However, the drag to the overall financial health of the banking sector came from reduced business activities due to the pandemic and higher burden of provisioning charged to build up coverage against potential losses. This turn around looks more impressive in the presence of a narrowing average interest rate spread. Indicators for the management performance of the banking sector also depicted positive trends. In particular, the cost to income ratio recorded notable positive changes during CY20 which was down to 2.7x against 3.9x recorded in SPLY due to lower cost (slowdown in branch expansion) despite low income (due to squeezing interest rate spread).

Fig: Spreads compression following monetary easing

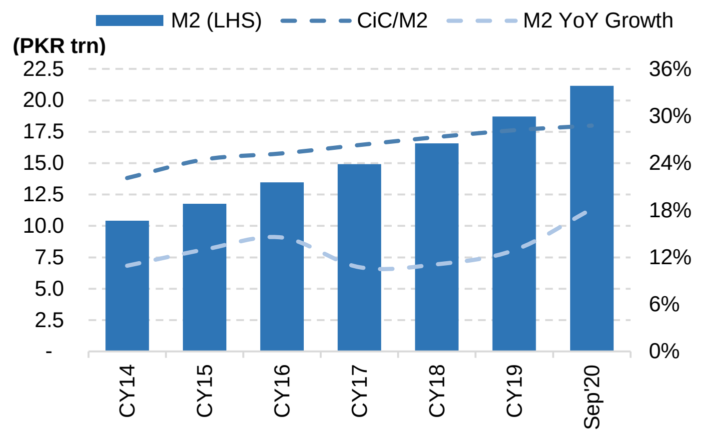


Source (s): SBP, AHL Research

- **Robust deposits growth in tandem with rapid expansion in M2:** With the government's concerted efforts to curb the black economy – a plague for economic growth, came a marked rise in the currency-in-circulation (CiC). Flow of funds towards the banking system also gained pace since the COVID outbreak as economic activity took a major hit. However, even after the lifting of the lockdown and resumption of economic activity, deposit growth continued at an impressive pace - 3QCY20 saw a 17.4% YoY growth (~14-Yr high) while Oct'20 saw a 20.4% YoY acceleration (a high since Dec'16). This was complemented by a noticeable expansion in the money supply (M2) - Broad Money is up 12% CYTD / 18.1% YoY as at Oct'20 (avg. growth of 13% during CY15-19) while CiC as a proportion of M2 has accelerated to ~30% (average of 26% during CY15-19). Rise in CiC can be explained by the strict KYC-AML regulations that have been enforced, in addition to a dip in economic activity. Expansion in money supply has, however, driven remarkable deposit growth in the banking system which has been spurred by significant jump in government borrowings for budgetary support (19% CYTD / 18%

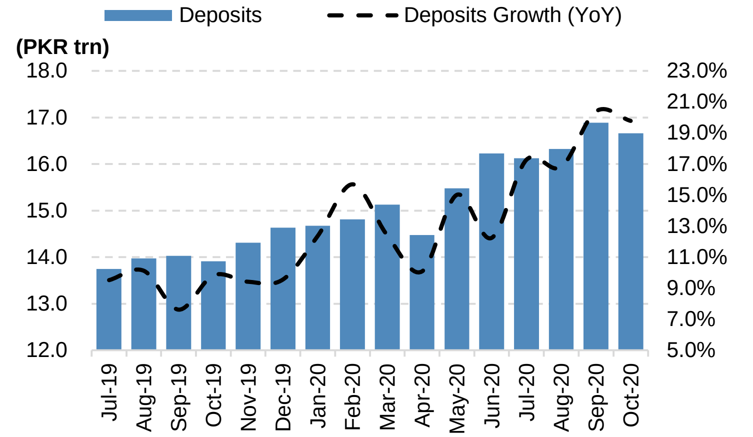
YoY during Oct'20). Interestingly, FYTD deposit growth has outpaced total broad money growth (0.65% and 0.36% respectively) as CiC has registered negative growth of 0.30%. Going forward we forecast banking sector deposits to continue its robust momentum owing to documentation drive and expansion in M2, as the pandemic is likely to strain fiscal health and incur elevated borrowings for budgetary support. Our assumptions for sector deposit growth are set at 13% and 12.4% for CY21 and CY22.

Fig: Broad Money expansion



Source (s): SBP, AHL Research

Fig: Robust deposits growth

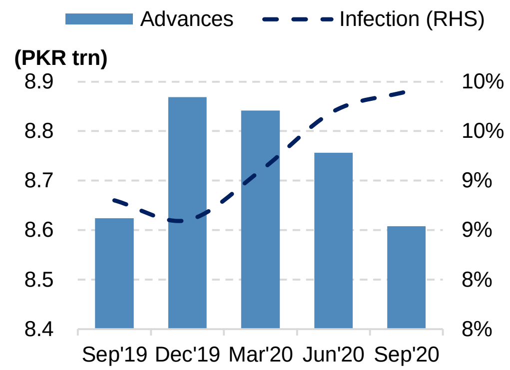


Source (s): SBP, AHL Research

- **Coverage ratios strengthened through aggressive general provisioning:**

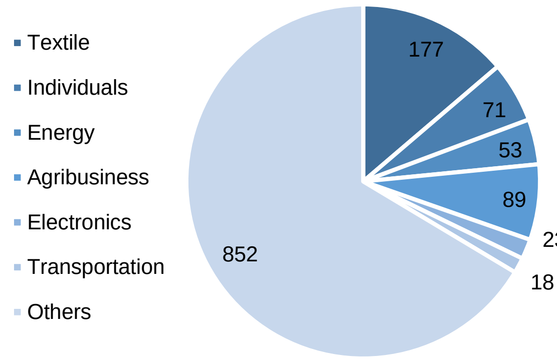
Following the outbreak of the pandemic, investors have kept a close eye on the asset quality of the banking system. The SBP's principal deferral facility and loan restructuring schemes have helped contain pressure – PKR 659bn worth of loans have been deferred (~8% of loans) and PKR 211bn worth of loans have been restructured (~3% of loans). While the actual impact on NPL accretion will be seen once the moratorium expires next year (12% YTD surge in NPLs as at Sep'20). Banks have solidified their coverage ratios to build buffers to absorb any potential losses by booking substantial general provisioning. Average coverage ratios of the banking sector are currently at ~101% as at Sep'20 against ~94% as at Dec'19, while infection has crept up to 9.2% against 8.1% as at Dec'19, partially owing to negative loan growth of 3% YTD. We have assumed NPLs to rise next year across the board (+10% YoY for AHL universe) while we have assumed provisioning expenses to come down significantly (-45% YoY for AHL universe) due to the high base because of heavy general provisioning booked this year.

Fig: Loan growth under pressure



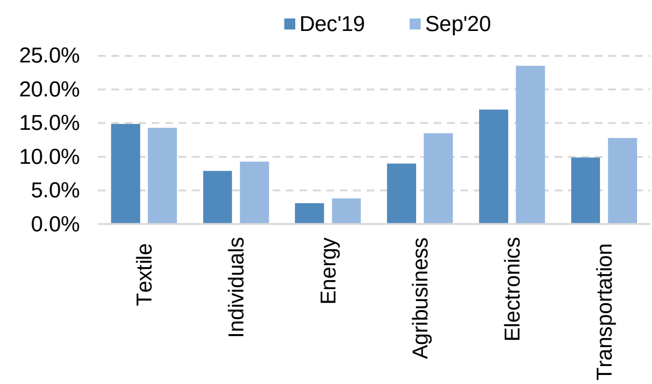
Source (s): SBP, AHL Research

Fig: NPLs break-up as at Sep'20



Source (s): SBP, AHL Research

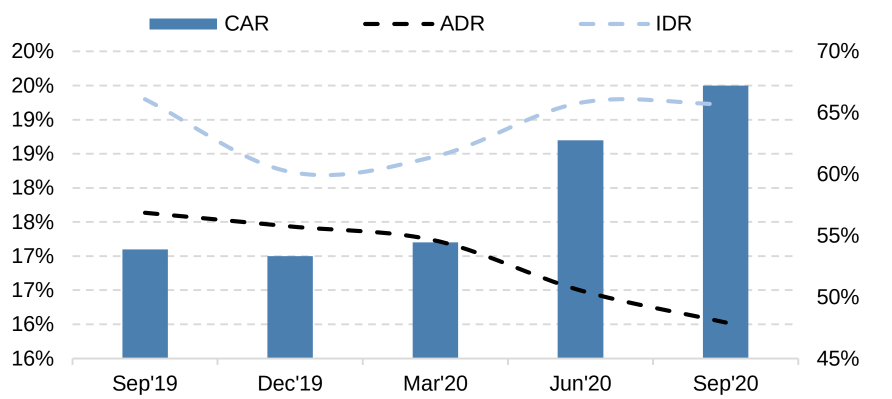
Fig: Sector-wise change in infection



Source (s): SBP, AHL Research

- **Banks capital ratios much stronger than 2008 crisis:** Unlike the 2008 crisis, banks in Pakistan entered the current crisis posed by the COVID-19 pandemic with strong balance sheets. In CY08 and CY09, CAR for the banking sector stood at 12.2% and 14.0%, respectively. CAR for the industry is currently at a concrete 19.5% against 17.1% SPLY (vs. requirement of 11.5%), while Common Equity Tier 1 (CET1) ratio stands at 14.8% against a requirement of 9%. Currently only 3 banks have reported a CAR below the regulatory requirements versus 4 banks SPLY, while 25 banks' CAR is above 15% against 21% in SPLY. Owing to banks' strong balance sheets, the SBP encouraged banks to lend more and fuel the economic revival in the country. For instance, the SBP had reduced the Capital Conservation Buffer (CCB) from 2.5% to 1.5% in order to free up liquidity for banks to fuel credit growth in the economy. Slowdown in credit growth and higher investments in risk-free debt instruments has contributed to controlled expansion in risk weighted assets which increased by 3.7% YoY during Sep'20.

Fig: Low ADR leading to stringer CAR



Source (s): SBP, AHL Research

Key risks

- More than expected NPL accretion once the SBP principal deferment facility ends.
- Prolonged second wave of COVID-19 can keep economic activity and credit demand in check.
- Extension of COVID may also force the SBP to introduce another loan deferment/rescheduling facility.

Habib Bank Limited

Fundamentals to ignite cheap valuations

- **Asset quality – The cutting edge:** Elevated provisioning is expected to clock-in drastically lower in CY21, following hefty general provisioning (0.84% of gross loans as at Sep'20 against 0.3% as at Dec'19) during the year to build coverage against possible NPL accretion. Total provisioning during 9MCY20 has settled at PKR 8.5bn (PKR 6bn general provisioning charge). Coverage has been built up, reaching 100% as at Sep'20. We expect provisioning to come down ~50% during CY21, with coverage settling at 95%. Asset Quality is resilient so far (Sep'20 infection: 6.7% against 9.9% for the industry) with domestic NPLs down 2% YTD (industry NPLs: +12% YTD). We expect further support to earnings from a recovery in loan growth which we expect at 6% during CY21. We have assumed infection at an average of 7.2% over the next 5 years.
- **PIBs to support NIMs:** With the 625 bps rate cut to reflect fully on asset yields in 4QCY20, banking sector will witness NIMs compression. HBL has accumulated high yielding bonds which will sustain pressure on NIMs. Currently PIB portfolio of HBL stands at PKR 868bn, which is up 39% CYTD, with IDR inching up to 65% vis-à-vis 57% at Dec'19. However, in-line with industry trend, the bank's ADR has receded to 45% (Sep'20) against 51% (Dec'19), owing to lackluster demand amid despondent economic activity. NIMs for the bank are modelled at 3.9% as at CY21 against 4.6% as at CY20. We do highlight that we have assumed a 50 bps hike in 2QCY20, which will add further pressure to NIMs initially due to immediate liability re-pricing.
- **Cost pressures are over:** Exorbitant cost/income ratio has been the Achilles heel for the bank over the last couple of years. However, the worst is over for the bank. Key value drivers for the stock include a normalizing cost/income for the bank which had rocketed to levels as high as 92% (2QCY19). Business Transformation program (PKR 5.6bn in CY18 and ~PKR 1bn in CY19) has been completed on the domestic business, while costs related to the international business are likely to be nominal as per management. Moreover, NY branch (PKR 6.4bn in CY18, PKR 3.8bn in CY19) has been closed and the license has been surrendered in March this year while the bank's open FX position has reduced. We expect the bank's cost/income to arrive at 59% for CY20, down from 74% in CY19 (consolidated basis).
- **Valuations reign supreme:** The bank currently trades at a CY21 P/B of 0.7x compared to last 5-Yr average of 1.4x – a discount of 50%. With ROE of the bank set to clock in at ~13% as at Dec'20 (CY19: 7.2%) and hover around an average of ~15% over the next 5 years, we think the stock valuations are at a bargain. We have a "BUY" call on the stock with a Dec'21 TP of PKR 166/share.

Key metrics		2019A	2020E	2021F
Earnings per share	PKR	10.5	22.1	20.3
Dividend per share	PKR	5.0	6.0	6.0
Book value per share	PKR	153.2	174.7	185.9
Price to Earning	x	15.1	5.8	6.4
Price to Book	x	1.0	0.7	0.7
ADR	%	51.0	42.2	39.5
IDR	%	56.6	63.2	66.1
NIMs	%	3.9	4.5	3.8
ROE	%	7.2	13.5	11.2

Source (s): Company Financials, AHL Research

Recommendation	HBL PA BUY
Target Price (Dec'21)	165.9
Last Closing	129.9
Upside (%)	27.7
Shares (mn)	1,467
Free float (%)	50.0
Market Cap. (PKR mn)	190,559
Market Cap. (USD mn)	1,195.0

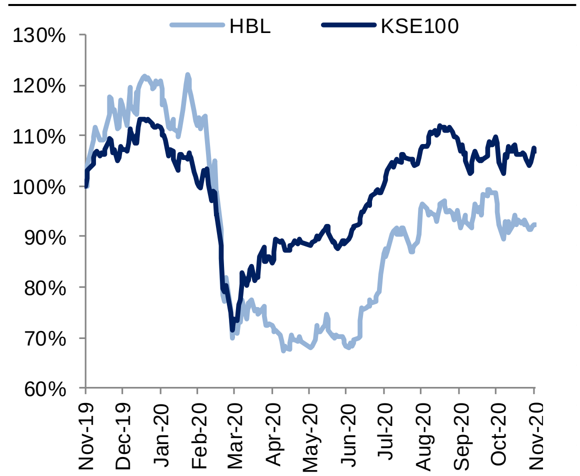
Major Shareholders

- Agha Khan Fund For Economic Development

Price Performance

	3M	6M	12M
Return (%)	-3.9	34.9	-7.5
Avg. Volume (000)	1,229	1,556	1,578
ADTV (mn) - PKR	163	185	200
ADTV (000) - USD	1,005	1,127	1,247
High Price - PKR	139.6	139.6	171.8
Low Price - PKR	126.0	95.9	94.8

Relative Performance



Source: Bloomberg

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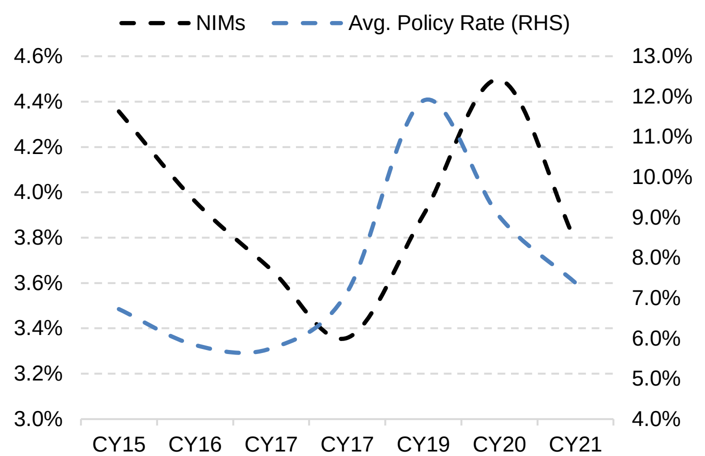
PKR mn	2019A	2020E	2021F
Income Statement			
Net Mark-up Income	101,323	129,134	125,519
Non-Mark-up Income	24,162	31,870	31,721
Total Income	125,485	161,004	157,240
Provisioning	3,314	10,759	5,806
OPEX	93,290	95,470	102,332
Post Tax Profit	15,333	32,399	29,725
Balance Sheet			
Advances	1,166,957	1,141,640	1,206,735
Deposits	2,437,597	2,910,079	3,288,390
Investments	1,379,607	1,838,869	2,172,074
Borrowings	382,206	436,512	493,258
Total Equity TIER - II	224,752	256,273	272,629

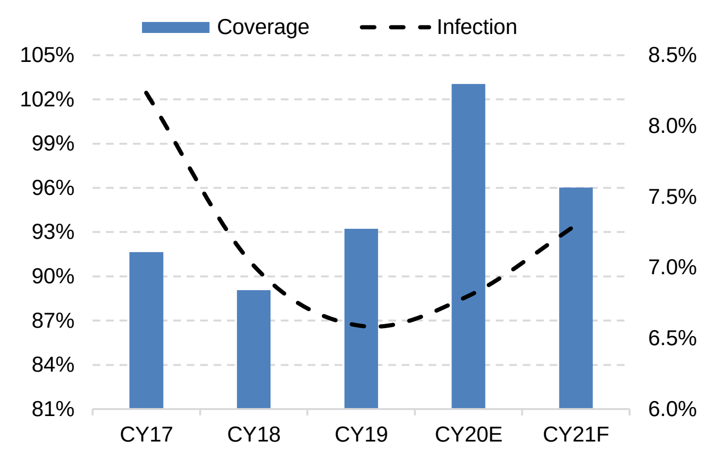
Source (s): Company Financials, AHL Research

Fig: NIMs and avg. Policy Rate



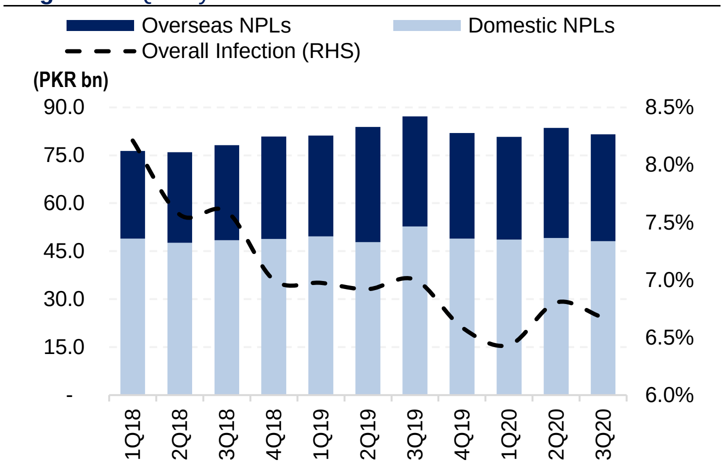
Source (s): Company Financials, AHL Research

Fig: Coverage beefed up



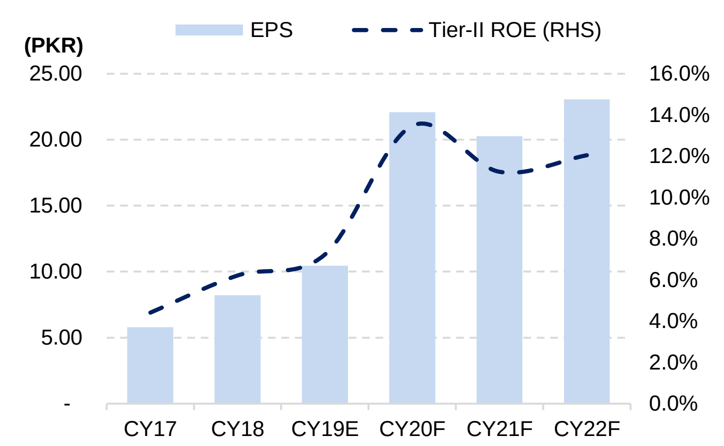
Source (s): Company Financials, AHL Research

Fig: Asset Quality under control



Source (s): Company Financials, AHL Research

Fig: Approaching normalized ROEs



Source (s): Company Financials, AHL Research

MCB Bank Limited

Banking with prudence

- **Investments fort:** Maturity profiling of investments is a primary source of support to the bank's NII going forward. A shift from the lower end of the yield curve to the higher end when interest rates had peaked, should help arrest pressure on the bank's NIMs, following monetary easing of 625bps. As per the management, the average yield on the bank's bond portfolio stands at 11.9% while average yield on T-bills is 11.6%. As at 9MCY20, PIBs contribute 36% to investments vis-à-vis 30% SPLY. We model the bank's investment yields to settle at 8.2% during CY21 and an average of 9% (5-yr forward), while IDR is assumed at an average of ~69% over the next 5 years. The bank is likely to continue its shift towards shorter tenor securities given that the interest rates have most likely bottomed out. The T-Bills portfolio of the bank has seen a 37% jump YTD while the PIB portfolio has increased 20% YTD.
- **CASA king:** The bank's CASA ratio has always been its prized possession. Currently at 93%, the bank has boasted impeccable deposit mix with CASA averaging at 92% over the last 5 years compared to peer average of 83%. With monetary policy expected to start tightening next year, the bank's stellar deposit mix will support NIMs expansion, which are expected to settle at 4.4% in CY21 and an average of 4.6% over our investment horizon.
- **Prudent lending to shield from NPLs:** MCB's conservative and prudent lending strategies have always helped it sustain impressive asset quality. Gross ADR is currently at 42% (industry average: 49%) while last 10-Yr average stands at 50% against 56% for the banking sector. In the last 2 years, overall NPLs in the banking system have registered a whopping 34% rise, since the SBP initiated its monetary tightening regime. MCB during the said period has seen a minimal 4% jump in its NPLs. This has in part been supported by recoveries flowing in from NIB in addition to its prudent lending and strict credit risk management. As at 3QCY20, MCB has recovered ~PKR 5.5bn (18.4% of total NIB NPL stock). We expect a drastic reduction in provisioning expenses next year (-57% YoY) as coverage has been beefed up to 96% currently compared to 87% as at Dec'19, with general provision constituting 1.2% of gross loans against a normalized 0.2% pre-COVID.
- **Attractive valuations:** Like most of the banking sector, MCB trades at an attractive valuation: CY20 and CY21 P/B of 1.12x and 1.10x respectively, a ~32% discount from an average of 1.62x during CY15-CY19. We project average ROEs at an average of 18.8% over our investment horizon compared to last 5-Yr average of 15.1%. The bank offers a lucrative CY21 dividend yield of 11.4% at a DPS of PKR 20.00/share and payout of 78%.

Key metrics		2019A	2020E	2021F
Earnings per share	PKR	19.9	26.3	24.8
Dividend per share	PKR	17.0	20.0	20.0
Book value per share	PKR	143.3	156.6	159.1
Price to Earning	x	10.4	6.5	7.1
Price to Book	x	1.4	1.1	1.1
ADR	%	54.4	49.7	39.6
IDR	%	61.8	71.7	70.9
NIMs	%	4.7	5.2	4.4
ROE	%	14.6	17.5	15.7

Source (s): Company Financials, AHL Research

	MCB PA
Recommendation	**BUY**
Target Price (Dec'21)	226.0
Last Closing	174.7
Upside (%)	29.3
Shares (mn)	1,185
Free float (%)	35.0
Market Cap. (PKR mn)	207,042
Market Cap. (USD mn)	1,298.4

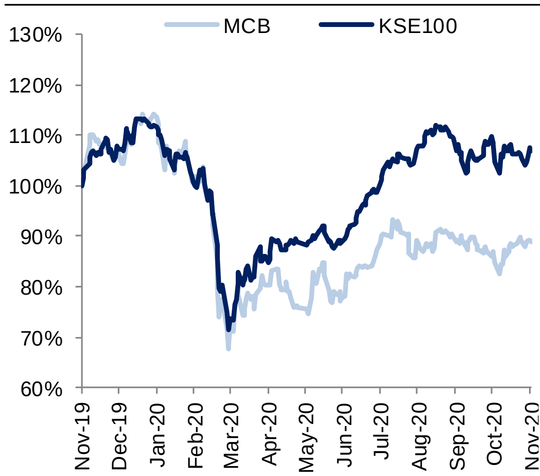
Major Shareholders

- Maybank International Trust (Labuan) Berhad

Price Performance

	3M	6M	12M
Return (%)	1.7	19.2	-12.5
Avg. Volume (000)	569	515	584
ADTV (mn) - PKR	98	88	104
ADTV (000) - USD	605	535	651
High Price - PKR	179.7	183.3	224.4
Low Price - PKR	162.2	146.6	132.9

Relative Performance



Source: Bloomberg

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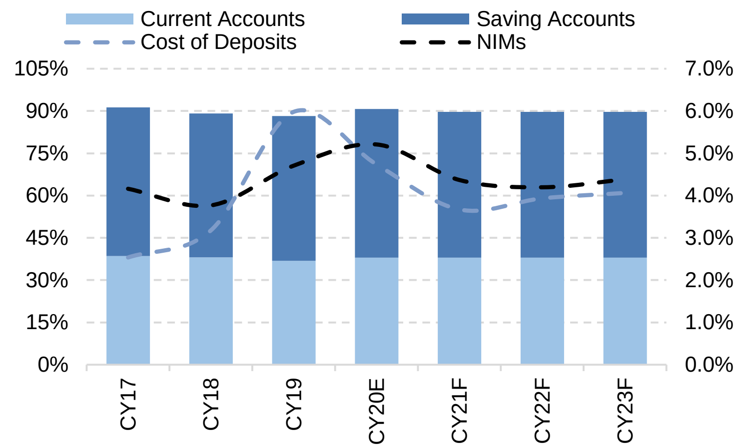
PKR mn	2019A	2020E	2021F
Income Statement			
Net Mark-up Income	63,718	76,490	73,444
Non-Mark-up Income	17,518	21,977	23,408
Total Income	81,236	98,467	96,852
Provisioning	2,674	6,587	2,955
OPEX	38,748	40,519	45,608
Post Tax Profit	23,529	31,220	29,346
Balance Sheet			
Advances	548,473	526,714	561,514
Deposits	1,226,593	1,455,040	1,644,195
Investments	757,442	1,042,937	1,165,711
Borrowings	92,860	174,605	180,861
Total Equity TIER - II	170,606	185,551	188,570

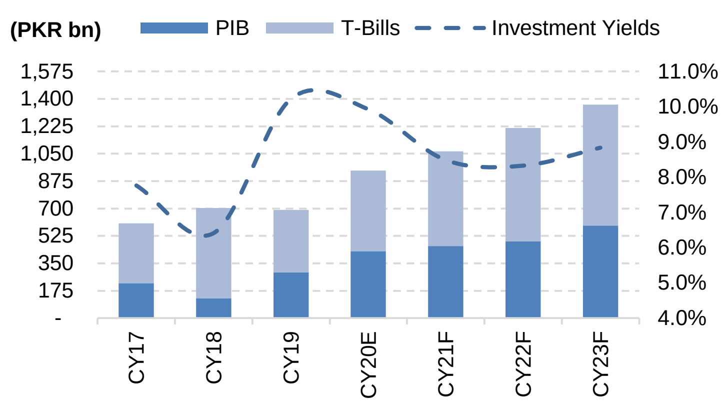
Source (s): Company Financials, AHL Research

Fig: Deposit mix



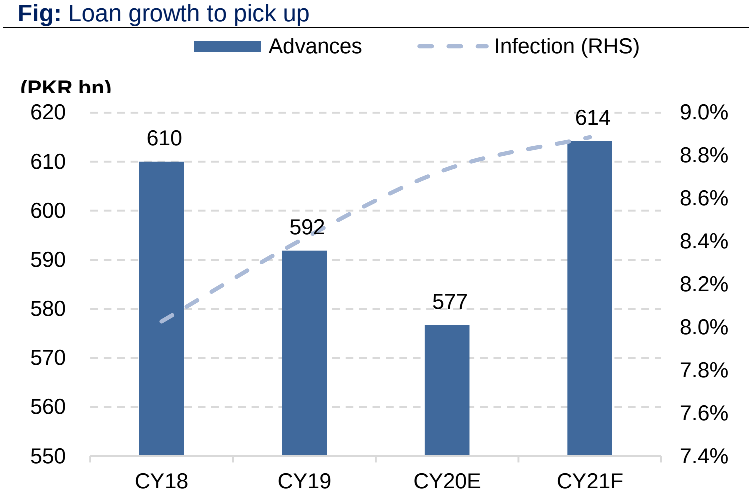
Source (s): Company Financials, AHL Research

Fig: Shift towards shorter end of the curve



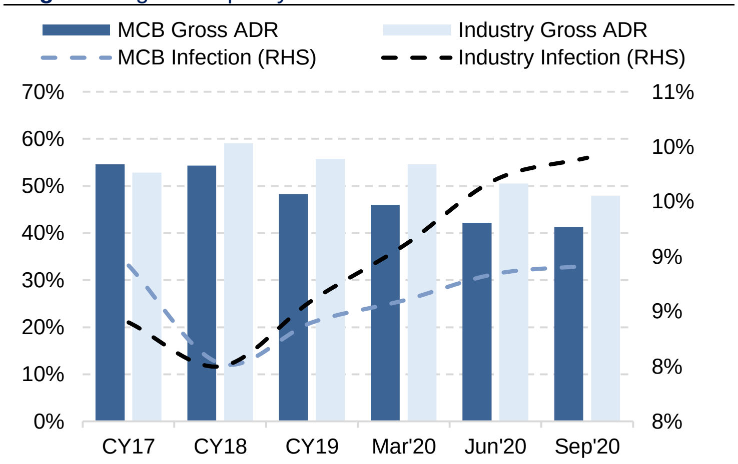
Source (s): Company Financials, AHL Research

Fig: Loan growth to pick up



Source (s): Company Financials, AHL Research

Fig: Shining asset quality



Source (s): Company Financials, AHL Research

United Bank Limited

An attractive equity story

- **Deposit mobilization with a focus on current accounts:** UBL's domestic business continues to stand on a firm footing with factors like low cost deposits growing 11% YoY in 9MCY20 on the domestic book but the bank expects this to pick pace further (14-15%) as more informal sectors are documented. The strong deposit franchise of the bank helped leverage its position during the monetary easing (-625bps) by cushioning pressure on NIMs in terms of lower cost of deposits (4.3% against peer avg. 5.2% as at Sep'20). The bank will continue focusing on keeping its deposit portfolio optimized with a focus on current accounts (~45% presently). We model cost of deposits at an avg. of 4% during CY21-25 and current accounts at avg. 38%.
- **NIMs to normalize:** The bank's fixed PIB portfolio (PKR 278bn) yields 9.3% on average while floater PIBs (PKR 317bn) yield an average of 8%. T bills (PKR 295bn) yield an average of 8.3%. Average maturity of the bond portfolio is 1.7 years with ~PKR 100bn worth of bonds expected to mature in CY21 (~PKR 50bn that are due to mature are yielding ~7%). The management expects rollover into higher yielding bonds to support NIMs going forward which are expected to settle at 4.3% in CY20 and 3.5% in CY21 due to decline in income from advances due to lower credit yields (CY21F: 7.6%, CY20E: 9.2%).
- **De-risking strategy to continue**: On the domestic loan book, the management is confident on its outlook (infection currently at 6.3%). However, provisioning of PKR 14.9bn has been booked during 9MCY20 out of which PKR 13.2bn has been booked on the international book. International coverage stands at 96.2% (with FSV benefit) against 90.9% as at Dec'19. We have modelled PKR 19.4bn provisioning charge in CY20E (coverage: 92%) which is likely to come down to around PKR 12.7bn in CY21F (coverage: 93%).
- **Digitalization to remain key focus area:** To recall, the President reiterated the bank's strategy to improve the international business front in last conference call held by UBL and laid great emphasis on further enhancing the digital front. Given this, we expect a 5% jump in fee income in CY21F. More focus on digitalization goes in line with the bank's strategy to keep cost-to-income in check which is now 46%, against an average of 51% recorded in CY19.
- **Recovering ROE:** Reiterating our view of a more gradual earnings recovery for UBL, we expect the bank to post an EPS of PKR 16.2 | 17.1 in CY20E and CY21F, respectively. UBL currently trades at a P/B of 0.8, at a ~36% discount to its last 5-Yr avg. of 1.25x. UBL is operating at a trailing ROE of 10.6% and is expected to accelerate to an avg. of 14.8% over the next 5 years (last 5-Yr avg.: 14.2%).

