Pakistan Strategy 2023

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Pakistan Investment Strategy 2023

Synopsis

Synopsis: The KSE-100 index is expected to generate a total return of 24.5% to 49,374 points by Dec'23. Our forward P/E for 2023 arrives at 3.8x, which is even lower than the trough P/E of the 2008 financial crisis (4.1x), and at a noteworthy discount to historical average P/E of 7.9x. While earnings growth is expected at 11.8% in 2023.

Economic Outlook: Given Pakistan's huge external debt issues, we believe another IMF program remains the only choice. Pakistan has a total external debt servicing obligation of USD 23bn in FY23, of which USD 6bn has been repaid, and, USD 4bn rolled over. Moreover, with further repayment obligations of USD 75bn during FY24-26, the external account remains in a tight spot. The government estimates disbursements of USD 103bn during the next three years to finance the repayments and the current account deficit using a combination of bilateral, private debt, and multilateral flows. To unlock these flows, it is pertinent that Pakistan stays engaged with the IMF for the long term.

- GDP growth is expected at 1.78% during FY23 against 5.97% last year.
- CAD is expected to narrow down to USD 7.2bn (2.0% of GDP) in FY23.
- A combination of lower revenues, higher flood spending, and rising borrowing costs is likely to keep the fiscal deficit around PKR 5.0trn (5.9% of GDP).
- We expect a tight monetary policy stance to continue until Aug'23, when we expect inflation to ease off to 11%-13%, providing room for a rate cut.
- Cost pressures, supply shocks, electricity and gas tariff hikes, and a weaker PKR were the primary triggers for higher CPI. With international commodity prices down and the high base effect kicking in, inflation should come down, in 2023.
- We expect Pakistan to complete the current program with another program post-general elections which will be essential to address both long-term structural issues as well as external financing needs.

Valuations:

- The KSE-100 Index trades at a P/E of 3.8x – 7% lower than the P/E multiple of the 2008 (4.1x) financial crisis (52% discount to the historic average).
- The KSE-100 Index trades at a P/B of 0.6x – 22% lower than the P/B of 2008 (0.8x) financial crisis (61% discount to the historic average)
- The KSE-100 Index is trading even lower than the Sri Lanka's P/E of 4.0x.

AHL's sector views:

- **E&Ps:** Resolution of gas circular debt and depreciation of PKR against USD will keep the sector in limelight.
- **Banks:** Significant growth in deposits and elevated interest rates to keep banking sector earnings upbeat.
- **Fertilizer:** Pricing power, and strong recovery in demand in the following year post-floods is expected to escalate earnings.
- **Cement:** With multi-year high interest rates and demand slowdown, the sector was expected to face the heat, however, the addition of alternative coal, energy efficiencies and higher retention prices should stimulate bottom line.
- **Power:** The addition of new plants, PKR depreciation, and another circular debt clearance for newer IPPs will support the profitability and cash flows.
- **OMCs:** Absence of inventory gains will keep the profitability in check however, the resolution of circular debt will improve cash flows.
- **Autos:** Import restrictions, demand destruction, higher interest rates, and elevated car prices expected to dent automobile sales and earnings.

Exhibit: AHL Research - Top Picks

Sector	Top Picks
E&P	PPL | OGDC | MARI
Banks	FABL | BAFL | MEBL | UBL
Cement	LUCK | MLCF | FCCL
Fertilizer	ENGRO | FFC
Power	HUBC

Source (s): AHL Research

Closing prices are as of 23-Dec-2022

Model Portfolio

Exhibit: AHL Model Portfolio

Company	Portfolio Weight	KSE100 weight	PE (x)	PB (x)	DY (%)	Comment
OGDC	15.00%	3.15%	2.00	0.28	10.28	High reserve life, historic low multiple, resolution of gas circular debt to re-rate valuation, gas tariff hike to improve cash flows.
PPL	15.00%	2.57%	1.89	0.27	6.96	Gas price hike to support cash flows going forward, resolution of gas circular debt to re-rate multiples, historic lowest multiples
ENGRO*	12.50%	5.50%	4.12	0.55	15.43	Stable profitability from 660MW Thar coal project, stable fertilizer and RLNG handling business, expansion in tower business.
LUCK*	12.50%	3.26%	3.13	0.50	2.33	Diversified business (largest cement player in Pakistan, coal power plant, KIA, cement business in DR Congo/Iraq, majority stake in ICI, Samsung assembling plant).
MARI	10.00%	2.76%	3.26	1.09	15.35	Production increase from Sachal gas processing complex to boost profitability, no restriction on dividend, lower exposure to gas circular debt.
MEBL*	10.00%	3.10%	3.32	1.16	9.66	Supreme asset quality, one of the highest ROE in the sector, pioneer Islamic Bank in Pakistan, beneficiary of increased Sukuk issuance, and enjoys no minimum cost of deposit criteria.
HUBC*	10.00%	4.09%	1.71	0.47	23.85	The addition of coal plants, PKR depreciation, and another circular debt clearance for newer IPPs will support profitability and cash flows.
BAFL*	7.50%	1.24%	2.07	0.40	21.79	Strengthening foothold in digital and Islamic banking space, well-positioned balance sheet, ADR above minimum threshold of 50% and attractive valuation validated by buy-back.
FFC	7.50%	4.69%	4.58	2.18	16.98	Stable agri demand and outlook, diversified investments to add value.

Source (s): AHL Research, *Consolidated

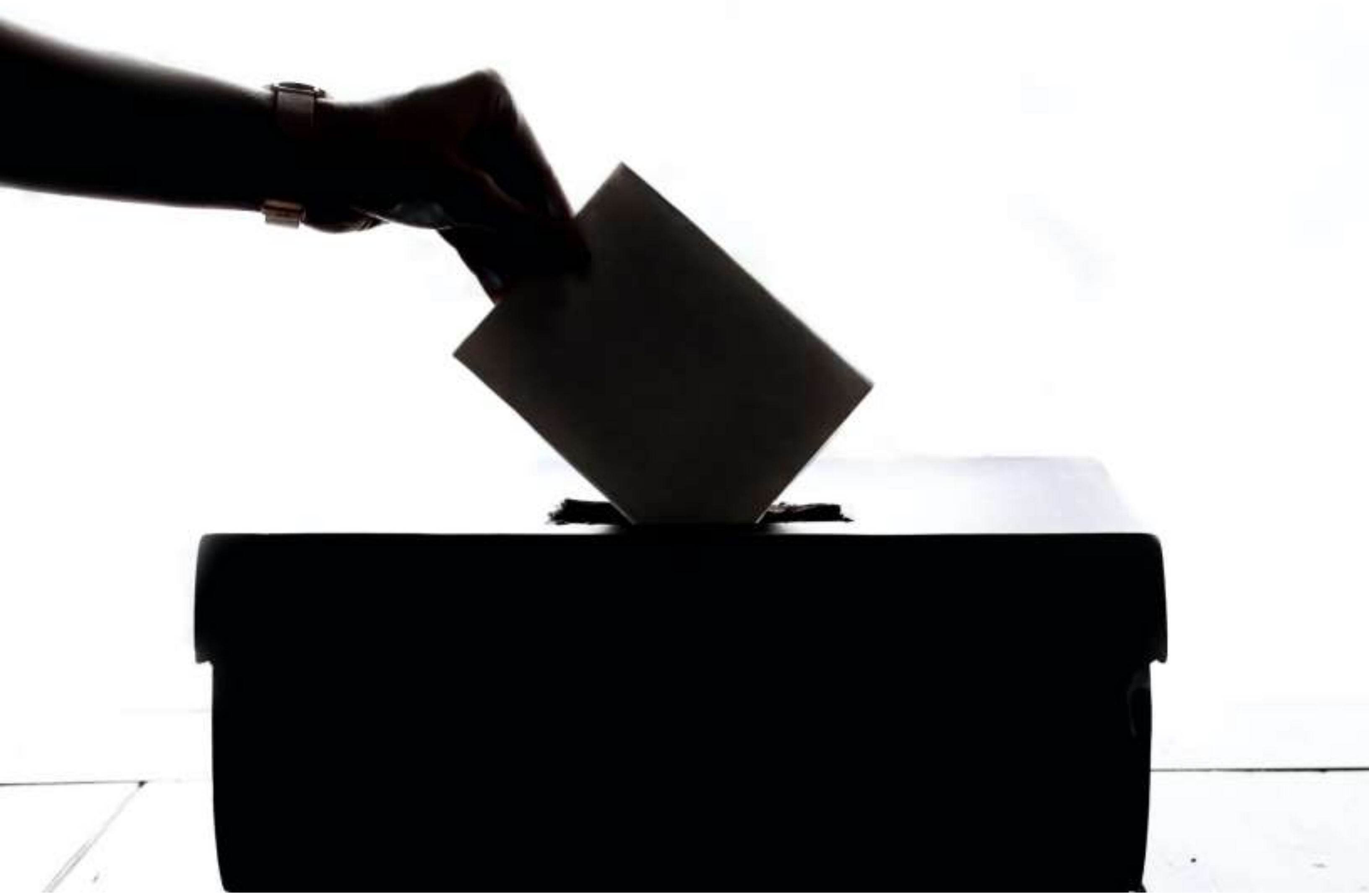
Table of Contents

Pakistan at a Glance

Exhibit: Pakistan at a Glance

Economy		Equities	
Population (mn)	227	Major Stock Exchange	Pakistan Stock Exchange
Middle Class (of population)	36.0%	Benchmark Index	KSE-100
GDP/Capita (USD, FY22)	1,798	Total Market Cap (USD bn, Dec 22)	28.7
GDP size (USD bn, FY22)	383	Free Float Market Cap (USD bn, Dec 22)	7.9
GDP Growth (FY22)	5.97%	Market Cap as % of GDP	7.5%
Sovereign Rating	S&P: CCC+, Moody's: Caa1	Avg. Daily Traded Value (USD mn, CY22)	34
SBP Reserves (USD bn, Dec 22)	5.8	Avg. Daily Traded Volume (USD mn, CY22)	229
Current Account Deficit (USD mn, 5MFY23)	3,099	MSCI Category	Frontier Markets
Fiscal Deficit (PKR bn, 1QFY23)	809	Number of Stocks in MSCI FM	20
CPI Inflation (5MFY23 Avg.)	25.14%	Largest Sector	Banks
Policy Rate (Dec'22)	16.00%	Largest Stock	OGDC
Total Debt and Liabilities (% of GDP, FY22)	89.2%	Net Foreign Flows (USD mn, 2022)	(48.0)
Total Public Debt (% of GDP, FY22)	73.5%	Foreign Holdings (% of FF Mkt. Cap)	16.7%

Source (s): PSX, SBP, MSCI, PBS, NCCPL, AHL Research



Politics

The overstated impasse

Politics

Domestic Politics

Elections in 2023 to settle the political dust

There is no doubt that heightened levels of political instability has further augmented the macroeconomic challenges faced by the country. No-confidence motion leading to the change of government earlier in the year led that IMF program falling off track, with support from friendly countries also cooling off. Bilateral and multilateral creditors both need stability and consistency in economic policies. Six finance ministers in the last four years is not a great record to boast.

Moreover, the breakup of the cordial civil-military relationship was also unfortunate. The change in the political leadership and the political noise that emerged heavily damaged the investment climate which was already coming under pressure due to worsening macros.

That said, in the coming year we do expect much of the dust to settle, with the general elections to take place latest by 3QCY23. A new government is taking charge with a fresh mandate shall bring about a new economic direction leading to some semblance of stability and consistency. Notably, we expect the new government to take tough measures that deal with structural reforms at the onset of a 5-year mandate, with limited concerns regarding damage to political capital.

Months leading up to the election will be noisy. The PTI has been demanding elections for a while and the lack of breakthrough in back door negotiations between the incumbent government and the opposition has not been healthy. However, we do expect communication channels to remain open. News reports also suggest a possible return of ex-PM Nawaz Sharif from London to Pakistan, with his arrival viewed by some commentators as a signal towards General Elections. The statement from the military establishment regarding an institutional decision to stay away from politics has been welcomed well by political parties. The current political impasse is only exacerbating the economic challenges being faced by the country and the sooner the political parties sit together, the better.

Foreign Policy – Pragmatism over populism

United States: As Boris Johnson said, “Stay close to the Americans!”

The most encouraging development since the new government came has been to take up re-engagement with the US. Bilateral communication on a govt as well as military level has been positive. Relatively softer stance by the PTI recently is also very welcoming as engagement with the US is an unavoidable and inevitable aspect of Pakistan’s foreign policy in the long term. It is also pertinent to mention that the US needs to engage with Pakistan to ensure no misuse of Afghan territory for terrorism against the West. Recent statements by the militant group TTP are a significant cause of worry not just for Islamabad but for Washington as well. All efforts of Washington to counter militant groups activities require intelligence support and coordination from Pakistani agencies. The US has provided close to a USD 100mn in aid for flood relief which although is not very significant, it does point to a thawing in relation. Moreover, relations with the US are also important given the clout the Biden administration has on multilateral agencies particularly IMF.

Afghanistan: Relationship souring

A primary concern on the foreign policy front lies in the face of mounting tension with the Afghan Taliban government. Border clashes have only increased since the Taliban came into power and the notion of amicable ties with the Afghan Taliban is slowly dying down. This is likely to be a huge challenge for the government that comes into power as Pakistan cannot afford to be on hostile terms with Afghanistan especially with the TTP showing signs of resurgence.

China: All-weather friend

China will likely continue keeping Pakistan close to itself. We think that is important for Pakistan as well given almost 30% of the external debt is owed to China, and the country desperately requires rollover of its debt. CPEC phase-II implementation will be a key force in strengthening this relationship further as the Chinese have not been particularly happy over the same. Also, from a strategic point of view, China does need Pakistan to counter India’s rising influence in the region.

Floods

Inundated with Economic Woes

Floods: Economic hit from the calamity

- Pakistan recorded its worst floods since 2010 with rainfall crossing 390mm in the monsoon season, which was 3 times higher than the national 30-year average of 135mm.
- 15% of the population / over 33mn people affected in light of the torrential rains, compared to 20mn people affected by the floods in 2010. Total deaths of 1,739 people as per NDMA, with another 12,867 injured.
- Estimated impact of loss to the economy is estimated at ~PKR 3.3trn (USD 15bn), which is around 3.9% of GDP.
- GDP growth to shrink to 1.78% in FY23 against earlier base case assumption of 2.97%. Rebound is expected next year with GDP to settle at 3.9%.
- Inflation witnessed further pressure, given temporary supply shocks.
- International donors and multilateral agencies have pledged USD 2.9bn to date in flood relief.
- Immediate sectoral demand hit was witnessed in cement, steel, automobile, OMCs, and fertilizer; however, the majority of these sectors would benefit from the rehabilitation process.

Loss to the economy estimated at USD 14.6bn / PKR 3.3trn (3.90% of GDP)

Our assessment suggests that these floods will debilitate the Pak economy with losses estimated at USD 14.6bn / PKR 3.3trn (3.90% of the GDP). The primary hit will be on the loss to the housing sector, which is estimated at a mammoth USD 7.8bn (2.09% of the GDP). This is followed by the destruction of agricultural crops, whereby a material quantum of the cultivated area was inundated, eroding output and yields this year; we project a cumulative impact of USD 5.3bn / PKR 1.2trn (1.41% of the GDP). Moreover, the loss of transportation and communication (mainly road and bridges damaged) will set back the economy by USD 1.3bn / PKR 297bn (0.35% of the GDP). Whereas perished livestock translates to a loss of USD 159mn / PKR 36bn (0.04% of the GDP).

Exhibit: Loss assessment summary

	Value (PKR mn)	Value (USD mn)	% of GDP
Housing	1,763,046	7,836	2.09%
Transport and Communication	297,420	1,322	0.35%
Agriculture	1,194,390	5,308	1.41%
Livestock	35,733	159	0.04%
Total	**3,290,589**	**14,625**	**3.90%**

Source (s): AHL Research

On the fiscal front, the government will have to engage in mass rehabilitation and renovation efforts. With major infrastructure destroyed, people displaced and on the verge of starvation, although some temporary rehabilitation and food distribution were undertaken, a long-term solution is required. As per NDMA's situation report, Jun'22 to date over 13,115 kilometers of road, nearly 439 bridges and an estimated 897,014 houses have been destroyed, while close to 1,391,467 homes have been damaged across the country. Key communication links and infrastructure destruction (road and railway) may need to be fixed in the medium term, across Pakistan.

As an immediate relief measure, in order to facilitate those that were suffering, the PM announced that the government released PKR 5bn for relief, and the family of every deceased to be allocated financial assistance of PKR 1mn. While each flood victim family was to receive PKR 25,000 under the Benazir Income Support Program (PKR 80bn allocated for this purpose). This adds up to PKR 86bn in fiscal spending. It is likely that the country's fiscal deficit could witness some pressure this year amid social spending and rehabilitation, potential subsidy for agriculture sector and decline in tax collection amid economic slowdown.

Our estimates suggest that while total loss to the economy will arrive at PKR 3.3trn, reconstruction and rehabilitation costs would be PKR 2.1trn / USD 9.2bn, with majority of the cost incurred for housing, roads and communication.

Exhibit: Loss Assessment

	Unit	Quantity	Cost per unit	Total Cost	
				PKR mn	$ mn
Housing					
Partial Damage Houses	No	1,391,467	300,000	417,440	1,855
Fully Damage Houses	No	897,014	1,500,000	1,345,521	5,980
Shops	No	170	500,000	85	0.38
Total				**1,763,046**	**7,836**
Transport and Communication					
Roads	Kms	13,115	20,000,000	262,300	1,166
Bridges	No	439	80,000,000	35,120	156
Total				**297,420**	**1,322**
Agriculture					
Cotton	000 bales	2,994	349,564	1,046,593	4,652
Sugarcane	000 tons	4,433	27,703	122,797	546
Rice	000 tons	500	50,000	25,000	111
Total				**1,194,390**	**5,308**
Livestock					
Animals	000 No.	1,164	30,691	35,733	159
Grand Total				**3,290,589**	**14,625**
Reconstruction Cost*				**2,060,466**	**9,158**

Source (s): NDMA, AHL Research, *Ex Agri and Livestock

Pakistan Economy

The IMF song on loop

External funding gap the biggest challenge

Pakistan has a total external debt servicing obligation of USD 23bn in FY23, of which USD 6bn has been repaid, and USD 4bn been rolled over by bilateral creditors. While the government had received commitments from bilateral and other multilateral creditors to fund the remaining amount, delays in completion of the 9th review have cast a shadow on those commitments. Moreover, with further repayment obligations of USD 79bn during FY24-26, the external account remains in a tight spot. Finance Ministry is targeting disbursements of USD 103bn during the next 3 years to finance the repayments and the C/A deficit (USD 32bn), using a combination of bilateral and private debt (USD 65bn), and multilateral flows (USD 38bn). Unlocking these flows, however, would require Pakistan to stay engaged with the IMF with another bigger SBA (Standby Agreement) program necessary post General Elections later this year.

Continuation of the IMF program critical to stay afloat

The IMF's Extended Fund Facility (EFF) program has once again fallen off track, reflected by the delays in completion of the 9th review (pending since Nov'22). IMF has raised concerns of the fiscal slippages emanating from a combination of the devastating floods and revenue shortfall particularly from Petroleum Development Levy (PDL). Moreover, there have been concerns over the accuracy on the flood rehabilitation expenditure budget. We believe the government cannot afford to exit the IMF program given the scale of external financing needs, where majority of the funding sources are linked to an IMF endorsement. We expect a host of revenue and fiscal consolidation measures in the coming weeks including i) imposition of GST on petroleum products and removal of GST exemptions, ii) increase in gas tariff, and iii) reduction in electricity subsidies etc.to get the program back on track and to pave the way for release of the next tranche of USD 1bn in Feb'23.

PKR has artificially stabilized but further depreciation likely

PKR/USD has stabilized over the past few months following administrative measures undertaken by the SBP including limits on LC opening, bans on certain imports and curbs on dollar repatriation to keep dollar outflows in check. This has however, created a vibrant grey market with 10-12% gap between official and unofficial rates hurting official remittances in the process (10% decline in 5MFY23). We do not see these measures as sustainable and expect the SBP to gradually loosen administrative measures as the IMF's 9th review concludes and other flows materialize. In this backdrop, we expect the PKR/USD to depreciate to 250/263 by Jun/Dec'23.

Tight monetary and fiscal policy to continue

We expect inflation to remain elevated over the next 6 months with average (Dec'22-May'23) headline inflation of 23.3% as a combination of low base effect administrative measures take shape. SBP shall maintain a tight monetary with likely easing starting Aug'23 as inflation falls to mid-teens. Fiscal tightening is also likely to continue as IMF program keeps policy makers in check with hike in gas prices, GST and PDL on the cards. That said, given additional flood related expenditures and slower than targeted revenue growth, we expect fiscal deficit of 5.9% of GDP in FY23E, well above the budgeted target of 4.9%. In the backdrop of a tight monetary and fiscal policy and the impact of floods, we estimate FY23E GDP growth to fall to 1.8% (FY22: 5.97%).

Economic Indicators Summary

Exhibit: Economic Indicators Summary

Economic Indicators/ Factors	FY23E	FY22A	Unit	Rationale
GDP	1.78	5.97	%	A sharp slowdown in growth as the economy faces numerous challenges including, 1) major floods, 2) delays in external financing, 3) political noise, 4) high inflationary pressures and 5) monetary and fiscal tightening.
Total Revenue	9.3	8.0	PKR trn	FBR collection target of PKR 7.4trn seems over-optimistic. We expect a shortfall to be partially covered by imposing GST on petroleum products, additional taxes on non-essential, and higher FED on cigarettes.
Total Expenditure	14.3	13.3	PKR trn	Current spending (the more rigid part of expenditure) is expected to remain up due to the higher cost of borrowing while the IMF is demanding a cut in developmental expenditure. Expenditure will overshoot due to higher flood-related expenses in addition to higher borrowing costs.
Fiscal Deficit	5.9	7.9	% of GDP	The fiscal deficit is likely to remain high despite austerity measures underway as part of the IMF program. A combination of lower revenues and higher flood and borrowing costs is likely to keep the fiscal deficit around PKR 5.0trn (5.9% of GDP).
Imports (Goods)	59.0	72.2	USD bn	Administrative measures to curtail import bill to continue, lower oil prices to support, and lower machinery import to help bring down import bill in FY23.
Exports (Goods)	30.3	32.5	USD bn	The downside risk to this remains mainly the global recession leading to demand suppression.
Current Account Deficit	7.2	17.4	USD bn	Narrowing of Current Account Deficit expected in FY23 to USD 7.2bn on the back of lower imports, hence lower trade deficit.
Inflation	24.4	12.1	% YoY	Cost pressures, supply shocks, subsidy reversals, tariff hikes and a weaker PKR have been the primary contributors to a surge in inflationary pressure, with international commodity prices down and high base effect kicking in, headline inflation should come down, going forward.
Interest Rates	17.00	13.75	Period end-Jun (%)	We expect a tight monetary policy to continue until Aug'23 when we expect inflation to ease off to 11%-13% providing room for a rate cut. Gradual easing of rates in FY24 shall provide a breathing ground for recovery in GDP growth.
External debt financing requirement	30.8	34.3	USD bn	We expect that Pakistan will remain in the IMF program and unlock pending tranches of the IMF which shall pave the way for fund flows from other international creditors. All said, we continue to see risks skewed to the downside for PKR in 2023.
IMF review	-	-	-	Ninth review completion followed by the disbursement of ~USD 1.2bn expected in Feb'23.

Source (s): SBP, PBS, AHL Research

Economic Growth

Subdued and suppressed

We estimate FY23E GDP growth to fall to 1.78% (FY22: 5.97%) as the economy struggles with multiple challenges emanating from: i) devastating floods, ii) surging inflationary pressures resulting in steep monetary and fiscal tightening, iii) political instability, and iv) adoption of administrative measures to curtail imports. Industrial sector (-2.4% contraction) is likely to drive GDP weakness with modest growth in services (3.18%) and agriculture (1.71%).

In the first quarter of FY23, Pakistan recorded the worst floods since 2010, with rainfall crossing 390mm, which is three times higher than the national 30-year average of 135mm. The government officially declared a "national emergency", with estimated loss to the economy of ~PKR 3.2trn (USD 14bn), which is around 4.2% of GDP. Therefore, it will not be presumptuous to assume that, as a country, we may find it challenging to transact with a disaster of such magnitude. The negative impact on human lives, agriculture crops, livestock, the balance of payments position, inflation and the country's fiscal health remains undeniable. Factoring-in the impact of these floods in our GDP growth model, we expect a decline in production of cotton crop (34% YoY) and rice (-6% YoY).

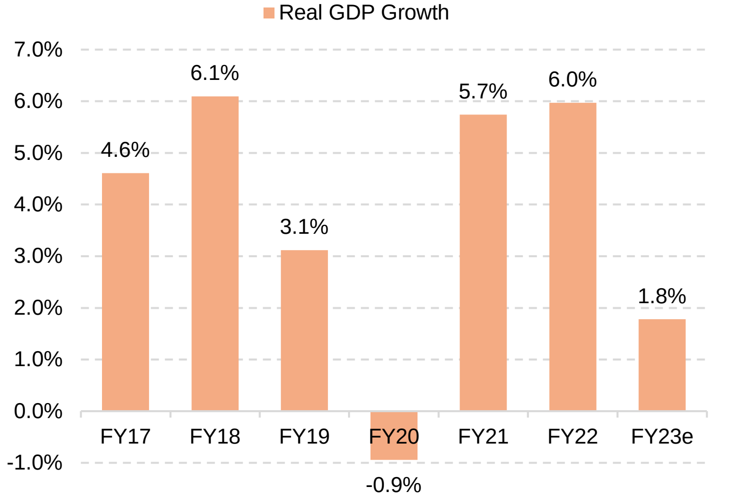
However, with Rabi season falling after the monsoon season, we expect production of wheat and sugarcane to provide support to the agriculture growth, taking the sector’s growth to 1.7% in FY23. In addition, the industrial sector continues to struggle with tight macro-economic policies and resultant demand destruction playing a major role in suppressing its performance. Latest trends in high frequency indicators such as cements, autos, textile and others also signal at a decline in overall industrial growth during the remaining part of the year, taking the overall growth of the sector to -2.4% during FY23. Lastly, on the back of moderate growth in agriculture and a decline in industrial growth amid a subdued domestic demand, we anticipate the services sector growth to slow down as well to 3.2%.

Gradual recovery in growth from FY24:

While the economy faces multiple challenges in FY23, we expect the growth momentum to gradually pick up in FY24 (3.9% GDP growth), as a combination of the low base effect, political stability following a general election, and macroeconomic adjustments under the new IMF program start to bear some fruit. Some of the key factors behind a recovery in FY24 include:

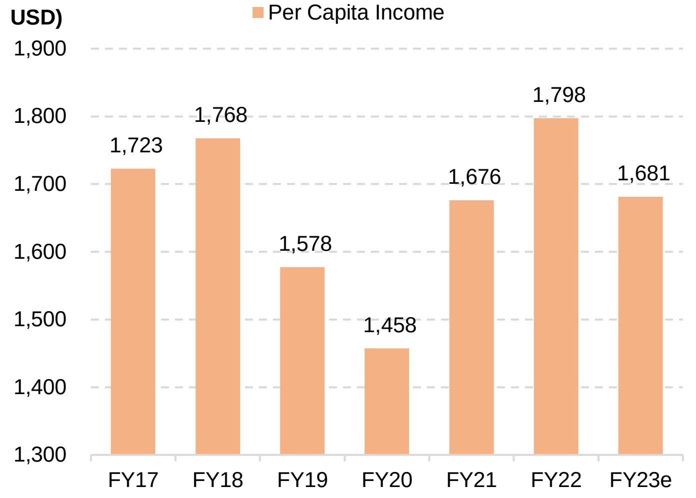
- Political clarity – We expect General Elections 2023 (2H2023) to serve as a catalyst for much-needed political stability and clarity following months of political instability in the aftermath of the successful No-Confidence motion against ex-Prime Minister Imran Khan’s government in Feb’22.
- Falling commodity prices – The lower oil and international commodity prices shall result in an improving balance of payments situation as well as a significant reduction in inflation. We expect the C/A deficit to remain in check in FY24 despite an economic recovery, while inflation is expected to moderate to 10.4% (FY23E: 24.4%) helping policy rates to ease to 13% in FY24 from 16% currently.
- Increased fiscal discipline – The government commenced a concerted effort to remove untargeted subsidies and increase revenue, which will result in curtailment of the fiscal deficit to 5.9% by the end of the fiscal year 2023, from last year’s 7.9% deficit.