Key metrics	Unit	2019A	2020E	2021F
Earnings per share	PKR	15.6	16.2	17.1
Dividend per share	PKR	12.0	10.0	12.0
Book value per share	PKR	155.9	155.6	161.8
Price to Earning	x	10.5	7.3	6.9
Price to Book	x	1.1	0.8	0.7
ADR	%	48.9	40.6	38.1
IDR	%	56.1	70.1	71.0
NIMs	%	3.5	4.0	3.4
ROE	%	10.6	10.4	10.8

Source (s): Company Financials, AHL Research

UBL PA

Recommendation	BUY
Target Price (Dec'21)	148.7
Last Closing	118.7
Upside (%)	25.3
Shares (mn)	1,224
Free float (%)	40.0
Market Cap. (PKR mn)	145,273
Market Cap. (USD mn)	911.0

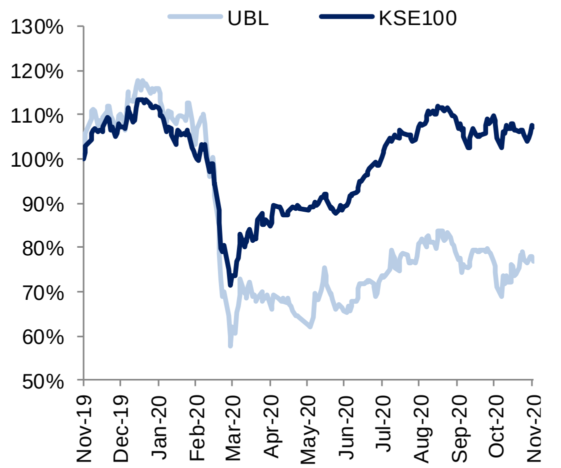
Major Shareholders

- Bestway (Holdings) Limited

Price Performance

	3M	6M	12M
Return (%)	-6.4	23.6	-24.2
Avg. Volume (000)	1,258	1,528	1,354
ADTV (mn) - PKR	151	177	171
ADTV (000) - USD	929	1,069	1,059
High Price - PKR	129.3	129.3	182.0
Low Price - PKR	106.5	96.0	89.4

Relative Performance



Source: Bloomberg

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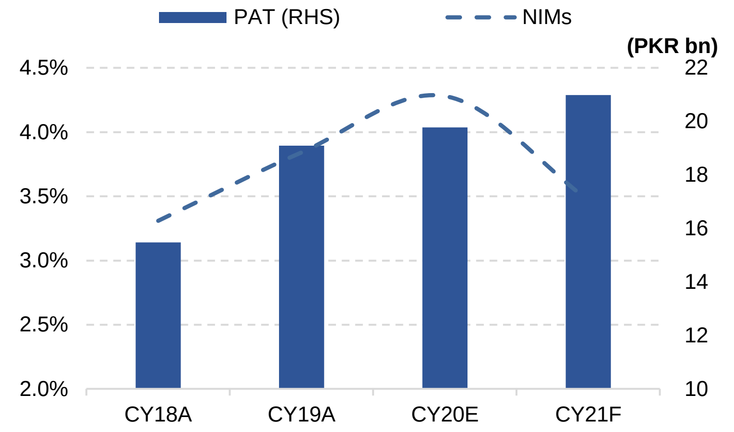
PKR mn	2019A	2020E	2021F
Income Statement			
Net Mark-up Income	63,341	76,352	70,592
Non-Mark-up Income	23,558	18,888	20,338
Total Income	87,676	96,178	91,787
Provisioning	7,314	19,371	11,233
OPEX	44,632	44,496	46,378
Post Tax Profit	19,048	19,710	20,848
Balance Sheet			
Advances	754,552	694,934	613,733
Deposits	1,557,995	1,725,745	1,930,973
Investments	874,562	1,209,220	1,371,643
Borrowings	170,405	189,832	154,478
Total Equity	190,872	190,503	198,087

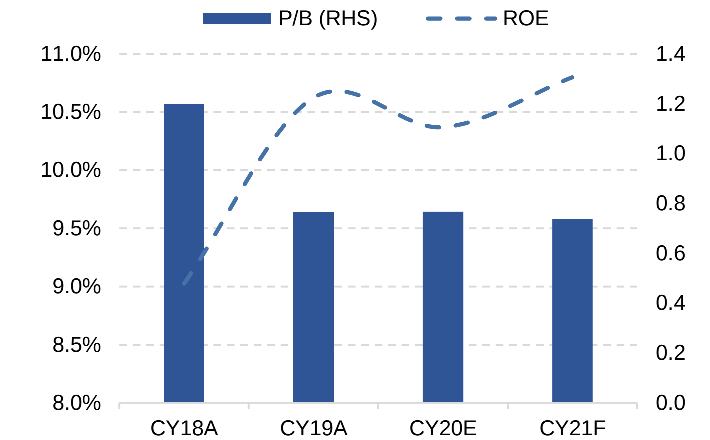
Source (s): Company Financials, AHL Research

Fig: NIMs vs. PAT



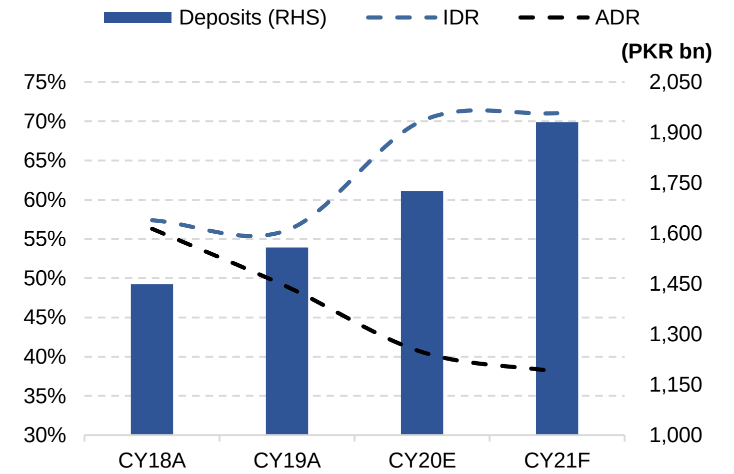
Source (s): Company Financials, AHL Research

Fig: P/B and ROE



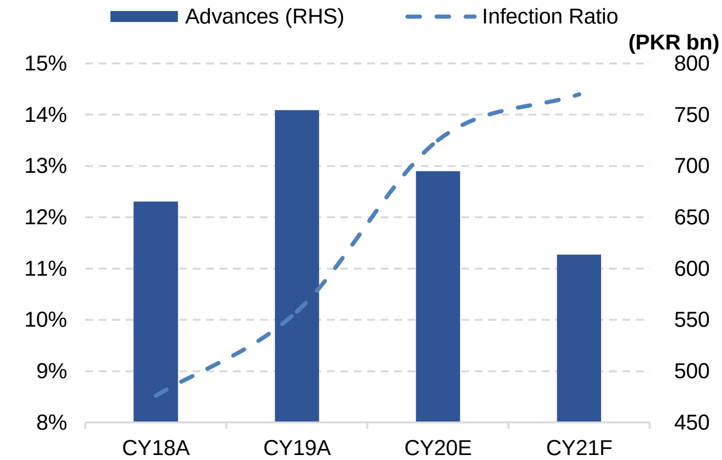
Source (s): Company Financials, AHL Research

Fig: IDR to compensate for low ADR



Source (s): Company Financials, AHL Research

Fig: Advances and infection



Source (s): Company Financials, AHL Research

Fertilizer
The safest bet

Fertilizers

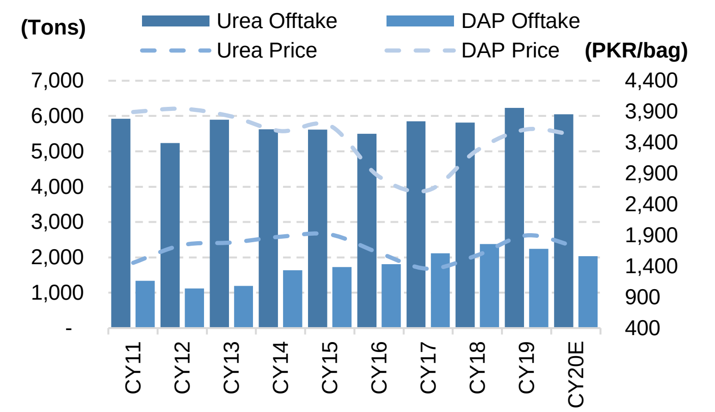
The safest bet

- **Agriculture performance & fertilizer offtake:** In FY20, the agriculture sector's contribution to GDP of Pakistan was 19.3% as compared to 18.7% YoY in FY19. For CY21, we expect urea offtake to clock-in at 6.2mn tons while DAP offtake is expected at 2.1mn tons.
- **Pricing outlook:** During CY20TD, average urea prices dropped by 10% YoY to PKR 1,716/bag CYTD as compared to an average price of PKR 1,896/bag during CY19 as the manufacturers passed on the impact of abolition of GIDC on fertilizer feed and fuel gas. Going forward, any cost push inflationary pressure would be passed on to the end consumer, we view.
- **Detailed judgement of GIDC and outcome of the review petitions:** The amount of GIDC will be recovered in fourty eight equal monthly installments. As far as GIDC on concessionary gas is concerned, the companies have taken stay order against the GIDC on new plants citing Fertilizer policy of 2001 which clearly states that USD 0.77 charged as concessionary gas *"will be inclusive of all taxes, duties, levies, fees and charges whatsoever, whether local, federal or provincial. However, GST or similar duty may be imposed on such determined price provided it is adjusted against GST, payable on fertilizer produced."*
- **Inventory levels:** Pakistan's inventory of urea is estimated to be around 0.2mn tons as at 31st Dec'20, while forecasted demand for Dec'20 is expected to clock in at 1.1mn tons taking total offtake to 6.0mn tons in CY20.
- **Plants running on RLNG:** In CY21, RLNG plants are expected to operate for 6-8 months, and resultantly the production of the country (expected at 6.0mn – 6.2 tons) would be sufficient enough to cater the total urea demand of the country while also sufficient enough to maintain 0.2mn tons of buffer stock in the country.
- **International urea prices:** International urea prices have tumbled sharply to USD 289/ton in Sep'20 (a decline of 12% YoY). However, we expect prices to recover and remain stable by the end of this year as Indian and Brazilian demand is expected to kick-in from the ongoing month.

Key risks

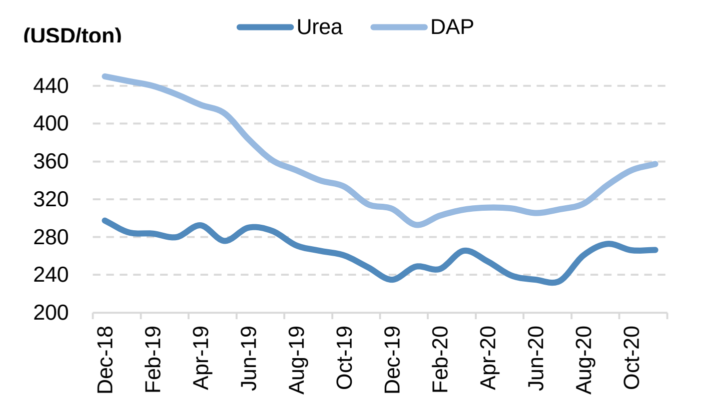
- Jump in gas tariff and inability to pass on the impact to consumers.
- GST registration issue for the dealers
- Natural disasters such as floods and earthquake.

Fig: Urea and DAP offtake and prices



Source (s): SBP, AHL Research

Fig: International Urea and DAP prices



Source (s): SBP, AHL Research

Fauji Fertilizer Company Limited

Stable earnings, stable payout

- **5-yr Earnings CAGR of 7%:** Keeping in view the company's diversified portfolio of business in banking, energy and FMCG sectors, we expect the company's profitability to grow at 5-yr CAGR of 7.3% to PKR 18.43/share in CY24. For CY21 and CY22, we expect bottom-line to arrive at PKR 15.73/share and PKR 16.85/share, respectively. Stability in essential business will be a major growth driver tagged with dividend income from AKBL, FFBL and FFCEL.
- **Urea offtake to remain stable:** We expect stable urea offtake (average of 2.5mn tons and 122% utilization level during last 5 years), to clock-in at 2.5mn tons for CY21. In addition, on the trading side we anticipate DAP offtake of the company at 0.3mn tons during CY21.
- **GIDC payment to be made in 48 months:** At the start of CY20 the government reduced the GIDC on gas, the benefit of which was passed on via drop in urea selling price. However, the pending case of GIDC in court was dismissed, making it mandatory to pay all pending GIDC payments till Jun'20 in 24 months' time. A review petition was filed by the company but it was again rejected but payment time was extended to 48 months.
- **Payout ratio:** The company has a higher dividend payout ratio of (5-year average at 83%) translating into an attractive dividend yield of 12.5% for CY21.
- **Thar energy to add further value:** During CY19 the company further invested PKR 1.3bn in the project, taking the company's total investment to PKR 2.8bn. The company still retains a 30% stake in Thar Energy Limited (TEL) which is a 330MW local coal based power plant at Thar. We expect earnings contribution of PKR 1.41/share on annualized basis from CY23 and a contribution of PKR 5.27/share to our target price.

Key metrics	Unit	2019A	2020E	2021F
Earnings per share	PKR	13.4	14.4	15.7
Dividend per share	PKR	10.8	12.0	13.0
Book Value per share	PKR	28.0	30.4	33.1
Price to Earning	x	7.5	7.2	6.6
Price to Book	x	3.6	3.4	3.1
Dividend Yield	%	10.6	11.5	12.5
Net Margins	%	16.2	19.4	20.2

Source (s): Company Financials, AHL Research

	FFC PA
Recommendation	**BUY**
Target Price (Dec'21)	136.5
Last Closing	104.1
Upside (%)	31.1
Shares (mn)	1,272
Free float (%)	55.0
Market Cap. (PKR mn)	132,465
Market Cap. (USD mn)	830.7

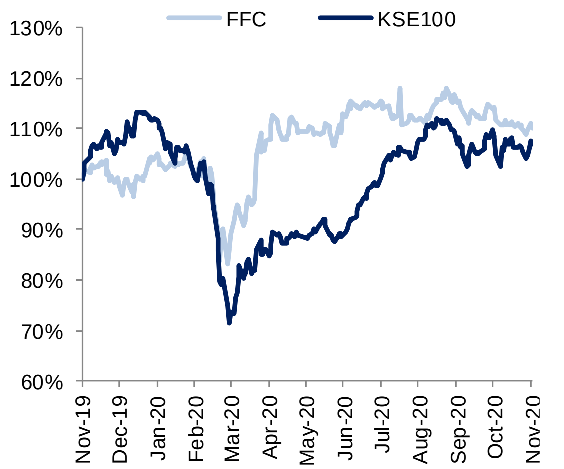
Major Shareholders

- Fauji Foundation

Price Performance

	3M	6M	12M
Return (%)	-1.8	-0.3	8.8
Avg. Volume (000)	778	973	1,088
ADTV (mn) - PKR	84	106	115
ADTV (000) - USD	514	639	710
High Price - PKR	111.7	111.7	111.7
Low Price - PKR	103.1	100.8	78.8

Relative Performance



Source: Bloomberg

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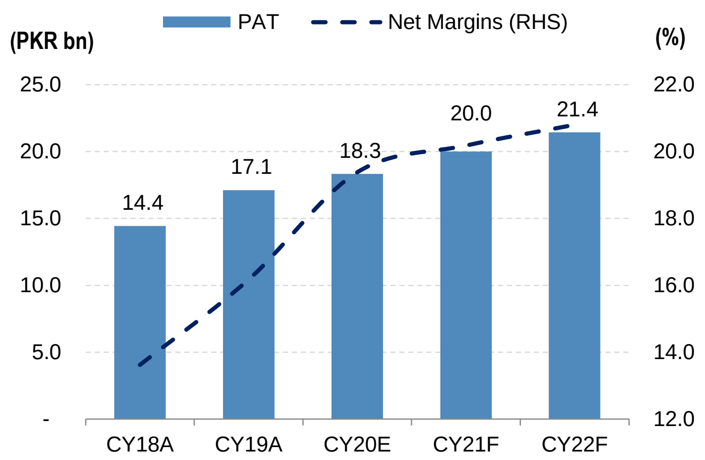
PKR mn	2019A	2020E	2021F
Income Statement			
Net Sales	105,783	94,525	99,159
Gross Profit	30,737	31,370	32,968
Other Income	7,191	6,070	6,356
Other Expenses	2,477	1,830	1,424
Post Tax Profit	17,110	18,320	20,009
Balance Sheet			
Shareholder's Equity	35,567	38,623	42,096
Trade and Other Payables	76,009	64,120	67,221
Total Liabilities	117,823	102,863	103,271
Current Assets	97,301	89,034	93,511
Non-Current Assets	56,089	52,452	51,856
Total Assets	153,390	141,486	145,366

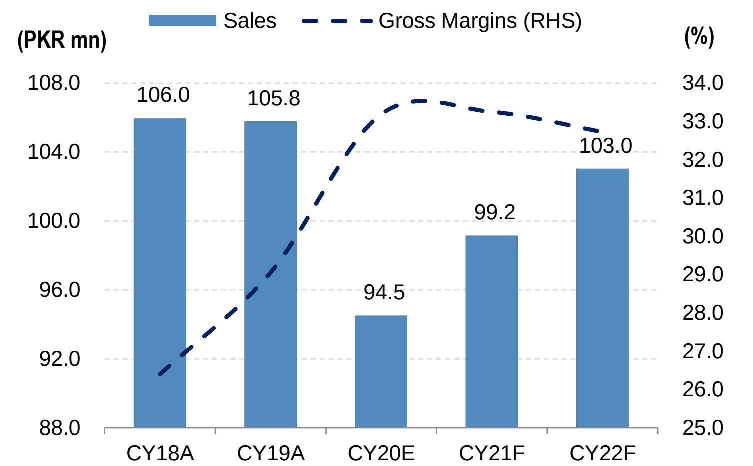
Source (s): Company Financials, AHL Research

Fig: Profitability



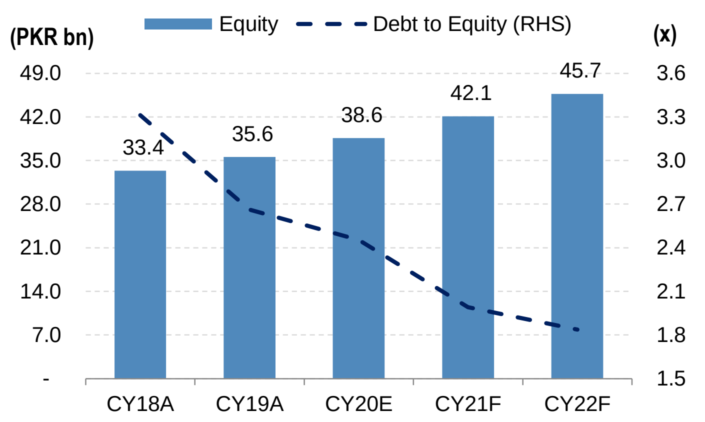
Source (s): Company Financials, AHL Research

Fig: Sales in relation to Gross Margins



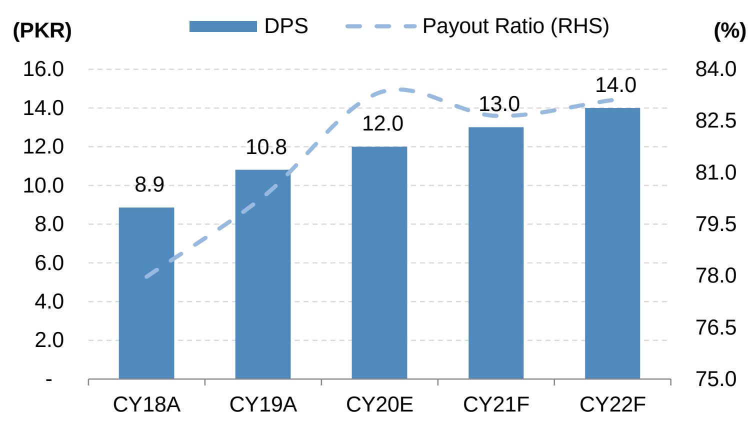
Source (s): Company Financials, AHL Research

Fig: Debt to Equity



Source (s): Company Financials, AHL Research

Fig: Dividend payout



Source (s): Company Financials, AHL Research

Engro Corporation Limited

Championing diversification

- **Earnings to grow at a 5-year CAGR of 16%:** We expect the company to post 5-year profitability CAGR of 16.30%. For CY21 and CY22 we forecast earnings to clock-in at PKR 43.4/share and PKR 47.2/share, respectively. This is anticipated on account of i) Engro Powergen Thar Power Limited (EPTPL) and Sindh Engro Coal Mining Company (SECMC) which has been operational since last year, 2) volumetric growth amid expansion in polymer business including PVC, VCM and hydrogen peroxide fueling higher profitability, 3) steady business operations from Elengy terminal based on fixed RoE, and 4) Engro Powergen Qadirpur, which is likely to remain stable amid secure gas supply.
- **Thar projects complete one year:** Sindh Engro Coal Mining Company (SECMC) has been operational for more than one year and has provided low cost electricity to the national grid. SECMC has provided estimated 4mn tons of coal to mine mouth power plant namely Engro Power Thar Limited (EPTL), which then produced around 4,305 GwH electricity with its 660MW plants in Jun'20. We expect earnings contribution in CY21 of PKR 12.16/share and PKR 2.44/share from EPTL and SECMC, respectively.
- **Other businesses:** EFERT's earnings are expected to drop given ambiguity on the continuation of concessionary gas for the company. EPCL's bottom-line is expected to grow given expected rise in usage of caustic soda amid higher orders from textile companies. Whereas, expansion in PVC III, VCM debottlenecking and OVR efficiency projects are expected to reach completion in CY21. While the Hydrogen Peroxide project has been delayed till CY22. Meanwhile, operations of Engro Powengen Qadirpur, Engro Elengy and Engro Vopak are anticipated to be steady with relative stability in PKR/USD parity which is likely to bode well for the businesses. Furthermore, FCEPL is expected to be stable owed to increase in demand for packaged milk business.
- **Future investments:** For upcoming projects such as RLNG terminal, Naptha cracking facility and incremental investment in Thar mine mouth power plant in Phase 3 and 4 of CPEC, the company has sufficient liquidity, standing at PKR 58bn as at Sep'20.

Key metrics	Unit	2019A	2020E	2021F
Earnings per share	PKR	28.7	41.7	43.4
Dividend per share	PKR	24.0	31.0	33.0
Book Value per share	PKR	338.9	346.3	364.5
Price to Earning	x	12.0	7.4	7.1
Price to Book	x	1.0	0.9	0.8
Dividend Yield	%	7.0	10.1	10.8
Net Margins	%	7.3	15.6	15.4

Source (s): Company Financials, AHL Research

	ENGRO PA
Recommendation	**BUY**
Target Price (Dec'21)	410.5
Last Closing	306.8
Upside (%)	33.8
Shares (mn)	576
Free float (%)	55.0
Market Cap. (PKR mn)	176,755
Market Cap. (USD mn)	1,108.5

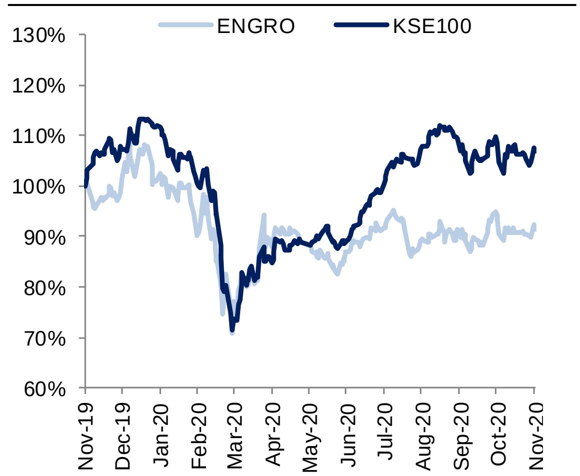
Major Shareholders

- Dawood Hercules Corporation Limited

Price Performance

	3M	6M	12M
Return (%)	2.3	5.2	-9.2
Avg. Volume (000)	562	678	755
ADTV (mn) - PKR	172	205	232
ADTV (000) - USD	1,050	1,240	1,445
High Price - PKR	318.3	319.2	366.0
Low Price - PKR	291.8	277.2	237.7

Relative Performance



Source: Bloomberg

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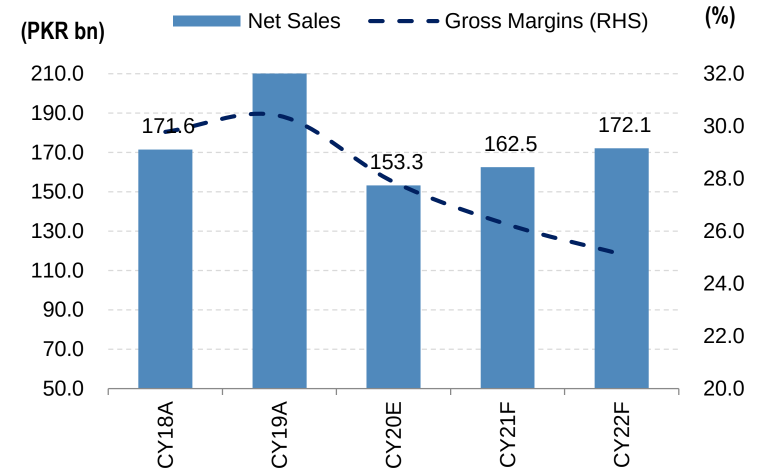
PKR mn	2019A	2020E	2021F
Income Statement			
Net Sales	225,920	153,350	162,491
Gross Profit	68,686	42,753	42,659
Other Income	13,663	2,456	2,605
Other Expenses	8,478	4,271	4,307
Post Tax Profit	16,533	23,999	24,984
Balance Sheet			
Shareholder's Equity	195,249	199,553	210,023
Trade and Other Payables	102,807	39,899	39,792
Total Liabilities	354,996	159,634	78,786
Current Assets	206,078	107,725	112,336
Non-Current Assets	344,168	251,462	176,472
Total Assets	550,245	359,187	288,808

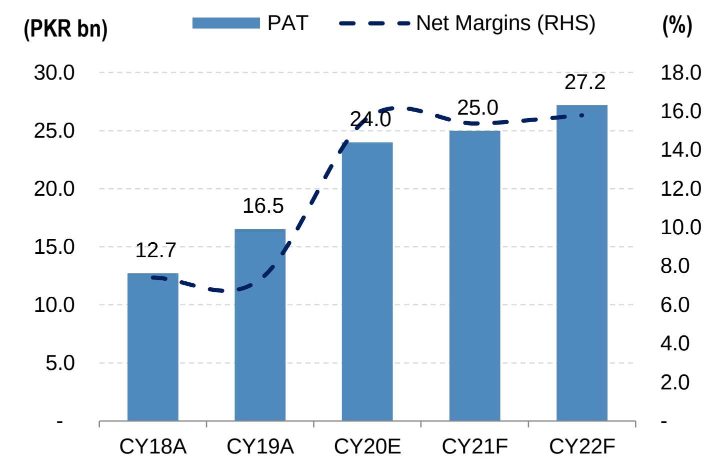
Source (s): Company Financials, AHL Research

Fig: Net Sales in relation to Gross Margins



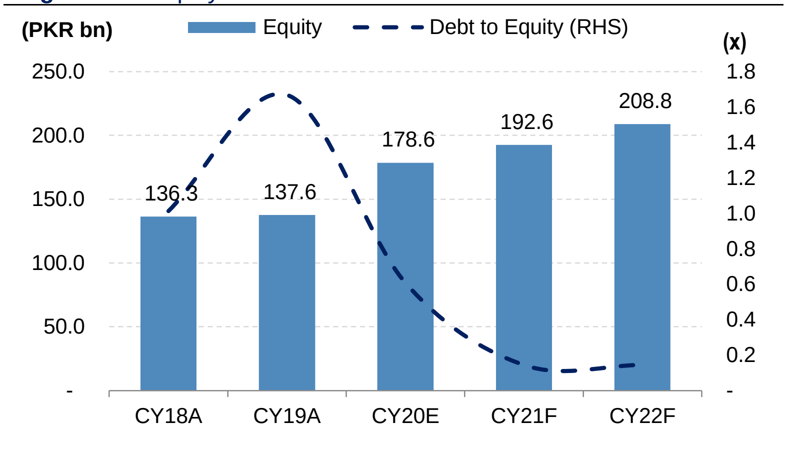
Source (s): Company Financials, AHL Research

Fig: Profitability margin



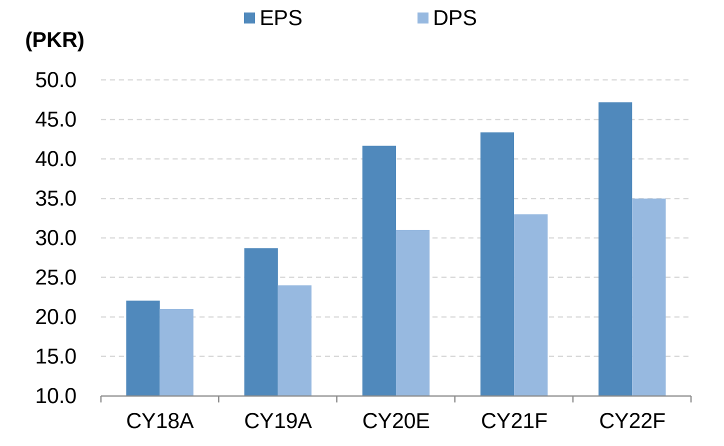
Source (s): Company Financials, AHL Research

Fig: Debt to Equity



Source (s): Company Financials, AHL Research

Fig: Earnings in relation to dividends



Source (s): Company Financials, AHL Research

Engro Fertilizers Ltd.

Sow today, yield tomorrow

- **Urea demand:** We expect urea demand for CY21 to arrive at 5.8MT, which is a 10-year average. Based on available gas, EFERT can produce up to 2.0MT urea during CY21 as per our estimates. However, if additional gas will be provided to the company then the production could increase to 2.2 MT urea in CY21.

- **Ambiguity on the concessionary gas:** For company's EnVen plant, the company is receiving concessionary gas at the rate of USD 0.7/mmbtu. However, the company started receiving concessionary gas in 2013 as compared to the initial agreement of 2011. This is expected to create ambiguity on the conclusion of the concessionary gas flow in 2021 or 2023. However, given the agreement of 10 years for the concessionary gas flow, we believe there would be litigation on the matter and on prudent basis, we have assumed the company will book gas at industry rate from Jul'21.

- **Reduction in urea price:** At the start of CY20, the ECC accepted the proposal put forward by Ministry of Industries and Production to provide relief in terms of reduction in GIDC rate on manufacturers. Once this was approved the company passed on the benefit to consumers by decreasing urea prices by PKR 160/bag. Moreover, keeping in view adverse impact of pandemic on the country, the company further reduced its urea price to PKR 240/bag. With this, the estimated benefit of PKR 28bn is expected to be passed on to the farmers. Therefore, overall price reduction comes out at PKR 400/bag since start of 1QCY20, taking the Urea price per bag to PKR 1,604/bag from PKR 2,004/bag previously.

- **SC mandates payment of GIDC:** The honorable supreme court has mandated payment of GIDC which was to be paid in within 24 installments over two years. However, the company applied for a review petition which was reject but extended installment period to 48 months over five years for non-concessionary gas. Furthermore, the company was able to get a stay order for concessionary gas and we expect the decision to be in the favor of the company.

- **Earnings to arrive at PKR 7.5/share in CY21:** We expect the company's earning in CY21 and CY22 to clock-in at PKR 7.5/share and PKR 7.1/share, respectively. The stock is trading at CY21 PE 8.1x along with a dividend yield of 12% (highest amongst the peers).

- **Income tax disallowance:** FBR has made income tax disallowance on sales to unregistered dealers, which was made applicable from 1st Oct'20. The company is discussing the possible solutions with FBR regarding income tax disallowance. If the matter is not resolved, then the company will consider passing on the cost to the consumers.

Key metrics	Unit	2019A	2020E	2021F
Earnings per share	PKR	12.6	10.9	7.5
Dividend per share	PKR	13	11	7.5
Book Value per share	PKR	32.4	32.3	32.3
Price to Earning	x	5.8	5.6	8.1
Price to Book	x	2.3	1.9	1.9
Dividend Yield	%	17.7	18.1	12.3
Net Margins	%	13.9	12.4	8.4

Source (s): Company Financials, AHL Research

EFERT PA

Recommendation	BUY
Target Price (Dec'21)	77.8
Last Closing	60.8
Upside (%)	27.8
Shares (mn)	1,335
Free float (%)	45.0
Market Cap. (PKR mn)	81,213
Market Cap. (USD mn)	509.3

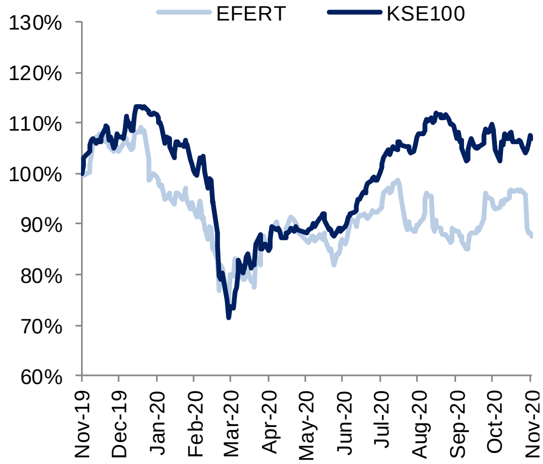
Major Shareholders

- Engro Corporation Limited

Price Performance

	3M	6M	12M
Return (%)	-3.1	1.7	-12.4
Avg. Volume (000)	2,577	2,487	2,608
ADTV (mn) - PKR	165	158	167
ADTV (000) - USD	1,012	957	1,034
High Price - PKR	67.1	68.5	75.6
Low Price - PKR	58.9	56.7	50.7

Relative Performance



Source: Bloomberg

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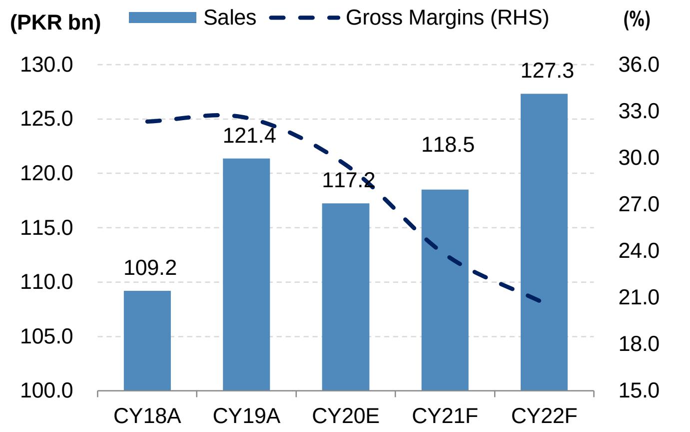
PKR mn	2019A	2020E	2021F
Income Statement			
Net Sales	121,355	117,240	118,501
Gross Profit	39,540	34,649	28,186
Other Income	4,352	1,447	1,611
Other Expenses	2,623	2,170	2,697
Post Tax Profit	16,871	14,595	9,980
Balance Sheet			
Shareholder's Equity	43,279	43,186	43,151
Trade and Other Payables	37,685	10,753	9,329
Total Liabilities	83,767	50,276	47,438
Current Assets	55,888	24,775	24,230
Non-Current Assets	71,159	68,687	66,360
Total Assets	127,047	93,462	90,589

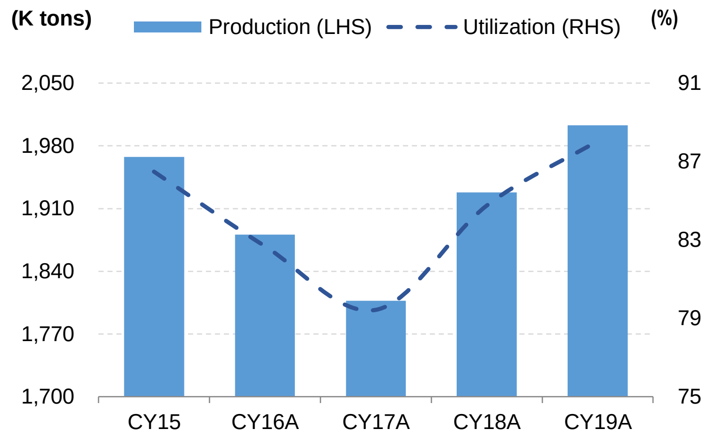
Source (s): Company Financials, AHL Research

Fig: Sales and Gross margins



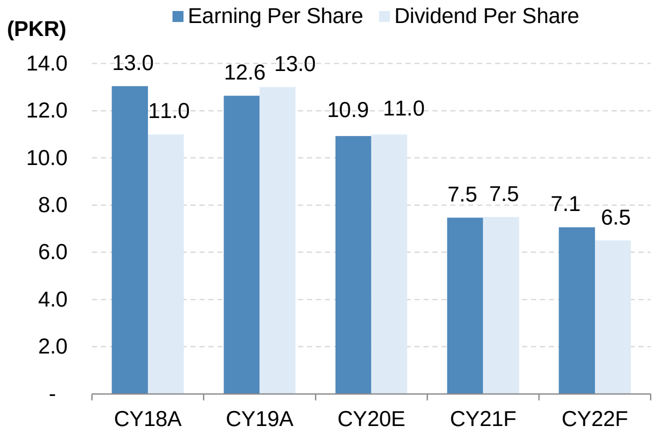
Source (s): Company Financials, AHL Research

Fig: Urea production



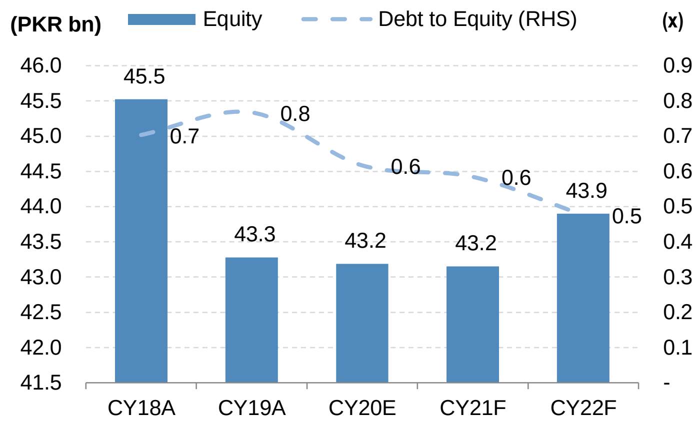
Source (s): Company Financials, AHL Research

Fig: EPS in relation to DPS



Source (s): Company Financials, AHL Research

Fig: Debt to Equity



Source (s): Company Financials, AHL Research

Exploration and Production

Enticing valuations

Exploration and Production

International oil price outlook

- **COVID-19 pandemic:** The COVID-19 pandemic is the most significant event in the long history of commodity demand and supply shocks. With the pandemic hitting worldwide in Feb'20/Mar'20, followed by lockdown in major oil consuming countries, the global oil demand in the following months plunged sharply with an estimated cut of 30-35mn bopd. Countries that are net exporters of oil faced an extraordinary two-way shock: a global economic contraction driven by the COVID-19 pandemic and an oil market collapse with the benchmark price for United States crude oil (WTI), briefly going negative for the first time in history (Apr'20).