Figure: GDP growth



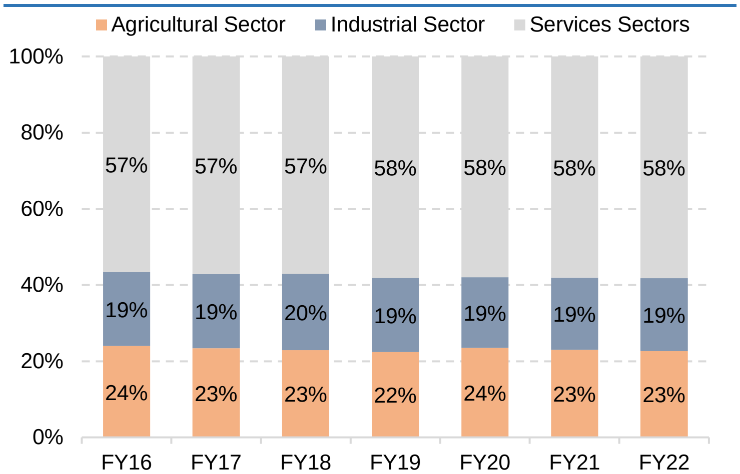
Source (s): Pakistan Economic Survey, AHL Research

Figure: Per Capita GDP (in USD)



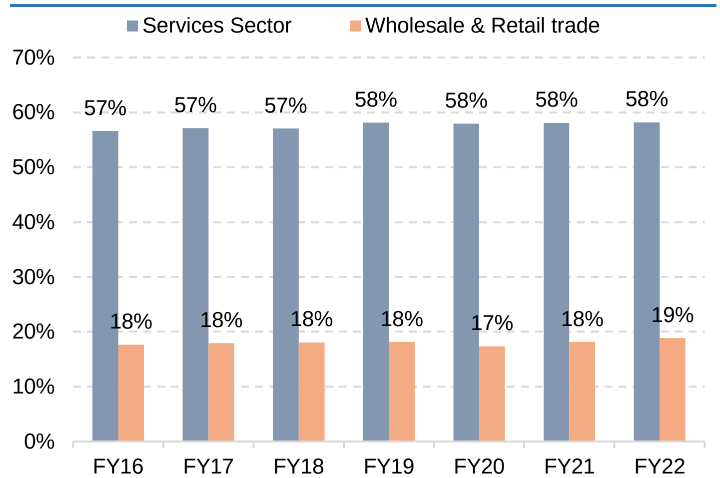
Source (s): Pakistan Economic Survey, AHL Research

Figure: GDP Composition over the years



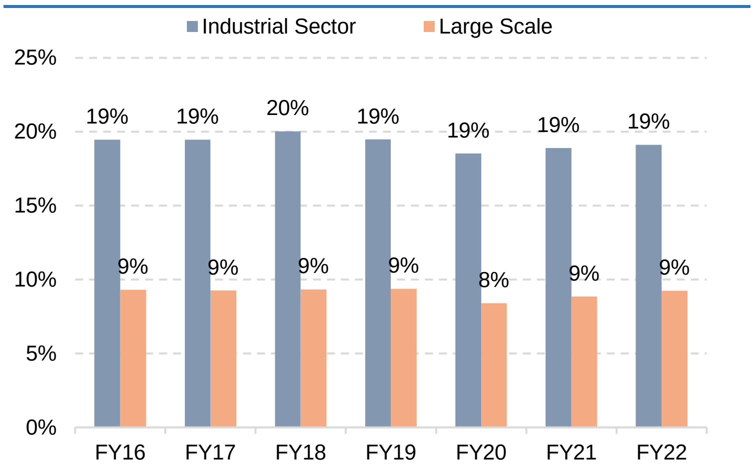
Source (s): PBS, AHL Research

Figure: Share of Services Sector in GDP



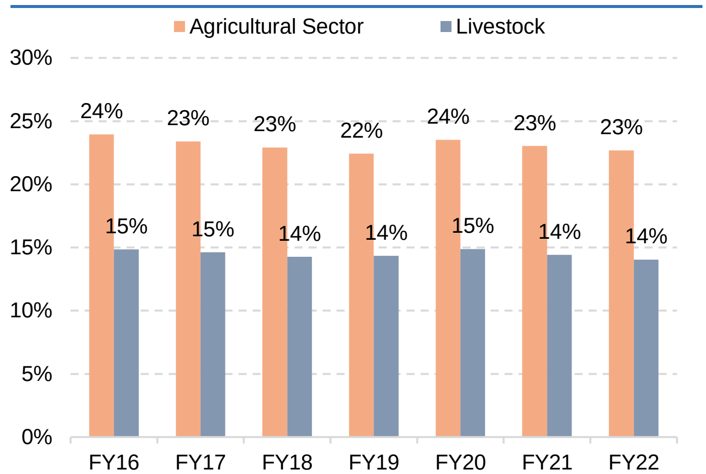
Source (s): PBS, AHL Research

Figure: Share of Manufacturing Sector in GDP



Source (s): PBS, AHL Research

Figure: Share of Agriculture Sector in GDP



Source (s): PBS, AHL Research

Public Finance Management

Fiscal consolidation underway

Pakistan's fragile fiscal position was exacerbated by the flood-induced economic slowdown. While IMF has been pushing for fiscal consolidation to contain the high budget deficit, higher borrowing costs, flood-induced expenditure, and lower revenue collection, an economic slowdown and import compression is likely to keep the fiscal deficit above original targets. Our assumption for the fiscal deficit is PKR 4.97trn (5.9% of GDP) well above the budget target of PKR 3.8trn (4.9% of GDP).

While recent decline in oil price has yielded benefit on the fiscal side in terms of improved fiscal space given removal in subsidies, it has also affected the government's tax collection to a large extent (sales tax and custom duties collection declined due to lower value of petroleum products). On fiscal policy front, we expect the government's performance to be characterized by the recurring themes of underperformance in revenue collection against targets, sub-optimal development spending relative to recurrent expenditure, and continued losses from State-Owned Enterprises (SOEs). Taking some tough and un-populous measures this time around, the government introduced some new taxes in the Budget along-with a variety of measures for tariff rationalization primarily focused on revving up the overall revenue, in-line with the pre-requisites of IMF for approval of pending reviews. As per the IMF document, the government, for FY23, targets the underlying primary surplus of 0.4% of GDP while revenue collected by FBR is projected to fall marginally relative to GDP (to 8.9%) due to declining import related revenue. Ultimately, we believe the government will be faced with the difficult task of balancing borrowings to support economic recovery and avoiding a further buildup of debt that will further weaken debt sustainability metrics.

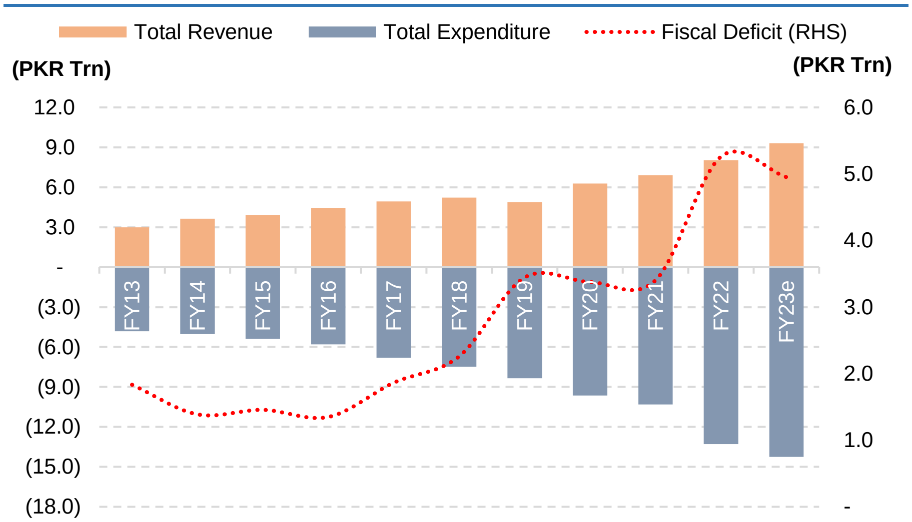
Revenue targets likely to be missed: One of the key concerns on the fiscal front is the government's revenue target aiming to an increase in overall revenue (gross revenue receipts) by 30% YoY in FY23, with hopes that FBR tax collections will rise to PKR 7.4trn. Tax-GDP ratio is projected at 9.5%, compared to 10.1% last year. This in our view, seems over optimistic, given slow reforms on tax front. In line with the conditions set forth in the recent IMF negotiations, the government has aimed for an increase in overall revenue target on the back of higher FBR tax collections as well as non-tax income. These goals will also solidify the government's medium-term target of expanding the tax base, streamlining the collection process and formalizing the economy, in effort to minimize budget deficits. While tax revenue growth has been on track thus far, we see risks to the downside emanating from a sharp slowdown in economic activity and a prolonged curb on imports. Moreover, we foresee a shortfall in non-tax revenue targets particularly Petroleum Development Levy (PDL).

Mini-Budget on the cards: To recall, in its latest seventh and eighth review report, the IMF stated that the government has committed to activating contingency measures as soon as monthly data show signs of underperformance against the (IMF) program revenue targets, including an immediate increase in GST on fuel as a prelude to reaching 17%; further streamlining of GST exemptions including on sugary drinks and other unwarranted exemptions, and/or increasing Federal Excise Duty on cigarettes and other RDs, if required. This calls for another mini-budget due to the emerging threat of revenue shortfall; we believe the government would exercise all aforementioned contingency measures in addition to revising up GST rate from the current 17%. Our working suggests every one percent increase in GST from hereon will result in additional tax collection of ~PKR 85bn.

Ballooning expenditure: Total expenditure outlay for FY23 is budgeted at PKR 9.5trn (4% higher YoY than FY22R of PKR 9.1trn), comprising of a forecasted expenditure/GDP ratio of 12%, ~700bps less than 19.5% average for FY20-22, which seems a difficult obstacle, unless there is a sharp reduction in current expenditure. Current Expenditure is budgeted to contribute 92% to total expenditure (last year: 93%) while Development Expenditure is budgeted to contribute 9% to the total budgeted expenditure. The federal PSDP outlay for FY23 has been set at PKR 727bn (+9% YoY from FY22B) while PKR 1,463bn (+13% YoY) has been set aside for provinces (Total PSDP of PKR 2,263bn - highest ever - will contribute 2.9% to the GDP and compares favorably to the revised figure of PKR 1,836bn for FY22). Pertinently, the federal PSDP for FY23 is 83% higher than the revised estimate of PKR 550bn for FY22 as the primary focus of the government was to adopt austerity measures that curtail the overheating economy last year.

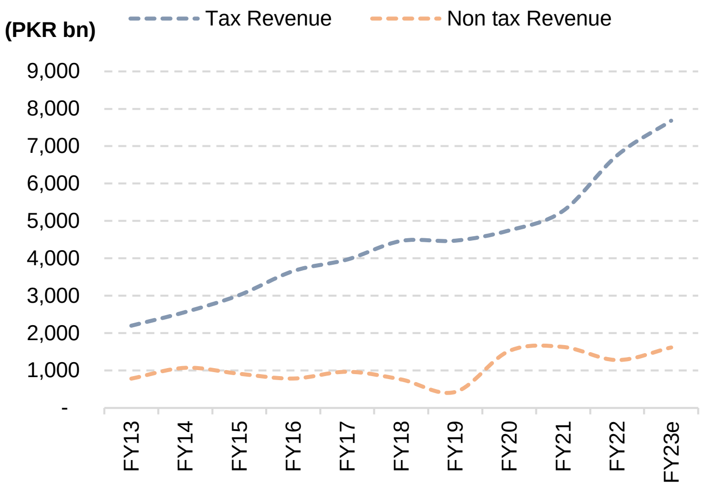
Fiscal deficit to decline to 5.9% of GDP in FY23E: We expect the fiscal deficit (as a % of GDP) to clock-in at 5.9% in FY23E, compared to 7.9% in FY22. The government had forecasted fiscal deficit at 4.9% for FY23, to be spurred by revenue growth (additional tax measures i.e. higher super tax as well as planned withdrawals of SRO and cut in non-productive spending, particularly through the removal of subsidies). While we make some headway in this direction, given the fiscal performance in the first 5 months and the devastating floods, we estimate fiscal deficit to exceed targets by ~1% of GDP. The downside risks to fiscal deficit include: government's ability to raise the projected revenue, staggered PDL implementation, the provincial commitment to deliver the historically high surpluses agreed, and the significant containment of current spending relative to GDP in a pre-election year. All said, we believe the IMF will take the current socio-economic condition of the country into consideration while finalizing targets and performance of Pakistan as expenditure side is expected to augment further due to flood relief being provided by the authorities. With this, we might get a waiver on 'Ceiling on the general government primary budget deficit, cumulative' performance criteria in the upcoming review.

Figure: Pakistan's Fiscal Deficit – Trend and Forecast



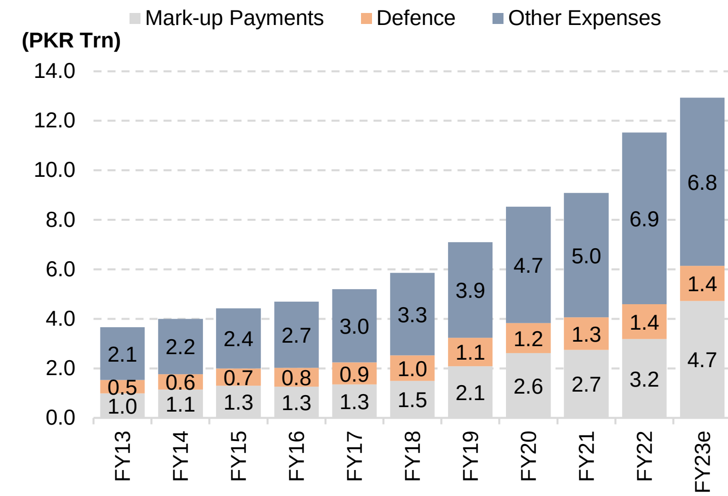
Source (s): MoF, AHL Research

Figure: Non-tax and Tax Revenue – Trend and Forecast



Source (s): MoF, AHL Research

Figure: Current Expenditure – Trend and Forecast



Source (s): MoF, AHL Research

Exhibit: Pakistan Fiscal Operations

PKR bn	FY19	FY20	FY21	FY22	FY23e	FY24f
Total Revenue	**4,901**	**6,272**	**6,903**	**8,035**	**9,300**	**10,674**
Tax Revenue	**4,473**	**4,748**	**5,273**	**6,755**	**7,682**	**8,809**
Federal	4,072	4,334	4,764	6,143	7,081	8,140
Provincial	402	414	508	612	602	669
Non-Tax	**427**	**1,524**	**1,631**	**1,280**	**1,617**	**1,865**
Federal	341	1,422	1,480	1,152	1,481	1,703
Provincial	86	102	150	128	136	162
Less: Provincial Share	3,273	4,423	2,750	3,182	4,098	4,698
Total Expenditure	**8,346**	**9,648**	**10,307**	**13,295**	**14,252**	**15,287**
Current Expenditure	**7,104**	**8,532**	**9,084**	**11,521**	**12,937**	**13,772**
Mark-up Payments	2,091	2,620	2,750	3,182	4,726	5,322
Defence	1,147	1,213	1,316	1,412	1,413	1,450
Other Expenses	3,866	4,699	5,018	6,927	6,798	7,000
Development Expenditure & net lending	1,219	1,204	1,316	1,657	1,151	1,350
Federal PSDP	502	468	441	400	450	550
Provincial PSDP	506	622	770	1,217	700	800
Statistical Discrepancy	**22**	**(87)**	**(93)**	**116**	**165**	**165**
Budget Balance	**(3,445)**	**(3,376)**	**(3,403)**	**(5,260)**	**(4,953)**	**(4,612)**
Primary Balance	**(1,354)**	**(757)**	**(654)**	**(2,077)**	**(227)**	**709**

% of GDP						
Total Revenue	11.2	13.2	12.4	12.0	11.0	11.1
Tax Revenue	10.2	10.0	9.5	10.1	9.1	9.1
Nontax Revenue	1.0	3.2	2.9	1.9	1.9	1.9
Total Expenditure	19.1	20.3	18.5	19.9	16.9	15.9
Current	16.2	17.9	16.3	17.2	15.3	14.3
Mark-up Payments	4.8	5.5	4.9	4.8	5.6	5.5
Defence	2.6	2.6	2.4	2.1	1.7	1.5
Development Expenditure and net lending	2.8	2.5	2.4	2.5	1.4	1.4
Budget Deficit	7.9	7.1	6.1	7.9	5.9	4.8
Primary Balance	(3.1)	(1.6)	(1.2)	(3.1)	(0.3)	0.7

Source (s): MoF, AHL Research

External Account

The 'IMF' song - On loop

Pakistan is still faced with a combination of: 1) an extremely bleak growth outlook, 2) more fiscal tightening on the horizon, and 3) a growing concern on funding gap that is reliant on foreign flows. Silver-lining in this situation is the narrowing of Current Account Deficit to USD 7.2bn (-1.9% of GDP) in FY23E from USD 17.4bn (-4.6% of GDP in FY22). Our base case assumption is that Pakistan will be able to unlock pending tranches of the IMF following which, we will see funds flowing-in from other international creditors too. All said, we continue to see risks skewed to the downside for PKR in 2023.

Contractionary monetary and fiscal policies helping current account: Most of the government's efforts have been focused upon taming down the ballooning external deficit, which rose to USD 17.4bn (4.6% of GDP) in FY22. A combination of contractionary fiscal as well as monetary policies have successfully curtailed aggregate demand of late, which in effect has managed to recover the precarious Current Account Deficit. CAD fell by 68% YoY during 4MFY23, led by an import slump (-12%) while exports rose albeit a modest 3% YoY. Impact of floods on the CAD is expected to remain muted as slower domestic growth and lower global commodity prices can offset the impact of higher food and cotton prices coupled with lower textile exports. Moreover, as witnessed after previous natural disasters, international aid and assistance could cushion the current account, which should remain in the vicinity of previously forecast 1.9% of GDP.

…But declining remittances a bit of a worry: We expect the trade deficit to continue at a declining trend, led by incentives for export-oriented sectors, impact of lower oil prices and volumes on the import bill and a slowdown in imports such as machinery. On the export front, downside risk remains mainly the global recession that is likely to dent the overall jump in exports. A key risk that has emerged on the current account in the recent months is the deteriorating trend in remittances, which have fallen by 10% during 5MFY23. A sizeable gap (10-12%) between the official and unofficial exchange rates amid administrative measures undertaken by the SBP is the major reason for the declining official remittances trend, with rising flows via unofficial channels. We believe such as a large gap between the two rates is unsustainable and counterproductive to the successful negotiations on the 9th review, which is a likely catalyst for things to normalize in the exchange markets.

Bridging funding gap - An Achilles' heel: SBP's reserves plunged to a four year low (USD 5.8bn as of Dec 23, 2022), a sharp contrast to both ours and government expectations that resumption of the IMF program and additional commitments in the wake of the floods would help improve the FX reserves. The successful and timely completion of the remaining reviews of the IMF program is critical for the country's external account as all major bilateral and multilateral flows are linked to the IMF program. Moreover, additional funding is needed for reconstruction efforts, the quantum of which is also dependent to a large extent on the support of multilateral agencies including World Bank, IMF and ADB.

What we know so far from media sources, is that out of total Pakistan's debt obligations for FY23 of around USD 23bn, some USD 6bn has been repaid. Moreover, loans worth USD 4bn have been rolled over by multilateral and donor agencies. In addition, the government is also in talks with multilateral lenders to rollover another USD 8.3bn in loans. According to the SBP, foreign inflows totaled USD 4bn in 1HFY23 while it expects inflows to improve in 2HFY23. To note, in addition to this funding gap, SBP is also expecting Pakistan's current account deficit to be around USD 10bn for FY23. Moreover, total gross financing requirement in the next three years - FY24-26 equals to ~USD 78.8bn (excluding CAD), against which Pakistan expects disbursement worth ~USD 103bn mainly from private creditors (~USD 65.2bn), and other non-IMF creditors such as World Bank, ADB, rollovers etc. (~USD 38.2bn). However, we believe, for unlocking these flows we would be requiring another IMF program, bigger in size, as being in IMF would mean measures are undertaken to keep the economy on track.

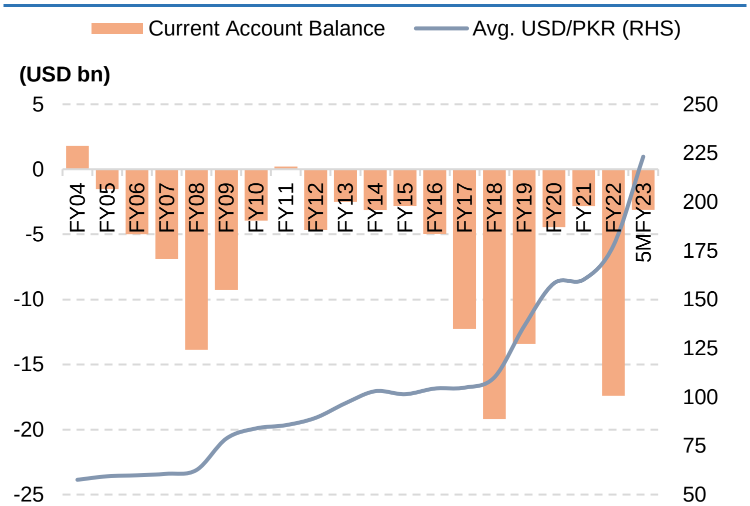
PKR has artificially stabilized but measures are not sustainable

The IMF program clearly stipulates a commitment to maintaining a market-determined exchange rate to improve external imbalances and eventual reserve build-up. The authorities have been taking administrative measures such as limits on the opening of LCs', a ban on imports of certain products, curbs on dollar repatriations, etc. This, while ensuring some degree of stability in the official exchange rate, has unfortunately been counterproductive as it created a vibrant grey market in the process. Resultantly, a wide gap continues to persist between official and unofficial open market rates. According to our market research, the gap between official and unofficial exchange rates has hovered around 10-12% which has resulted in a vibrant grey market with more overseas Pakistanis opting to send remittances via unofficial channels. This trend, as discussed earlier, is also evident from the sharp decline in official remittances. We estimate, the country losing around USD 150-200mn monthly flows due to the artificial gap in official and unofficial rates.

PKR depreciation to continue as official and unofficial rates converge

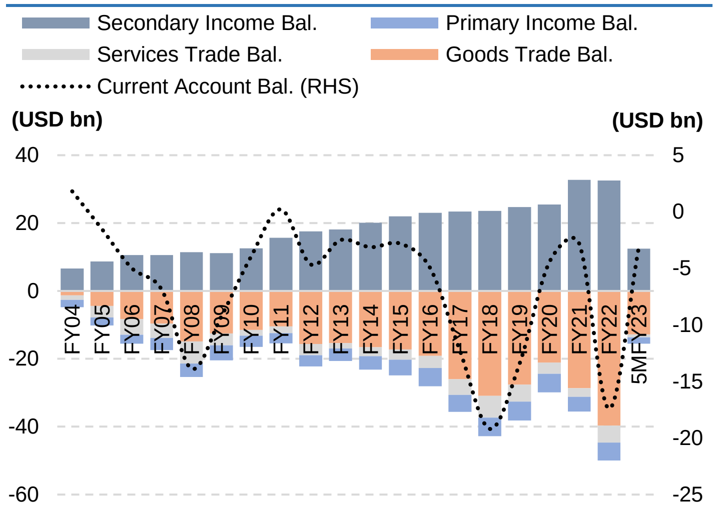
We do not expect artificial currency control measures with multiple exchange rates to be sustainable and expect the SBP to gradually relax administrative measures as the next IMF tranche and linked bilateral and multilateral inflows start to materialize (likely in 1QCY23). In this backdrop, we expect the official rate to converge towards the unofficial rate with June/Dec 2023 PKR/USD closing rates of 250/263, respectively.

Figure: Current Account Balance vs Currency



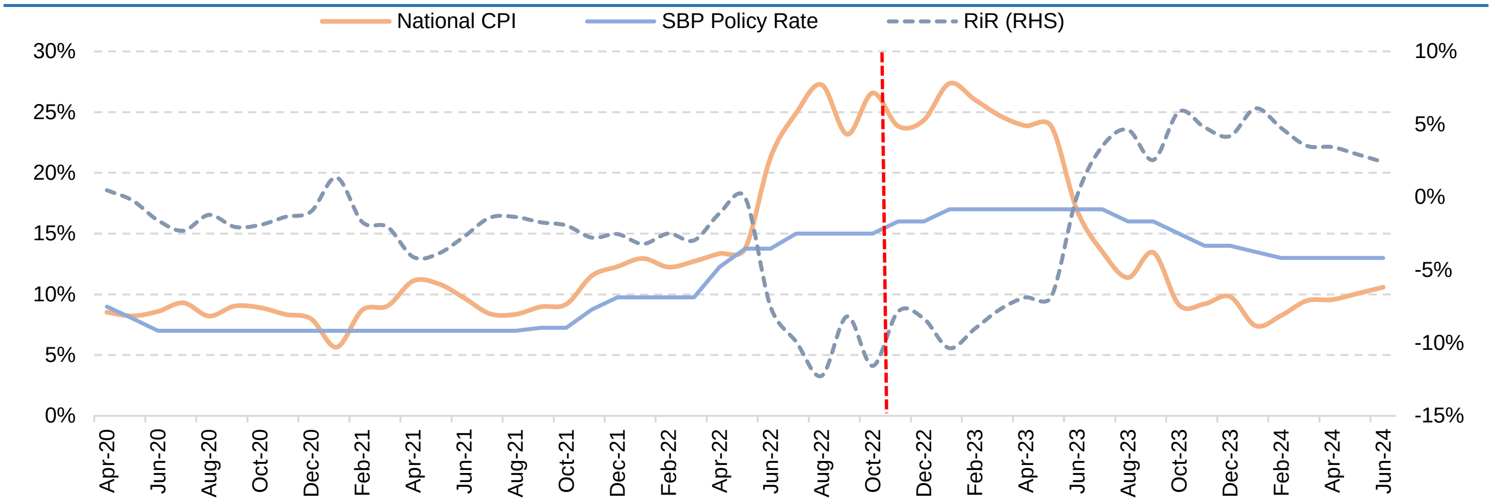
Source (s): SBP, AHL Research

Figure: Current Account Balance Breakup



Source (s): SBP, AHL Research

Figure: Real Interest Rate – Trend and Forecast



Source (s): SBP, PBS, AHL Research

Exhibit: Current Account Balance

USD mn	FY19a	FY20a	FY21a	FY22a	FY23a	FY24f
Current Account Balance	(13,434)	(4,449)	(2,820)	(17,405)	(7,169)	(8,212)
% of GDP	-4.2%	-1.5%	-0.8%	-4.6%	-2.0%	-2.3%
Exports of Goods	24,257	22,536	25,639	32,471	30,295	33,530
Imports of Goods	51,869	43,645	54,273	72,152	59,033	66,438
Balance on Trade in Goods	(27,612)	(21,109)	(28,634)	(39,681)	(28,739)	(32,907)
Exports of Services	5,966	5,437	5,945	6,950	7,020	7,371
Imports of Services	10,936	8,753	8,461	11,969	10,371	10,889
Balance on Trade in Services	(4,970)	(3,316)	(2,516)	(5,019)	(3,350)	(3,518)
Balance on Trade in Goods and Services	(32,582)	(24,425)	(31,150)	(44,700)	(32,089)	(36,425)
Balance on Primary Income	(5,610)	(5,459)	(4,400)	(5,296)	(5,734)	(6,268)
Balance on Secondary Income	24,758	25,435	32,730	32,591	30,653	34,481
Workers' Remittances	21,740	23,131	29,450	31,279	29,449	31,374

Source (s): SBP, AHL Research

IMF Extended Fund Facility Program

Life without IMF is not an option

The IMF's Extended Fund Facility (EFF) program has once again fallen off track reflected by the delays in completion of the 9th review (pending since Nov'22). IMF has raised concerns of the fiscal slippages emanating from a combination of the devastating floods and revenue shortfall, particularly from the Petroleum Development Levy (PDL). There have also been concerns over the accuracy of the budgeted flood rehabilitation expenditure. Survival without IMF is not an option in our view given the scale of the external financing needs, where the majority of the funding sources are linked to an IMF endorsement.

Host of administrative measures needed for completion of 9th review

We expect the government to implement a number of revenue and fiscal consolidation measures in the coming weeks to address the concerns raised by the IMF and pave the way for the completion of the 9th review and release of USD 1.2bn tranche in 1QCY23. That said, the fund is expected to provide a wavier on 'Ceiling on the general government primary deficit criteria' in the 9th review on account of higher flood related expenditure and higher borrowing costs. We believe the IMF will advocate the implementation of the following measures during the remainder of the current EFF program:

- Immediate increase in GST on fuel,
- Increase in Federal Excise Duty on cigarettes,
- Implementation of a market determined exchange rate policy,
- Initiation of the privatization of State-Owned Enterprises (SOEs),
- Increase in gas tariff,
- Increase in Petroleum Development Levy (PDL) to PKR 50/litre on diesel from PKR 30/litre currently,
- Cut in Public Sector Development Programme (PSDP) disbursement in order to contain fiscal expenditure and meet budget deficit targets, and
- Rationalization of electricity tariff

The implementation of the above measures over the remainder of the EFF program in our view will ensure the release of the remaining three tranches (worth USD 2.6bn) by Jun'23 as IMF is the only viable option left to manage the external financing needs. With the 10th review also due in early 2023, as per the 7th and 8th combined review IMF report, combining the ongoing 9th review with the 10th review remains a possibility- though this may further delay the IMF disbursement (cumulative of USD 1.9bn).