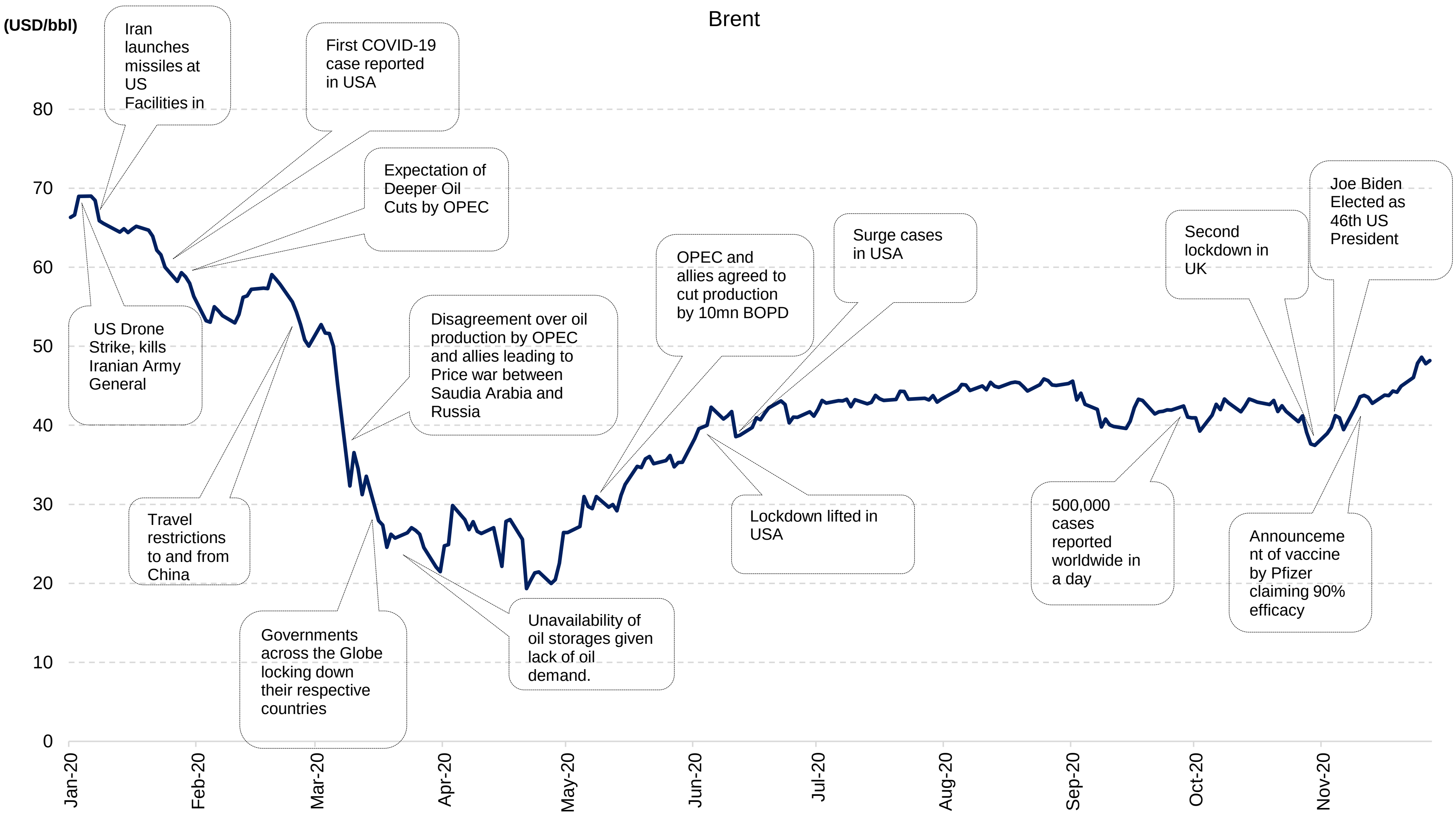
- **Historic production cuts:** The COVID-19 pandemic forced some of the world's largest oil producers to agree on the terms of historic output cuts. The alliance of OPEC and OPEC+ members agreed to cut production by 10mn bopd along with additional 5mn bopd cuts by G20 countries. Moreover, during Jun'20 OPEC+ meeting, these cuts were further extended till Jul'20. After rebounding from April lows, oil demand recovered in a more sluggish trajectory with prices averaged nearly 40% QoQ higher in the 3QCY20.

- **Demand outlook:** The lockdown and travel restrictions have created an unprecedented demand shock in global oil markets and has changed the entire equation of demand/supply and most importantly storage across the globe. The global oil demand is heavily dependent on the duration of the second wave of COVID-19, as surging COVID cases in the United States and Europe are prompting renewed lockdowns, curfews, mask mandates, and travel restrictions, which would weigh in on economic activity and transportation demand in the near term. However, progress on vaccine development give hopes that the oil market will regain some balance next year. In CY21, world oil demand is expected to grow by 5.89 mb/d to 98.80 mb/d. Major contributor for the growth is expected to be demand from United Sates (+1.7mb/d YoY), Asian countries (+1.20 mb/d YoY) and China (+0.97 mb/d YoY).

- **Supply outlook:** The non-OPEC oil supply growth for CY21 is expected to clock in at 64.88 mb/d which is an increase of 1.13 mb/d YoY mainly due to growth from OECD countries (+0.39 mb/d YoY) and non-OECD countries (+3.53 mb/d). Moreover, supply for OPEC in CY21 is expected to jump up by 2.80 mb/d to 33.50mb/d as compared to 30.70 mb/d in CY20.

- **Oil price drivers:** We believe that international oil prices in 2021 are dependent mainly on the pace of recovery from the current pandemic challenges. Moreover, fuel demand and the rate of inventory drawdowns in CY21 will determine the trend of oil prices until safe and effective vaccines become available to a critical mass of people around the globe. Moreover, another important aspect will be the political relationship and trade between US and China post the victory of Democratic candidate Joe Biden in the US presidential election 2020. Any clash of interest in OPEC and OPEC+ countries post pandemic to gain market share is another aspect to look out for. Moreover, President-elect Joe Biden's policy pertaining to Iran will also be an important and deciding factor in the demand-supply gap. Additionally, the policies of the central banks across the globe would be important to watch as they are supporting growth momentum at the moment and likely to expedite the same in much of the year ahead. For AHL Research Universe, we have assumed oil prices to average at USD 45/bbl in 2021.

Exploration and Production
Event Graph



Exploration and Production

Enticing valuations

- **Pakistan's hydrocarbon production:** During FY20, Pakistan's oil production tumbled by 14% YoY to settle at 76,739 bopd against 89,030 bopd during FY19 amid partial shutdown at major oil production fields given impostion of lockdown by the govt. to contain COVID-19. Similarly, gas production witnessed a slide of 8% YoY arriving at 3,597 mmcfd in FY19 vis-à-vis 3,936 mmcfd in FY18. For FY21, we expect production flows to normalize from major fields such Nashpa, KPD-TAY, Adhi and TAL Block.

- **Exploration targets:** The domestic E&P companies spud a total of 58 wells out of 92 planned wells, which comprises of 25 exploratory and 33 development/appraisal wells during FY20. Within the wells drilled, 10 oil & gas discoveries were made. For FY21, 80 wells (44 exploratory and 36 development/appraisal wells) are planned to be spud by local E&P companies.

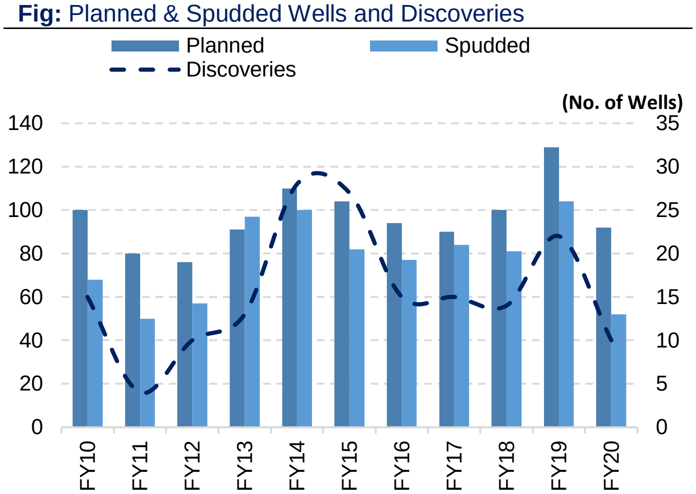
- **Trading at cheap valuations:** The AHL E&P sector is currently trading at a PER of 5.3x based on FY21 earnings expectations compared to a PER of 7.3x of the KSE-100 Index and a five year historical PER of 7.5x of the sector.

- **Dependency on PKR/USD parity and oil price movement:** For the AHL E&P Universe, weaker PKR/USD parity has a positive impact on earnings while a stronger Rupee has a vice versa impact. We estimate that for every 5% Pak Rupee depreciation, profitability of AHL E&P Universe will improve by 3%. Whereas companies in the E&P Universe are dependent on Arab Light whereby a USD 5/bbl change in oil price will have a 3% and 8% impact on the AHL E&P Universe earnings in FY21 and FY22, respectively.

Key risks

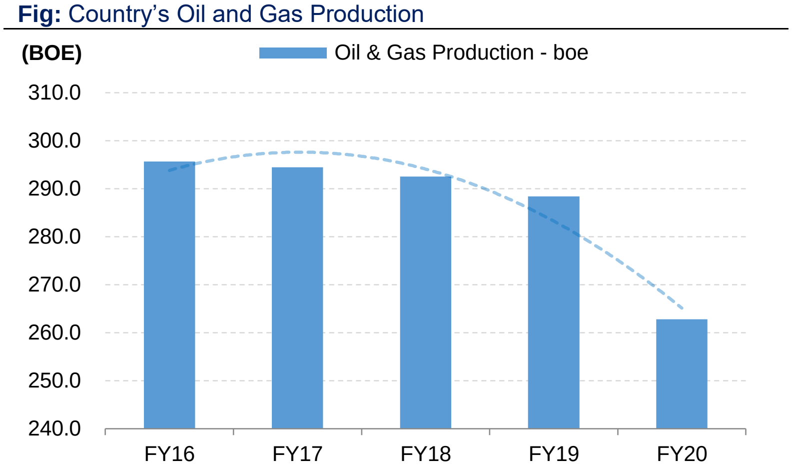
- Appreciation of Pak Rupee against USD and prolonged drastic fall in oil prices.
- Unfavorable decision of windfall levy in court of law.
- Inability to expand hydrocarbon reserves and low Reverse Replacement Ratio (RRR).
- Higher COVID-19 infection ratio resulting in extended lockdowns countrywide.
- Prolonged structural issues delaying new discoveries from coming online.

Fig: Planned & Spudded Wells and Discoveries



Source (s): Company Financials, AHL Research

Fig: Country's Oil and Gas Production



Source (s): Company Financials, AHL Research

Oil Price Sensitivity

Case-1: Oil Prices Assumption (USD/bbl) and Fair Values

Code	Current Price	TP Dec-21	Upside (%)	Stance	EPS (PKR) 2021	EPS (PKR) 2022	DPS (PKR) 2021	DPS (PKR) 2022	P/E (x) 2021	P/E (x) 2022	DY (%) 2021	DY (%) 2022
PPL	90.2	123.1	36.5	Buy	16.5	14.3	1.00	1.00	5.5	6.3	1%	1%
OGDC	99.6	144.3	44.9	Buy	17.9	17.4	7.25	7.00	5.6	5.7	7%	7%
MARI	1,364.1	1,583.5	16.1	Buy	209.5	192.3	6.75	6.50	6.5	7.1	0%	0%
POL	392.4	422.4	7.7	Hold	41.6	39.3	37.00	35.00	9.4	10.0	9%	9%

With USD 30/bbl in FY21 and going forward

Case-2: Oil Prices Assumption (USD/bbl) and Fair Values

Code	Current Price	TP Dec-21	Upside (%)	Stance	EPS (PKR) 2021	EPS (PKR) 2022	DPS (PKR) 2021	DPS (PKR) 2022	P/E (x) 2021	P/E (x) 2022	DY (%) 2021	DY (%) 2022
PPL	90.2	136.3	51.2	Buy	17.2	17.4	1.50	1.50	5.2	5.2	2%	2%
OGDC	99.6	166.5	67.2	Buy	19.6	22.0	7.75	8.75	5.1	4.5	8%	9%
MARI	1,364.1	1,774.0	30.1	Buy	211.3	220.3	6.75	6.50	6.5	6.2	0%	0%
POL	392.4	492.8	25.6	Buy	46.8	50.3	42.00	45.00	8.4	7.8	11%	11%

With USD 40/bbl in FY21 and going forward

Base Case: Oil Prices Assumption (USD/bbl) and Fair Values

Code	Current Price	TP Dec-21	Upside (%)	Stance	EPS (PKR) 2021	EPS (PKR) 2022	DPS (PKR) 2021	DPS (PKR) 2022	P/E (x) 2021	P/E (x) 2022	DY (%) 2021	DY (%) 2022
PPL	90.2	148.7	64.9	Buy	17.9	20.4	1.50	2.00	5.0	4.4	2%	2%
OGDC	99.6	187.1	87.8	Buy	21.2	26.1	8.50	10.50	4.7	3.8	9%	11%
MARI	1,364.05	1,962.5	43.9	Buy	213.1	247.5	6.75	6.50	6.4	5.5	0%	0%
POL	392.4	556.6	41.9	Buy	50.9	60.0	46.00	54.00	7.7	6.5	12%	14%

With USD 50bbl in FY21 and going forward

Case-4: Oil Prices Assumption (USD/bbl) and Fair Values

Code	Current Price	TP Dec-21	Upside (%)	Stance	EPS (PKR) 2021	EPS (PKR) 2022	DPS (PKR) 2021	DPS (PKR) 2022	P/E (x) 2021	P/E (x) 2022	DY (%) 2021	DY (%) 2022
PPL	90.2	158.7	76.0	Buy	18.7	22.9	1.50	3.00	4.8	3.9	2%	3%
OGDC	99.6	207.3	108.1	Buy	22.9	30.2	9.25	12.00	4.3	3.3	9%	12%
MARI	1,364.1	2,118.0	55.3	Buy	215.0	270.4	6.75	6.50	6.3	5.0	0%	0%
POL	392.4	617.2	57.3	Buy	55.0	69.4	50.00	62.00	7.1	5.7	13%	16%

With USD 60/bbl in FY21 and going forward

Oil & Gas Development Company Limited

A sound bet

- **Production & developmental projects:** The oil and gas production in FY20 witnessed a fall of 11% and 12% YoY, respectively due to extended annual turnarounds and lockdown amid COVID-19 outbreak. With normalization of production post lockdown, we expect oil and gas production to witness a growth of 8% and 12% YoY, respectively in FY21, stemming from Nashpa, Uch, Qadirpur, Adhi and KPD-TAY. Moreover, fourteen wells were also added to the production system during FY20. Furthermore, Gundanwari and Chabaro Development Project is expected to be completed in 2HFY21, which will add 18 mmcfd and 25 bopd of oil and gas, respectably. Meanwhile, for Qadipur Compression Project, upgradation of turbine has commenced and PC contractor selection is in final stages. The estimated completion time is in 2HFY22. Similarly, for Uch Compression EPCC contractor will be hired, with expected completion in 2HFY23.
- **Planned operations & activities for FY21:** The company has planned to drill 26 exploratory & appraisal wells followed by 12 developmental and 7 re-entry wells. Furthermore, OGDC has commenced working on Shale Pilot Project. The company spud pilot well KUC-1 at Kunnar ML during FY20 for the purpose of assessing prospects of shale gas and gather firsthand information. In addition, the company along with PPL, MARI and GHPL formed a consortium (each company has a 25% stake), which has submitted a bid for Abu Dhabi's Offshore Block-8. If the consortium wins the bid, it will expand footprint of OGDC, PPL and MARI outside Pakistan.
- **Higher reserve life**: According to PPIS's Oil & Gas Reserve Report for Jun'20, OGDC's reserve life is expected to be 14 years. The company's oil and gas reserves stand at 118mn bbls and 7,768 bcf, respectively as per Jun'20 reserves. Dhok Hussain's hydrocarbon reserves of 11mn BOE were added to OGDC's total reserves in Jun'20.
- **Trading at the cheapest PE multiple:** The stock is currently trading at an implied oil price of USD 13.53/bbl as compared to Arab Light Price of USD 46.62/bbl with FY21 PER of 4.7x and P/B of 0.6x along with a dividend yield of 9%. We expect the company to post a bottom-line of PKR 21.24/share and PKR 26.10/share in FY21 and FY22, respectively.

Key metrics		2020A	2021E	2022F
Earnings per share	PKR	23.2	21.2	26.1
Dividend per share	PKR	6.75	8.50	10.50
Book Value per share	PKR	160.2	174.6	190.9
Price to Earning	x	4.7	4.7	3.8
Price to Book	x	0.7	0.6	0.5
Dividend Yield	%	6.2	8.5	10.5
Net Margins	%	40.9	36.1	37.7

Source (s): Company Financials, AHL Research

	OGDC PA
Recommendation	**BUY**
Target Price (Dec'21)	187.1
Last Closing	99.6
Upside (%)	87.8
Shares (mn)	4,301
Free float (%)	15.0
Market Cap. (PKR mn)	428,372
Market Cap. (USD mn)	2,686.4

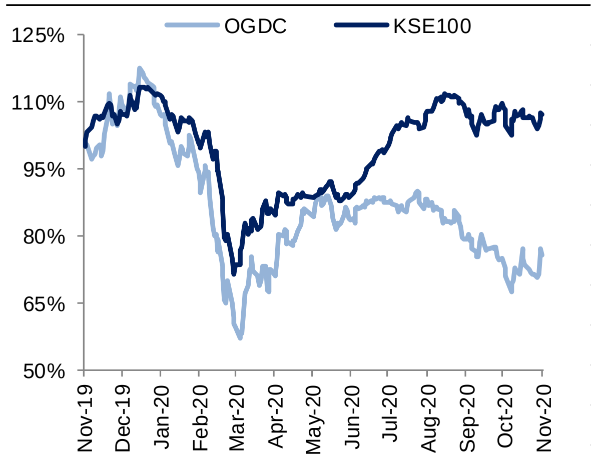
Major Shareholders

- Govt. of Pakistan

Price Performance

	3M	6M	12M
Return (%)	-12.7	-13.1	-24.7
Avg. Volume (000)	2,089	2,172	3,075
ADTV (mn) - PKR	212	235	343
ADTV (000) - USD	1,305	1,426	2,144
High Price - PKR	114.8	118.2	154.2
Low Price - PKR	88.9	88.9	75.0

Relative Performance



Source: Bloomberg

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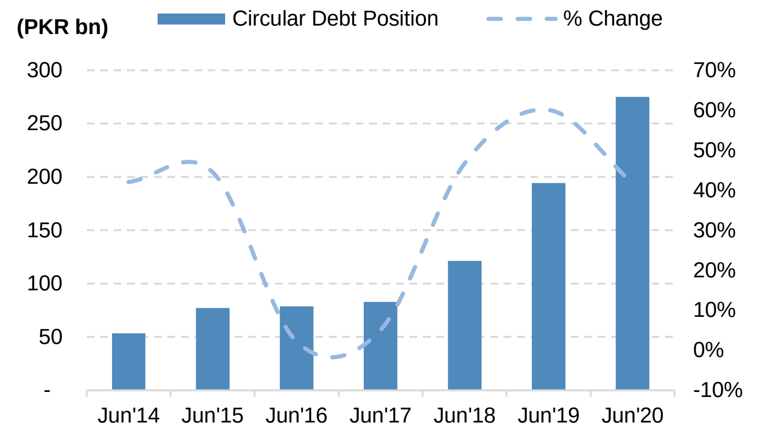
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	244,857	253,155	297,556
Gross Profit	149,078	157,395	198,347
Operating Profit	125,794	119,064	153,861
Finance Cost	3,011	2,628	3,245
Post Tax Profit	100,082	91,348	112,263
Balance Sheet	**2020A**	**2021E**	**2022F**
Shareholder's Equity	688,858	750,781	821,193
Trade and Other Payables	94,347	97,544	114,652
Total Liabilities	172,606	175,464	196,274
Current Assets	556,769	619,931	707,113
Non-Current Assets	304,695	306,314	310,355
Total Assets	861,464	926,245	1,017,467

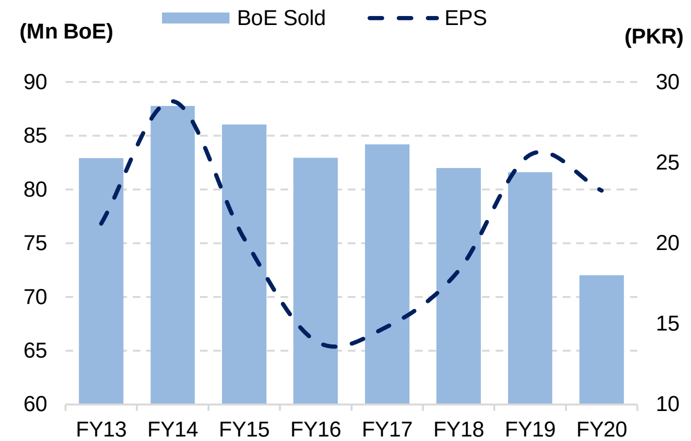
Source (s): Company Financial, AHL Research

Fig: OGDC's Circular Debt Position



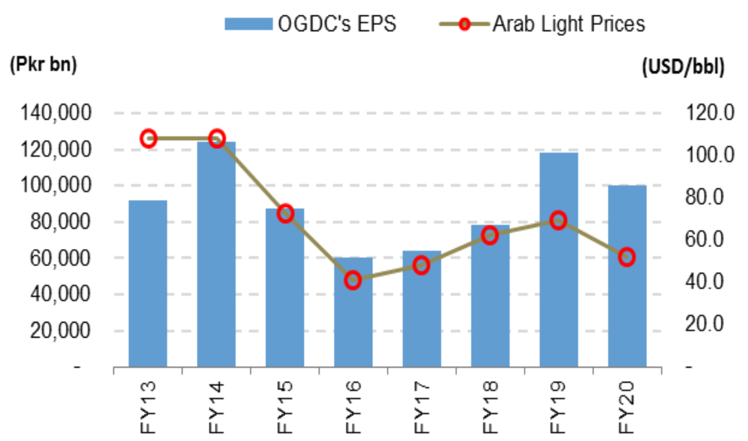
Source (s): Company Financials, AHL Research

Fig: OGDC BoE sold and EPS



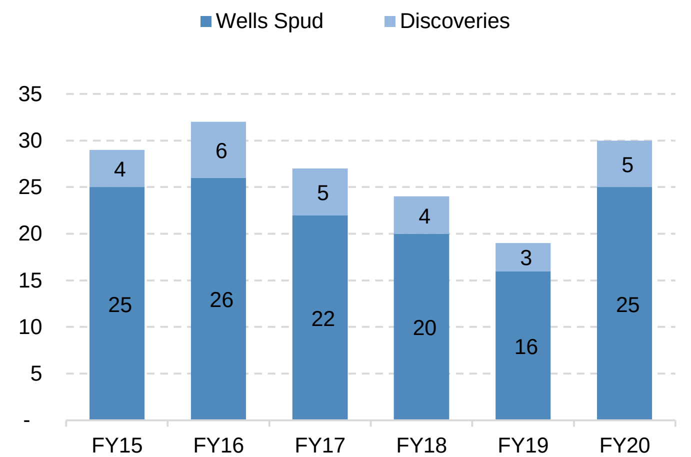
Source (s): Company Financials, AHL Research

Fig: OGDC's Earnings in relation to Arab Light Prices



Source (s): Company Financials, AHL Research

Fig: OGDC's Hydrocarbon Discoveries against Wells Spud



Source (s): Company Financials, AHL Research

Pakistan Petroleum Limited

Circular debt resolution to unlock value

- **Update on production & development projects:** PPL displayed a fall in oil and gas production of 11% and 12% YoY, respectively in FY20 due to natural decline at Kandkhot and Sui followed by temporary halt in production due to lockdown in the country. We expect oil and gas production to recover by 9% and 6% YoY in FY21, given additional production from new discoveries at Benari, Morgandh, and Mamikhel South to the production system tagged with increase in production from regular fields like Gambat South, TAL, Nashpa and Adhi Block. Moreover, company is adding new development wells in Sui to mitigate natural decline (Sui-106 and Sui-110 commencing production). The company is also commissioning phase II of GPV-IV plant in Gambat South Block which is expected to reach completion in 2QFY21. After completion the plant will produce an additional 30mmcfd of gas. Furthermore, gas pipeline at Benari is being setup to start production from the well.
- **Outlook on future operations:** For FY21 the company plans to spud 10 wells (5 exploratory and 5 developmental). The company has entered into farm-in agreement, in which operatorship of Baska Block from ZhenHua will be transferred to the company. Similarly, PPL has executed agreement to acquire Shakarganj West Block's 50% working interest from OGDC. Moreover, the company has farmed-out 50% and 2.5% stake at Punjab Block to OGDC and GHPL, respectively.The company is also farming out 32% working Block 8 at Iraq to MARI. Along with this, the company farmed-out 12.5% and 1.3% stake of Musakhel to POGC and GHPL, respectively. Lastly the company is diversifying into mineral mining projects entering into iron ore, zinc and lead mining.
- **Bottom-line to settle at PKR 17.93/share in FY21:** We expect profitability to depict a 3-Yr CAGR of 5%. PAT is expected to settle at PKR 17.93/share in FY21 amid i) Normalization in oil and gas production and ii) Oil Prices expected to hover around USD 50/bbl towards the end of FY21. At present, the stock is trading at a FY21 PE multiple of 5.0x and P/B of 0.6x along with a dividend yield of 2%.
- **Circular debt strain:** Circular debt piled up on PPL's balance sheet is emanating from the gas sector and currently stands at PKR 329bn – 2.1x of net sales (FY20). Moreover, the net receivables position stood at PKR 213bn which translates into cash/share of ~PKR 78.3. The overdue receivables amount to PKR 289bn. Any progress on the circular debt resolution front specifically for the gas sector will result in hefty inflows for the company, which should help in re-rating of multiples whilst also reviving healthy dividend payouts.

Key metrics		2020A	2021E	2022F
Earnings Per Share	PKR	18.5	17.9	20.4
Dividend Per Share	PKR	1.0	1.5	2.0
Book Value Per Share	PKR	126.6	141.6	159.0
Price to Earning	x	4.7	5.0	4.4
Price to Book	x	0.7	0.6	0.6
Dividend Yield	%	1.2	1.7	2.0
Net Margins	%	31.9	31.6	32.9

Source (s): Company Financials, AHL Research

	PPL PA
Recommendation	**BUY**
Target Price (Dec'21)	148.7
Last Closing	90.2
Upside (%)	64.9
Shares (mn)	2,721
Free float (%)	24.5
Market Cap. (PKR mn)	245,295
Market Cap. (USD mn)	1,538.3

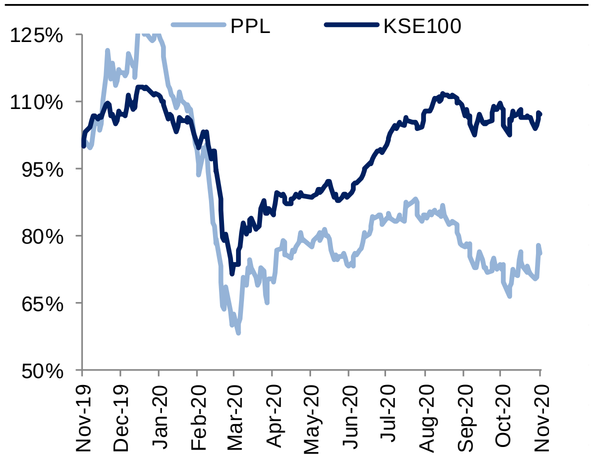
Major Shareholders

- Govt. of Pakistan

Price Performance

	3M	6M	12M
Return (%)	-9.5	-3.8	-24.3
Avg. Volume (000)	2,570	4,035	3,905
ADTV (mn) - PKR	237	388	395
ADTV (000) - USD	1,451	2,341	2,442
High Price - PKR	103.1	104.9	151.8
Low Price - PKR	78.9	78.9	69.1

Relative Performance



Source: Bloomberg

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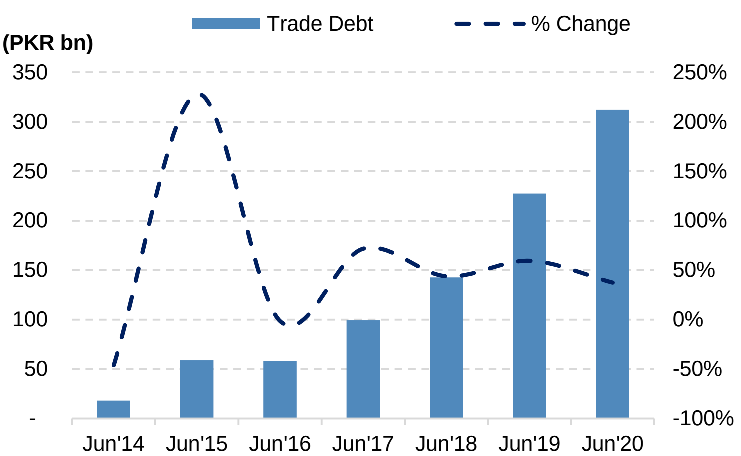
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	157,593	151,697	158,050
Gross Profit	91,034	84,939	91,363
Other Income	6,465	4,520	5,068
Finance Cost	1,070	1,289	1,510
Post Tax Profit	50,256	47,723	51,421

Balance Sheet	2020A	2021E	2022F
Shareholder's Equity	344,598	384,158	427,416
Total Liabilities	197,304	183,887	188,155
Current Assets	345,528	353,498	385,938
Fixed Assets	158,997	177,170	192,256
Non-Current Assets	196,374	214,547	229,633
Total Assets	541,902	568,045	615,571

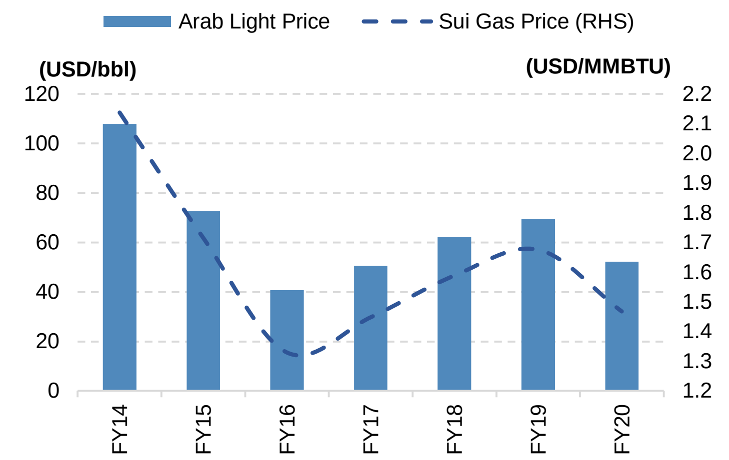
Source (s): Company Financial, AHL Research

Fig: PPL's Circular Debt Position



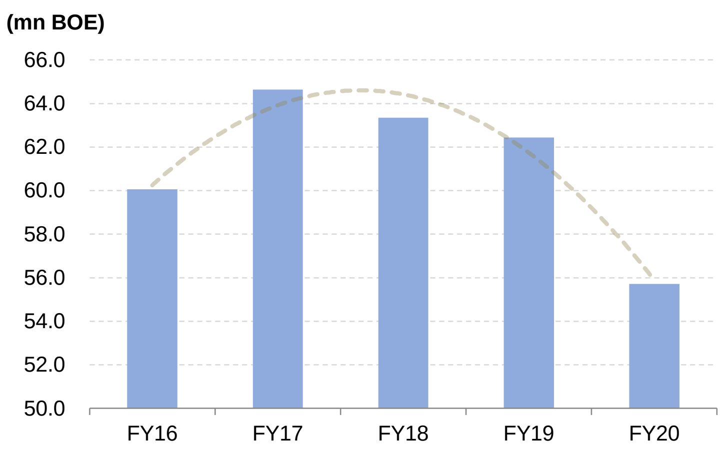
Source (s): Company Financials, AHL Research

Fig: Arab Light vs. Sui Gas Price



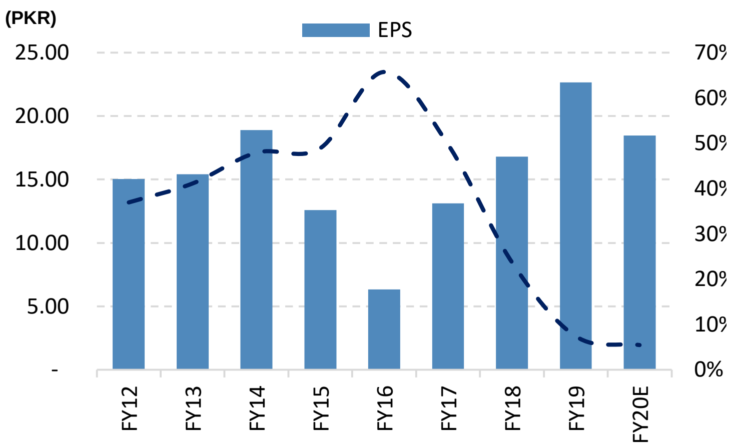
Source (s): Company Financials, AHL Research

Fig: Production in terms of BoE



Source (s): Company Financials, AHL Research

Fig: Earnings in Relation to Dividend Payout



Source (s): Company Financials, AHL Research

Pakistan Oilfields Ltd.

Biggest beneficiary of oil price rebound

- **Drilling activity:** The company plans to drill two exploratory wells DG Khan Well and Kithar South well in 3QFY21. Meanwhile, Mamikhel South (which is a new discovery) is undergoing evaluation and will be appraised. This well is expected to commence production in 3QFY21. Whereas, appraisal well Jhandial-2 was sidetracked and is undergoing testing, which will also determine and reassess reserve size. Furthermore, after abandoning drilling and testing activity at Balkassar Deep-1, the company commenced drilling at upper developed zone of the well. At present the well is producing 30-35 bopd of oil and is still under testing phase. Development Wells Ratana-5 and Mardenkhel-4 are expected to be spud in 2HFY20.
- **Hydrocarbon production:** Due to outbreak of COVID-19 and resultant lockdown to counter it, the oil and gas production was effected (partial shutdown at TAL and Adhi), plummeting by 13% and 9% YoY, respectively in FY20. We expect oil and gas production in FY21 to climb up by 9% and 13% YoY, respectively owed to addition of oil and gas production from Mamikhel South-01 and Pindori-10 tagged with normalized production from TAL Block and Adhi. We expect oil and gas production to have a 3-Yr CAGR of 8% and 7%, respectively.
- **Exploration licenses:** The company obtained Exploration License and Petroleum Concession Agreement for Taung Block in Sindh during FY20, where company has a 40% stake with MARI and a 60% operating interest. Subsequent to this, the company has commenced 3-D data acquisition at this block. Furthermore, the company plans to participate in government's next bidding round for new exploration licenses. Moreover, the company is evaluating Eni Pakistan's hydrocarbon portfolio and will make decision after assessment.
- **Highest dividend yield:** During FY21 the company is anticipated to declare a dividend payout and dividend yield of 90% and 12%, respectively. The stock is currently trading at an implied oil price of USD 26.40/bbl as compared to Arab Light price of USD 46.62/bbl currently with FY21 PER of 7.8x and P/B of 3.7x. We expect the company to post earnings of PKR 50.92/share and PKR 59.97/share in FY21 and FY22, respectively.

Key Metrics		2020A	2021E	2022F
Earnings Per Share	PKR	57.7	50.9	60.0
Dividend Per Share	PKR	50.0	46.0	54.0
Book Value Per Share	PKR	141.9	139.9	149.9
Price to Earning	x	6.1	7.7	6.5
Price to Book	x	2.5	2.8	2.6
Dividend Yield	%	14.3	11.7	13.8
Net Margins	%	42.9	37.5	39.4

Source (s): Company Financials, AHL Research

POL PA

Recommendation	BUY
Target Price (Dec'21)	556.6
Last Closing	392.4
Upside (%)	41.9
Shares (mn)	284
Free float (%)	45.7
Market Cap. (PKR mn)	111,388
Market Cap. (USD mn)	698.5

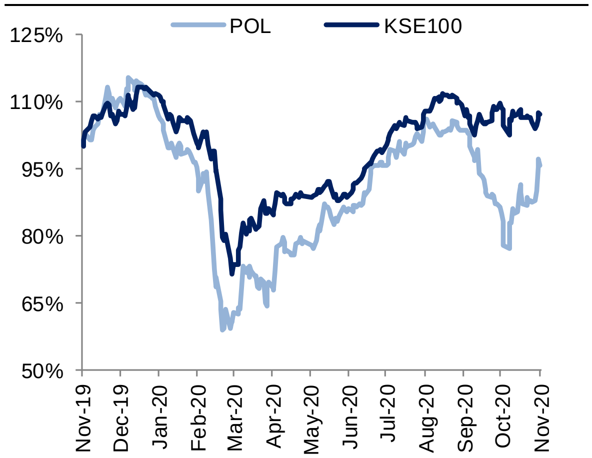
Major Shareholders

- The Attock Oil Company Ltd.

Price Performance

	3M	6M	12M
Return (%)	-9.7	23.8	-5.6
Avg. Volume (000)	387	375	404
ADTV (mn) - PKR	149	143	144
ADTV (000) - USD	916	868	894
High Price - PKR	434.5	437.1	473.4
Low Price - PKR	315.7	315.7	241.1

Relative Performance



Source: Bloomberg

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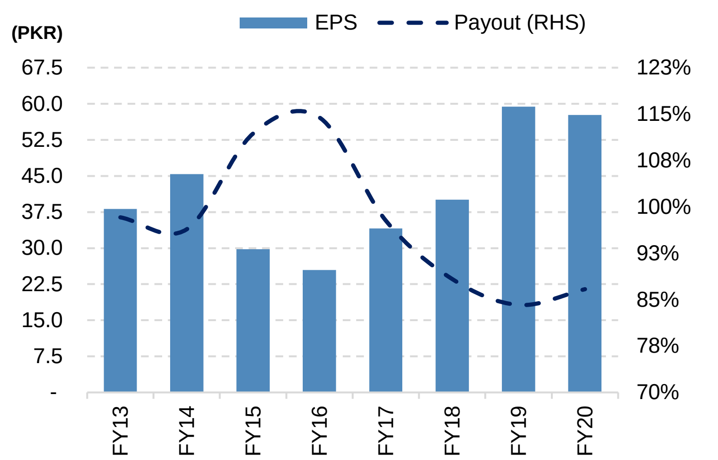
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	38,196	38,574	43,166
Gross Profit	22,368	20,449	23,875
Other Income	4,558	2,882	4,098
Finance Cost	2,212	1,502	2,314
Post Tax Profit	16,376	14,453	17,023

Balance Sheet	2020A	2021E	2022F
Shareholder's Equity	40,267	39,700	42,559
Total Liabilities	51,329	53,780	57,816
Current Assets	59,276	60,893	68,189
Fixed Assets	7,057	6,239	5,367
Non-Current Assets	32,320	32,587	32,186
Total Assets	91,596	93,480	100,375

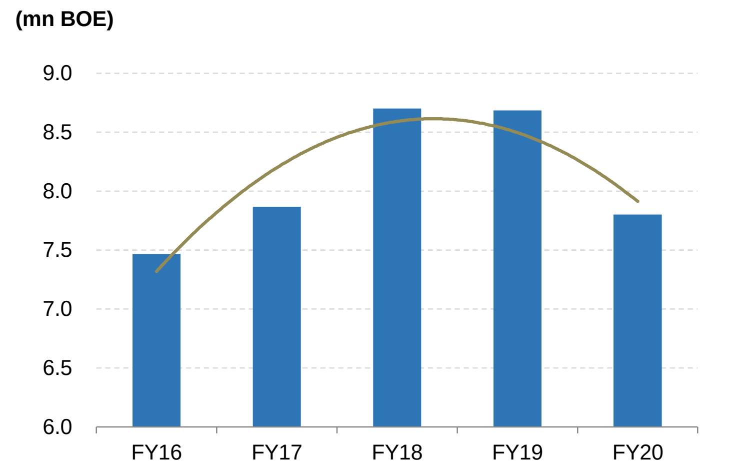
Source (s): Company Financial, AHL Research

Fig: POL Adjusted EPS and Payout Ratio



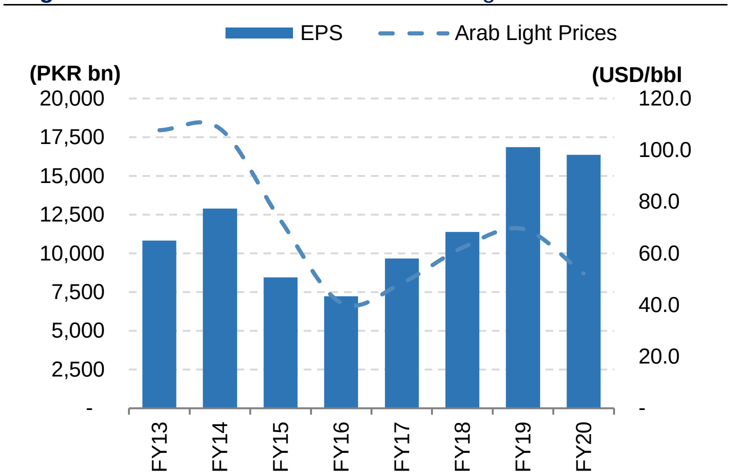
Source (s): Company Financials, AHL Research

Fig: POL's Production in terms of BoE



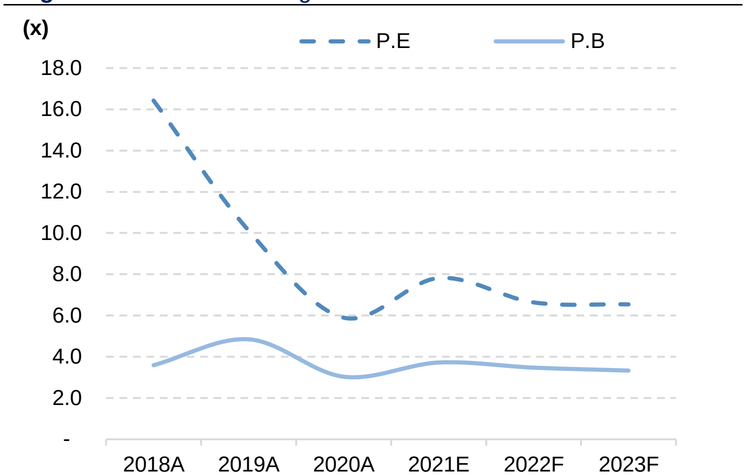
Source (s): Company Financials, AHL Research

Fig: POL's Bottom-line in relation to Arab Light Prices



Source (s): Company Financials, AHL Research

Fig: POL's Price to Earning and Price to Book



Source (s): Company Financials, AHL Research

Cements

Reversion to pre-COVID levels

Cement Sector

Reversion to pre-COVID levels

- **COVID-19 disrupted demand:** FY20 took off on a detrimental note with the construction sector hit by setbacks such as adoption of fiscal consolidation policies by the government together with contractionary monetary policy stance of the SBP, which curtailed public and private sector demand. Albeit, as the economy gradually adjusted to stabilization measures post a period of economic consolidation, demand started showing signs of improvement. This, however, remained short-lived as the outbreak of Coronavirus temporarily pushed back economic reforms and crisis control (country-wide lockdown) became the dominant government response. As a result, total dispatches only managed to grow by 2% over SPLY at 47.8mn tons in FY20 whereas domestic offtake dipped by 1% YoY to 40.0mn tons. Whereas exports of cement and clinker, primarily via land to Afghanistan together with seaborne exports to African countries and Bangladesh, although decent, also bore the brunt of global trade restrictions (growing by 20% YoY to 7.8mn tons).

- **Unmanageable cost pressures:** Meanwhile with the last leg of the expansionary cycle (to 69.23mn) tons coming into effect in FY20 (with LUCK, KOHC and PIOC adding another 7.60mn tons), in the backdrop of shrinking demand, pricing power of the sector derailed to a point where most players were rendered incapable of absorbing rising cost pressures (PKR depreciation, energy tariff hikes, augmented packaging costs, costs associated with new expansions as well as the budding financial burden with the policy rate jacking up to 13.25%). This translated to heavy losses in the outgoing year.

- **Leading the market rally:** Despite all, the cement sector managed to generate a colossal return of 87% since Mar'20TD when the market touched its low, outperforming the KSE-100 index (53% during the period) as signs of imminent recovery started appearing. Going forward, we believe more value can be unlocked as fundamentals remain encouraging aided by a sharp rebound in demand, steady pricing power (end of expansion cycle: 2017-2020), low coal prices and comparatively lower interest rates (forecast at levels under those seen in FY20 over our investment horizon).

- **Dispatches growth to rebound:** To recall, cement offtake posted a 3-yr historic CAGR (FY17-FY20) of 4% attributable to demand stemming from the North region (6% CAGR) against slowdown in South (-4% CAGR). Albeit, as urban projects take off in South and work commences on strategically critical mega energy projects in North, we foresee total cement dispatches to post a 3-yr forward CAGR of 8% to FY23 (8% in both North and South).
  - **Housing:** In particular, recent activity witnessed in the construction sector (primarily housing demand), aligns with our broad outlook for cement demand. As per Governor SBP, housing plays a key role in supporting economic growth and in the first four months of FY21, commitments for a massive billion dollar new investments have already been made. This has been an outcome of a combination of the governments amnesty for the construction sector (exemption from wealth declaration under section 111 of Income Tax Ordinance), as well as the SBP's stipulation to banks to enhance their mortgage loans and financing for builders/developers to at least 5% of their private sector credit by Dec'21. Moreover, the government's focus on low-cost housing under the Naya Pakistan Housing Scheme is also set to augment cement offtake. Our preliminary calculations suggest that 100,000 houses under the Naya Pakistan Housing

Program could augment cement demand by 2.3mn tons (5.8% of FY20 local demand).

- **Dams:** With the commencement of colonies construction next to the site of Mohmand dam (situated at Swat River) and Diamir Bhasha dam (River Indus) - a historic feat for the country – we forecast domestic cement demand to remain robust over the next 4-8 years. We also highlight that various dams are near completion (Karot and Suki Kinari). With that, we estimate cement demand from dams at a cumulative 11mn tons between FY21-FY29, while the per annum demand (inclusive of projects near completion) is forecast at 2.38mn tons. Please find the table below to gauge foreseeable demand.

Table: Total Expected Demand of Cement

Project	Generation	Lead Project	Commencement	Completion	Timeline (Years)	Expected Demand*
Karot	720MW	CPEC	FY16	FY22	7.0 years	215,000
Suki Kinari	870MW	CPEC	FY17	FY23	6.5 years	230,000
Dasu (stage - I)	2,160MW	WAPDA	FY17	FY23	7.0 years	515,000
Mohmand	800MW	WAPDA	FY20	FY25	6.0 years	330,000
Tarbella Extension V	1,410MW	WAPDA	FY21	FY25	4.5 years	180,000
Kohala	1,100MW	CPEC	FY20	FY26	8.0 years	250,000
Daimer Bhasha	4,500MW	WAPDA	FY21	FY29	9.0 years	660,000
Total Expected Demand						**2,380,000**

Source (s): AHL Research, *Tons per annum

- **Pricing relief:** With growth swept to the side by the outbreak of coronavirus, pricing relief for the cement sector had been long overdue. As v-shaped recovery in demand post-end of lockdown improved business confidence, cut in FED to PKR 1,500/ton and higher retail prices in North, aided sector-wide retention prices. This translated to augmented margins in 1QFY21. Going forward, with demand growth projected to remain healthy, we view pricing power not to face any headwinds.
- **New expansions on the horizon?** With the sector staging a remarkable comeback and the current climate affirming the notion of growth, we cannot rule out the possibility of new expansions being deliberated. Pertinently, some players have already explicitly made announcements, while some are still on the drawing board phase. To recall, new expansions have historically been planned once utilization is expected to cross 80%; with regard to the same we do highlight that utilization in 1QFY21 arrived at ~79% (and although some of the demand was rolled over from the last quarter), we foresee sector utilization to cross 85% (full year basis) in the next two years, indicating that a fresh round of expansions may be planned. Albeit, it takes about 2 years to set up a brownfield project whereas a Greenfield plant may take over 4 years to commence operations, granted all provincial and environmental requirements are met. So an immediate risk is impossible. We have listed below potential new expansions in the sector, adding an estimated 20mn tons to the sector (two players still contemplating size).

Table: Cement Expansions

Group / Company	Estimated Expansion*	Type	Region
DGKC	3.6	Brownfield	North
KOHC	3.5	Brownfield	North
FCCL	2.1	Greenfield	North
BWCL	2.3	Brownfield	North
LUCK	2.3	Brownfield	South
Fatima Cement	3.0	Greenfield	North
Habib Rafiq	na	Greenfield	North
Sapphire	3.0	Greenfield	North
Saif	na	Greenfield	North
Total	**19.8**		

Source (s): AHL Research, *Million Tons per annum

Investment requirement for a European plant is around USD 125/ton, USD 90/ton for a Chinese plant and approximately USD 100/ton for a hybrid plant. While it is hard to gauge financing potential of new players for said projects, balance sheet of existing listed players such as LUCK, FCCL and KOHC remains sufficiently unlevered to support new investments. However, DGKC, MLCF and BWCL may announce such plans after a time lag given their debt-heavy balance sheets at present.

Key risks

- Extension of second wave of coronavirus to induce fresh lockdowns both locally and internationally and hinder growth in offtake.
- Inquiry of the Competition Commission of Pakistan (CCP) on hike in cement prices. To recall, a similar case was conducted in 2009, whereby hefty penalties (check table below) were levied on the sector; although stay orders were obtained against the decision, fresh investigation may keep a check on prices.

Table: CCP Penalty 2009

Company	PKR mn	PKR/share
LUCK	1,272	3.93
BWCL	1,041	1.75
DGKC	933	2.13
MLCF	586	0.53
ACPL	374	2.72
PIOC	364	1.60
DCL	345	0.71
FCCL	266	0.19
CHCC	262	1.35
FECTC	174	3.47
KOHC	103	0.51
POWER	87	0.08
DNCC	42	0.44
GWLC	39	0.10
FLYNG	12	0.07

Source (s): CCP, AHL Research

- Rebound in coal prices is a downside risk to cement companies' margins. Outlook for long term global coal demand is expected to weaken led by competition from renewable energy sources (which are more efficient in cost terms as well as safer for the environment). Albeit, the recent hike has been a product of winter season hike as well as augmenting commodity prices (sharp rebound in construction activity owed to various stimulus packages announced world over to counter COVID-19). We have assumed coal to average at USD 65/ton in FY21 and witness a minor 1% incline p.a. post that over the next 5 years. Please check the sensitivity below.

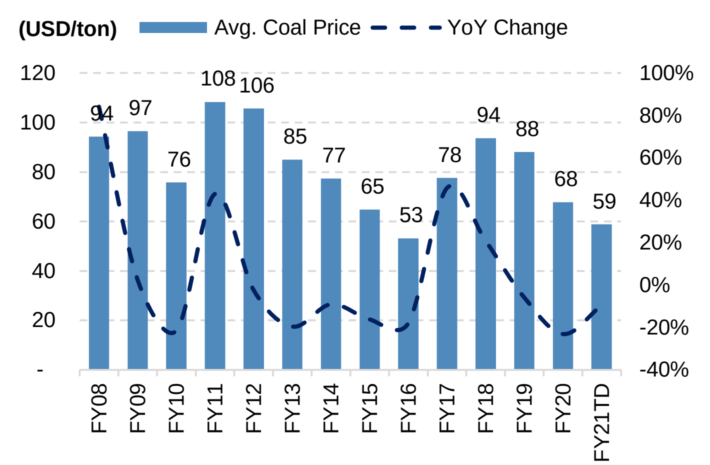
Table: Sensitivity Analysis of Coal Prices - FY21

		Coal Price				
		55.00	**60.00**	**65.00***	**70.00**	**75.00**
EPS	LUCK	37.55	35.15	32.76	30.36	27.97
	KOHC	13.55	12.19	10.83	9.47	8.14
	ACPL	13.45	11.76	10.06	8.37	6.67
	FCCL	2.44	2.35	2.25	2.15	2.05
	DGKC	8.08	6.71	5.33	3.95	2.57
	MLCF	3.12	2.98	2.85	2.72	2.59

Source (s): AHL Research, *Base case

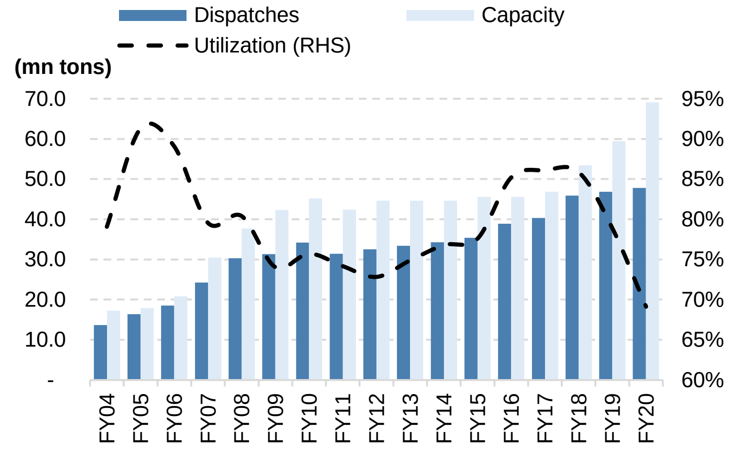
- Materialization of new expansions sooner than expected to prompt a fresh price war.
- PM's energy relief package is an upside risk as it may curtail energy costs and aid profitability. In order to support industrialization and revive economic demand, Prime Minister Khan has announced a relief package for SME's and large industries, providing electricity on off-peak hour rates throughout the year as well as 25% discount on additional units consumed over last year. Although we await official notification, this can be a potential upside for companies relying on the national grid.

Fig: International Coal Prices - Trend



Source (s): Bloomberg, AHL Research

Fig: Dispatches and Utilization of Cement Sector



Source (s): APCMA, AHL Research

Lucky Cement Limited

Luck favours the bold

Our top pick in the AHL Cement universe is Lucky Cement Limited (LUCK) with a Dec'21 sum of the parts based target price of PKR 947.6/share. From its last closing, the stock provides a stellar return of 46%, we recommend BUY. Our investment thesis is premised on a 5-yr forward earnings CAGR of 55% by FY25 to PKR 30,202mn (EPS: PKR 93.40) in the company's standalone business together with the group's ability to establish a well-diversified portfolio, which unlocks potential for a higher multiple and shields against operational risks in the cement business.

- **The economy marches on:** Cement manufacturers are enjoying some respite after an elongated period of economic wreckage. Fortunately, though, the momentum does not appear temporary. For LUCK, being the largest cement manufacturer in Pakistan post addition of a 2.8mn tons plant in Jan'20 (total capacity set around 11.7mn tons), this new exuberance has been nothing short of perfection. The company's market share (over 19% in the next 5 years vs. past 3-yr average of 16%) will render it to attain augmented offtake in upcoming years. In addition, conclusion in the outgoing expansionary cycle and reopening of the economy after a dreaded coronavirus-induced hiatus, brought some confidence on the pricing front; players in North had particularly been quick to jack up retail prices. Whereas cut in FED to PKR 1,500/ton, lower interest rates as well as soft coal prices should also bode well for margins. We expect earnings in FY21 to arrive at PKR 10,593mn (EPS: PKR 32.76) vis-à-vis PKR 3,344mn (EPS: PKR 10.34) in FY20, and generate a 5-yr CAGR of 55% by FY25 to PKR 30,202mn (EPS: PKR 93.40).
- **All that glitters, is gold:** LUCK's strategic divergence to various sectors has been parallel to none. With a footprint in North and South of Pakistan and expansion beyond borders in DR Congo (1.2mn tons) and Iraq (2.9mn tons; of this, 1.2mn tons clinker facility in the city of Samawah, is expected to come online in Dec'20), LUCK's cement dominance remains undisputable. Whereas the company's 54% share in ICI Pakistan Limited - a listed chemical company – also augments value of the portfolio. Meanwhile the company's PKR 20bn automobile plant in Pakistan alongside South Korean auto giant Kia, after commissioning operations in the outgoing year, has started posting operational profits, signaling exceptional reception in the market. Finally, investors have been eagerly waiting COD of LUCK's 100% owned 660MW coal power plant (Jun'21), a project of national importance, which will also solidify LUCK's presence in the energy sector.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	10.3	32.8	46.3
Dividend per share	PKR	-	10.00	14.00
Book Value per share	PKR	306.7	339.5	375.8
Price to Earning	x	44.6	19.8	14.0
Price to Book	x	1.5	1.9	1.7
Dividend Yield	%	-	1.5	2.2
Net Margins	%	8.0	17.0	21.2

Source (s):Company Financials, AHL Research

	LUCK PA
Recommendation	**BUY**
Target Price (Dec'21)	947.6
Last Closing	648.6
Upside (%)	46.1
Shares (mn)	323
Free float (%)	40.0
Market Cap. (PKR mn)	209,751
Market Cap. (USD mn)	1,315.4

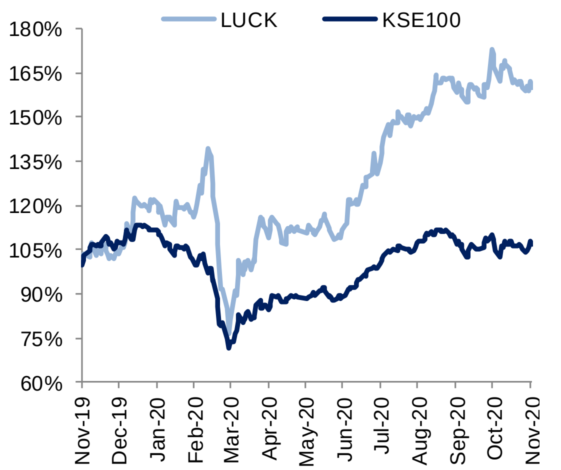
Major Shareholders

- Associated Companies

Price Performance

	3M	6M	12M
Return (%)	7.2	40.9	55.7
Avg. Volume (000)	853	1,003	1,085
ADTV (mn) - PKR	557	598	561
ADTV (000) - USD	3,412	3,617	3,454
High Price - PKR	702.1	702.1	702.1
Low Price - PKR	605.0	439.6	310.3

Relative Performance



Source: Bloomberg

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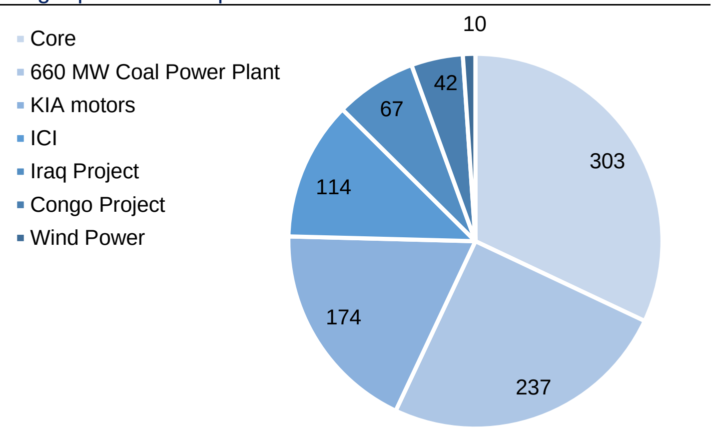
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	41,871	62,403	70,697
Gross Profit	6,077	16,947	20,826
Other Income	3,186	3,812	6,490
Other Expenses	378	1,225	1,388
Post Tax Profit	3,344	10,593	14,984
Balance Sheet			
Shareholder's Equity	99,184	109,777	121,527
Trade and Other Payables	19,355	25,273	28,489
Total Liabilities	36,685	34,307	37,668
Current Assets	28,468	32,311	49,563
Non-Current Assets	107,401	111,773	109,632
Total Assets	135,868	144,084	159,195

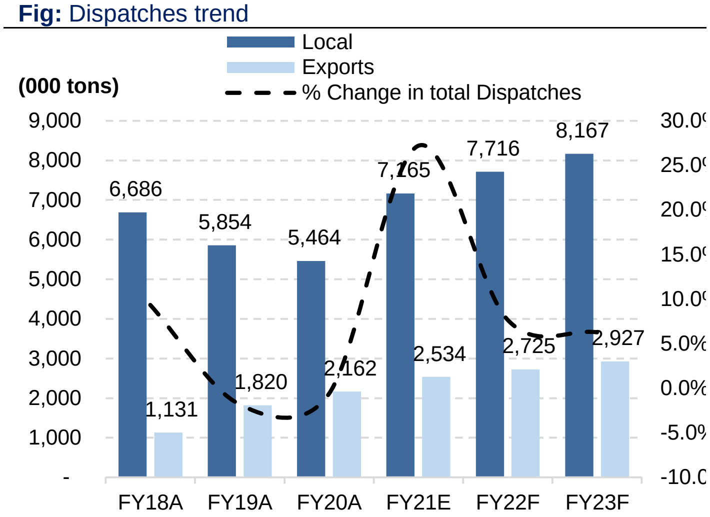
Source (s):Company Financials, AHL Research

Fig: Target price break-up



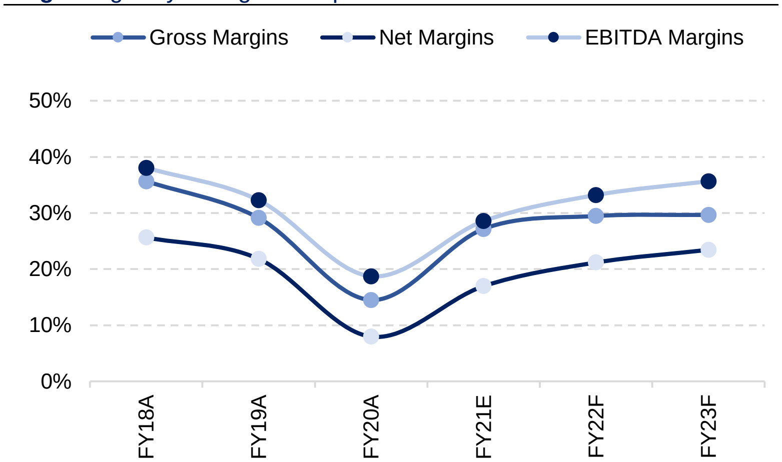
Source (s): Company Financials, AHL Research

Fig: Dispatches trend



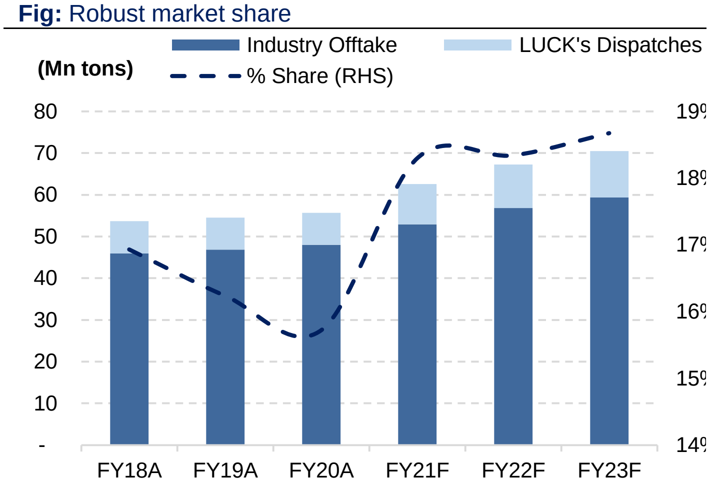
Source (s): Company Financials, AHL Research

Fig: Marginally stronger than peers



Source (s): Company Financials, AHL Research

Fig: Robust market share



Source (s): APCMA, Company Financials, AHL Research

D.G. Khan Cement Company Limited

Worst is over

We have a BUY recommendation for D.G. Khan Cement Company Limited (DGKC) with our Dec'21 sum of the parts target price set at PKR 144.32/share, providing an upside of 39% from current levels. Our liking for the stock is backed by i) turnaround in company bottom-line from a loss in FY20 of PKR 2,159mn (LPS: PKR 4.93) to double-digit earnings forecast within the next two years at PKR 4,978mn (EPS: PKR 11.36) in FY22, ii) emerging power efficiency with the addition of a new 30MW coal-power plant and a 10MW Waste Heat Recovery (WHR) plant at the Hub, Baluchistan plant, set to take company reliance off of the national grid completely, and iii) diverse portfolio adding PKR 53.72/share to the target price.

- **Turning green:** Despite posting a weak financial year in 2020, DGKC's bottom-line is set to observe a sharp inflection this year given i) double-digit demand growth, ii) conclusion of expansionary cycle which has reinvigorated pricing confidence, while lower FED post cut in FY21 budget to PKR 1,500/ton has aided retention prices, iii) soft coal prices, and iv) 625bps slash in interest rate by the SBP, which has drastically reduced the company's financial risk. That said, we project earnings to settle at PKR 2,335mn (EPS: PKR 5.3) in FY21 and PKR 4,978mn (EPS: PKR 11.4) in FY22. We also highlight that the company management is currently deliberately setting up a new 3.6mn tons plant in North, which may further open up earnings potential.
- **Investment in power key for efficient energy mix:** DGKC is undertaking installation of a new 30MW coal power plant and a 10MW waste heat recovery plant at its HUB, Baluchistan plant, with expected operational commissioning in Jun'21. This will enable the company's captive energy mix to easily meet its 113MW annual power requirement (32.4MW Waste Heat Recovery, 24.6MW gas power plant, 33MW dual fuel plant, 23.84MW FO power plant, and 60MW coal fired power plant). This will allow the company to completely evade reliance on the national grid, translating into improved margins and profitability going forward.
- **Notable group companies keep the company's operational risk limited:** DGKC's diverse portfolio ranging from Banking (MCB and UBL), E&P (PPL), Automobiles (Hyundai), Textile (NML and NCL), Insurance (AICL), Packaging (Nishat paper), and Dairy (Nishat Diary), adds PKR 53.72/share to the company's Dec'21 target price. Moreover, this supports a stable income stream for the company (dividend income), at an average of PKR 2.5bn per annum.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	(4.9)	5.3	11.4
Dividend per share	PKR	-	1.00	2.00
Book Value per share	PKR	152.1	156.4	165.8
Price to Earning	x	(17.3)	19.5	9.1
Price to Book	x	0.6	0.7	0.6
Dividend Yield	%	-	1.0	1.9
Net Margins	%	(5.7)	5.0	10.1

Source (s):Company Financials, AHL Research

	DGKC PA
Recommendation	**BUY**
Target Price (Dec'21)	144.3
Last Closing	103.8
Upside (%)	39.0
Shares (mn)	438
Free float (%)	50.0
Market Cap. (PKR mn)	45,490
Market Cap. (USD mn)	285.3

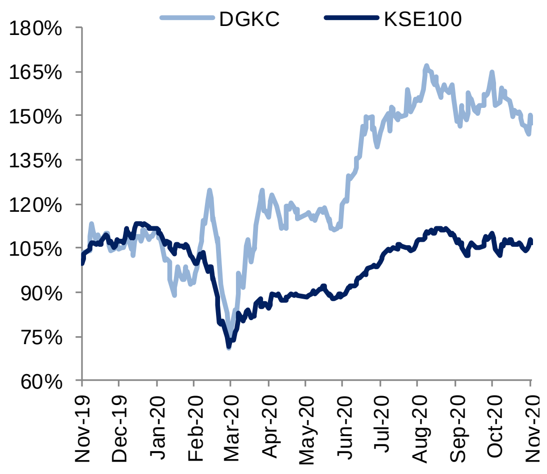
Major Shareholders

- Nishat Mills Limited

Price Performance

	3M	6M	12M
Return (%)	-4.8	25.7	42.9
Avg. Volume (000)	3,793	4,934	5,243
ADTV (mn) - PKR	419	514	468
ADTV (000) - USD	2,560	3,098	2,884
High Price - PKR	117.6	117.6	117.6
Low Price - PKR	101.1	78.2	50.1

Relative Performance



Source: Bloomberg

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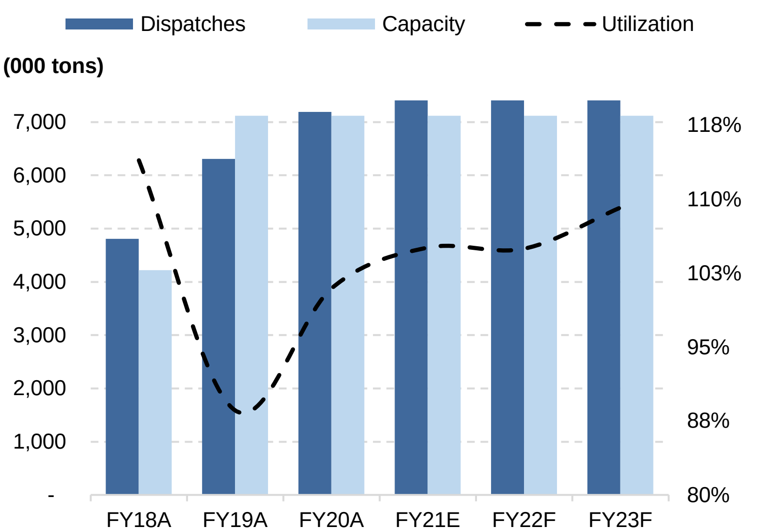
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	38,033	46,674	49,084
Gross Profit	1,586	8,140	11,147
Other Income	2,430	2,235	2,568
Other Expenses	530	607	942
Post Tax Profit	(2,159)	2,335	4,978
Balance Sheet			
Shareholder's Equity	66,644	68,541	72,643
Trade and Other Payables	11,332	11,782	12,204
Total Liabilities	62,907	56,020	49,737
Current Assets	34,095	32,841	33,875
Non-Current Assets	95,456	91,720	88,504
Total Assets	129,552	124,561	122,380

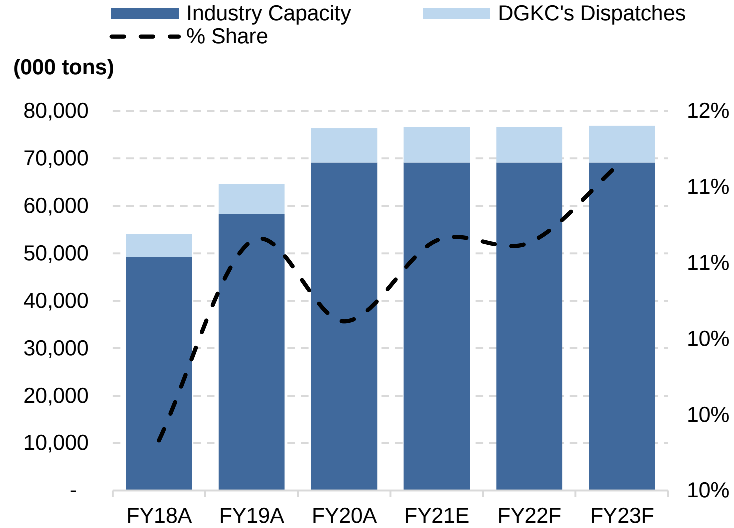
Source (s):Company Financials, AHL Research

Fig: Utilization to pick up



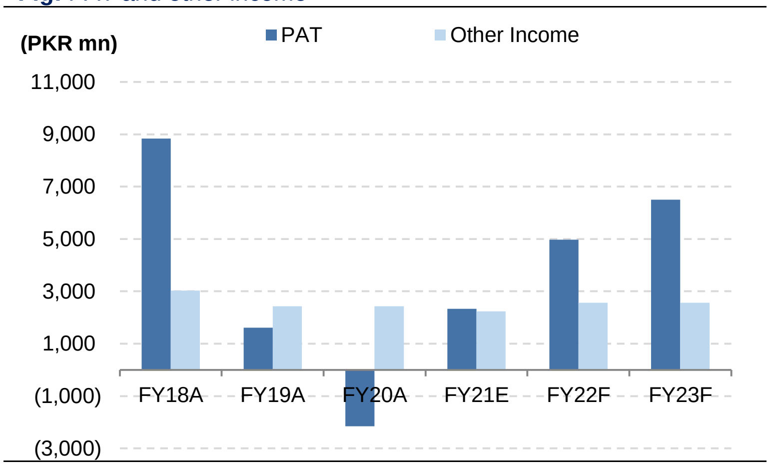
Source (s): Company Financials, AHL Research

Fig: Growing market share



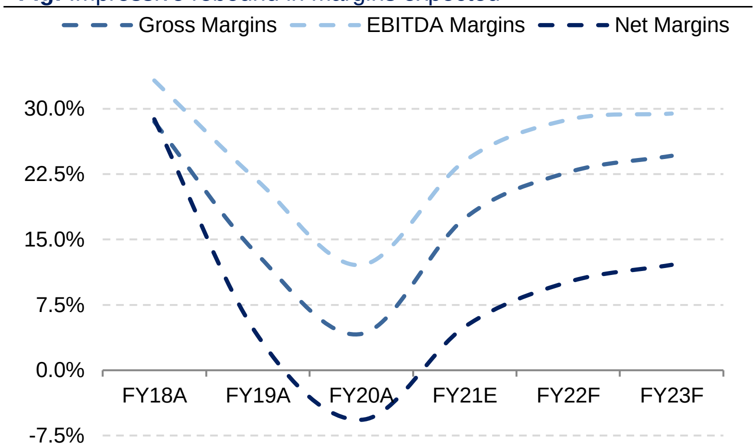
Source (s): Company Financials, AHL Research

Fig: PAT and other income



Source (s): Company Financials, AHL Research

Fig: Impressive rebound in margins expected



Source (s): Company Financials, AHL Research

Maple Leaf Cement Factory Limited

Cost efficiencies propel earnings

We have a BUY recommendation for Maple Leaf Cement Factory Limited (MLCF); the stock offers a noteworthy 26% from current levels on our Dec'21 target price of PKR 49.21/share. The scrip made a bull run at the index this year recovering remarkably after the index tanked in Mar'20, albeit, as fundamentals improve, we believe more value can be unlocked. Our conviction is hinged upon i) continuation of earnings momentum of 1QFY21 going forward as core concerns have been addressed, ii) improving energy efficiency which should translate into strong margins over the investment horizon, and ii) easing debt position coupled with rate cuts undertaken by the SBP to alleviate the company's financial risk.