Another IMF program post General Election to address long-term funding needs

Given the scale of the external financing needs over the medium to long term (USD 103bn during FY24-26), we believe the government will have to remain engaged with the IMF beyond the current EFF. We expect the new government elected post General Elections (latest by 2HCY23) to sign up for another longer-term IMF program which would be essential to address both long-term structural issues as well as sizeable external financing needs.

Inflation and Interest rates

Tight monetary stance to continue, some breather in FY24

Cost pressures, supply shocks, subsidy reversals, tariff hikes, and a weaker PKR have been the primary contributors to a surge in inflationary pressure in the economy in the past few months. Average inflation for 5MFY22 has clocked in at 25.1% compared to 9.32% same period last year. We expect headline inflation to remain elevated in 2HFY23 with an average CPI of 23.8% from Jan-Jun'23. This shall drive the FY23E average inflation to 24.4%.

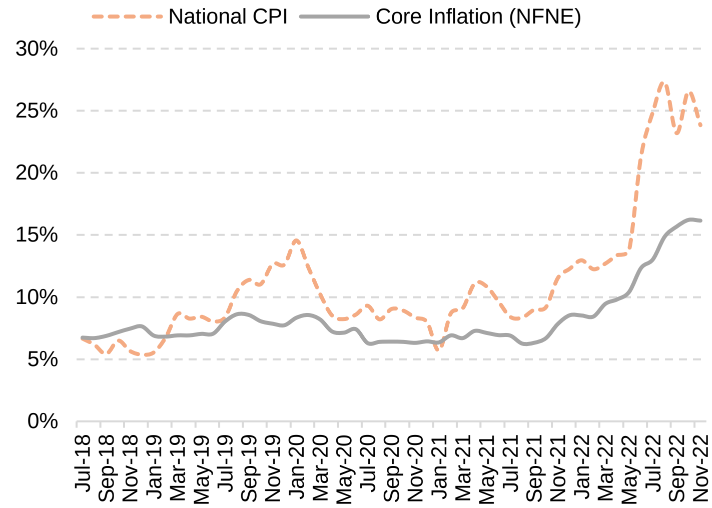
Our expectation for headline inflation incorporates currency depreciation, an adjustment in utility prices including gas and power tariffs, and the imposition of GST on petroleum products. Pertinently, the SBP views headline inflation could climb higher than the pre-flood projection of 18-20% to 21-23% in FY23 due to higher food prices. For the current fiscal year 2023, SBP believes that floods will have a potential negative impact on the output of cotton, rice as well as livestock sector this year, therefore, priority should be given to necessary imports to curb food inflation. That said, we believe, upside risks to the inflation forecast include fiscal slippages; while a decline in oil prices, faster contraction than expected in aggregate demand, and exchange rate appreciation may lead to a decline in inflation readings earlier than expected.

Beyond FY23: Going forward, on the macro level, lower oil and other key commodities' prices coupled with a high base effect kicking in, are expected to lead to a reduction in factor prices with the CPI likely to fall to ~10.2% in FY24F. The Monetary policy committee also views headline inflation to decline in the second half of 2023 and fall within the upper range of 5-7% by the end of FY24, which in our view is an optimistic assumption.

Monetary tightening to continue, gradual easing from FY24

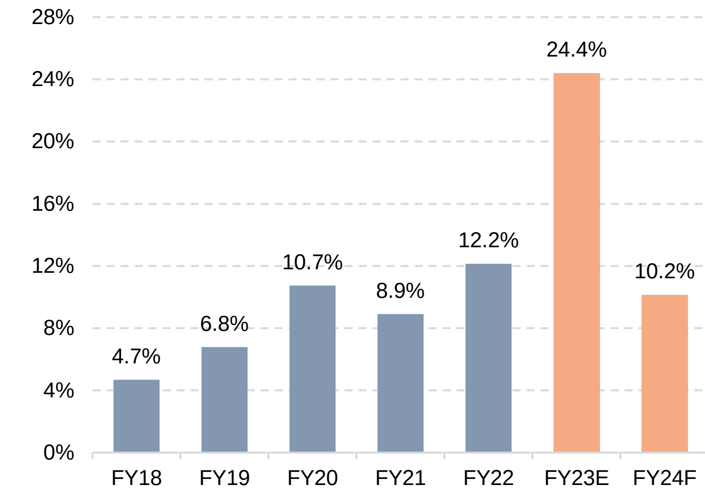
With the onset of FY23, the MPC after increasing the policy rate by 125bps in Jul'22, once again hiked it by another 100bps in Nov'22, taking it to 16% with the view that the prevailing rate prudently strikes a balance between maintaining growth post floods and managing inflation. Moreover, MPC in their last MPS stated that some supply shocks have been more persistent with a risk that it does not spill over in broader prices. However, growth prospects show weakness, which should curb demand-side pressures and keep underlying CPI in check. We expect SBP to maintain a tight monetary stance in 2HFY23 as inflation remains elevated with another 100bps of monetary tightening in 1QCY23 to a policy rate of 17%. Looking beyond FY23, we see a sharp decline in inflationary pressures with inflation falling to ~11-13% by Aug/Sep'23 which would pave the way for the start of the monetary easing cycle, with a likely 4% rate reduction in FY24. While we do see room for further rate cuts in FY24, we believe SBP will likely adopt a more cautious approach given the likely volatility in commodity prices and supply-side challenges in the economy. Our assumption is for rates to fall to 13% by Jun'24.

Figure: National CPI vs Core Inflation (NFNE)



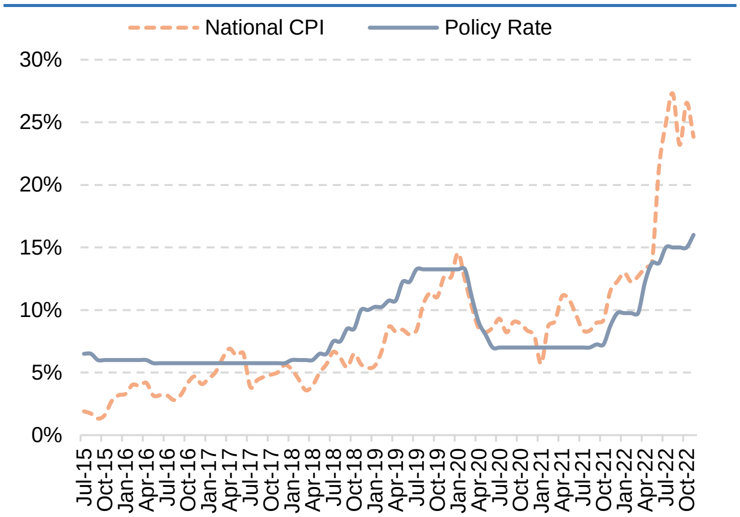
Source (s): PBS, AHL Research

Figure: National CPI – Trend and Forecast



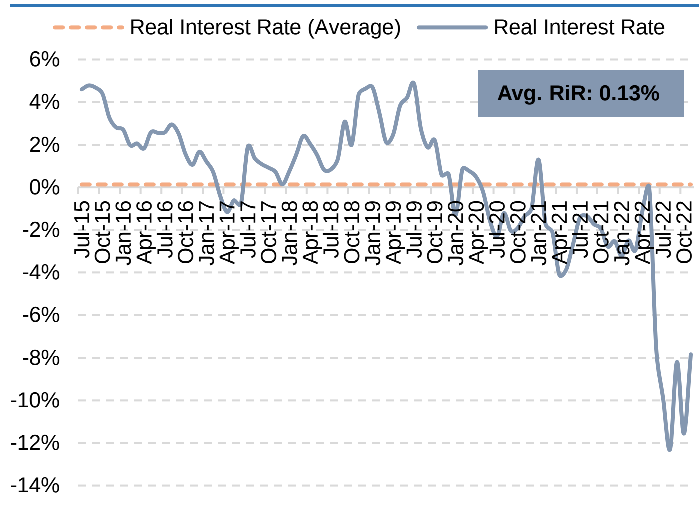
Source (s): PBS, AHL Research

Figure: National CPI vs Policy Rate



Source (s): PBS, SBP, AHL Research

Figure: Real Interest Rate



Source (s): PBS, SBP, AHL Research

Key risks

In the negotiations with the IMF that are currently underway for the ninth review of the EFF program, Pakistan's focus would be to convince the fund of the implementation of the tough administrative measures in a phased manner including curtailment of untargeted subsidies, imposition of further taxes and agreement to its flood-driven damage assessment. Moreover, Pakistan needs to provide assurance regarding the meeting of pre-requisites of subsequent reviews. While we believe the government will have no option but to follow the IMF guidelines, there is a serious risk to macro stability if the authorities decide to not go along with the IMF. Moreover, politics remain another source of concern for the overall macro-outlook and our broader thesis, as any prolonged political crisis could derail the IMF program and the overall macro stability. Higher oil price is another key risk for the economy and our thesis, as every USD 10/bbl change in oil prices has a USD 2.4bn annualized impact on the external account and a material impact on the inflation outlook which could further delay the monetary easing cycle and economic recovery. Some of the major risks and repercussions arising from a derailment/exit from the IMF program in our view include:

- Deterring confidence of all stakeholders leading to suspension of existing programs and funding from other multilateral institutions like ADB, World Bank, AIIB, etc.
- Further deterioration in the Credit Default Spread and sovereign debt valuations.
- Suspension of debt repayment and request for a debt moratorium and rescheduling of external debt from bilateral creditors.
- Further downgrade by credit rating agencies.
- Sovereign default which would have a top-down spillover effect in terms of currency devaluation, hyperinflation amid commodity shortages, credit crunch, and a banking crisis.

Taking a cue from the other countries that defaulted on their sovereign payments, such as Argentina, a bigger IMF bailout programme with stringent conditions and regular monitoring of the progress to ensure the plan is on track seems to be one solution. But this would mean the elimination of untargeted subsidies, lower spending, reduced monetary emission, a further devaluation of the currency, and higher interest rates, all of which would have severe repercussions for the economic recovery.

Key Economic Indicators

Exhibit: Key Economic Indicators

		FY18a	FY19a	FY20a	FY21a	FY22a	FY23e	FY24f
Real								
Real GDP Growth		6.1%	3.1%	-0.9%	5.7%	6.0%	1.8%	3.9%
Nominal GDP	$ bn	356.8	321.8	300.8	348.7	382.8	367.0	367.9
CPI and Policy Rate								
CPI (YoY average)		4.7%	6.8%	10.7%	8.9%	12.2%	24.4%	10.2%
Policy Rate (Period end)		6.5%	12.3%	7.0%	7.0%	13.8%	17.0%	13.0%
External Sector								
Exports (Goods)	$ bn	24.8	24.3	22.5	25.6	32.5	30.3	33.5
Imports (Goods)	$ bn	55.7	51.9	43.6	54.3	72.2	59.0	66.4
Trade Deficit (Goods)	$ bn	30.9	27.6	21.1	28.6	39.7	28.7	32.9
Remittances	$ bn	19.9	21.7	23.1	29.5	31.3	29.4	31.4
FX Reserves (Period end)	$ bn	16.4	14.5	18.9	24.4	15.5	15.8	20.4
SBP FX Reserves (Period End)	$ bn	9.8	7.3	12.1	17.3	9.8	9.9	14.6
Bank FX Reserves (Period End)	$ bn	6.6	7.2	6.8	7.1	5.6	5.9	5.9
Exchange Rate (Period end)	USD/PKR	121.5	160.1	168.1	157.5	204.8	250.0	270.0
PKR Appreciation / (Depreciation) (%)		(13.7)	(24.1)	(4.8)	6.7	(23.1)	(18.1)	(7.4)
Fiscal Sector								
Total Revenue	PKR bn	5,228	4,901	6,272	6,903	8,035	9,280	10,674
Tax Revenue	PKR bn	4,467	4,473	4,748	5,273	6,755	7,663	8,809
Nontax Revenue	PKR bn	761	427	1,524	1,631	1,280	1,617	1,865
Total Expenditure	PKR bn	7,488	8,346	9,648	10,307	13,295	14,253	15,287
Current Expenditure	PKR bn	5,854	7,104	8,532	9,084	11,521	12,937	13,772
Budget Deficit	PKR bn	2,260	3,445	3,376	3,403	5,260	4,953	4,612
% of GDP								
Current Account Deficit		6.3%	4.9%	1.5%	0.8%	4.5%	2.0%	2.3%
Trade Deficit		8.7%	8.6%	7.0%	8.2%	10.4%	7.8%	8.9%
Fiscal Deficit		5.8%	7.9%	7.1%	6.1%	7.9%	5.9%	4.8%
External Debt		18.0%	21.1%	23.4%	22.7%	21.4%	20.4%	21.8%
Domestic Debt		41.9%	47.3%	49.0%	47.1%	46.4%	40.3%	38.2%

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

AHL Economic Pulse Poll

AHL conducted survey on anticipations of key stakeholders with respect to some of Pakistan's focal macroeconomic indicators and capital market for the forthcoming year 2023. Our survey covered participants across the financial industry including Asset Managers, Banks, Insurance, DFIs as well as corporates outside the financial services namely E&Ps, Cements, Fertilizers, Steel, Textiles and Pharmaceuticals. We would like to express our gratitude to all the respondents who participated in the survey.

- **Poll survey theme:** Our poll survey is mainly focused on the anticipations of key stakeholders with respect to Pakistan's macroeconomic and index targets. We incorporated such questions so as to gauge participants' anticipations regarding forthcoming GDP growth, inflation, interest rate, fiscal deficit, PKR parity against USD, current account deficit, international oil & coal prices, foreign exchange reserves, index target, and foreign flows for the year 2023.
- What does our survey suggest? The result of our survey suggests that majority of the respondents expect continued economic slow-down in 1HCY23. Moreover, inflation is expected to remain elevated in FY23 while majority expects interest rate to close Jun'23 in the range of 15-16%. Current account expectations are in-line with SBP's expectation of 3% of GDP. On currency outlook, market expects parity to settle above PKR 250/USD by FY23 end. Lastly, majority respondents expect the KSE-100 index to close CY23 somewhere between 45,000-50,000 level. Enlisted below are detailed responses received from the poll participants:

1) GDP growth expectation for FY23
- 67% expect it to remain below 2%,
- While remaining 33% of the total respondents are of the view that Pakistan's GDP growth will remain in the range of 2-3%.

2) Average inflation for FY23
- 63% of the poll participants expect inflation to cross 22%,
- 33% of the respondents expect it to remain in between 20-22%,
- While remaining 4% expect it to remain below 20%.