- **Earnings to reflect improved dynamics:** We forecast the company to post earnings of PKR 3,134mn (EPS: PKR 2.85) in FY21, in stark variation from a loss of PKR 3,559mn (LPS: PKR 3.24) in SPLY, amid reviving fundamentals. We cite these as: improved pricing outlook given end of the outgoing expansion cycle and cut in FED to PKR 1,500/ton, soft coal prices vis-à-vis last year, and 625bps cut in the benchmark policy rate. These are expected to reinvigorate margins and hence, support the robust growth in bottom-line.

- **On the energy efficiency bandwagon:** While the company already has an operational Waste Heat Recovery (WHR) of 16MW, a 15.8MW gas captive plant and a 40MW coal power plant, MLCF has taken up upgradation of its WHR plant to 25MW. The expected capex for the project is PKR 1.8bn with commercial operations date set for Sep'21. Once this comes online, the company will become self-reliant and avoid buying electricity from the national grid. Consequentially, we foresee margins to hover near 30% (FY22-FY25) and aid profitability.

- **Debt concerns squashed as management accelerates the repayment pace:** Amongst the AHL cement universe, MLCF has the second highest debt to equity of 0.5x as at 1QFY21 compared to an average of 0.3x of other coverage companies. Although the company managed to raise an additional PKR 6bn via an 85% right issuance at PKR 12/share (premium of PKR 2/share), its borrowing remained a colossal PKR 19.5bn at the end of FY20. Albeit, as company dynamics took a U-turn in 1Q (debt came down to PKR 16.8bn) and are expected to roll over in the following year (we forecast total debt at PKR 13.9bn at close of FY21), with MLCF's cash generation ability sufficient to retire its debt entirely by FY23.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	(3.2)	2.9	4.8
Dividend per share	PKR	-	-	1.00
Book Value per share	PKR	31.5	34.3	38.1
Price to Earning	x	(8.0)	13.7	8.1
Price to Book	x	0.8	1.1	1.0
Dividend Yield	%	-	-	2.6
Net Margins	%	(12.2)	10.3	15.1

Source (s):Company Financials, AHL Research

	MLCF PA
Recommendation	**BUY**
Target Price (Dec'21)	49.2
Last Closing	39.0
Upside (%)	26.2
Shares (mn)	1,098
Free float (%)	45.0
Market Cap. (PKR mn)	42,836
Market Cap. (USD mn)	268.6

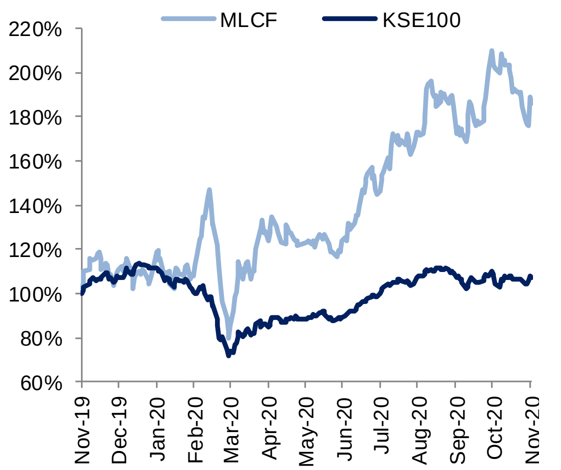
Major Shareholders

- Kohinoor Textile Mills Limited

Price Performance

	3M	6M	12M
Return (%)	8.6	50.4	77.3
Avg. Volume (000)	14,243	15,040	14,412
ADTV (mn) - PKR	568	533	440
ADTV (000) - USD	3,492	3,235	2,709
High Price - PKR	43.9	43.9	43.9
Low Price - PKR	35.4	24.5	16.7

Relative Performance



Source: Bloomberg

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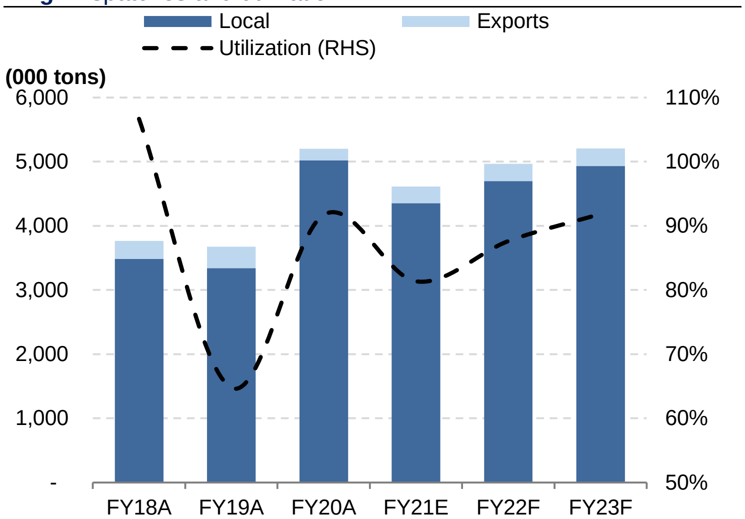
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	29,118	30,558	34,878
Gross Profit	585	7,181	9,970
Other Income	146	182	184
Other Expenses	161	424	621
Post Tax Profit	(3,559)	3,134	5,260
Balance Sheet			
Shareholder's Equity	34,550	37,683	41,845
Trade and Other Payables	8,176	6,698	6,994
Total Liabilities	32,448	25,395	19,792
Current Assets	17,374	15,936	17,208
Non-Current Assets	49,624	47,142	44,429
Total Assets	66,998	63,078	61,637

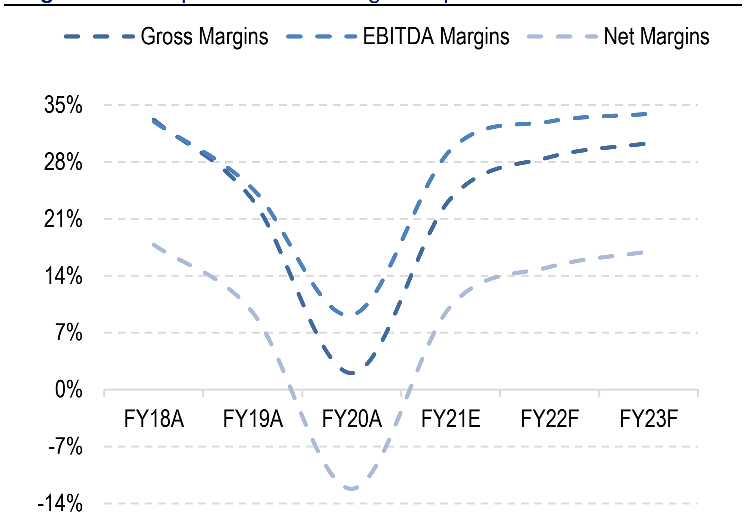
Source (s):Company Financials, AHL Research

Fig: Dispatches and utilization



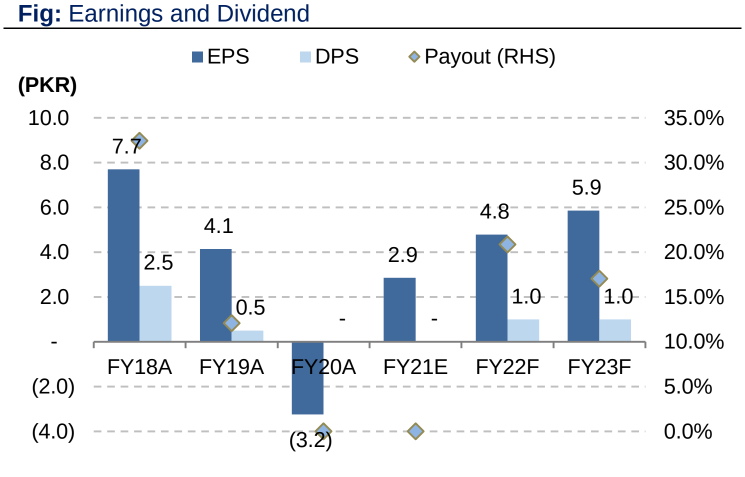
Source (s): Company Financials, AHL Research

Fig: Marked improvement in margins expected



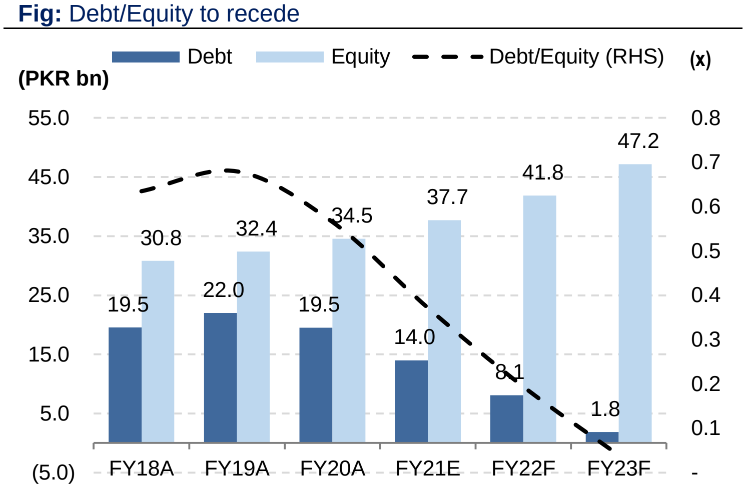
Source (s): Company Financials, AHL Research

Fig: Earnings and Dividend



Source (s): Company Financials, AHL Research

Fig: Debt/Equity to recede



Source (s): Company Financials, AHL Research

Power Generation
Powering the Economy

Power Generation

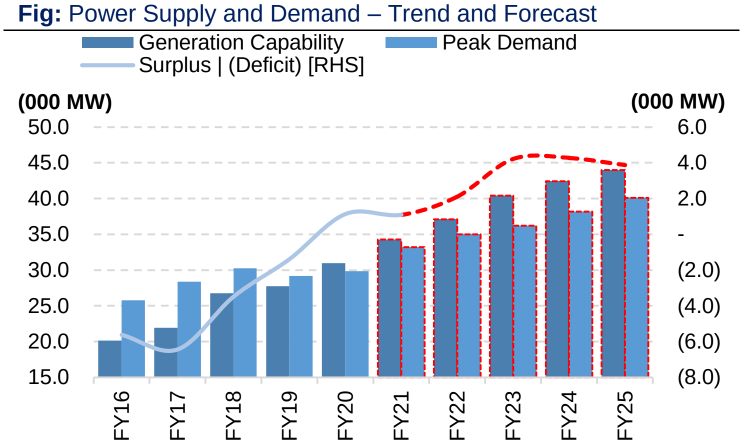
Powering the economy

- **Govt Signed MoUs with IPPs; Liquidity problem likely to be addressed:** In order to control the rising electricity tariff in the country, the Govt. has signed MoUs with IPPs which has been approved by the Federal Cabinet. We view this to be a win-win situation for both parties as IPPs will get their outstanding dues (clause of MoUs) with their working capital problems expected to be resolved while the govt. will be able to slash annual returns. However, no conclusion has been reached on the payment of dues; IPPs have been demanding a single bullet payment whereas the Govt. is considering 33% as upfront payment with the remainder to be cleared in the following two years. In addition to this, debt servicing of IPPs under the 2002 policy has been terminated, which will also increase the dividend paying capacity.
- **Long Term Tariff Structure:** All IPPs have a long term tariff arrangement ranging from 20-30 years whereby the power purchaser is bound to pay the Capacity Purchase Price (CPP) to the power producer, regardless of whether electricity is purchased or not during the period. The tariff of power companies is split into two components: i) Capacity Purchase Price, and ii) Energy Purchase Price (EPP). The CPP has no dependency on the load factor of the power generation company while the EPP component is a pass through item which includes the fuel cost and variable operational and maintenance costs. However, as per the latest MoUs, nature of the PPA with will converted into take-and-pay (earlier take-or-pay) once a Competitive Trading Bilateral Contract Market (CTBCM) will be implemented. In this regard, NEPRA has also approved an implementation plan with an Apr'22 deadlines.
- **Increasing Demand:** Nine (9) Special Economic Zones (SEZs) have been established under the China-Pakistan Economic Corridor (CPEC). As per the document submitted to the Senate Special Committee on CPEC, the total expected demand for these SEZs is more than 900MW. In addition, the Govt's Naya Pakistan Housing Program of 5mn houses will also spur power demand. As per Central Power Purchasing Agency Guarantee Limited (CPPAG), power demand is expected to grow by 6% in the next 5 years from 26.3KMW in 2020 to 35.4KMW in 2025.

Key Risks

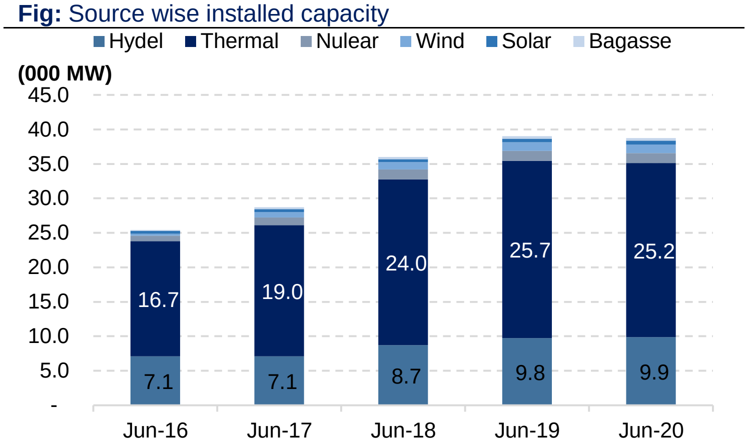
- Lower power demand due to economic slowdown and delay in CPEC-based SEZs.
- Rising circular debt may prolong the liquidity crisis and keep payout muted.
- No consensus on payment of receivables.

Fig: Power Supply and Demand – Trend and Forecast



Source (s): State of Industry Report, AHL Research

Fig: Source wise installed capacity



Source (s): State of Industry Report, AHL Research

Power Generation

MOUs: PKR 800bn saving expected

Main features of MoUs signed with 1994 Power Policy Power Plants:

- Existing capacity payments shall be reduced by 11%.
- USD exchange rate and US CPI indexations shall be discontinued on 50% of the reduced capacity payment, which shall be fixed at National Bank of Pakistan's TT/OD selling PKR/USD exchange rate prevailing as on August 12, 2020 (PKR 168) without any local or international currency indexation or inflation adjustment for the future.
- Any heat rate sharing by any IPP as per its existing arrangement shall cease to exist.
- USD exchange rate and US CPI indexations on reduced variable O&M and 50% of the reduced capacity payment shall continue as per existing arrangement.
- The parties shall look into the possibility of termination of plants considering their commercial and technical viability.
- The parties acknowledge that the IPPs predate the creation of the NEPRA regime.

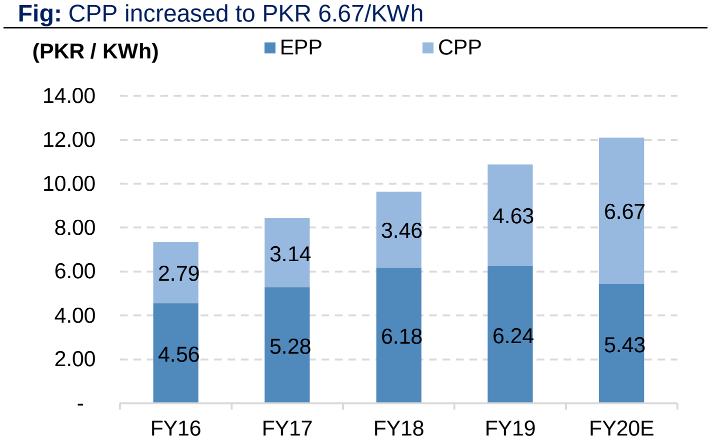
Why revise PPAs?

- Capacity Purchase Price (CPP) has increased to PKR 6.7/KWh during 2020 compared to PKR 2.8/KWh during 2016.
- PKR has depreciated against US Dollar.
- High volatility in power demand due to 49% share of domestic consumers. In summers it touches ~23K MW compared to ~8K MW during winters. Generation capability has reached ~28K MW.

Main features of MoUs signed with 2002 Power Policy Power Plants:

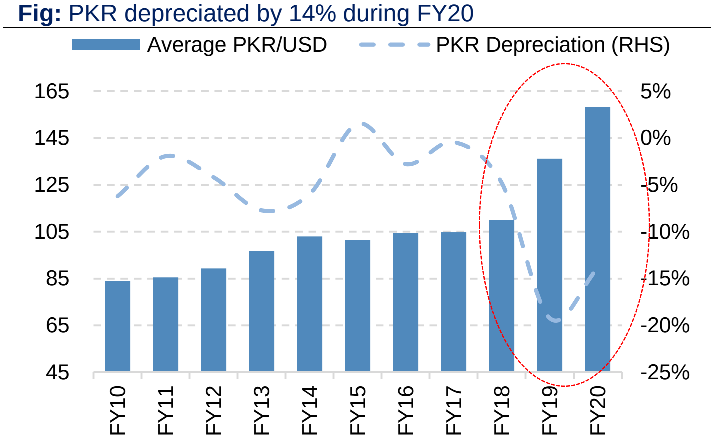
- Any efficiency gains of oil fired projects, above the NEPRA determined benchmark level, will be shared with power purchasers as follows:
  - First 0.5% efficiency improvement: 70:30
  - Second 0.5% efficiency improvement: 60:40
  - Third 0.5% efficiency improvement: 50:50
  - Above that: 40:60
- Power producer will share 50:50 the operation and maintenance (O&M) savings. This will be done after creating a reserve for major overhaul. In case of un-utilization of reserves, the remainder will also be shared with power purchasers at a ratio of 50:50.
- Rate on delayed payment after due date till first 60 days has been reduced to KIBOR+2% and thereafter at KIBOR+4.5%.
- RoE will be calculated at PKR 148/USD with no further indexation.

Fig: CPP increased to PKR 6.67/KWh



Source (s): CPPA (G), AHL Research

Fig: PKR depreciated by 14% during FY20

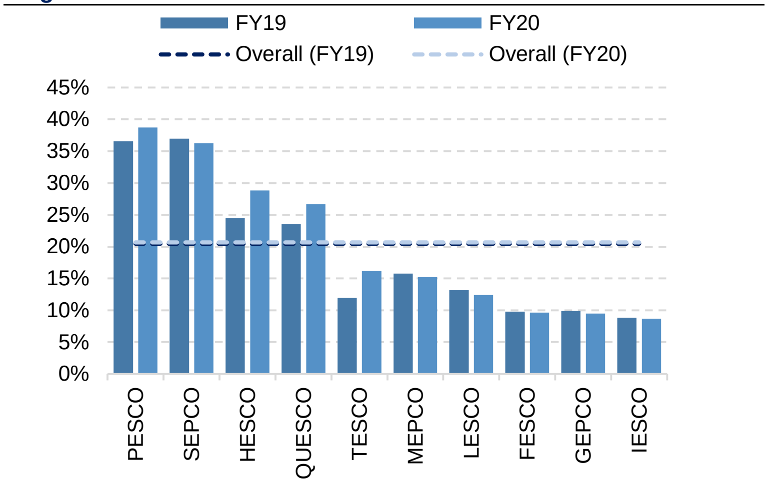


Source (s): SBP, AHL Research

Power Generation

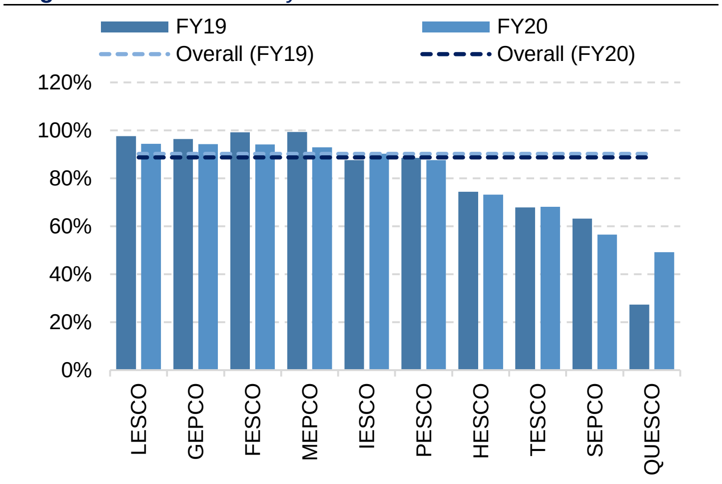
Focus Charts

Fig: DISCO wise T&D Losses



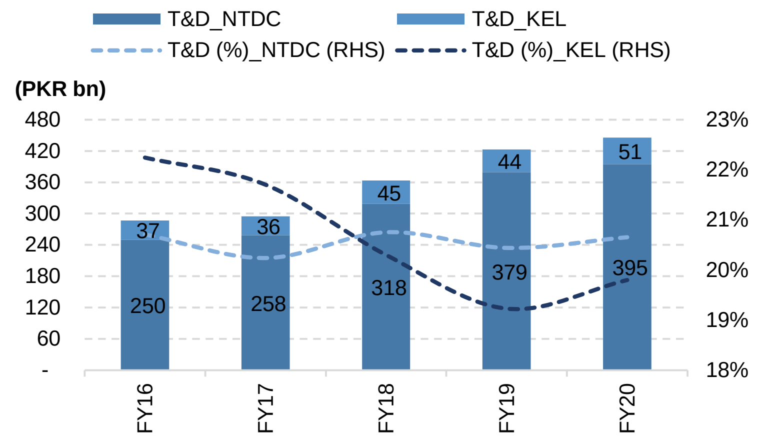
Source (s): State of industry Report, AHL Research

Fig: DISCO wise recovery



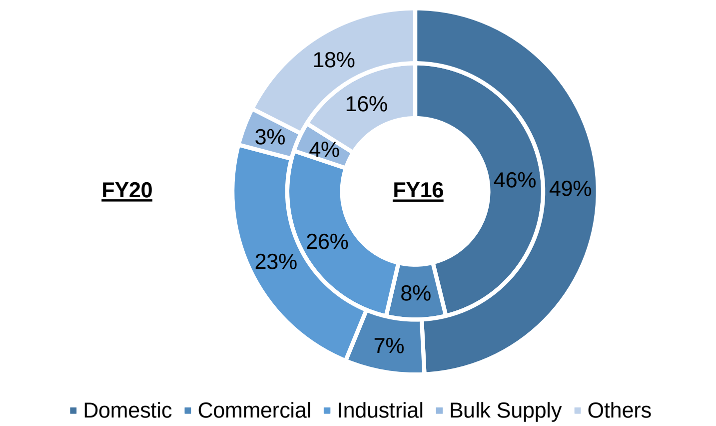
Source (s): State of industry Report, AHL Research

Fig: Country's T&D losses reached at ~PKR 446bn during FY20



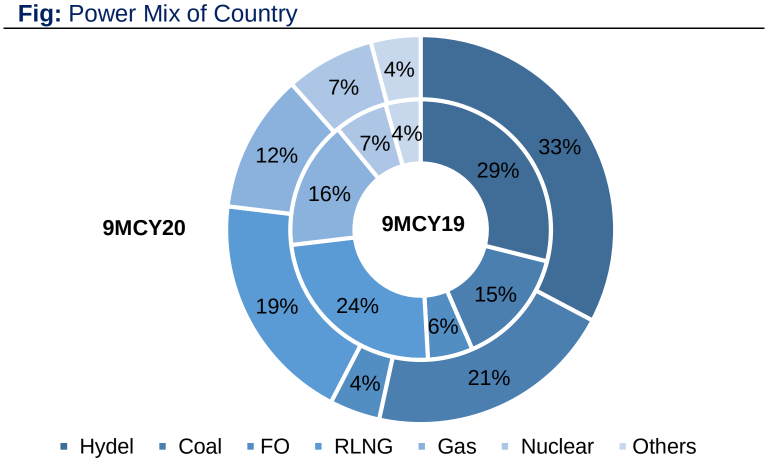
Source (s): State of industry Report, AHL Research

Fig: Break up of power consumers



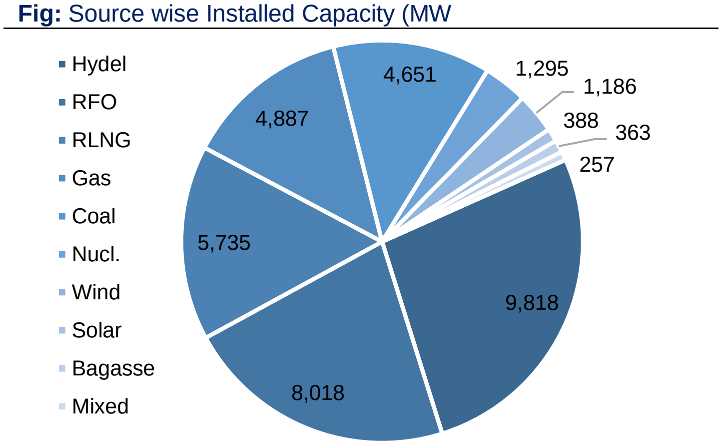
Source (s): State of industry Report, AHL Research

Fig: Power Mix of Country



Source (s): NEPRA, AHL Research

Fig: Source wise Installed Capacity (MW



Source (s): State of industry Report, AHL Research

The Hub Power Company Limited

Investments Galore

- **Strong Earnings Growth:** During Aug'19 the China Power Hub Generation Company (CPHGC) commenced commercial operations and started providing electricity to the National Grid thereon. Given the addition of CPHGC, we expect the earnings of HUBC to grow to PKR 27.8/share in FY22 from PKR 8.7/share in FY19. In FY20, CPHGC contributed PKR 9.8/share (1QFY21: PKR 2.7/share) to the earnings of the company. We also highlight that TEL and ThalNova achieved financial closure during Jan'20 and Sep'20 with expected CoD in Mar'22 and Jun'22, respectively. We project TEL and ThalNova to contribute 2.68/share and 1.54/share, respectively to HUBC's earnings in FY23.
- **Payouts to Recuperate from 2022:** HUBC has delivered high payout at an average of 93% historically (2014-18). However, due to its investment commitments, the company skipped the dividend during FY19 and FY20. Apart from equity requirement for power plants (CPHGC, TEL, SECMC and ThalNova), rising circular debt has also curtailed ability of the company to make dividend payments. Considering the same, the Power division has submitted a plan to the Economic Coordination Committee (ECC) to reduce the annual addition to the circular debt to PKR 75bn/annum till FY23 from PKR 532bn/annum recorded in FY20. As a result, we project the company to once again resume dividend payments (FY22 payout expected at 46% / PKR 12.75/share.
- **Coal plants are higher in merit order:** Being the cheaper source of power generation (Coal cost PKR 6.0/KWh compared with 12.4/KWh of FO, 6.8/KWh of RLNG and Gas), coal power plants are higher in the merit order list. The CPHGC was placed at the 5th number (as of 20th Nov'20) in merit order. The plants with higher number in merit order are expected to be given preference for payments. To recall, during issuance of the last SUKUK, coal plants were given preference over other plants (~34% of total payment was made to coal plants). In future, we expect these plants to continue hovering over others in the merit order and therefore, be given preference for payments.

Key metrics		2020A	2021E	2022F
Earnings	PKR	19.3	23.7	27.8
Dividend	PKR	-	6.50	12.75
Book value	PKR	64.7	82.7	100.0
Price to Earning	x	3.8	3.3	2.8
Price to Book	x	1.1	1.0	0.8
Dividend Yield	%	-	8.2	16.2
Net Margins	%	51.83	63.25	62.09

Source (s): Company Financials, AHL Research

HUBC PA

Recommendation	BUY
Target Price (Dec'21)	150.8
Last Closing	78.9
Upside (%)	91.1
Shares (mn)	1,297
Free float (%)	75.0
Market Cap. (PKR mn)	102,358
Market Cap. (USD mn)	641.9

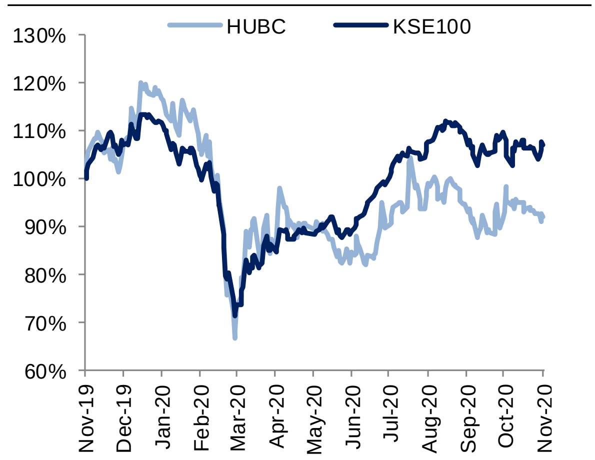
Major Shareholders

- Mega Conglomerate (Pvt.) Ltd.

Price Performance

	3M	6M	12M
Return (%)	-6.7	1.0	-11.4
Avg. Volume (000)	2,538	3,131	2,886
ADTV (mn) - PKR	207	253	239
ADTV (000) - USD	1,276	1,527	1,480
High Price - PKR	86.2	89.8	103.2
Low Price - PKR	75.4	70.3	57.4

Relative Performance



Source: Bloomberg

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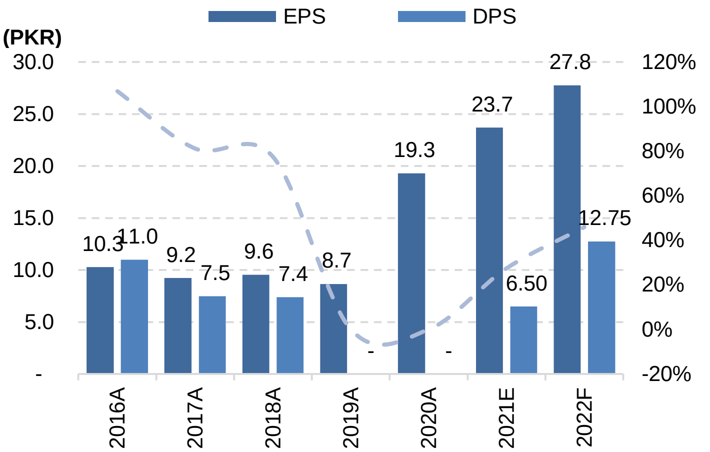
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	48,321	48,611	57,987
Gross Profit	30,490	29,431	37,415
Operating Profit	29,220	28,284	36,256
Share of Profit from Associates	12,691	14,216	15,958
Post Tax Profit	25,044	30,746	36,005

Balance Sheet	2020A	2021E	2022F
Shareholder's Equity	83,931	107,223	129,773
Trade and Other Payables	77,323	75,323	73,323
Total Liabilities	176,457	163,394	157,099
Current Assets	129,284	117,624	121,856
Non-Current Assets	131,105	152,994	165,016
Total Assets	260,388	270,618	286,872

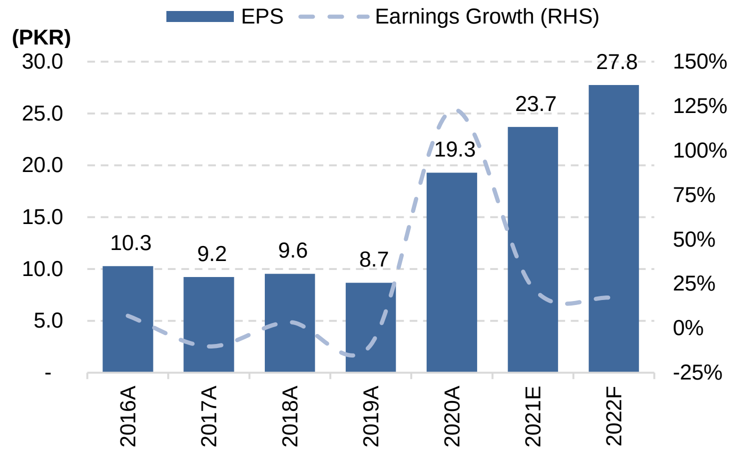
Source (s): Company Financial, AHL Research

Fig: Payout is expected to increase from 2022



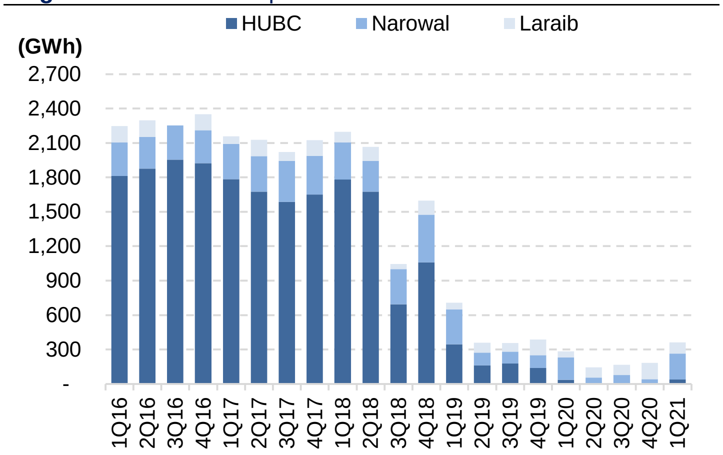
Source (s): Company Financials, AHL Research

Fig: Earnings has grown due to addition of coal power plants



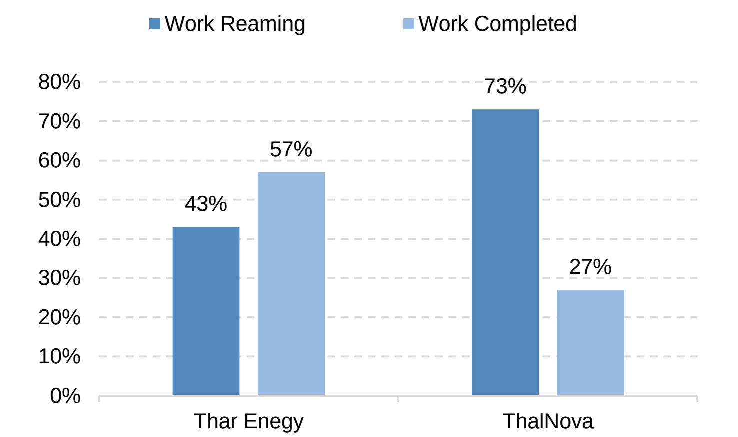
Source (s): Company Financials, AHL Research

Fig: Load factor to hub plant has decreased



Source (s): Company Financials, AHL Research

Fig: Construction work status of Thar Energy and ThalNova



Source (s): Company Analyst Briefing Presentation, AHL Research

Oil and Gas Marketing Companies

Stability in Oil prices to boost profitability

Oil Marketing & Gas Companies

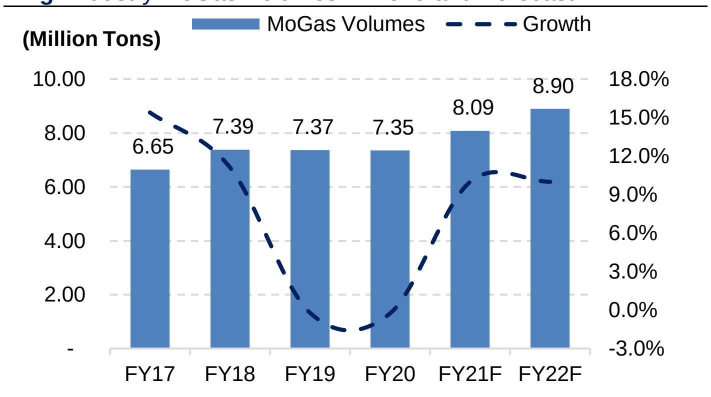
Stability in Oil prices to boost profitability

- **FY21 to Witness Double Digit Sales Growth:** Post easing in lockdown situation, quick economic recovery (improvement in large scale manufacturing and growth in car sales) together with lower oil prices and control on smuggling of fuels improved demand of local petroleum products (MS, HSD and FO volumes increased by 7%, 11% and 30% in 5MFY21). Likewise, Furnace Oil (FO) sales are also going up due to decline in prices, rendering FO a more feasible electricity generation source. We expect white oil sales of the industry to increase by 10% in FY21.
- **Change in Pricing Mechanism to Minimize Inventory Loss Quantum:** As per new policy framework, the ex-refinery prices of Motor Gasoline and High Speed Diesel will be revised on a fortnightly basis. This fortnightly revision in petroleum prices will help minimize the quantum of inventory losses, which used to be a major problem for OMCs. Likewise, exchange losses will no longer be a threat for the sector as the Ministry of Energy adopted the decision taken by ECC on 9th Apr'20 to make exchange rate movement a part of cost of product.
- **Margin Revision of Regulated Products:** Uptick in inflation is beneficial for the OMC sector as margin revision of regulated products is linked with the consumer price index. We anticipate margins of MS and HSD to increase by PKR 0.45/liter (highest ever margin increase in a year due to last year's consumer price index reading of 10.7% together with high base) to average at PKR 3.05/liter in FY21 from PKR 2.81/liter.
- **Profitability to Improve in FY21:** To recall, during FY20 the entire sector bore the brunt of volatility in ex-refinery prices which resulted in inventory losses. Albeit, the current oil trajectory appears favorable for the OMC sector as the commodity has recovered from its low of $13.34/bbl on 21st Apr'20. Furthermore, we believed economic stabilization should aid demand of retail fuels, while increased surveillance on borders will curb smuggling, which will bode well for the sector.