3) Interest rate expectation for Jun'23 and Dec'23
- Jun'23: 52% of the respondents expect the interest rate to be in the range of 15-16%, 33% of participants expect the interest rate to cross the 16% mark, while the remaining 15% expect it to slide below 15%.
- Dec'23: 48% expect it to cross 14%, 29% expect it to be in the range of 13-14%, while the remaining 23% of the respondents expect the interest rate to remain below 13%.

4) Current account deficit expectation for FY23
- 41% expect CAD to remain in the range of USD 8-10bn,
- 37% expect CAD to remain below USD 8bn,
- While the remaining 22% of participants expect it to cross the USD 10bn mark.

5) Fiscal deficit (% of GDP) for FY23
- 48% of the respondents expect fiscal deficit (as a % of GDP) to fall within the range of 6-7%,
- 48% expect it to be more than 7%,
- While the remaining 4% expect it to be less than 6%.

7) USD/PKR Parity Expectation for Jun'23 and Dec'23

- Jun'23: 52% expect parity to settle above PKR 250/USD, 44% of the respondents expect parity to hover in the range of PKR 230-250/USD, while the remaining 4% expect parity to remain below PKR 230/USD.
- Dec'23: 63% anticipate parity to close above PKR 260/USD, 33% expect it to remain in between PKR 240-260/USD, while the remaining 4% expect parity to remain below PKR 240/USD.

8) KSE-100 Dec'23 target

- 59% of the participants expect the KSE-100 index to remain in the range of 45,000-50,000 pts,
- 30% expect it to remain below 45,000 pts,
- While the remaining 10% expects it to cross the 45,000 level.

9) Foreign exchange reserves for FY23

- 63% of the respondent anticipates FX reserves to remain below USD 10bn,
- 33% expect it to remain in the range of USD 10-12bn
- While the remaining 4% expect it to cross USD 12bn mark.

10) International oil price expectation for CY23

- 52% of the respondents expect oil prices to trade in the range of USD 70-80/bbl,
- 37% expect it to remain below USD 70/bbl,
- While 11% expect it to trade above USD 80/bbl.

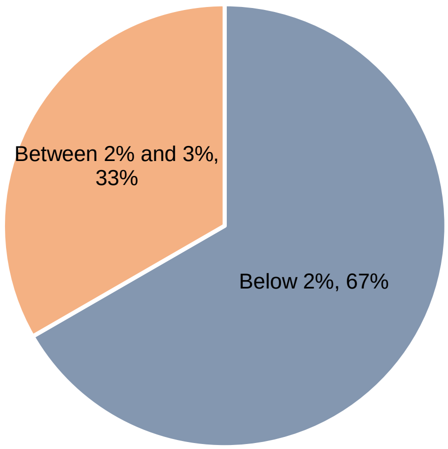
11) International coal price expectation for CY23

- 52% expect it to be in the range of USD 150-200/ton,
- 33% of the respondents believe coal prices to remain below USD 150/ton,
- While 15% expect it to cross USD 200/ton.

12) Foreign investor's portfolio investment for CY23

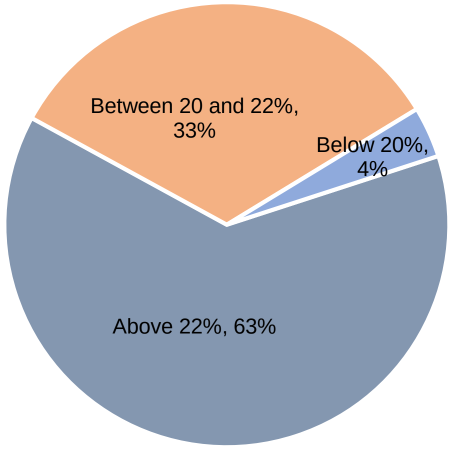
- 37% expect breakeven
- 30% expect a net outflow of up to USD 200mn
- 19% expect a net outflow of above USD 200mn

Exhibit: GDP growth for the fiscal year 2023



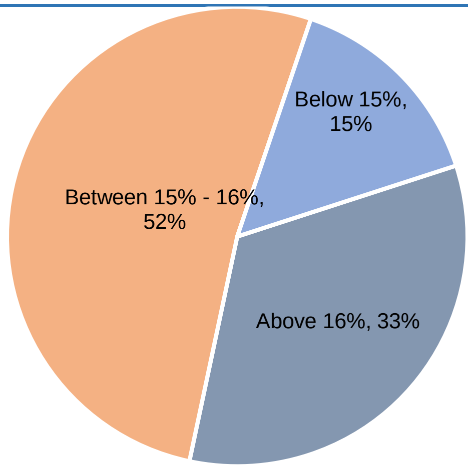
Source (s): AHL Research

Exhibit: Average inflation for the fiscal year 2023



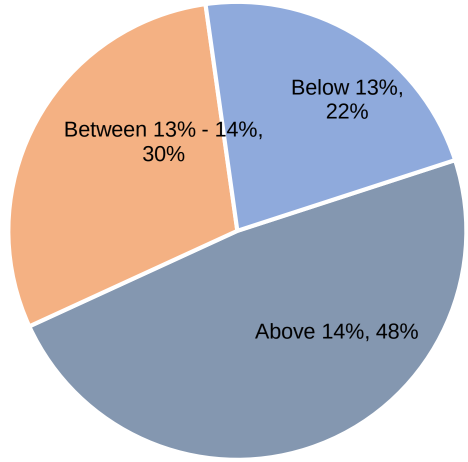
Source (s): AHL Research

Exhibit: Interest rates for the period ending June 2023



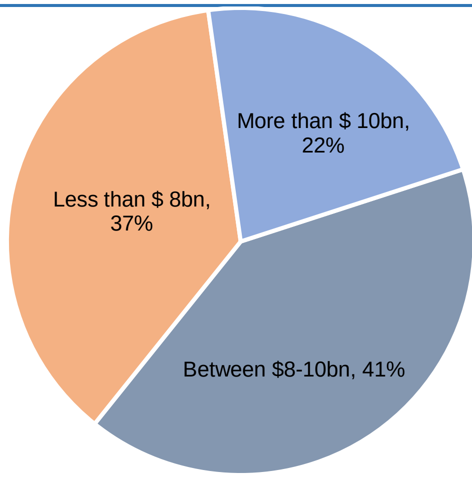
Source (s): AHL Research

Exhibit: Interest rates for the period ending Dec 2023



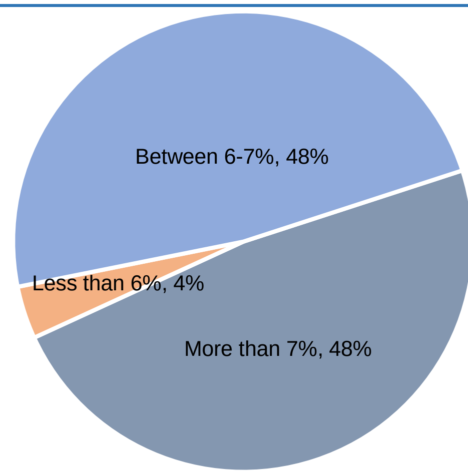
Source (s): AHL Research

Exhibit: Current account deficit for the fiscal year 2023



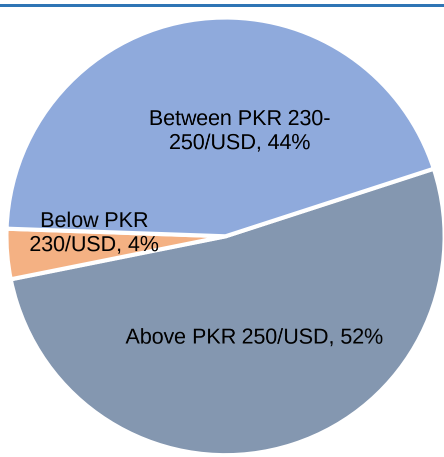
Source (s): AHL Research

Exhibit: Fiscal deficit (% of GDP) for the fiscal year 2023



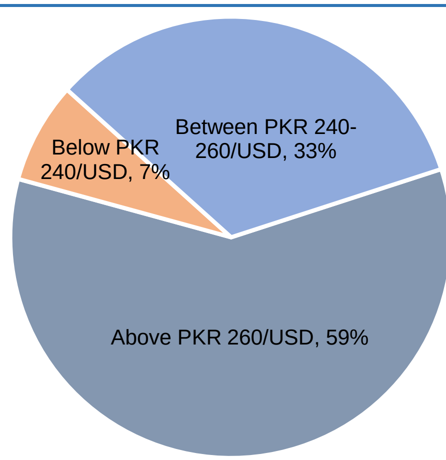
Source (s): AHL Research

Exhibit: Currency for the period ending June 2023



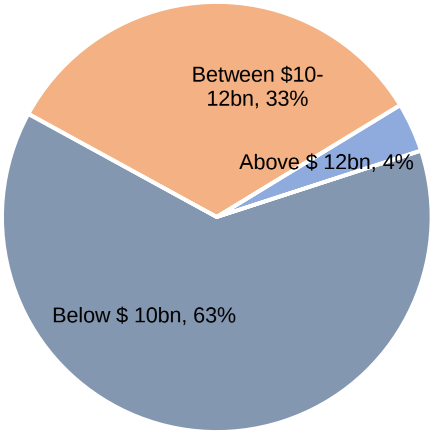
Source (s): AHL Research

Exhibit: Currency for the period ending Dec 2023



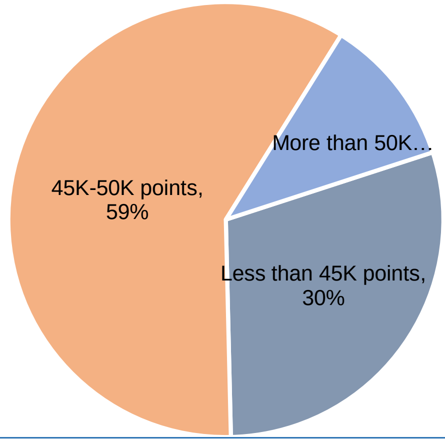
Source (s): AHL Research

Exhibit: SBP reserves for the period ending June 2023



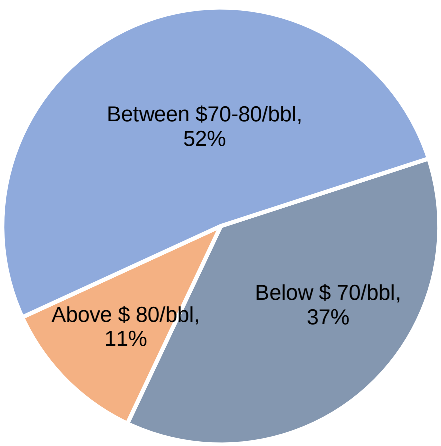
Source (s): AHL Research

Exhibit: KSE100 index for the period ending Dec 2023



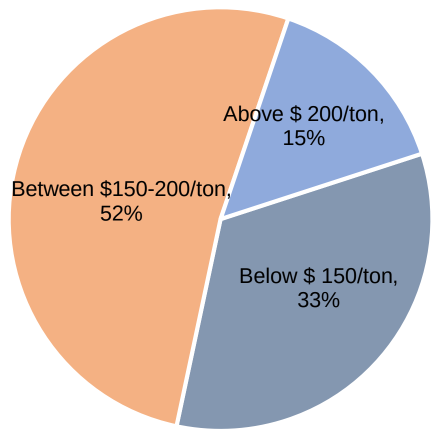
Source (s): AHL Research

Exhibit: Average oil prices for the calendar year 2023



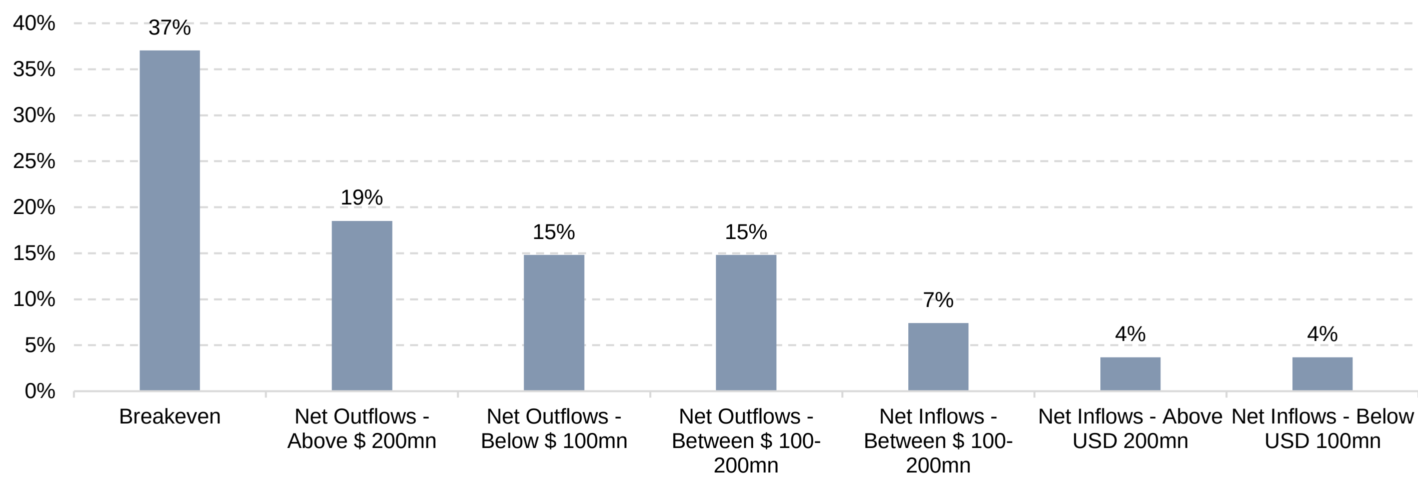
Source (s): AHL Research

Exhibit: Average coal prices for the calendar year 2023



Source (s): AHL Research

Exhibit: Foreign investor's portfolio investment for the calendar year 2023



Source (s): AHL Research

Pakistan Capital Market

The 10k bet

Our Dec'23 target for the KSE-100 Index is set at 49,374 points, portraying an upside of 24.5% from the closing of 23[th] Dec'22. We believe the second half of the following year would fare much better for equities with the rebirth of domestic investor confidence in the market as the political dust settles with a new government set to take charge post-general elections. In addition, we expect more clarity on the economic front, particularly with another IMF program under the new government including implementation of structural reforms under the recommendation of the IMF. Moreover, we do not rule out the possibility of re-rating in the market in early 1HCY23 given the resolution of gas circular debt (detailed discussion later on at page # 37).

Exhibit: KSE100 Index Target Estimates 2023

Valuation Basis	Weight	Target
Target Price Based	33%	54,670
Earnings Growth	33%	48,694
Justified PE	33%	44,759
Average Target 2023	**100%**	**49,374**
Index Closing 23-Dec-22		39,669
Expected Return 2023		**24.5%**

Source (s): AHL Research

12% Earnings growth in 2023e

Led by index heavyweights Banks and E&Ps: Earnings growth in 2023 is estimated at 11.8%, the uptick is attributable to earnings growth in both the heavyweight Banking (20.6%) and E&P sector (11.9%), which have a cumulative ~32.6% weight in the KSE-100 index. Reduction in super tax (4% in 2023 vs. 10% in 2022), PKR depreciation, and hydrocarbon additions shall stem growth in the E&P sector; whereas growth in the banking sector profitability will be driven by higher interest rates, higher non-interest income, and relatively lower tax rate during 2023. Cements should remain in the limelight due to an expected decline in coal prices along with cheaper coal availability onshore and the expected revival of demand in 1HCY23 amid election-year euphoria and post-flood reconstruction and rehabilitation activities. Lastly, the profitability of the fertilizer sector is projected to increase attributable to higher pricing and margins of urea, however, phosphate manufacturers may face the brunt amid lower margins and volumetric decline.

The profitability of ex-oil, and ex-banks in the AHL Universe reveals a decline to 10.5%. This is anticipated to be largely triggered by the cyclical sectors i.e. OMCs (-68.9%) amid absence of inventory gains, Autos (-46%) on account of import curbs and demand destruction, Steel (-37%) due to subdued demand and higher interest rates, and Textiles (-16%) as global recessionary environment has dampened the order book while import curbs have created difficulties for raw material import.

Exhibit: Corporate Sector KSE-100 Earnings Growth: Trend & Forecast

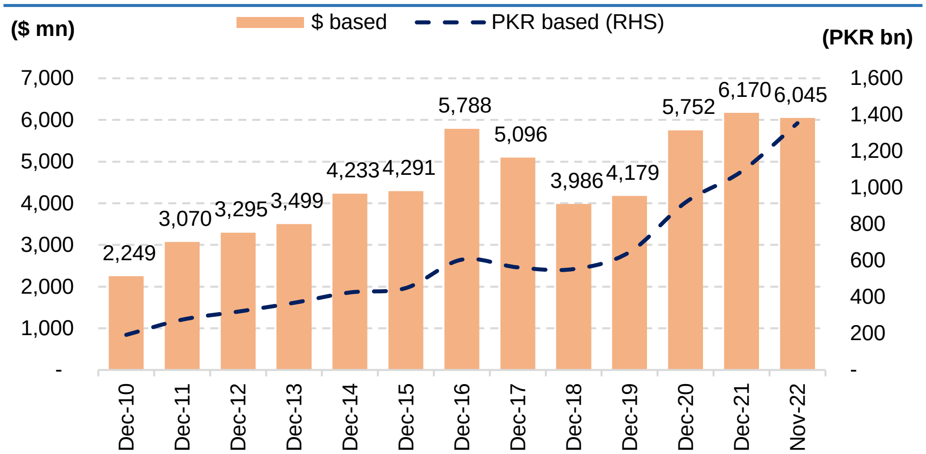
(%)	2017a	2018a	2019a	2020a	2021a	5-Y Avg.	2022e	2023e	2024f
E&P	30.7	27.8	46.3	(10.5)	(4.6)	17.9	30.5	37.2	(2.4)
Banks	(21.2)	6.7	20.7	33.4	13.4	10.6	7.7	33.2	14.8
Fertilizer	(53.3)	33.6	(3.2)	40.3	20.5	7.6	(22.1)	37.2	8.3
Cement	(5.3)	(6.3)	(38.0)	nm	nm	(16.5)	28.5	24.2	(1.0)
OMCs	68.3	(11.8)	(35.3)	(121.3)	nm	(25.0)	143.2	(68.9)	47.7
Autos	37.4	8.4	(36.0)	(55.3)	177.5	26.4	0.9	(46.2)	75.6
Power	(43.8)	6.9	32.2	9.8	22.3	5.5	(16.2)	24.8	13.6
Textiles	26.7	16.7	39.0	(66.2)	277.7	58.8	75.0	(16.1)	19.6
Chemicals	27.2	61.7	(2.2)	(2.1)	101.9	37.3	18.0	(21.0)	(0.2)
Steel	101.1	(10.7)	(14.0)	nm	nm	25.5	(19.0)	(37.0)	10.0
KSE100	**(7.9)**	**7.2**	**7.4**	**0.1**	**44.8**	**10.3**	**14.3**	**11.8**	**9.3**

Source (s): Company Financials, AHL Research

Flush of domestic liquidity

Pakistan's equity market has absorbed foreign outflows amounting USD 1,930mn since CY17TD. Moreover, in CY22, the foreigners have offloaded equities worth USD 32mn, whereas major domestic outflows include Mutual Funds (USD 179mn) and Insurance companies (USD 130mn). This has been absorbed by local individuals (USD 142mn) and Companies (USD 73mn) and highlights the high levels of liquidity available with the other local investors. We also highlight that institutional investment in equities by Mutual Funds and Insurance companies has come down to just 12.8% and 17.4% as percentage of their AUMs (from 48.5% | 42.0% in 2017), which signals a potential re-rating of the equity bourse once funds are redirected towards the stock market. This could be reason enough for the market to potentially yield strong returns in the forthcoming year.

Figure: Assets Under Management of Mutual Fund Industry



Source (s): MUFAP, AHL Research

Exhibit: KSE All Ownership

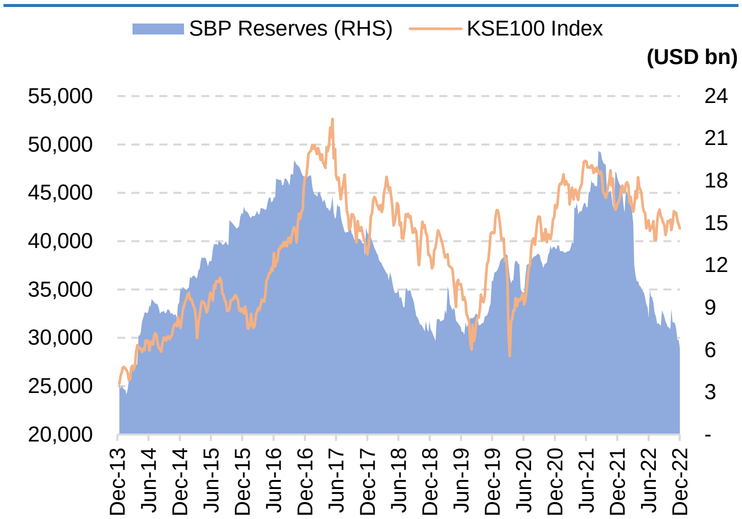
PKR bn	AUM / Investment	Equity Exposure	% of total AUMs/ Investments	KSEAll Ownership
MF	1,354	173	12.8%	9.8%
Banks	16,343	158	1.0%	9.0%
Insurance (ex. SLIC)	314	55	17.4%	3.1%
State Life Insurance	1,200	90	7.5%	5.1%
Foreign	na	51	na	2.9%
Other*	na	1,233	na	70.1%
Total	**19,211**	**1,759****		

Source (s): MUFAP, FMR, Company Financials, AHL Research,
**Total free float market cap

KSE-100 and SBP Reserves

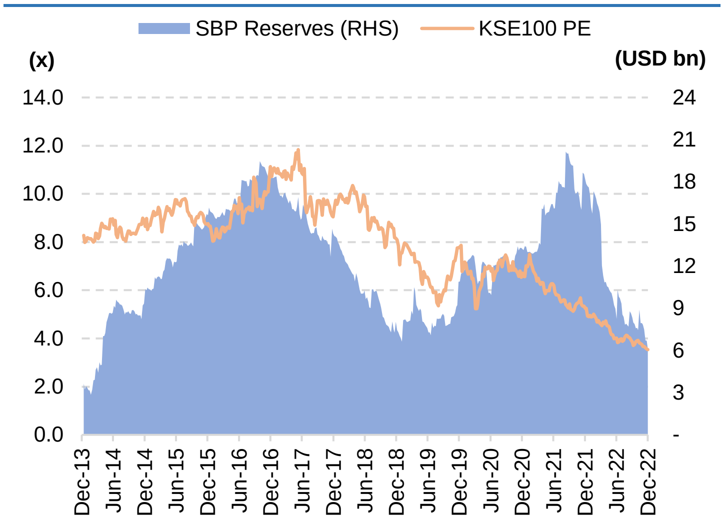
- At any given time, the level of the KSE-100 Index is a combination of corporate performance as well as investors' confidence in Pakistan's economy. Similarly, SBP's reserves exhibit the country's ability to finance its imports and other foreign exchange commitments.
- SBP's reserves have undergone a dip of USD 11.6bn or 65.4% since the start of CY22. Likewise, the KSE-100 index has shown a decline of 9.4% during the same period. Going forward, in the long term, both the indicators which depict confidence in the economy should move in tandem with the macroeconomic climate, which should accelerate towards sustainability.
- We believe that the government's economic reforms (which may appear challenging for numerous sectors), should eventually aid investors' confidence in the market.
- More importantly, the resumption of the IMF program and inflows from multilateral partners, and rollover from bilateral partners, will help bridge the external financing gap.
- Influx of funds is expected from various sources including inflows from Saudi Arabia and China, extension of Saudi Oil Facility (from USD 1.2bn to USD 2.4bn), and borrowings from multilateral institutions such as ADB, IDB, and World Bank. Moreover, given our expectations of another IMF program in 2H2023, additional inflows shall become available to fund the external debt.

Figure: SBP reserves vs. KSE100 Index



Source (s): SBP, PSX, AHL Research

Figure: SBP reserves vs. KSE100 P/E



Source (s): SBP, Bloomberg, AHL Research

KSE-100 vs. Macros

Looking at the relative level of the KSE-100 average PE (over the last 13 years), we noticed an interesting comparative trajectory in-line with the country's five key macro indicators e.g. Twin deficits (as a % of GDP), policy rate, inflation, and FX reserves. For instance, during FY08-FY09, the KSE-100 index traded at an average PER of 8.6x (bottom PE multiple was 3.9x), with most of the mentioned macros worse off against the current scenario barring inflation and interest rates. Therefore, we believe that with the resumption of the current IMF program in 1QCY23, a bigger IMF program next year, and a new gov't set to take charge in 2HCY23, macros should depict improvement and the market PE will adjust accordingly, reflecting the narrowing market-macro dichotomy.

Exhibit: Key Economic Indicators and KSE100 Price to Earning, Price to Book, and Dividend Yield

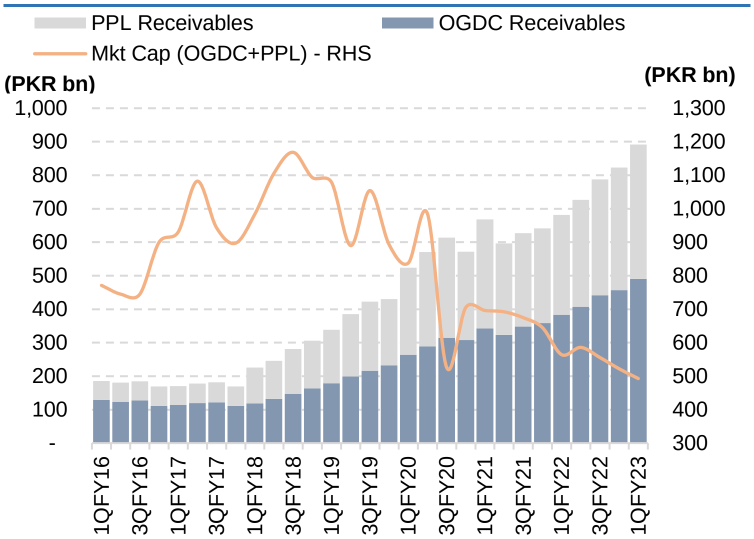
Year	CAD*	Fiscal Deficit*	Avg. Inflation	Policy Rate		Forex Reserves^			GDP Growth	PE (x)	PB (x)	Dividend Yield
				Avg.	Period End	Total	SBP	Banks				
FY08	8.2%	7.3%	11.9%	10.4%	12.0%	11.4	8.6	2.8	5.0%	9.8	2.5	na
FY09	5.5%	5.2%	21.0%	14.1%	14.0%	12.4	9.1	3.3	0.4%	7.4	1.2	7.3%
FY10	2.2%	6.2%	10.1%	12.8%	12.5%	16.8	13.0	3.8	2.6%	8.1	1.7	5.9%
FY11	-0.1%	6.5%	13.7%	13.8%	14.0%	18.2	14.8	3.5	3.6%	7.8	1.8	5.8%
FY12	2.1%	6.8%	11.0%	12.4%	12.0%	15.3	10.8	4.5	3.8%	6.6	1.8	6.5%
FY13	1.1%	8.2%	7.4%	9.9%	9.0%	11.0	6.0	5.0	3.7%	7.4	1.7	6.2%
FY14	1.3%	5.5%	8.6%	9.8%	10.0%	14.1	9.1	5.0	4.1%	9.0	2.1	5.2%
FY15	1.0%	5.3%	4.6%	8.8%	7.0%	18.7	13.5	5.2	4.1%	9.7	2.0	5.5%
FY16	1.6%	4.1%	2.9%	6.0%	5.8%	23.1	18.1	5.0	4.6%	9.6	1.7	6.0%
FY17	3.6%	5.2%	4.8%	5.8%	5.8%	21.4	16.1	5.3	4.6%	11.1	1.8	4.8%
FY18	5.4%	5.8%	4.7%	6.0%	6.5%	16.4	9.8	6.6	6.1%	9.5	1.5	5.9%
FY19	4.2%	7.9%	6.8%	9.9%	12.3%	14.5	7.3	7.2	3.1%	6.2	1.0	6.4%
FY20	1.5%	7.1%	10.8%	11.8%	7.0%	18.9	12.1	6.8	-0.9%	6.8	1.0	7.4%
FY21	0.8%	6.1%	8.9%	7.0%	7.0%	24.4	17.3	7.1	5.7%	5.8	1.0	5.9%
FY22	4.5%	7.9%	12.2%	9.7%	13.8%	15.5	9.8	5.6	6.0%	3.9	0.7	9.5%
FY23e	2.0%	5.9%	24.4%	16.2%	17.0%	15.8	9.9	5.9	1.8%	3.8	0.6	10.2%