Key Risks

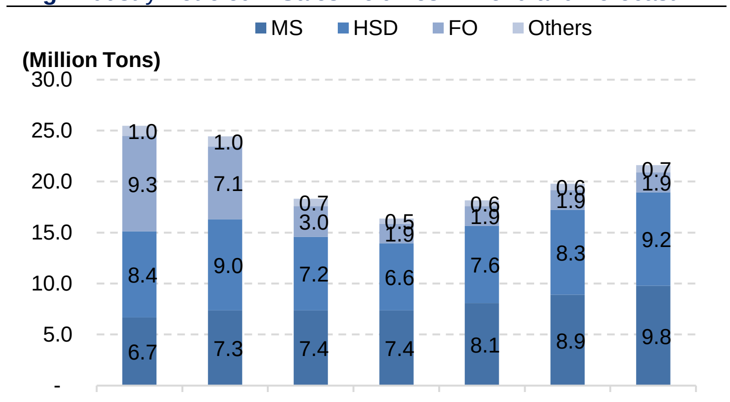
- Decline in ex-refinery prices may result in inventory loss.
- Uncontrolled arrival of smuggled fuel from Iran.

Fig: Industry MoGas Volumes – Trend and Forecast



Source (s): OCAC, AHL Research

Fig: Industry Petroleum Sales Volumes – Trend and Forecast



Source (s): OCAC, AHL Research

Pakistan State Oil

Cash inflows to improve valuations

- **Increasing Retail Fuel Market Share:** During 5MFY21, PSO's white oil sales increased by 18% YoY to 2.94mn tons (MS 1.44mn tons and HSD 1.50mn tons) compared to 2.50mn tons while market share increased to 46.4% from 45.5% in 5MFY20. We expect PSO volumes to settle at 8.20mn tons, up by 13% YoY on account of i) Significant growth in auto sales, ii) Expensive CNG prices resulting in higher demand of MS, iii) Revival of economic activity in full swing, iv) Improving farmers' yields on agriculture output, and v) Augmented tourist activities within Pakistan due to closure of major international tourist spots.

- **Reduction in Borrowings to Support Bottom-line:** PSO reduced its short term borrowing from PKR 149bn in Mar'20 to PKR 42bn as of Sep'20 which will have a material positive impact on company's profitability as drastic reduction in finance cost will increase earnings by PKR ~2.9bn. This will translate into earnings per share of PKR 6.1. Major inflows were recorded from i) Reduction in inventory position, ii) Partial recoveries on unfavorable exchange rate movement arising from FE-25 borrowings, and iii) Reduction in trade debts.

- **Efforts to Reduce Circular Debt Underway:** The government is undertaking measures to resolve the circular debt problem by negotiating with Independent Power Producers (IPPs). On the other hand, the government is also planning to inject another PKR 200bn through Energy Sukuk III to ease power sector debt. We expect PSO to receive a major chunk of this, which will further reduce reliance on short-term borrowings. We believe all these developments will be material positive for the company and allow the company to go for expansion plans.

- **Decline in Interest Rates is an Icing on the Cake:** The State Bank of Pakistan cumulatively reduced policy rate by 625bps from 13.25% in Mar'20 to 7.00% in Jun'20 in order to stimulate economic growth given lower financing cost encourages borrowing and investment. Reduction in interest rates bodes well for the company, as they have a huge reliance on short-term borrowings, by reducing finance costs drastically.

- **Rising Contribution in Revenue from RLNG Business:** During FY20, RLNG contributed 28% to total sales revenue (PKR 310bn), while the company posted a negative bottom-line of PKR 2.4bn due to massive decline in oil prices, which reduced gross margins. We anticipate RLNG contribution to go up amid surge in international oil prices which will improve gross margins.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	(13.8)	30.8	37.7
Dividend per share	PKR	-	10.0	15.0
Book Value per share	PKR	240.8	261.6	284.3
Price to Earning	x	(11.5)	6.2	5.1
Dividend Yield	%	-	5.2	7.8
Price to Book	x	0.7	0.7	0.7
Net Margins	%	(0.6)	1.3	1.4

Source (s): Company Financials, AHL Research

Recommendation	PSO PA BUY
Target Price (Dec'21)	285.4
Last Closing	192.1
Upside (%)	48.6
Shares (mn)	469
Free float (%)	45.0
Market Cap. (PKR mn)	90,167
Market Cap. (USD mn)	565.5

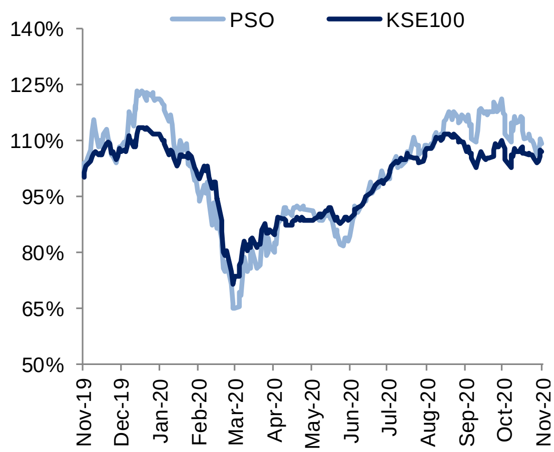
Major Shareholders

- Govt. of Pakistan

Price Performance

	3M	6M	12M
Return (%)	1.4	21.3	5.2
Avg. Volume (000)	1,810	1,800	2,018
ADTV (mn) - PKR	366	340	372
ADTV (000) - USD	2,228	2,053	2,316
High Price - PKR	213.1	213.1	216.9
Low Price - PKR	186.3	143.9	114.0

Relative Performance



Source: Bloomberg

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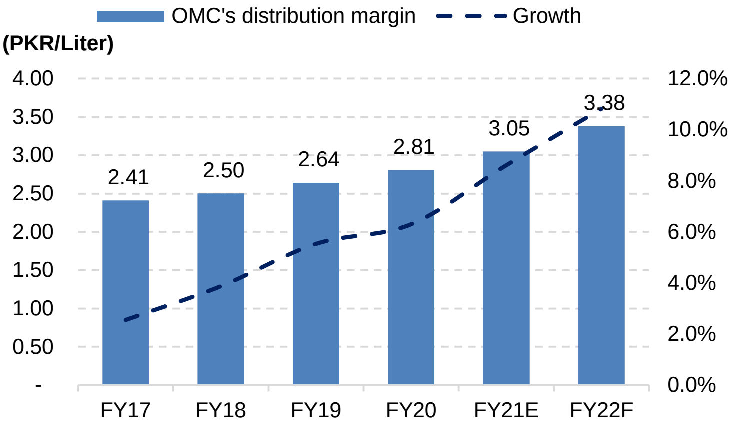
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	1,108,358	1,122,359	1,247,255
Gross Profit	12,227	38,289	44,218
Other Income	10,210	8,116	8,592
Finance Cost	13,427	7,087	7,768
Post Tax Profit	-6,466	14,462	17,693
Balance Sheet			
Shareholder's Equity	113,061	122,828	133,479
Interest Bearing Liabilities	67,687	69,662	72,137
Total Liabilities	228,657	228,396	243,188
Current Assets	292,904	301,113	324,726
Non-Current Assets	48,814	50,111	51,941
Total Assets	341,718	351,224	376,666

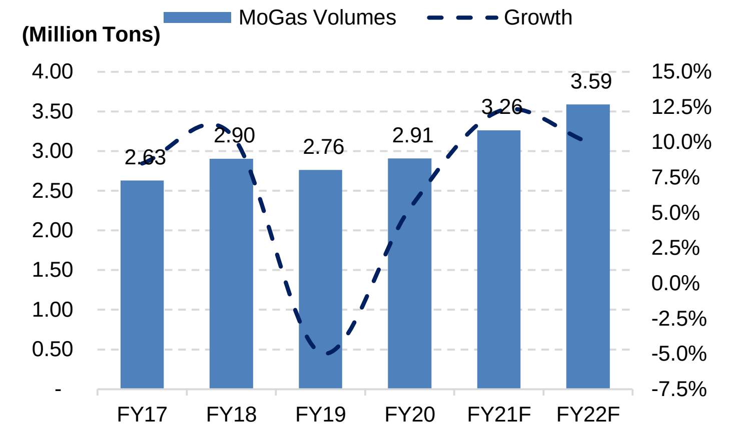
Source (s): Company Financials, AHL Research

Fig: OMC's distribution margin



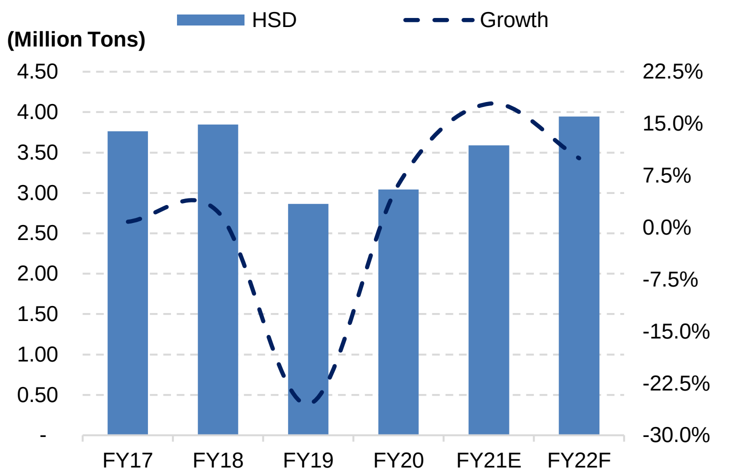
Source (s): Company Financials, AHL Research

Fig: MoGas Sales Volumes – Trend and Forecast



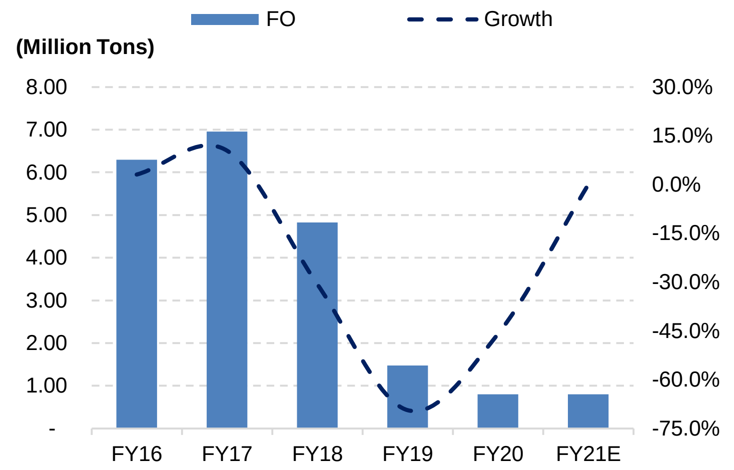
Source (s): Company Financials, AHL Research

Fig: HSD Sales Volumes – Trend and Forecast

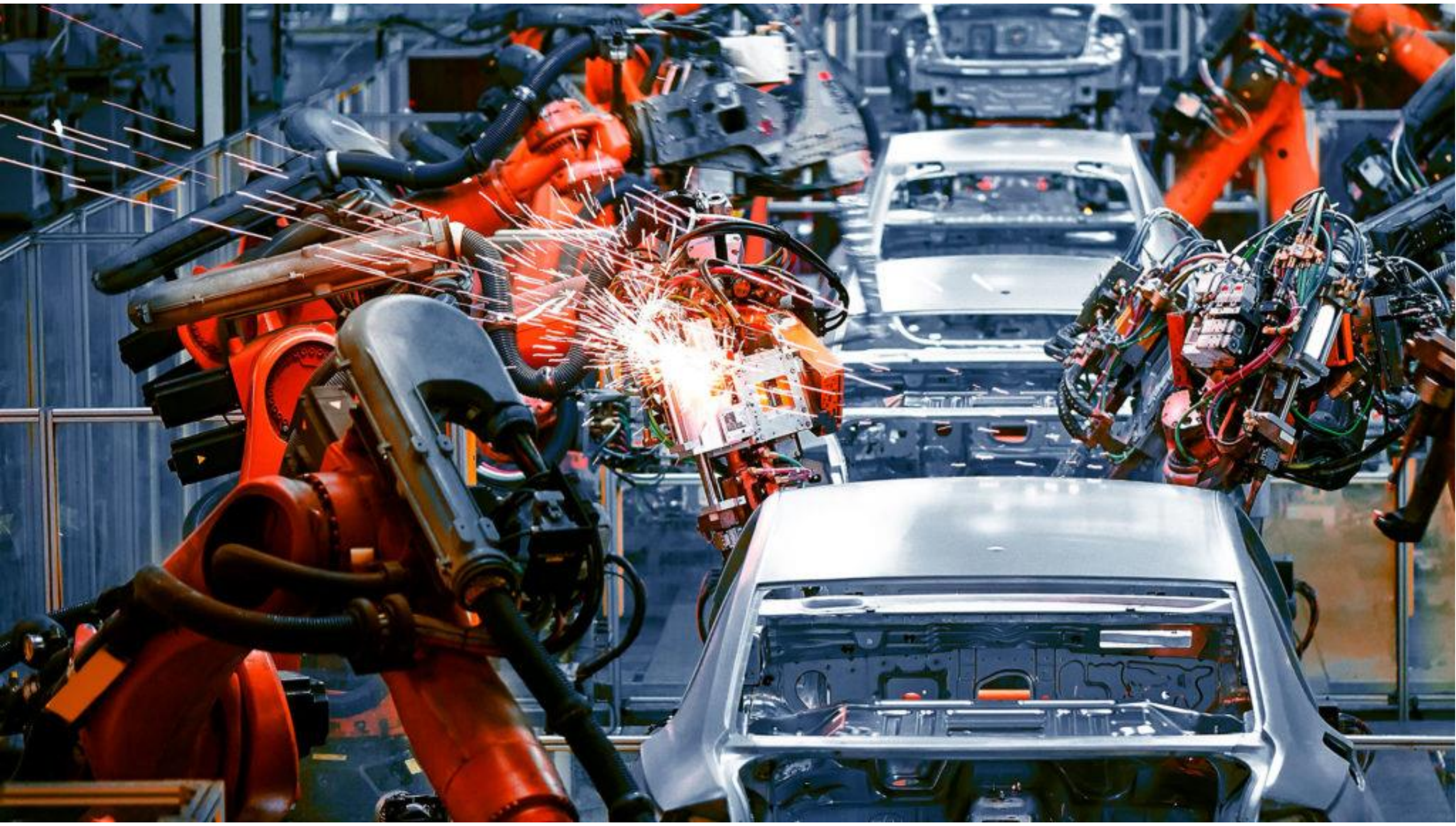


Source (s): Company Financials, AHL Research

Fig: FO Sales Volumes – Trend and Forecast



Source (s): Company Financials, AHL Research



Automobile Assemblers

Economic revival: Game-changer

Automobile Assemblers

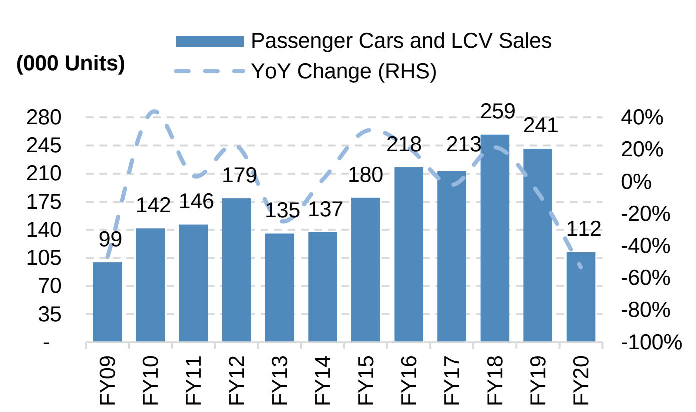
Economic revival: Game-changer

- **Macroeconomic improvement supporting volumes:** Reduction in COVID-19 cases in Pakistan improved the overall economic situation and resulted in earlier than expected revival in activity. On the other hand, incumbent government took extraordinary measures (easing restrictions, reducing interest rates, refinance schemes at lower rates) to keep the economy afloat. As a result, total automobile sales increased by 13% YoY to 51,465 units in 4MFY21 compared to 45,734 units in 4MFY20. We remain buoyant on the auto sector as we believe automobile sales are likely to witness double-digit growth in FY21 due to i) launch of new models to support volumes, ii) lower auto-financing rates, and iii) higher consumer spending.
- **Auto financing providing much needed support:** Post-outbreak of COVID-19, SBP adopted key measures to mitigate its impact such as reduction in the policy rate by 625bps to 7.00%, thereby providing much needed relief to auto-financing rates. We expect bank financing to emerge as a major factor for auto sector volumes given auto-financing accounts for approximately ~45%-50% of total automobile sales and lower rates will improve sales volumes drastically.
- **New autos policy to create more opportunities:** As per market sources, new autos policy will mainly provide tax incentives for environmental friendly cars especially Electric Vehicles (EV) and Hybrid cars and encourage further new players and existing players to launch new models to enjoy tax and duties benefits.
- **New players laying the strong foundation:** The final year of Automotive Development Policy (2016-2021) is showing its full effects as new and existing players are trying to make the most out of it. This will not only enhance competition but will give more choices to customers. Barring "big three" players (PSMC, INDU, and HCAR), new players (KIA, Hyundai, MG) are receiving an overwhelming response from customers as they launched new vehicles at competitive prices with which helped them penetrate the market and also dent market shares of the "big three".

Key Risks

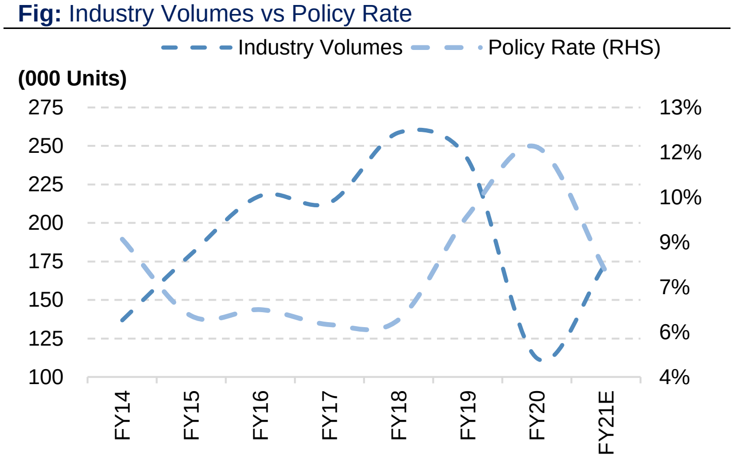
- Delay in new Auto Policy.
- Unexpected movement in exchange rates.
- Increase in Custom Duties, Regulatory Duties and Federal Excise Duties.

Fig: Total Passenger Cars and LCV Unit Sales - Trend



Source (s): PAMA, AHL Research

Fig: Industry Volumes vs Policy Rate



Source (s): PAMA, SBP, AHL Research

Indus Motor Company Limited

Proactive approach to retain market share

- **New models - A harbinger for growth:** During 4MFY21, Toyota has posted massive sales growth of 87% YoY to 17,196 units compared to 9,203 units SPLY. This year sales growth was led by newly launched Toyota Yaris which contributed 53% of total sales. The company is expected to make a strong comeback to regain its lost share from 25% to 27% in FY21 due to marked volumetric growth expected in the period under review (+52% YoY). Earnings for the current year are expected around PKR 9.2bn (EPS: PKR 117.26), up by 81% YoY against PKR 5.1bn (EPS: PKR 64.66) in FY20.
- **Corolla's potential facelift and launch of Toyota Cross expected**: The company is gearing up for competition and planning to launch two new variants namely Toyota Cross (CBU expected launch date is Dec'20) and Toyota Corolla Facelift (CKD expected launch date is Jan'21). A potential facelift as early as the beginning of CY21 will instigate a new life to the company's flagship Corolla. We believe the launch of Toyota Cross (SUV) will give tough competition to KIA's Sportage (SUV) and Hyundai Tuscon (SUV). Similarly, Toyota Corolla facelift will give competition to upcoming sedan models expected to launch by KIA and Hyundai in next couple of months.
- **Comfortable cash position:** INDU sits on massive piles of cash and cash equivalents of PKR 66bn. A mixed portfolio of term deposits, PIBs/TBills and mutual funds are a solid cushion for INDU and creates ample room for stunning dividend pay-outs, new model launch and investment in capacity expansion.
- **Upcoming policy will be key catalyst:** New autos policy will be implemented from 1st Jul'21 and will focus on attracting new players by providing incentives through tax advantages, promoting 'make in Pakistan' initiative which should benefit existing players. The policy will also promote environment friendly vehicles through reduction in duties on Electric Vehicles and Hybrid Cars. We believe any exemption in duties on Hybrid cars will be beneficial for INDU as Toyota is a pioneer and leader in manufacturing of hybrid cars (globally Toyota has sold more than 15 million Hybrid cars since 1997).
- **Stability in exchange rate to improve margins:** During the last 2 years, volatility in PKR against the greenback pressured automobile manufacturers to increase car prices which reduced overall demand and resulted in slowdown in sales volumes. We expect PKR to be less volatile this year which bodes well for the automobiles sector as it is heavily reliant on import of raw materials.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	64.7	117.3	144.3
Dividend per share	PKR	30.0	80.0	95.0
Book Value per share	PKR	524	561	610
Price to Earning	x	15.4	9.8	8.0
Price to Book	x	1.9	2.1	1.9
Dividend Yield	%	3.0	6.9	8.3
Net Margins	%	5.9	7.0	7.3

Source (s):Company Financials, AHL Research

INDU PA

Recommendation	BUY
Target Price (Dec'21)	1,723.4
Last Closing	1,151.3
Upside (%)	49.7
Shares (mn)	79
Free float (%)	17.1
Market Cap. (PKR mn)	90,495
Market Cap. (USD mn)	567.5

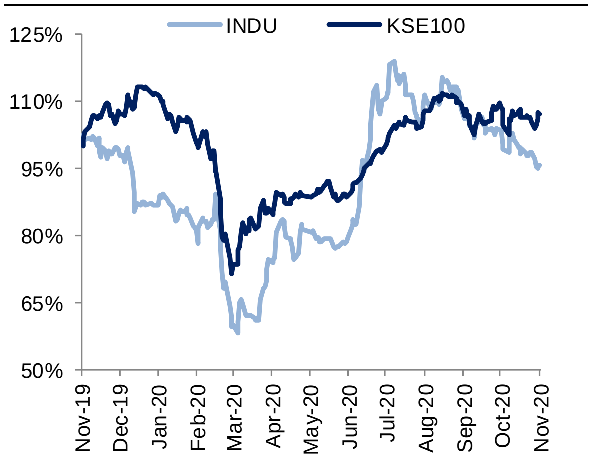
Major Shareholders

- Toyta Motor Corporation

Price Performance

	3M	6M	12M
Return (%)	-13.4	18.2	-6.6
Avg. Volume (000)	28	30	23
ADTV (mn) - PKR	35	36	27
ADTV (000) - USD	217	220	165
High Price - PKR	1,389.1	1,430.0	1,430.0
Low Price - PKR	1,144.5	929.8	700.4

Relative Performance



Source: Bloomberg

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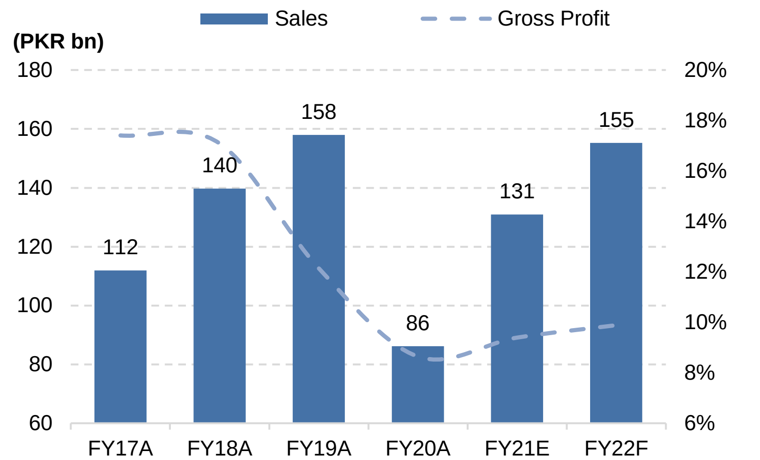
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	86,167	130,962	155,256
Gross Profit	7,451	12,306	15,354
Other Income	3,205	4,990	5,612
Finance Cost	86	140	222
Post Tax Profit	5,082	9,217	11,339
Balance Sheet			
Shareholder's Equity	41,169	44,098	47,970
Advances from customers	24,534	35,796	40,739
Total Liabilities	39,109	53,585	61,592
Current Assets	63,617	78,536	87,872
Non-Current Assets	16,661	19,147	21,690
Total Assets	80,278	97,683	109,562

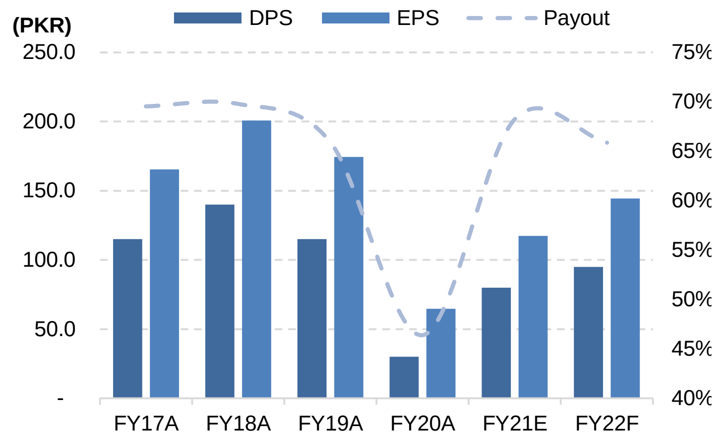
Source (s):Company Financials, AHL Research

Fig: Total Sales vs Gross margins



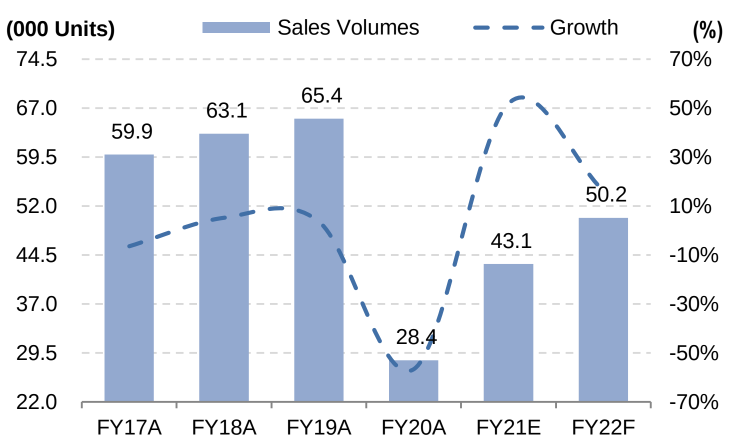
Source (s): Company Financials, AHL Research

Fig: Payout Ratio



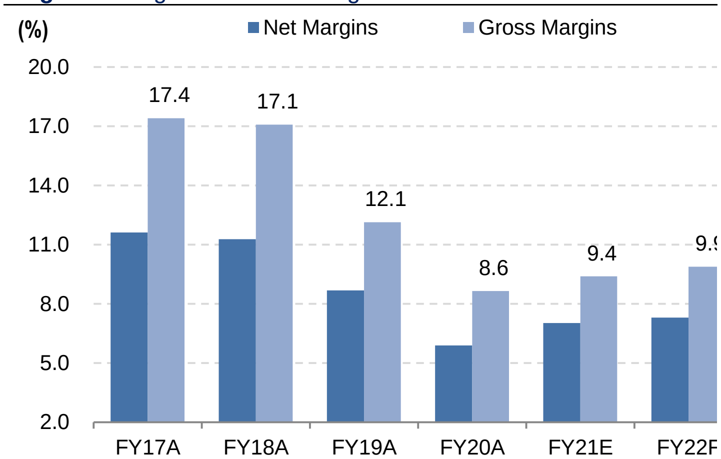
Source (s): Company Financials, AHL Research

Fig: Sales Volumes vs Growth



Source (s): Company Financials, AHL Research

Fig: Net Margins vs Gross Margins



Source (s): Company Financials, AHL Research

Millat Tractors Limited

Improving agriculture yields: Key catalyst

- **Economic growth to stimulate sales:** During the period under review, MTL outperformed the tractors' industry, whereby volumes surged by 50% YoY to 10,232 units in 4MFY21 compared to 6,823 units in SPLY due to improvement in farmers' yields, which bodes well for tractor industry. During FY21, we expect bottom-line to jump by a stellar 87% YoY to PKR 3,343mn (EPS: PKR 67.10) supported by topline growth of 58% (tractor sales expected at 31,473 units, up by 52% YoY from 20,706 units in FY20). We expect growth in sales volumes mainly on the back of a reviving economy, increased consumer financing and improvement in agricultural output.
- **Holding more than 60% market share:** Millat Tractors Limited (MTL) has secured the highest market share in the tractor industry averaging around 60% over the past many years and has maintained this share due to premium quality and reliability of the tractors. Despite 35% YoY decline in sales volumes during FY20, company maintained a market share of 63% to 20,706 units. We believe the company will maintain this market share due to i) lack of competition, ii) no new entrants in the tractor industry, and iii) imported tractors' prices are much higher than locally manufactured.
- **Sales tax subsidy for locally manufactured tractors**: The Economic Coordination Committee in its meeting held on 13th May'2020 approved PKR 1.5bn sales tax subsidy on locally manufactured tractors in order to promote the agriculture sector and increase crop yields. The adjustment of subsidy against payment of sales tax will remain applicable up till 30th Jun'21 from 28th Sep'20. We believe this development will be material positive for the local tractor industry especially for MTL as the company holds more than 60% of market share and this subsidy will be eligible for 30,000 tractors.
- **Higher localization - A competitive edge:** The 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 a localization of around 95% which has kept the margins stable for the company in recent years and has provided a competitive edge against peers.
- **Diversification in autos business reaping benefits:** The management invested in passenger cars' manufacturing business, a consortium led by Nishat group to manufacture Hyundai cars. MTL's stake in the venture is ~18% and is expected to be a key catalyst for the scrip going forward as currently Hyundai is adding PKR 79/share in MTL's target price.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	43.2	84.6	101.0
Dividend per share	PKR	40.0	80.0	100.0
Book Value per share	PKR	81.7	86.3	87.3
Price to Earning	x	16.4	11.9	10.0
Price to Book	x	8.6	11.7	11.5
Dividend Yield	%	5.7	8.0	10.0
Net Margins	%	9.4	11.8	12.7

Source (s):Company Financials, AHL Research

	MTL PA
Recommendation	**BUY**
Target Price (Dec'21)	1,259.6
Last Closing	1,004.6
Upside (%)	25.4
Shares (mn)	50
Free float (%)	45.0
Market Cap. (PKR mn)	50,060
Market Cap. (USD mn)	313.9

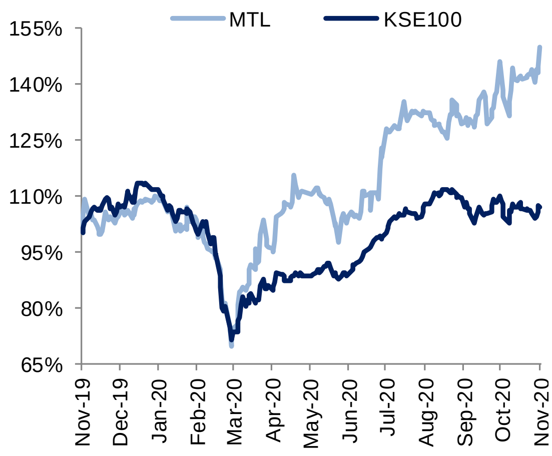
Major Shareholders

- Directors

Price Performance

	3M	6M	12M
Return (%)	13.1	35.0	42.6
Avg. Volume (000)	38	32	39
ADTV (mn) - PKR	35	28	29
ADTV (000) - USD	215	169	183
High Price - PKR	1,004.6	1,004.6	1,004.6
Low Price - PKR	842.8	655.6	468.5

Relative Performance



Source: Bloomberg

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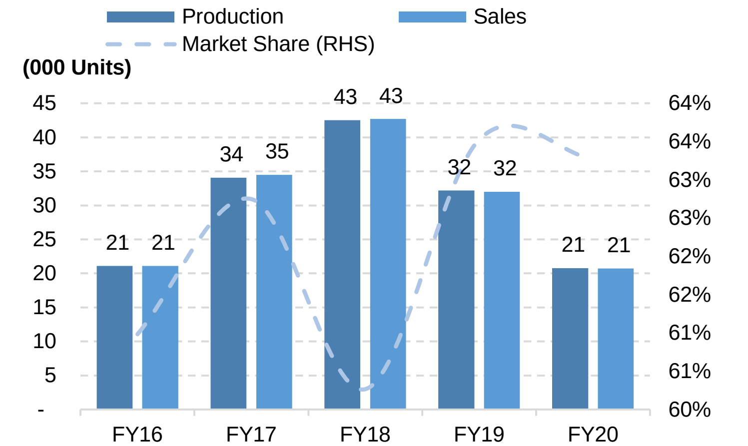
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	22,942	35,592	39,633
Gross Profit	4,246	7,636	9,000
Operating Profit	3,230	6,041	7,317
EBITDA	3,313	6,143	7,419
Post Tax Profit	2,151	4,216	5,031
Balance Sheet	**2020A**	**2021E**	**2022F**
Shareholder's Equity	4,072	4,302	4,349
Trade and Other Payables	6,256	8,333	8,574
Total Liabilities	6,733	8,687	8,928
Current Assets	7,782	9,967	10,242
Non-Current Assets	3,023	3,021	3,035
Total Assets	10,805	12,989	13,277

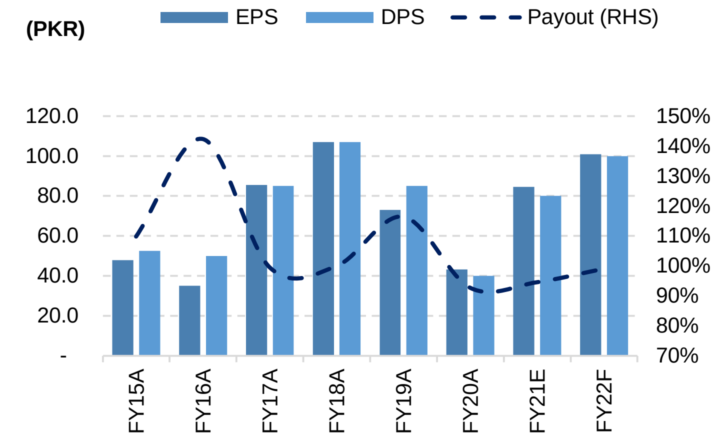
Source (s): Company Financial, AHL Research

Fig: Market Share



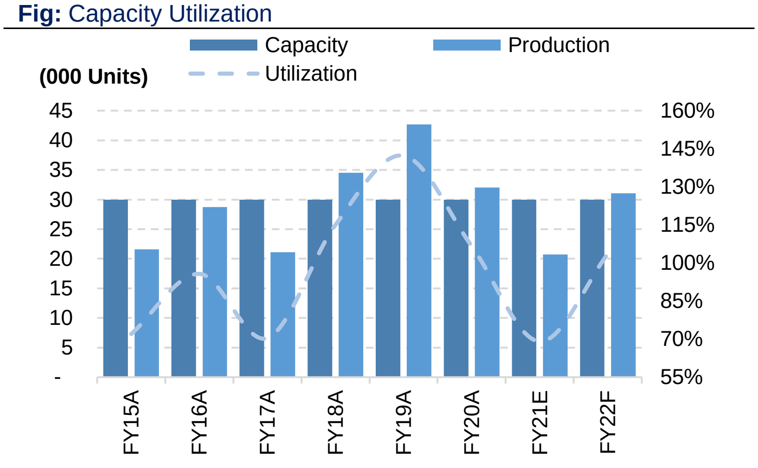
Source (s): Company Financials, AHL Research

Fig: Payout Ratio



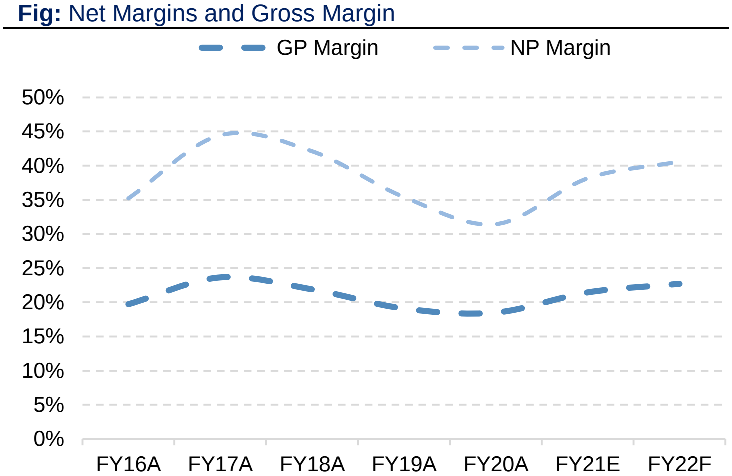
Source (s): Company Financials, AHL Research

Fig: Capacity Utilization



Source (s): Company Financials, AHL Research

Fig: Net Margins and Gross Margin



Source (s): Company Financials, AHL Research

Textile Composite

Global lockdown favoring textile sector

Textile Composite

Global lockdown favoring textile sector

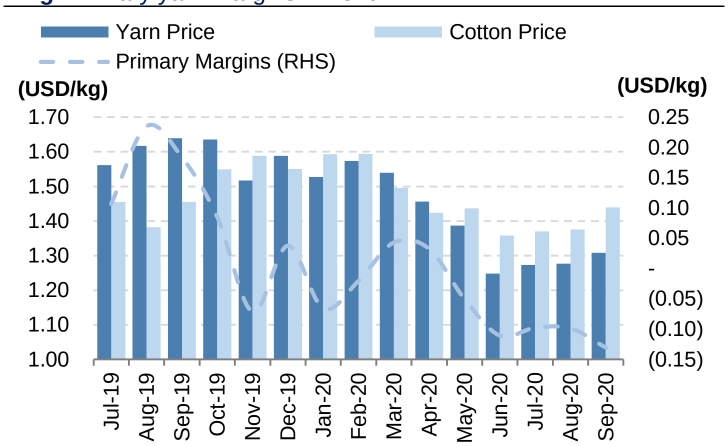
Key Investment Theme

- **Textile Exports to Remain in Spotlight:** Textile sector has posted a strong recovery after lifting of COVID-19 related restrictions from majority of export destinations (mainly Europe and America). A revival in sales was witnessed while backlog of orders also helped recover losses occurred during the lockdown period. As a result of full recovery in export markets, capacity utilization of the sector remained jovial. During 4MFY21, textile exports increased by 4% YoY to USD 4.8bn compared to USD 4.6bn with major growth witnessed in Knitwear (12% YoY) and Towels exports (12% YoY).
- **Shifting of Orders to Pakistan:** With Pakistan doing much better than its competitors on the COVID-19 front (India for instance has suffered tremendously), we witnessed a huge shift in orders to Pakistan. Additionally, the incumbent government has been extending its support to the export-oriented sector so as to further enhance competitiveness against regional countries. This has been in the form of lower financing rates, release of pending sales tax refunds and provision of electricity and gas at a subsidized rate. We believe renowned brands have begun trusting the “made in Pakistan” products and this will increase our textile exports.
- **Textile Policy to Support Industry:** New textile policy will play a pivotal role in improving exports as this upcoming policy will support SMEs and will allow consistency in government policies for the next five years. This may include i) Fixed rate of utilities, ii) Lower financing rates for BMR and capacity expansion, and iii) Improvement in the refund process.
- **GSP+ Status and FTA providing Competitive Edge:** Pakistan’s competitive edge is its GSP+ status and Free Trade Agreement (FTA) which allows the country to export products at 0% import tariff compared to an import tariff of 5-10%. Continuation of this should bode well for the sector.

Key Risks

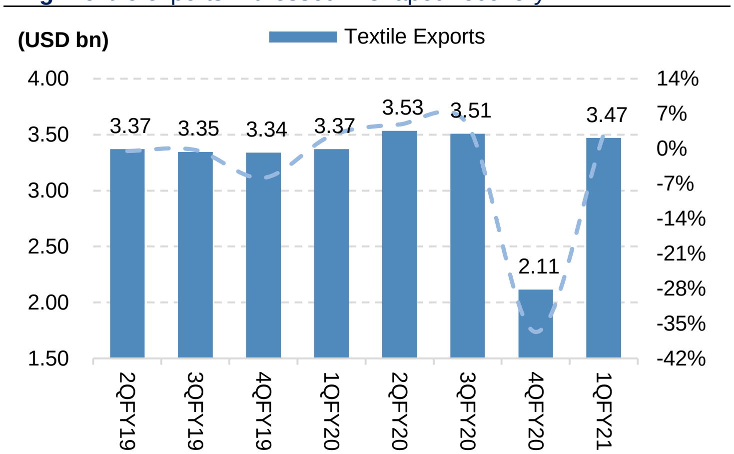
- Volatility in Cotton and Polyester prices.
- Delay in refund payments.
- Discontinuation of GSP+ Status.
- Appreciation of PKR against USD, which can lead to exchange losses and margin attrition.

Fig: Primary yarn margins - Trend



Source (s): PBS, BR, AHL Research

Fig: Textile exports witnessed V-shaped recovery



Source (s): Bloomberg, SBP, AHL Research

Nishat Mills Limited

Healthy margins to lead core income

- **Contribution of Core Income to Increase:** We expect core earnings of the company to counterbalance decline in non-core as we have revised down our dividend assumptions from NPL, LPL and PKGP. The rise in core earnings can be attributable to i) Higher margins on fabric and ready-made garments, ii) Subsidized financing rates (LTFF and ERF), iii) Subsidized gas and electricity tariffs, iv) Reduction in custom and regulatory duties on raw materials, and v) Regionally diversified customer base across the world which provides a sustainable growth to export sales. We expect FY21 earnings to settle at PKR 13.3/share, up by 36% compared to PKR 9.97/share in FY20.
- **Sale of Ready-made Garments and Expansion in Towel Business to Support Margins:** To recall, growth in profitability was attributed to improved margins of the value-added segment amid higher demand from Europe and the U.S. Going forward, NML's management is focusing primarily on the value-added segment; it is setting up a towel manufacturing unit which is expected to commission from 2QFY21. The company is also paying close attention to technological upgradation by replacing outdated machinery with new state-of-the-art equipment. This key development will support margins in the future.
- **Subsidized Gas and Electricity Price for Exporters:** To encourage export oriented sectors, the incumbent government announced a reduction in energy cost by fixing a uniform gas and electricity price of USD 6.5/mmbtu and USd 9/KwH, respectively. We believe for the export-oriented sector, NML would stand as a major beneficiary in the textile universe as Nishat Mills is currently the largest listed textile player in Pakistan with heavy power requirement for running various plants.
- **Trading at Sizeable Discount to its Potential:** We remain positive on NML due to (i) Equity portfolio, with a market value of PKR 100.8/share, after 30% portfolio discount, (ii) Majority of the sales come from value-added segment, (iii) Regular BMR which will improve capacity and efficiency of plant, and (iv) Economic revival in US and Europe as ~58% of the sales in FY20 were EU and US bound. Our SoTP based Dec'21 TP for NML works out to PKR 141.8/share, with an upside potential of 57% from current levels.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	10.0	13.3	17.1
Dividend per share	PKR	4.00	5.50	7.00
Book Value per share	PKR	203	212	224
Price to Earning	x	7.8	6.8	5.3
Price to Book	x	0.4	0.4	0.4
Dividend Yield	%	5.1	6.1	7.8
Net Margins	%	5.76	6.86	8.12

Source (s):Company Financials, AHL Research

Recommendation	NML PA BUY
Target Price (Dec'21)	141.8
Last Closing	90.2
Upside (%)	57.2
Shares (mn)	352
Free float (%)	45.0
Market Cap. (PKR mn)	31,721
Market Cap. (USD mn)	198.9

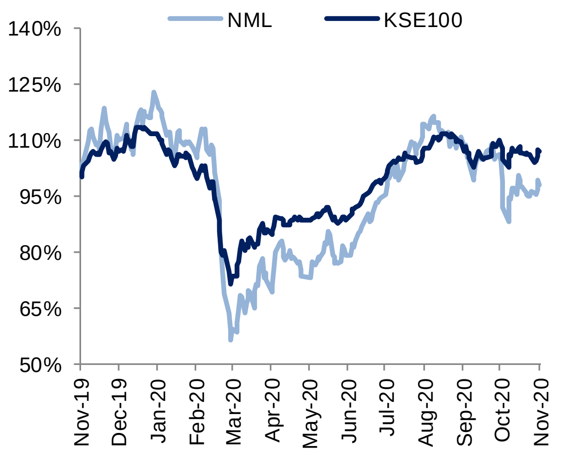
Major Shareholders

- D.G. Khan Cement Company Limited

Price Performance

	3M	6M	12M
Return (%)	-14.1	26.3	-5.7
Avg. Volume (000)	1,057	1,424	1,251
ADTV (mn) - PKR	104	131	114
ADTV (000) - USD	640	793	702
High Price - PKR	107.2	107.2	113.2
Low Price - PKR	81.1	70.4	52.0

Relative Performance



Source: Bloomberg

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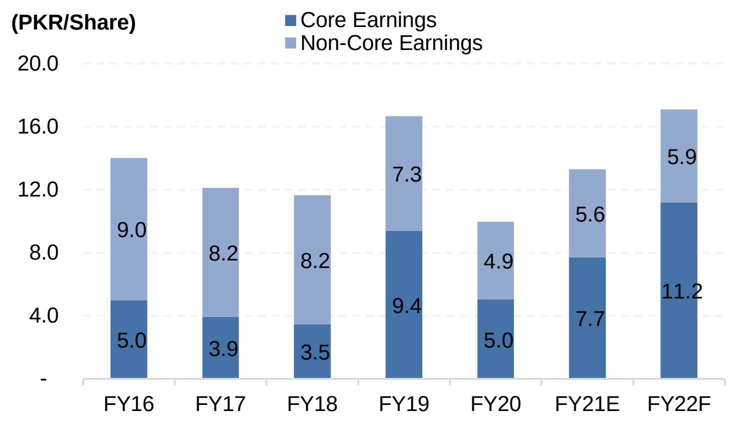
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	60,904	68,106	73,985
Gross Profit	7,276	8,975	11,046
Other Income	3,032	2,862	2,900
Finance Cost	1,502	1,287	1,362
Post Tax Profit	3,506	4,671	6,011
Balance Sheet			
Shareholder's Equity	71,428	74,693	78,770
Interest Bearing Liabilities	29,256	31,140	29,255
Total Liabilities	39,233	40,971	39,716
Current Assets	40,524	45,413	48,021
Non-Current Assets	70,137	70,251	70,465
Total Assets	110,661	115,664	118,485

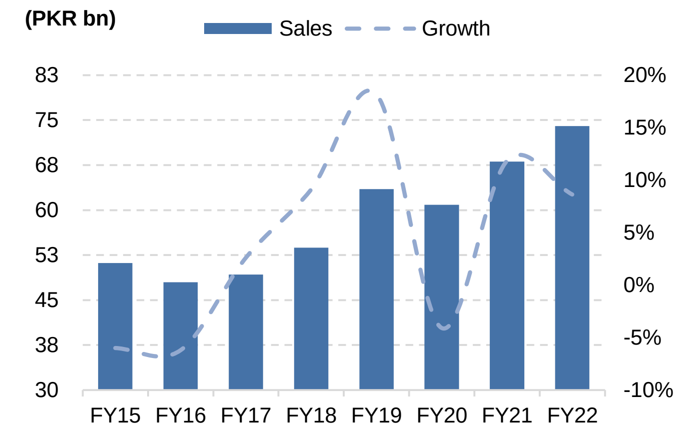
Source (s):Company Financials, AHL Research

Fig: Core and Non-Core Earnings



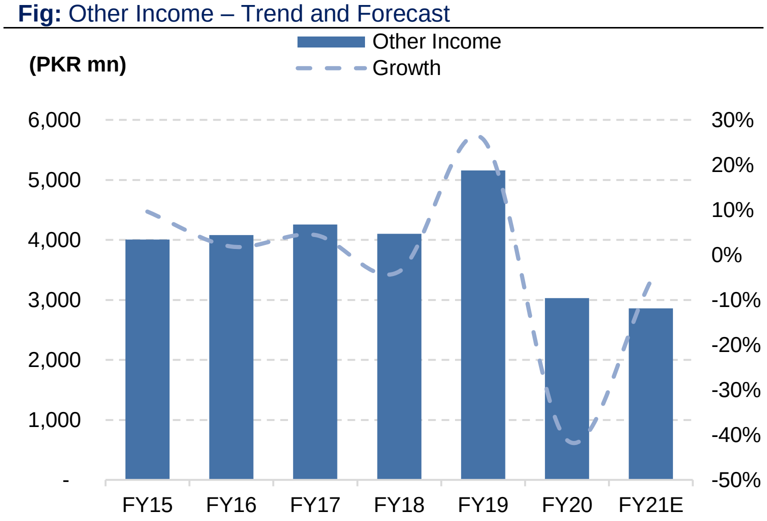
Source (s): Company Financials, AHL Research

Fig: Sales – Trend and Forecast



Source (s): Company Financials, AHL Research

Fig: Other Income – Trend and Forecast



Source (s): Company Financials, AHL Research

Fig: NML – Portfolio Value

	Jun-20	Nov-20
Companies	**Holdings**	**Portfolio Value**
Nishat Power	51.0%	3,974
DG Khan Cement	31.4%	14,518
MCB Bank	7.6%	14,983
Pakgen Power	27.6%	1,982
Nishat Chunian	13.6%	1,177
Adamjee Insurance	0.0%	4
Lalpir Power	28.8%	1,395
Others		5,046
Total Value of Investments		43,079
Total Value of Investments - PKR/Share		123
Discount Applied		30%
Contribution towards fair value - PKR/Share		**85.8**

Source (s): Company Financials, AHL Research

Interloop Limited

Materialization of new capacities to improve earnings

- **Hosiery division to post significant growth:** Currently, the hosiery division is operating at a 100% capacity utilization and it is expected to operate at maximum capacity for the entire year due to lagged impact of orders and addition of new customers. We believe hosiery sales are likely to increase at a 5-Yr CAGR of 17% due to increasing capacity, growing customer base and rising orders of socks. On the other hand, gross margins are set to improve further as product prices have not been affected and as per management of the company, they are yet to pass on the benefit of rupee devaluation to importers. We expect company to post earnings of PKR 6.64/share in FY21 and PKR 9.17/share in FY22, respectively.
- **Denim to contribute to profits in FY21:** To make the most of it, ILP successfully completed the first phase of the project and second phase of the project is almost ready and is expected to start its commercial operations in 4QFY21. The company is undertaking efforts to bring new clients on board for its denim segment and few reputable brands are placing orders at very attractive prices, which are currently utilizing significant capacity of their denim plant. Currently, the denim plant is expected to reach 100% capacity utilization in Nov'20 on account of rising orders and increasing customer base. We expect denim sales to contribute 8% to total sales and become profitable from 3QFY21.
- **Decline in raw material prices to improve earnings:** We expect gross margins to improve further led by decline in majority of the input prices (especially international cotton prices which are down by 10% due to lower demand as global economies are facing GDP contraction). Furthermore, addition of new machinery will improve efficiencies and economies of scale are also likely to fuel margins, going forward.
- **One of the world's largest socks supplier:** The company holds more than ~10% market share in the country's knitwear exports (around ~2% contribution to Pakistan's total textile exports) and 3.5%-4.0% of the world's total socks supplies.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	2.1	6.7	9.2
Dividend per share	PKR	2.00	3.50	4.50
Book Value per share	PKR	19.8	23.0	27.6
Price to Earning	x	21.3	9.2	6.7
Price to Book	x	2.2	2.7	2.2
Dividend Yield	%	4.6	5.7	7.3
Net Margins	%	5.0	12.3	13.3

Source (s):Company Financials, AHL Research

	ILP PA
Recommendation	**BUY**
Target Price (Dec'21)	80.9
Last Closing	61.3
Upside (%)	32.0
Shares (mn)	869
Free float (%)	15.0
Market Cap. (PKR mn)	53,251
Market Cap. (USD mn)	333.9

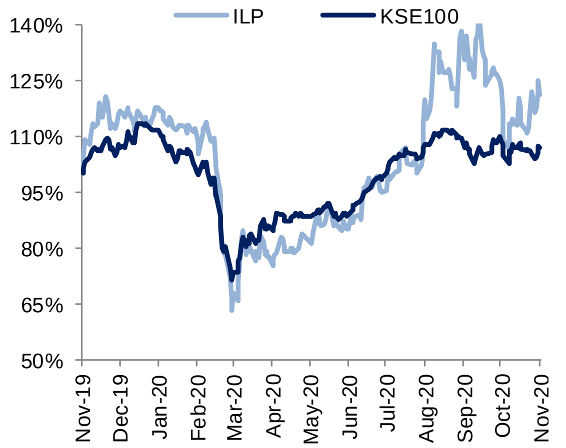
Major Shareholders

- Directors

Price Performance

	3M	6M	12M
Return (%)	5.8	43.6	15.6
Avg. Volume (000)	1,215	847	621
ADTV (mn) - PKR	77	51	36
ADTV (000) - USD	473	310	223
High Price - PKR	72.1	72.1	72.1
Low Price - PKR	53.7	42.7	32.0

Relative Performance



Source: Bloomberg

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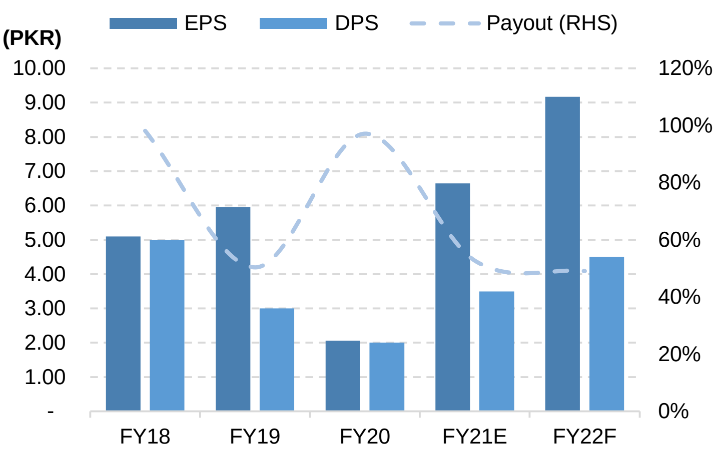
PKR mn	2020A	2021E	2022F
Income Statement			
Net Sales	36,303	47,091	60,035
Gross Profit	7,864	13,275	17,909
Operating Profit	3,154	7,066	9,524
Finance Cost	1,137	1,183	1,067
Post Tax Profit	1,796	5,793	7,999
Balance Sheet			
Shareholder's Equity	17,280	20,020	24,094
Interest Bearing Liabilities	21,619	25,191	22,288
Total Liabilities	28,088	31,985	29,352
Current Assets	20,446	24,232	25,967
Non-Current Assets	24,922	27,773	27,479

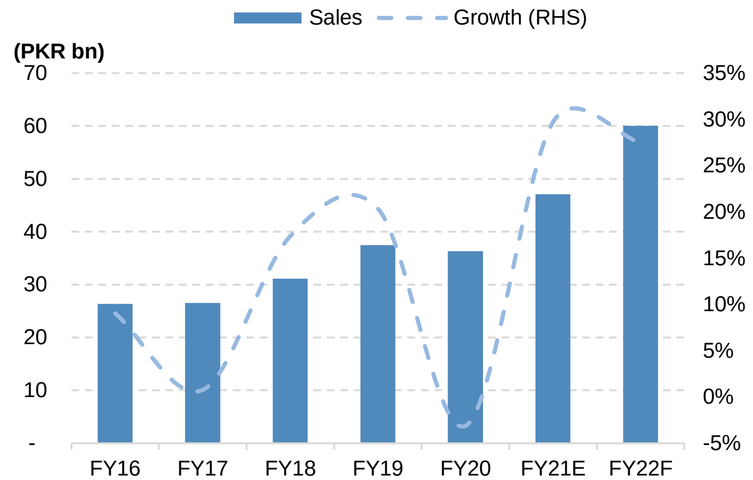
Source (s):Company Financials, AHL Research

Fig: EPS and DPS – Trend and Forecast



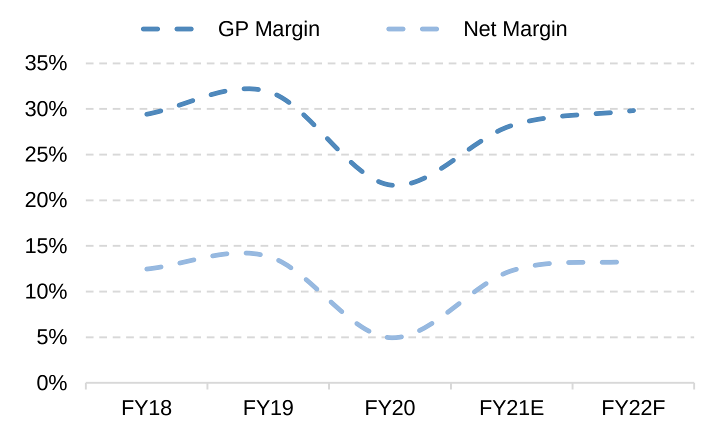
Source (s): Company Financials, AHL Research

Fig: Sales – Trend and Forecast



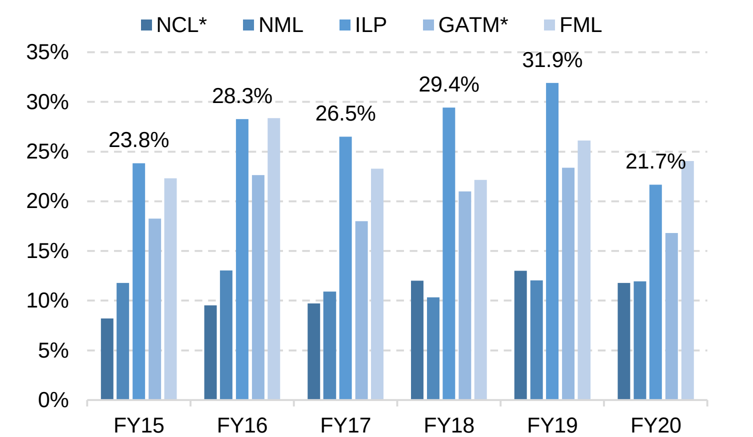
Source (s): Company Financials, AHL Research

Fig: Margins – Trend and Forecast



Source (s): Company Financials, AHL Research

Fig: Gross Margins Comparison



Source (s): Company Financials, AHL Research

Chemicals

Economic upswing to bolster profitability

Chemicals

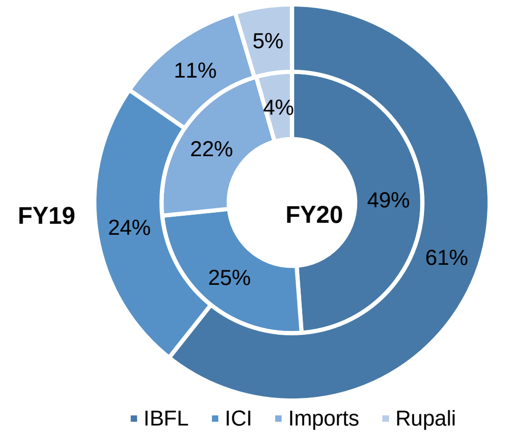
Economic upswing to bolster profitability

- **Economic recovery will improve the demand:** We anticipate a marked recovery in economic activity in the coming year, provided that the coronavirus threat remains under control, with the vaccine rollout expected early next year. The government's efforts to stimulate housing and construction industry through the construction package and housing finance are likely to be a major trigger for PVC demand in the country. Moreover, with global economic activity also expected to pick up, higher demand for PVC is expected to translate into higher PVC margins (USD denominated).
- **Global economies are reopening:** As global economies start reopening; we anticipate exports to show an improving trend. It is pertinent to mention that many textile players have publicly stated that export orders are pre-booked till Jun'21. Based on this premise, we expect demand uptick for PSF and PTA (given this is a raw material for the Textile sector).
- **Capacity addition and diversification:** To match the growing demand (Soda Ash, Polyvinyl Chloride, Hydrogen peroxide and Linear alkylbenzene sulfonic acid), domestic chemical companies have announced capacity and product addition whereby the expansions are near completion. We expect the companies which have announced said expansions to benefit from augmented sales on the back of higher demand of products (use of PVC has increased) and capacity addition of downstream industries (glass manufacturers have also increased their capacities).

Key Risks

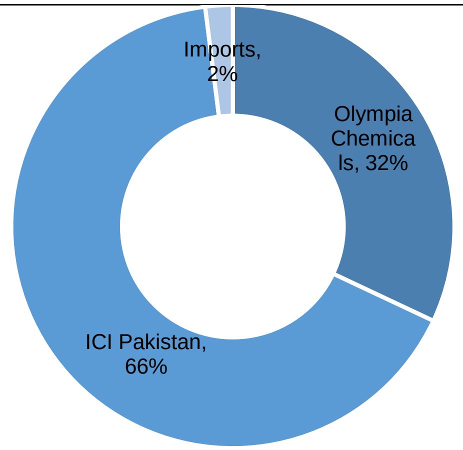
- Lower demand due to economic slowdown amid extension in second wave of COVID-19.
- Lower exports amid slowdown in global economies.

Fig 01: Market Size of PSF declined by 15% during FY20



Source (s): ICI Analyst Briefing Presentation, AHL Research

Fig 01: ICI is Market Leader in Soda Ash Market



Source (s): ICI Analyst Briefing Presentation, AHL Research h

ICI Pakistan Limited

Diversifying, Expanding and Growing

- **Demand Pushed Capacity Expansion of Soda Ash:** ICI is the market leader in Soda Ash market with a share of 66% followed by Olympia Chemicals (32%) and 2% share of imports. The company has approved an expansion of 125K tons at a total capital expenditure of ~PKR 11bn. With this addition, the total capacity will reach 550K tons from current levels of 425K tons. The plant is located at an ideal location in terms of access to major raw materials (salt and limestone) with continued long term and uninterrupted supply. Moreover, ~70% of domestic consumption of Soda Ash is in the North Region which protects the company from import risk. The plant is also self-sufficient in terms of energy needs with an energy mix including coal, gas and furnace oil. During FY20, mainly due to adverse effects of pandemic, revenue and EBITDA of Soda Ash segment registered a decline of 5% YoY (PKR 15.7bn) and 2% YoY (PKR 5.2bn), respectively. Pertinently, exports to India have decreased to zero due to trade ban with India. Despite this, the segment successfully exported 20K tons to other countries solidifying its exports base.

- **Morinaga Infant Formula, entering the Consumer Market:** ICI established a manufacturing facility for Morinaga infant formula. NutriCo Morinaga (Private) Limited, a subsidiary of ICI Pakistan (Holding: 51%). With a capacity to manufacture 12,000 tons p.a. of infant formula.

- **ICI Pharma 2nd Fastest Growing Organization after GSK:** During FY20, ICI Pharma became the 2nd fastest growing organization after GSK Consumer, with higher growth than the market. Revenue of the Pharma segment displayed a decline of 1% YoY to PKR 7.3bn, however EBITDA increased considerably by 173% YoY to PKR 0.8bn, mainly on the back of operational efficiencies and successful launches of new products. During FY20, ICI Pharma launched 8 new products from which “Merpen” was the second-best launch for the year. Whereas “Tenormin” has joined the elite club with revenue generation of over PKR 1bn. The segment also successfully completed amalgamation of Cirin Pharma (subsidiary) with ICI. Going forward, the management is looking forward to transform its Pharma segment into a competitive & profitable business with sustainable growth.

- **Diversification to Offset the PSF Underperformance:** During FY19, the company successfully commissioned the Masterbatch manufacturing facility. It is a colorant/pigment that is used in plastics and comes under the company’s Chemical and Agri Sciences business. In addition, the company has also signed an agreement with Huntsman Textile to manufacture and distribute textile effects products in Pakistan. This venture is expected to enhance the company’s profits going forward.

Key metrics		2020A	2021E	2022F
Earnings per share	PKR	27.4	37.9	53.0
Dividend per share	PKR	16.0	19.0	27.0
Book value per share	PKR	243.9	267.4	310.4
Price to Earning	x	25.4	18.6	13.3
Price to Book	x	2.8	2.6	2.3
Dividend Yield	%	2.3	2.7	3.8
Net Margins	%	4.6	5.3	6.1

Source (s): Company Financials, AHL Research

Recommendation	ICI PA BUY
Target Price (Dec'21)	959.5
Last Closing	703.0
Upside (%)	36.5
Shares (mn)	92
Free float (%)	15.0
Market Cap. (PKR mn)	64,930
Market Cap. (USD mn)	407.2

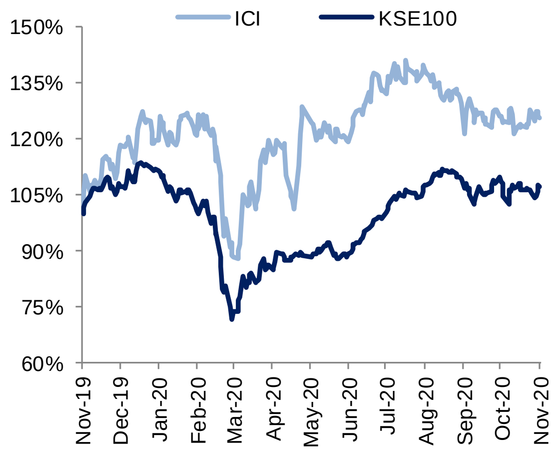
Major Shareholders

- Lucky Cement Ltd.

Price Performance

	3M	6M	12M
Return (%)	-8.8	1.3	19.6
Avg. Volume (000)	25	30	53
ADTV (mn) - PKR	18	22	36
ADTV (000) - USD	111	133	229
High Price - PKR	771.0	790.1	790.1
Low Price - PKR	679.3	666.9	491.6

Relative Performance



Source: Bloomberg

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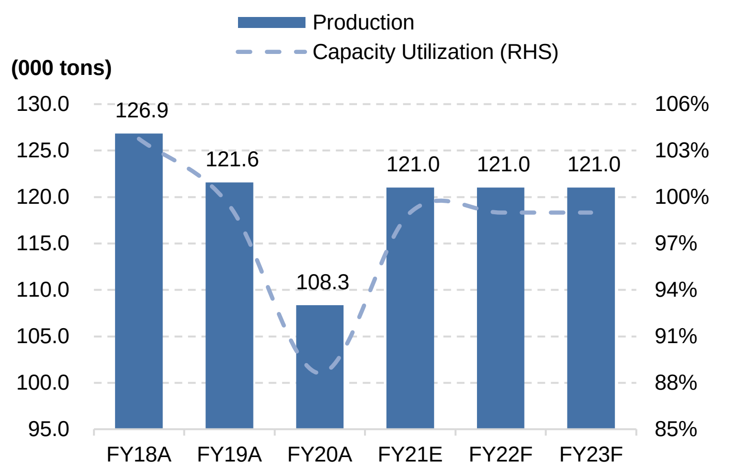
Income Statement	2020A	2021E	2022F
Net Sales	55,256	66,587	80,802
Gross Profit	10,917	11,964	15,399
Operating Profit	5,520	6,377	8,811
Financial Charges	1,891	1,150	1,053
Post Tax Profit	2,528	3,499	4,899

Balance Sheet	2020A	2021E	2022F
Shareholder's Equity	22,524	24,698	28,668
Trade and Other Payables	8,639	7,990	9,696
Total Liabilities	25,861	22,234	20,091
Current Assets	19,372	17,791	21,051
Non-Current Assets	29,013	29,141	27,707
Total Assets	48,385	46,932	48,758

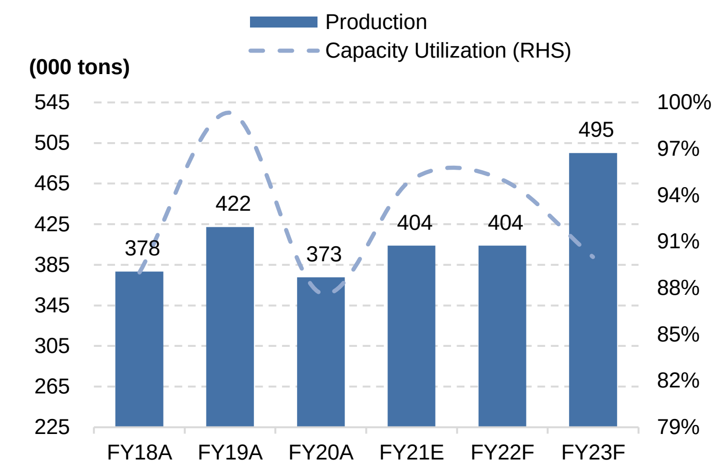
Source (s): Company Financial, AHL Research

Fig: PSF Segment Capacity Utilization



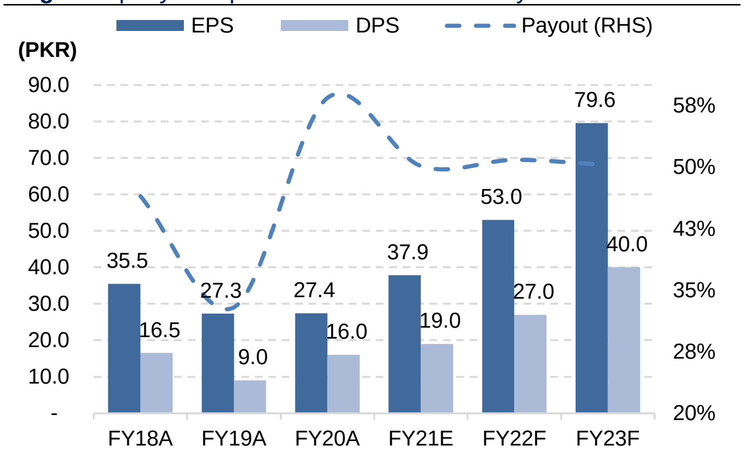
Source (s): Company Financials, AHL Research

Fig: Soda Ash Segment Capacity Utilization



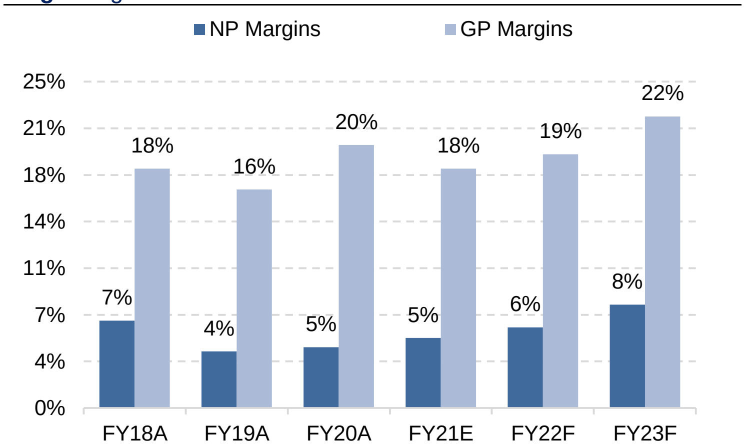
Source (s): Company Financials, AHL Research

Fig: Company is Expected to Maintain 50% Payout



Source (s): Company Financials, AHL Research

Fig: Margins - Trend and Forecast



Source (s): Company Financials, AHL Research

Engineering
Structurally strong

Engineering

Structurally strong

- **Jovial demand outlook:** Economic slowdown and COVID-19 led the contraction in the domestic steel sector during FY20 (LSM data suggests that production of long products shriveled by 18% while flat steel demand declined by 17%, imports of steel also took a hit of 27% YoY, as per PBS). That said, the trend is likely to witness a reversal in FY21 with demand.

- **Spotlight on construction - key trigger for long steel demand**: Demand emanating from recognition of the construction sector as an industry (announcement of tax benefits such as exemption from wealth declaration under section 111 of Income Tax Ordinance for projects announced prior to Dec'20), as well as the governments focus on Naya Pakistan Housing Scheme where our initial estimates suggest that construction of 100,000 houses could boost steel demand by 0.29mn tons. Meanwhile the State Bank has also mandated banks to increase exposure and lend up to 5% of their private sector credit offtake to builders/developers, while Karachi package also poses upside. Finally, we foresee construction of critically important dams to also generate robust long steel demand. Please find the table below whereby we estimate dams to cumulative add around 340k tons in steel demand per annum.

Table: Total Expected Demand of Steel

Project	Generation	Lead Project	Commencement	Completion	Timeline (Years)	Expected Demand*
Karot	720MW	CPEC	FY16	FY22	7.0 years	30,714
Suki Kinari	870MW	CPEC	FY17	FY23	6.5 years	32,857
Dasu (stage - I)	2,160MW	WAPDA	FY17	FY23	7.0 years	73,571
Mohmand	800MW	WAPDA	FY20	FY25	6.0 years	47,143
Tarbella Extension V	1,410MW	WAPDA	FY21	FY25	4.5 years	25,714
Kohala	1,100MW	CPEC	FY20	FY26	8.0 years	35,714
Daimer Bhasha	4,500MW	WAPDA	FY21	FY29	9.0 years	94,286
Total Expected Demand						**340,000**

Source (s): AHL Research, *Tons per annum

- **Automobile demand to turbocharge flat steel sector:** We believe the flat steel sector will be spurred by automotive demand (new car launches and low borrowing rates) and consumer electronics (given V-shaped recovery in the economy post initial outbreak of the novel coronavirus). To recall, in the past year flat steel demand had tumbled from peak 1.4mn tons to about 800k tons. Albeit, we believe the rapid turnaround in dynamics signal at a revival in demand to historic levels (CRC demand could settle at 600-700,000 tons while Galvanized demand is expected at 500,000 tons in FY21). Pertinently, only 20% of this will be catered to via imports (since Pakistan lacks expertise to produce certain complex flat steel parts and outer skins of cars) and the balance will be supplied by local players.

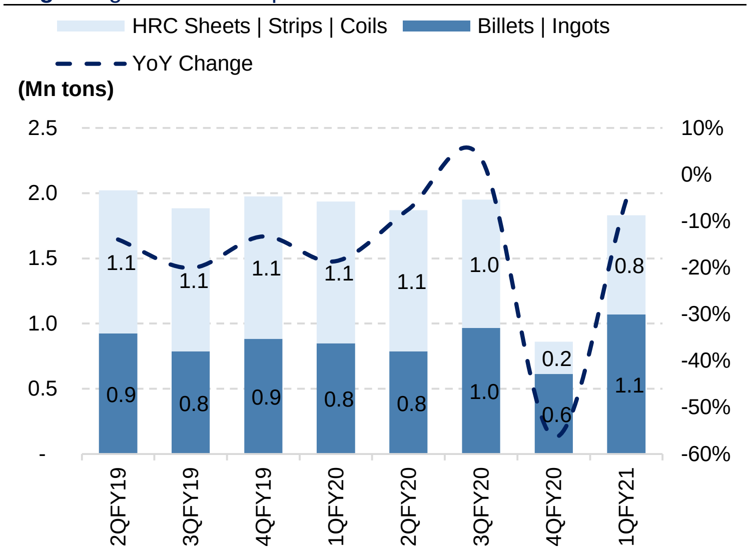
- **Expansionary cycle near conclusion:** GDP growth of prior years and unprecedented demand ensuing from the public and private sectors set in motion an era of expansion in the local steel space. Whilst most existing manufactures have already undergone expansion, or are at the tail end of their capacity additions, supply side pressure in the long steel market may be observed. Meanwhile, flat steel market remains less exposed to such competition amid risk of overcapacity and capital intensive nature of the business.

- **Price pass on post cost push inflation may not be a 100%:** Long steel sector remains overcrowded with several small units operating across the country. While different demand dynamics in both regions and quality control standards (or lack of) have kept price movement restricted. To top it off, new players continue to offer discounts so as to capture market share. Hence, prices may only see partial upside in the wake of significant cost side pressures (hike of PKR 4,000/ton in South during Nov'20 amid jump in scrap prices). On the flipside, flat steel market remains less exposed to threat of new entrants amid risk of overcapacity and capital intensive nature of the business, therefore, pricing remains less constrained. Pertinently, as HRC prices continue to escalate, flat steel players have effectively raised average prices by PKR 16,000 per ton already in FY21TD. Albeit, it will be pertinent to keep an eye on CRC import prices so as to avoid the risk of dumping.

Key risks

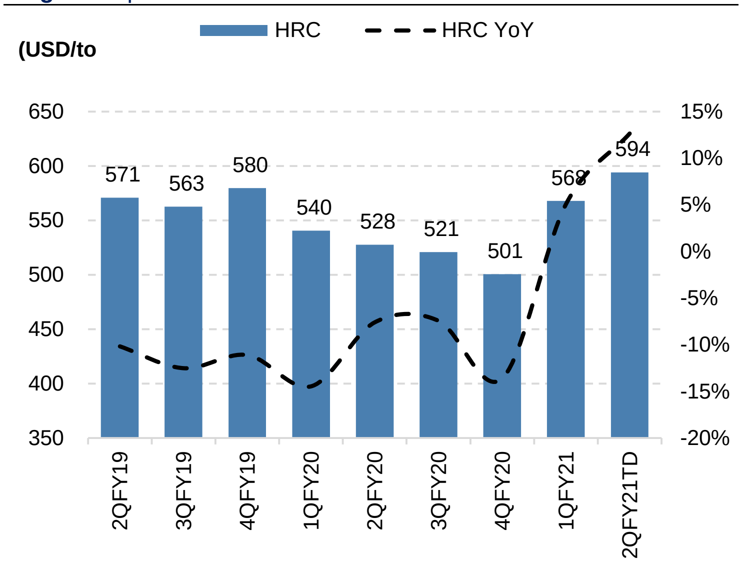
- Steel raw material prices have witnessed a sharp escalation globally as many countries effected by the Coronavirus pandemic announced stimulus packages to support the economies. Meanwhile as activity picked up post lockdown, many large steel units took longer to resume operations, creating a demand-supply imbalance. As a result, steel scrap (RM for long steel) has gone up to USD 370/ton at present from USD 300/ton last year while HRC prices have risen to USD 650/ton from USD 500/ton in FY20. If local players remain incapable of passing on this impact, margins may seriously be dented.
- Second wave of coronavirus may trigger fresh lockdowns internationally (such as those seen in Europe) which may disrupt the supply chain. Moreover, if local cases do not slow down, the incumbent government may resorts to shut down of industries which will hamper growth during the year.

Fig: Long and flat steel production



Source (s): PBS, AHL Research

Fig: HRC prices trend



Source (s): Bloomberg, AHL Research

Amreli Steels Limited

GoP incentives to reinvigorate fundamentals

Our DCF-based Dec'21 target price of PKR 46.32/share for Amreli Steels Limited (ASTL) offers an upside of 15% from current levels, we recommend BUY. Although the company makes prime quality rebars at its state of the art 425,000 tons p.a. site in Dhabeji and 275,000 tons plant in site area, choppy bottom-line performance of the company has pushed investors to the edge in the past. Albeit, with turnaround in the economy, we believe the company will finally post profits (as witnessed in 1QFY21) supported by i) improved utilization at 69% in the next five years compared to 59% on average in the past five years, and ii) economies of large scale production together with revision in depreciation policy to provide ease to margins.

- **Demand at inflection point:** Rebar demand has picked up quite substantially since 4QFY20, when the outbreak of coronavirus first emerged in Pakistan and induced a complete lockdown across the country. Astoundingly, the demand reflex post lockdown has been miraculous, led by announcement of a construction package with significant tax exemptions and SBP's instructions to banks to enhance their mortgage loans and financing for builders/developers to at least 5% of their private sector credit by Dec'21. With exuberance in demand expected to continue taking flight, we project ASTL's dispatches to grow at a 5-yr (FY20-FY25) CAGR of 11% to 460,000 tons per annum. This is expected to translate in to a plant utilization of 69% over the next five years vis-à-vis 59% historically (FY16-FY20).
- **Utilization levels to recover:** As utilization improves and benefits of large scale economies together with learning curve advantages become more visible, ASTL's margins are set to stabilize in the upcoming quarters, as opposed to the topsy-turvy trend observed in the past two years. In addition, the company has revised its depreciation policy to bring it in-line with the industry, which should also cushion margins. Albeit, pricing upside remains constrained due to i) discounts offered in South by new players (Naveena), and ii) lower prices in North where the company plans to penetrate further. Having said that, we forecast margins at a comfortable 10% over the next 5 years in contrast to 8% in the past two years.

Key metrics	Unit	2020A	2021E	2022F
Earnings per share	PKR	(3.8)	1.4	2.9
Dividend per share	PKR	-	-	0.5
Book Value per share	PKR	37.4	38.8	41.8
Price to Earning	x	(8.6)	28.3	13.6
Price to Book	x	0.9	1.0	1.0
Dividend Yield	%	-	-	1.2
Net Margins	%	(4.2)	1.2	2.0

Source (s):Company Financials, AHL Research

	ASTL PA
Recommendation	**BUY**
Target Price (Dec'21)	47.9
Last Closing	40.1
Upside (%)	19.5
Shares (mn)	297
Free float (%)	25.0
Market Cap. (PKR mn)	11,913
Market Cap. (USD mn)	74.7

Major Shareholders

- Abbas Akberali

Price Performance

	3M	6M	12M
Return (%)	-18.8	15.4	3.5
Avg. Volume (000)	2,952	2,853	2,187
ADTV (mn) - PKR	137	130	92
ADTV (000) - USD	834	782	566
High Price - PKR	53.5	53.5	53.5
Low Price - PKR	38.3	32.0	21.3

Relative Performance

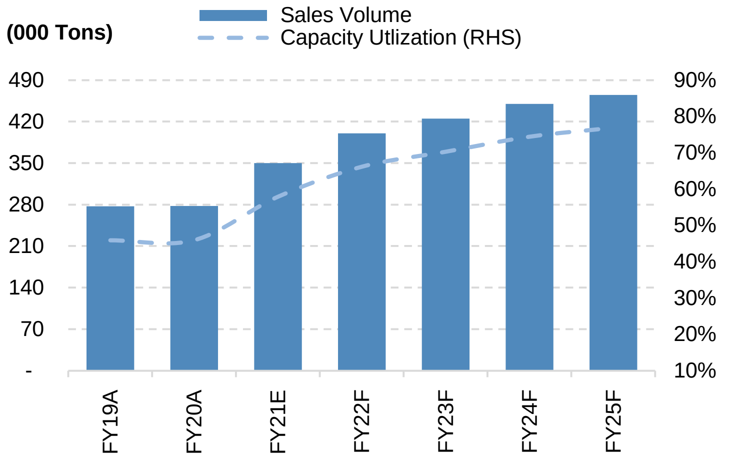
Source: Bloomberg

www.arifhabibltd.com

PKR mn	2020A	2021E	2022F
Income Statement			
Sales	26,532	36,017	43,958
Gross Profit	1,976	3,652	4,258
Distribution expenses	831	911	954
Finance Cost	2,299	1,657	1,484
Post / (Loss) Tax Profit	(1,127)	421	876
Balance Sheet			
Shareholder's Equity	11,113	11,534	12,410
Interest Bearing Liabilities	18,154	15,518	14,871
Current Liabilities	18,015	15,984	17,038
Total Liabilities	24,356	21,342	21,753
Current Assets	17,572	17,718	19,189
Non-Current Assets	17,898	15,159	14,974

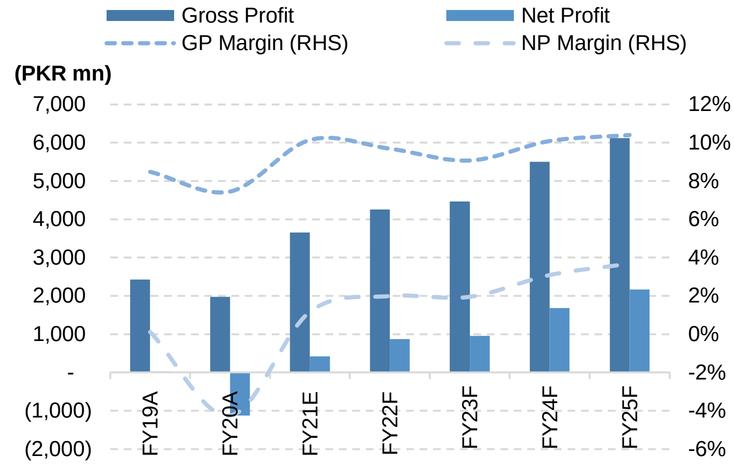
Source (s):Company Financials, AHL Research

Fig: Growth translating into improved utilization



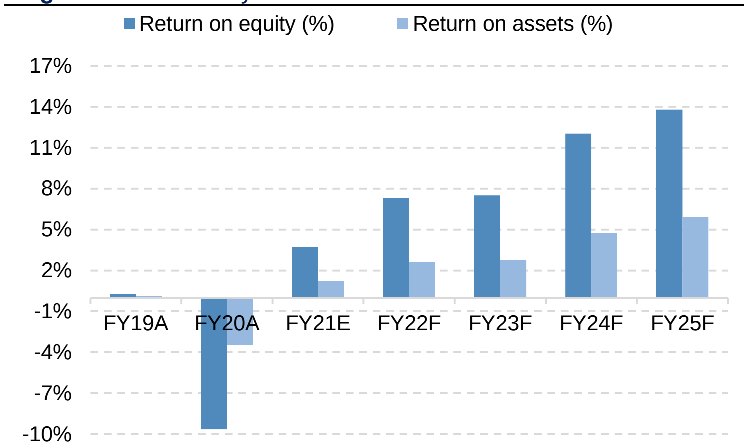
Source (s): Company Financials, AHL Research

Fig: Margins recovering



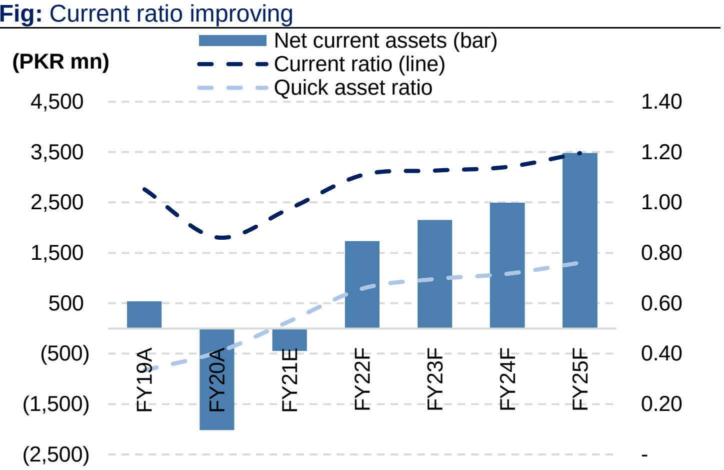
Source (s): Company Financials, AHL Research

Fig: Gradual recovery in ROE



Source (s): Company Financials, AHL Research

Fig: Current ratio improving



Source (s): Company Financials, AHL Research

Alpha stocks that could proliferate investors' wealth

- **UNITY:** In a short span of time, Unity has established itself as one of the largest fast moving consumer goods (FMCG) company of Pakistan. It registered a massive topline growth in the last few years from its edible oil, flour and animal feed business with plans to acquire a rice mill that will make UNITY a complete staple food company. In addition, the company is also expanding its existing oil refinery and flour mill capacity, as well as planning to diversify into soap manufacturing. Due to the aforementioned, we believe UNITY can post a topline jump of 50-60% in FY21 supported by healthy gross margins on account of rising palm oil prices.
- **TRG:** TRG Pakistan has always been in the limelight given its global portfolio. It owns 46.03% of TRG International Limited which (amongst others) owns IBEX Holdings Limited, Afiniti Limited and e-Telequote Limited. With the listing of its indirect subsidiary IBEX at the NASDAQ index (trading at a current market capitalization of USD 291mn), alongside other tech companies under its umbrella such as Afiniti (upcoming series E funding round estimated at USD 2.1bn) and e-Telequote (assumed USD 600mn), estimated portfolio value at a 25% discount would arrive at USD 759mn / PKR 55bn (PKR 101/share; PKR 134/share at no discount), signaling at a potential rerating of TRG.
- **STPL:** With the economy reopening post COVID-19 lockdown, STPL managed to post a significant turnaround with local sales of the company increasing due to imposition of anti-dumping duty on import of Electrolytic Tin Plate (ETP) while aggressive export market development also aided volumes. Another key catalyst for the company is completion of civil construction works on site for a new CRC plant planned by the company.
- **STCL:** Shabbir Tiles & Ceramics Limited is expected to generate alpha return in the upcoming year with the incumbent government incentivizing the construction sector which could boost the demand for tiles. STCL is the only brand in Pakistan manufacturing real porcelain tiles with water absorption of less than 0.5% using latest European technology to cater to the demand of premium tiles. The company has already posted EPS of PKR 0.61 in 1QFY21.
- **AGIL:** Current business environment appears favourable for the Auto sector with lower interest rates and rising aggregate demand translating into improved sales on local auto parts. We believe AGIL is set to benefit the most since they have a monopoly in the parts they manufacture. Moreover, new tractor scheme as well as launch of a new corolla should also propel sales. Currently automobile assemblers are operating at full capacity utilization, which will improve profitability.
- **KTML:** We expect KTML to record its highest ever topline in FY21 and generating solid returns at the index due to announcement of relief to export oriented sector by the government along with robust recovery in export orders. The company holds 55% shares in Maple Leaf Cement Factory (MLCF) which will be triggered by augmenting cement demand and pricing stability thus reflecting in KTML's share price. Currently, KTML is trading at a noteworthy discount (MLCF is trading at PKR 40 at the index, adding PKR 66 to KTML's SoTP, whereas its own Textile business can be valued at PKR 28/share, assuming a P/E multiple of 6x).
- **GATM:** GATM is expected to become the largest textile company of Pakistan as retail sales are growing at a rapid pace (~27% of total sales). Gross margins of the company are expected to remain upbeat led by addition of new machineries in spinning and garments division together with growing retail sales (which is a high margin business).

Recommendation summary

Fig: AHL Universe - Recommendation Summary

Code	Price	TP	Upside	Stance	EPS (PKR)			DPS (PKR)			P/E (x)		DY (%)		P/B (x)		ROE (%)	
	27-Nov-20	(Dec'21)	(%)		2020	2021	2022	2020	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
Exploration & Production																		
PPL	90.2	148.7	64.9	Buy	18.5	17.9	20.4	1.00	1.50	2.00	5.0	4.4	1.7	2.2	0.6	0.6	13.4	13.6
OGDC	99.6	187.1	87.8	Buy	23.3	21.2	26.1	6.75	8.50	10.50	4.7	3.8	8.5	10.5	0.5	0.4	11.3	11.6
POL	392.4	556.6	41.9	Buy	57.7	50.9	60.0	50.00	46.00	54.00	7.7	6.5	11.7	13.8	2.8	2.6	36.1	41.4
MARI	1,364.1	1,962.5	43.9	Buy	227.2	213.1	247.5	6.10	6.75	6.50	6.4	5.5	0.5	0.5	1.5	1.2	26.6	24.1
Commercial Banks																		
UBL	118.7	148.7	25.3	Buy	16.2	17.1	22.4	10.00	12.00	14.50	6.9	5.3	10.1	12.2	0.7	0.7	10.8	13.5
BAFL	34.6	43.1	24.4	Buy	6.1	6.7	7.2	4.00	4.00	4.00	5.2	4.8	11.6	11.6	0.6	0.6	12.3	12.5
MCB	174.7	226.0	29.3	Buy	26.3	24.8	27.9	20.00	20.00	20.00	7.1	6.3	11.4	11.4	1.1	1.1	15.7	17.3
HBL	129.9	165.9	27.7	Buy	22.1	20.3	23.1	6.00	6.00	10.00	6.4	5.6	4.6	7.7	0.7	0.7	11.2	12.0
ABL	84.0	101.8	21.3	Buy	14.4	16.0	16.4	8.00	8.00	8.00	5.2	5.1	9.5	9.5	0.7	0.7	14.6	14.1
NBP	40.0	49.4	23.4	Buy	16.3	15.9	16.1	-	-	2.00	2.5	2.5	-	5.0	0.3	0.3	12.4	12.1
AKBL	18.9	22.9	21.4	Buy	8.8	5.9	6.0	2.00	1.00	1.00	3.2	3.2	5.3	5.3	0.4	0.4	12.9	11.8
BOP	8.9	10.4	17.4	Buy	2.6	2.5	3.0	0.75	0.60	0.70	3.6	3.0	6.7	7.9	0.4	0.4	12.4	13.5
Fertilizer																		
ENGRO	306.8	410.5	33.8	Buy	41.7	43.4	47.2	31.00	33.00	35.00	7.1	6.5	10.8	11.4	0.8	0.8	12.2	12.6
FFBL	20.6								Coverage Restricted due to Advisory Mandate									
EFERT	60.8	77.8	27.8	Buy	10.9	7.5	7.1	11.00	7.50	6.50	8.1	8.6	12.3	10.7	1.9	1.9	23.1	21.7
FFC	104.1	136.5	31.1	Buy	14.4	15.7	16.8	12.00	13.00	14.00	6.6	6.2	12.5	13.4	3.1	2.9	49.6	48.8
FATIMA	28.4	NC	na	na	na	na	na	na	na	-	na	na	na	na	na	na	na	na
AHCL	38.0	NC	na	na	na	na	na	1.50	na	-	na	na	na	na	na	na	na	na
Cement																		
LUCK	648.6	947.6	46.1	Buy	10.3	32.8	46.3	-	10.00	14.00	19.8	14.0	1.5	2.2	1.9	1.7	10.1	13.0
FCCL	21.0	30.1	43.3	Buy	(0.0)	2.2	2.9	-	0.50	1.50	9.3	7.3	2.4	7.1	1.3	1.2	14.9	17.5
ACPL	141.9	187.3	32.0	Buy	8.1	10.1	18.3	3.50	3.00	8.00	14.1	7.7	2.1	5.6	1.1	1.0	8.1	13.8
DGKC	103.8	144.3	39.0	Buy	(4.9)	5.3	11.4	-	1.00	2.00	19.5	9.1	1.0	1.9	0.7	0.6	3.5	7.1
KOHC	212.3	228.9	7.8	Hold	(2.2)	10.8	16.9	-	2.00	6.00	19.6	12.6	0.9	2.8	2.1	1.9	11.1	15.7
MLCF	39.0	49.2	26.2	Buy	(3.2)	2.9	4.8	-	-	1.00	13.7	8.1	-	2.6	1.1	1.0	8.7	13.2
POWER	9.6	NC	na	na	(3.4)	na	na	na	na	-	na	na	na	na	na	na	na	na
Oil & Gas Marketing																		
PSO	192.1	285.4	48.6	Buy	(13.8)	30.8	37.7	-	10.00	15.00	6.2	5.1	5.2	7.8	0.7	0.7	12.3	13.8
APL	321.4	441.5	37.4	Buy	10.1	42.4	47.5	9.00	22.50	25.00	7.6	6.8	7.0	7.8	1.6	1.4	21.7	21.9
Automobile Assembler																		
PSMC	185.2	276.5	49.3	Buy	(33.4)	6.7	17.8	-	3.00	8.00	27.7	10.4	1.6	4.3	0.6	0.6	2.4	6.1
INDU	1,151.3	1,723.4	49.7	Buy	64.7	117.3	144.3	30.00	80.00	95.00	9.8	8.0	6.9	8.3	2.1	1.9	21.6	24.6
HCAR	287.8	373.7	29.9	Buy	4.8	11.3	31.8	1.00	5.00	13.00	25.4	9.0	1.7	4.5	2.4	2.0	9.5	24.2
MTL	1,004.6	1,259.6	25.4	Buy	43.2	84.6	101.0	40.00	80.00	100.00	11.9	10.0	8.0	10.0	11.6	11.5	100.7	116.3
Power Generation & Distribution																		
HUBC	78.9	150.8	91.1	Buy	19.3	23.7	27.8	-	6.50	12.75	3.3	2.8	8.2	16.2	1.0	0.8	32.2	30.4
NCPL	13.4	19.6	45.7	Buy	12.7	7.4	4.5	-	1.50	1.50	1.8	3.0	11.2	11.2	0.2	0.2	13.6	7.6
NPL	22.8	25.4	11.6	Buy	14.0	8.0	5.0	2.00	2.00	2.00	2.8	4.5	8.8	8.8	0.3	0.3	11.5	6.7
KAPCO	28.3	59.2	109.3	Buy	26.8	25.9	na	1.50	9.50	na	1.1	na	33.6	na	0.3	na	33.8	na
Textile Composite																		
NML	90.2	141.8	57.2	Buy	10.0	13.3	17.1	3.00	5.50	6.50	6.8	5.3	6.1	7.2	0.4	0.4	6.4	7.8
NCL	38.7	51.1	32.2	Buy	1.1	6.0	8.1	1.00	2.50	3.50	6.4	4.8	6.5	9.1	0.6	0.6	10.2	12.5
FML	99.2	137.1	38.2	Buy	7.8	13.1	16.8	2.34	5.23	6.72	7.6	5.9	5.3	6.8	1.5	1.3	21.4	23.5
ILP	61.3	80.9	32.0	Buy	2.1	6.7	9.2	2.00	3.50	4.50	9.2	6.7	5.7	7.3	2.7	2.2	31.1	36.3
Chemicals																		
LOTCHEM	13.0	15.4	18.8	Buy	1.1	2.0	2.2	0.75	0.75	0.55	6.6	5.9	5.8	4.2	1.1	1.0	17.0	17.5
EPCL	44.6								Coverage Restricted due to Advisory Mandate									
ICI	703.0	959.5	36.5	Buy	27.4	37.9	53.0	16.00	19.00	27.00	18.6	13.3	2.7	3.8	2.6	2.3	14.8	18.4
Engineering																		
ASTL	40.1	47.9	19.5	Buy	(3.8)	1.4	2.9	-	-	0.50	28.3	13.6	-	1.2	1.0	1.0	3.7	7.3
Technology & Communication																		
AVN	67.5	95.1	41.0	Buy	7.8	9.7	11.9	-	3.00	3.50	6.9	5.7	4.4	5.2	1.9	1.5	29.8	29.9

Source: PSX, AHL Research, * Group Company: No estimates are given, **Earning Consolidated Basis

List of abbreviation

1H	First Half
1Q	First Quarter
9M	9 Months
ADB	Asian Development Bank
AIDP	Auto Industry Development Policy
ADR	Advances Deposit Ratio
AHL	Arif Habib Limited
AML	Anti-Money Laundering
APCMA	All Pakistan Cement Manufacturers Association
ATA	Annual Turned Around
Avg	Average
bn	Billion
bbl	Barrel
bcf	Billion Cubic Feet
BoE	Barrels of Oil Equivalent
BoP	Balance of Payment
bpd	barrels per day
bps	Basis Points
CAB	Current Account Balance
CAD	Current Account Deficit
CAGR	Compounded Annual Growth Rate
CAR	Capital Adequacy Ratio
CASA	Current Account Saving Account
CEO	Chief Executive Officer
CFT	Combating the Financing of Terrorism
CKD	Complete Knock Down
CM	Chief Minister
CNG	Compressed Natural Gas
CNIC	Computerized National Identity Card
COD	Commercial Operations Date
CPEC	China Pakistan Economic Corridor
CPI	Consumer Price Index
CPP	Capacity Purchase Price
CPPA	Central Power Purchase Agency
CYTD	Calendar year to date
CY	Calendar Year
DAP	Di-ammonium Phosphate
DISCOS	Distribution Companies
DCF	Discounted Cash Flow
DPS	Dividend Per Share
DR	Discount rate
DY	Dividend Yield
E&P	Exploration & Production
EBITDA	Earning Before Interest, Taxes & Amortization
ECC	Economic Coordination Committee
EFF	Extended Fund Facility
EIA	Energy Information Administration
EM	Emerging Markets
EPCC	Engineering, procurement, construction & commissioning
EPP	Energy Purchase Price
EPS	Earrings Per Share
EU	European Union
EV	Enterprise Value
Ex	Excluding
FATF	Financial Action Task Force
FBR	Federal Board of Revenue
FIPI	Foreign Investor Portfolio Investment
FM	Frontier Markets
FMCGs	Fast Moving Consumer Goods
FO	Furnace Oil
FRDLA	Fiscal Responsibility and Debt Limitation Act
FTSE	Financial Times Stock Exchange
FX	Foreign Exchange Reserves
FYTD	Fiscal year to date
FY	Fiscal Year
GBP	Great Britain Pound
GDPg	GDP growth
GDP	Gross Domestic Product
GENCOs	Power Generation Companies
GEPCO	Gujranwala Electric Power Company
GIDC	Gas Infrastructure Development Cess
GHPL	Government Holdings (Pvt) Ltd.
Govt	Government
GSP	Generalised Scheme of Preferences
GST	General Sales Tax
HESCO	Hyderabad Electric Supply Company
HSD	High Speed Diesel
IDR	Investment Deposit Ratio
IFC	International Finance Corporation
IMF	International Monetary Fund
IPPs	Independent Power Producers
JIT	Joint Investigation Team
JPY	Japanese Yen
KO	Kerosene Oil
KSA	Kingdom of Saudi Arabi
KSE	Karachi Stock Exchange
LESCO	Lahore Electric Supply Company
LHS	Left hand side
LNG	Liquified Natural Gas
LPS	Loss Per Share
LSM	Large Scale Manufacturing
LTFF	Long Term Financing Facility
mn	Million
mb/d	Million barrels per day
ME	March End
MEPCO	Multan Electric Power Company
mmbtu	Metric Million British Thermal Unit
mmcfd	Million Cubic Feet Per Day
MoU	Memorandum of understanding
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
MS	Motor Spirit
MSCI	Morgan Stanley Composite Index
MTM	Mark to Market
MW	Mega Watts
NCCPL	National Clearing Company of Pakistan Limited
NEPRA	National Electric Power Regulatory Authority
NFA	Net Domestic Assets
NFC	National Finance Commission
NHA	National Highway Authority
NII	Net Interest Income
NIM	Net Interest Margins
NIR	Net International Reserve
NPL	Non Performaning Loans
NSS	National Saving Scheme
NTDC	National Transmission & Despatch Company
NY	New York
NYSDFS	New York State Department of Financial Services
OEM	Original Equipment Manufacturer
O&M	Operations & Maintance
OMCs	Oil Marketing Companies
OPEC	Oil Producing and Exporting Countries
OPEX	Operating Expense
p.a.	Per annum
PARCO	PAK ARAB REFINERY LTD
PAT	Profit After Tax
PBS	Pakistan Bureau of Statistic
PBV	Price to Book Value
PE	Price Earning
PER	Price Earning Ratio
PESCO	Peshawar Electric Supply Company
PIAC	Pakistan International Airline Corporation
PIB	Pakistan Investment Bonds
PKR	Pakistan Rupee
PM	Prime Ministers
POL	Petroleum Products Prices
PP	Petroleum Policy
PPA	Power Purchase Agreement
PPIS	Pakistan Petroleum Information Service
PR	Policy Rate
PSDP	Public Sector Development Program
PSM	Pakistan Steel Mills
PSX	Pakistan Stock Exchange
PTI	Pakistan Tehreek-e-Insaf
QESCO	Quetta Electric Supply Company
QR	Quick Response
RDs	Regulatory Duties
REER	Real Effective Exchange Rate
RFO	Residue Fuel Oil
RGDP	Real Gross Domestic Product
RHS	Right hand side
RIR	Real Interest Rate
RLNG	Regassified Liquified Natural Gas
ROA	Return on Assets
ROE	Return on Equity
RRR	Reserve Replacement Ratio
SBP	State Bank of Pakistan
SECMC	Sindh Engro Coal Mining Company
SME	Small Medium Enterprises
SOE	State-Owned Enterprises
SoTP	Sum of the parts
SPLY	Same period last year
TD	To Date
T&D	Transmission & Distribution
TPA	Tonnes Per Annum
UFG	Unaccounted for Gas
US	United States
UK	United Kingdom
USD	US Dollar
WAPDA	Water & Power Development Authority
YTD	Year-to-date
YoY	Year-on-Year

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- **Sum of the Parts (SoTP)**
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