Source (s): Bloomberg, SBP, PBS, AHL Research, *as % of GDP, ^USD bn

Resolution of circular debt – A key catalyst for the market

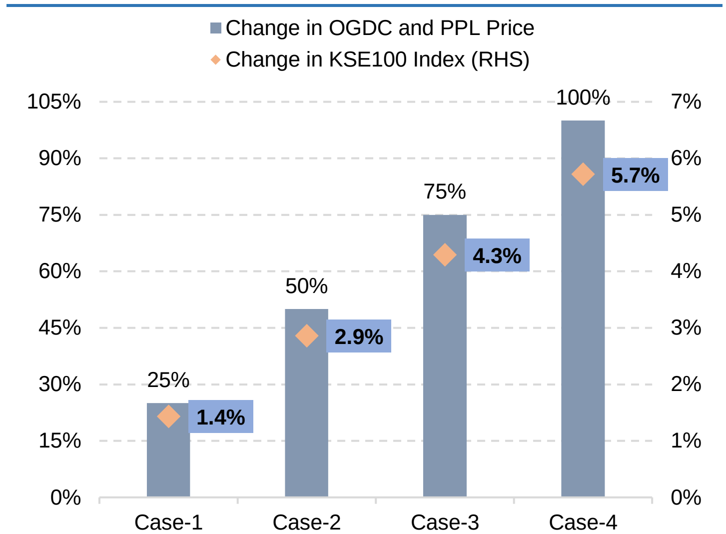
A major event for significant re-rating of the market could be the resolution of the gas circular debt, as the gov't needs to undertake structural reforms in the gas sector and settle prior arrears. Moreover, it has repeatedly been demanded by the IMF to embark on the rationalization of gas tariff, prepare a circular debt management plan, and clear gas circular debt arrears. The E&P companies (OGDC and PPL) could potentially receive a hefty amount on account of clearance of circular debt, which in turn can result in massive dividend payouts. To recall, OGDC and PPL have receivables from SNGP and SSGC amounting PKR 491bn (PKR 114.1/share) and PKR 401bn (PKR 147.4/share), respectively. The dividends can then be rerouted back to the gov't, aiding the re-rating of the KSE-100 index in general, and the E&P sector in particular. We have run a sensitivity to gauge the outperformance of the E&P sector, where 25%, 50%, 75%, and 100% increase in the market cap of OGDC and PPL post clearance of the circular debt (ceteris paribus), could propel the index by 1.4%, 2.9%, 4.3%, and 5.7%, respectively.

Figure: OGDC, PPL receivables and market cap trend



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

Figure: Impact of OGDC and PPL on KSE100 index



Source (s): PSX, AHL Research

Highway to stability (Key economic measures)

Inflationary pressure - Interest rate hike: To curb the rising inflationary pressure, the SBP has raised the policy rate by a cumulative 625bps throughout CY22. Inflation for FY22 remained at 12.2% and has increased to 25.14% during 5MFY23. The SBP expects inflation to remain between 21% - 23% for FY23 as a result of higher food inflation along with the fiscal policy adjustments done by the gov't/SBP.

Outlook: SBP's medium-term inflation target is 6-8%. We view that CPI is expected to recede significantly in 2HCY23 and our estimates suggest that FY24 CPI will clock in at 10.4%, aiding investor confidence and commencing the monetary loosening cycle from Aug'23 to 13% in Jun'24.

Reserves depletion / External imbalances - Currency depreciation: The PKR has witnessed significant pressure throughout CY22 – almost 20% dip against the USD. The SBP has allowed this depreciation of the currency in order to make imports expensive and incentivize exports. As a consequence of continuous PKR depreciation and controls imposed by the Central Bank on imports, trade deficit for the month of Nov'22 clocked in at USD 2.0bn, which is a 24-month low.

Outlook: Import controls are expected to remain in place during the rest of FY23, but pressure on the currency may mount given low reserve levels. However, the resumption of the IMF program and related multilateral flows, financial assistance from friendly countries, lower commodities prices, and lower current account deficit will relatively ease off pressure from the currency.

Accretion of circular debt - Increase in gas/electricity tariff: The government increased electricity prices by PKR 7.92/kWh in Jul'22. The objective of an increase in the prices of electricity is to reduce the deficit and pass on the impact of higher capacity and energy payments to end consumers. Pertinently, the deficit on the sale of gas is increasing by approx. PKR 170bn per annum, primarily due to delay in tariff notification. The only solution remains an increase in tariffs so as to counter future accumulation.

Outlook: Despite a hefty increase in electricity tariff in Jul'22, since then, PKR 700bn has piled up on account of numerous factors including 1) lower than expected power generation growth, 2) PKR depreciation (NEPRA tariff was set at a parity of PKR 200/USD, 3) lower recovery ratio at 83% as compared to last year average of 93%, and 4) higher T&D losses at 17.5% as compared to 15.0% during last year. We believe the gov't will pass on 50% of this amount (PKR 350bn) by increasing the power tariff by another PKR 6.2/kWh in Jan'23 (also recommended by the IMF), while the remaining amount will be adjusted in the FY24 tariff, where we believe that due to addition of low fuel cost based power plants including Thar coal (Shanghai, Thar Energy, Thal Nova), full impact of the nuclear power plant, the commencement of Nelum Jhelum, fuel cost is expected to decline significantly and the remaining amount will be adjusted against it. On the gas side, we believe that the gov't will raise the gas tariff (expected in Jan'23, also recommended by the IMF) as it was already approved by the ECC, and cabinet approval is pending at the moment.

Export competitiveness - Supply of gas and electricity to exporters with competitive pricing: With an intention to restore the export competitiveness of Pakistan, the government has decided to supply gas and electricity to exporters of five zero-rated sectors at competitive rates. The government has prescribed a price of USD 9.0/mmbtu for gas, along with a priority allocation and a fixed price of PKR 19.99/kWh for electricity.

Outlook: We believe that these policies will continue for the export-oriented sectors.

External financing Gap - IMF negotiations underway + Assistance from friendly countries: According to our estimates, the FY23 current account deficit is expected to arrive at USD 7.4bn coupled with debt servicing of nearly USD 20.5bn. Cumulatively, the gross external financing requirement clocks in at around USD 28bn.

Outlook: With the expected revival of the IMF program in 1QCY23, the fund is expected to finance part of this requirement while the remaining amount is expected to be contributed by multilateral and commercial borrowing alongside support from friendly countries including Saudi Arabia, China, and Qatar. However, we believe that post-election, the new gov't will opt for another IMF program and key structural reforms are likely to be implemented including but not limited to 1) Tax reforms and an increase in the tax net, 2) Further energy sector reforms, 3) Privatization of SOEs, 4) shift from untargeted subsidies to targeted subsidies, and 5) Expenditure control.

Privatization - Quick way to raise USD: At a time when the government needs additional flows, a quick way to raise funds is to undertake the privatization of state-owned enterprises (SOEs). Not only will this allow immediate fundraising, but it will also allow the private sector to bring in efficiencies to run these companies which will eliminate further fiscal damages in the future. Moreover, it will allow the government to focus on governance, which should be its primary responsibility. Historically, Pakistan has raised USD 2.6bn from FY05 to FY08 from privatization proceeds. However, during the last 4 years, no major deal has concluded on this front.

Outlook: The consultation and execution on privatization should be conducted on a war footing basis and at least on the transactions which are easier to execute including 1) sell off of RLNG power plants (Haveli Bahadurshah 1,230 MW and Balloki 1,223 MW), 2) Distribution Companies (DISCOs), 3) Real estate properties owned by federal gov't (domestic and foreign), and 4) Oil and Gas exploration sector companies after clearance of circular debt including OGDC, PPL, and MARI.

Capital Raising & Buybacks

Equity IPO during CY22: A total of three (3) equity IPO transactions were witnessed in CY22 as compared to eight (8) IPOs in 2021. Total transactions include 2 main board listings including the Pakistan First Developmental REITs project namely Globe REIT Residency, and Adamjee Life Assurance Company Ltd. Meanwhile, one gem board listing of Supernet was also executed this year. All these companies listed on the Pakistan Stock Exchange managed to raise PKR 1.3bn in CY22.

Exhibit: Equity capital raising during CY22 (IPO)

Company	Amount Raised (PKR mn)
Adamjee Life Assurance Company Ltd.	700
Supernet Ltd.	475
Globe Residency REIT	140
Total	**1,315**

Source (s): PSX, AHL Research

Capital raising through the right issue: A total of five (5) companies issued right shares in the outgoing year, raising PKR 8.8bn in capital. The trend of capital raising through right remained weak in CY22 amid overall economic challenges and a slowdown in economic activity.

Outlook for IPOs in 2023: We are expecting approximately 4-5 new IPOs in FMCG, Pharma, Technology and Textile sectors with an estimated capital raising of PKR ~7-8bn.

Buybacks in 2022: In CY22, six (6) companies have announced a buyback amounting to PKR ~31bn. We also believe that more companies are expected to announce buybacks given historic low multiples and confidence of sponsors to buy back their companies at enticing valuations, rather than routing the investment to other avenues at present.

Exhibit: Equity capital raising during CY22 (Right Issue)

Company	Amount Raised (PKR mn)
Flying Cement Company Ltd.	3,000
Pak Electron Ltd.	5,017
East West Insurance Company Ltd.	136
Oilboy Energy Ltd.	150
Cordoba Logistics & Ventures Ltd.	500
Total	**8,803**

Source (s): PSX, AHL Research

Exhibit: Buy Back during 2022

	Shares (mn)	Amount (PKR mn)
Completed Transactions		
NetSol Technologies Ltd.	2.0	184
Maple Leaf Cement Factory Ltd.	25.0	669
Bank Alfalah Ltd.	200.0	6,043
Sub Total		**6,897**
Ongoing Transactions		
Engro Corporation Ltd.	70.0	18,340
Lucky Cement Ltd.	10.0	4,465
JDW Sugar Mills Ltd.	2.0	876
Sub Total*		**23,681**
Total		**30,578**

Source (s): AHL Research, *@current market price

Events to Watch Out

JAN' 23
- Conversion of Faysal Bank Limited to Islamic Bank*
- COD of 3.15mn tons p.a Brownfield expansion of FLYNG
- Local Government Polls in Karachi and Hyderabad
- IFRS 9 to be implemented across the banking sector
- Gas and electricity hike expected
- Monetary Policy Meeting on 23rd Jan' 23

FEB' 23
- Expected Completion of Ninth IMF Review
- BMR of TBB Plant of PTL
- T Bills worth PKR 0.9tn to be matured

MAR' 23
- Monetary Policy Meeting on 16th Mar'23
- COD of Hydrogen Peroxide Project of EPCL

APR' 23
- Monetary Policy Meeting on 27th Apr'23

MAY' 23
- Commencement of Hosiery Plant VI of Interloop
- MSCI Quarterly Review

JUNE' 23
- Monetary Policy Meeting on 12th Jun'23
- Federal Budget 2023-24
- COD of Mi.Da. plant of AGHA
- Launch of locally assembled Panasonic Smart TV by PAEL
- 35th OPEC and non-OPEC Ministerial Meeting
- COD of 2.16mn ton p.a Brownfield expansion BWCL
- First spud-in at Block 5 of Abu Dhabi Block by consortium (OGDC, PPL, MARI & GHPL)

JUL'23
- COD of 1.28mn ton p.a Brownfield Expansion by ACPL

AUG' 23
- Commencement of production from Bannu West (MARI)
- MSCI Quarterly Review

SEP' 23
- Retirement of CJP Umar Atta Bandial and appointment of new CJP (expected)
- MSCI Quarterly Review

OCT'23
- General Elections scheduled

NOV' 23
- COD of OGDC's Dakhni Compression project
- Off-Year Elections in USA

DEC' 23
- MSCI Quarterly Review
- Expiry of GSP+ scheme

Sector Events
Economic Events
Political Events

*Already notified by FABL

Why index lagged behind our 2022 target of 55k pts

1. Domestic political chaos

Ouster of incumbent Prime Minister: 2022 was a melting pot of one political crisis after another. It all began with the submission of opposition's no-confidence motion against ex-Premier Mr. Imran Khan on 28th March as key coalition partners as well as more than dozen MNAs from the ruling PTI switched sides. The ruling by the Deputy Speaker to reject the no-confidence motion on 3rd April and subsequent dissolution of the National Assembly led to another constitutional crisis which was finally resolved by intervention of the Supreme Court which ordered the NA secretariat to hold the no-confidence vote on 9th April finally leading to ouster of incumbent PM Imran Khan. Unfortunately, the political crisis didn't end there as ousted PM Imran Khan took to the street with massive rallies across the country leading to more political turmoil. The result of all this political tug of war was 1.8% decline in the KSE 100 index within a few weeks.

2. Delays in IMF review

While the country needs a dot plot to economic recovery, it became increasingly hard to focus on policies that could fix external account deficiencies, and control inflation while underscoring the need to dial back towards moderate and sustainable growth. In addition, it remained imperative to follow stringent conditions of the IMF in order to secure other external financing. This has come at a cost though. While demand slowdown had already been put in motion as a result of lower disposable income and tighter financial conditions, a spectrum of pre-requisites of the IMF to observe strict fiscal discipline left little room for demand growth. Therefore, multiple delays in the program during the year proved to be a challenge for the sentiment at the index.

3. Massive external financing requirement / Default doubts

With multilateral and bilateral partners of Pakistan looking towards a signal for the IMF to release funds, delays in the IMF program triggered a debate with respect to the country potentially defaulting on its massive external payments this year. Although unlikely since many loans of the USD 32bn scheduled repayments in FY23 have either been rolled over or paid on time, panic created through this discussion gained traction due to the continuous slide in FX reserves from USD 18bn at the beginning of the year to USD 6bn at present. This was a major dampener for the index.

4. Commodity crisis post Russia-Ukraine War

The war in Europe had serious consequence for the global economy at large. With Russia being the second largest exporter of oil and the largest exporter of natural gas in the world, concerns grew of eminent sanctions on the country, disrupting global supply. As a result, international metals and commodities touched new highs. For a country like Pakistan, which is a net importer of petroleum products, this was particularly detrimental. While the PKR / USD parity was the first line of defense to deal with the external shocks (inflated import bills, the SBP had to make use of the second line of defense i.e., “interest rates” to curb the demand-pull inflation.

Rising inflation, higher interest rates, PKR depreciation and increasing domestic fuel prices kept businesses under pressure - Persistent oil price hike has been contributing to the poor market performance. The upsurge was mainly attributable to global demand supply imbalances. Being an import driven economy, Pakistan remains one of the major victims of this dramatic hike. High oil prices have translated into increased production costs for major industries and increased pressure on the external account.

5. Power tariff hike

In order to take account of high imported fuel costs, the government allowed fuel price adjustment of PKR 6.2/kWh, causing another dent to industrial profitability and hence, market performance.

Market Review

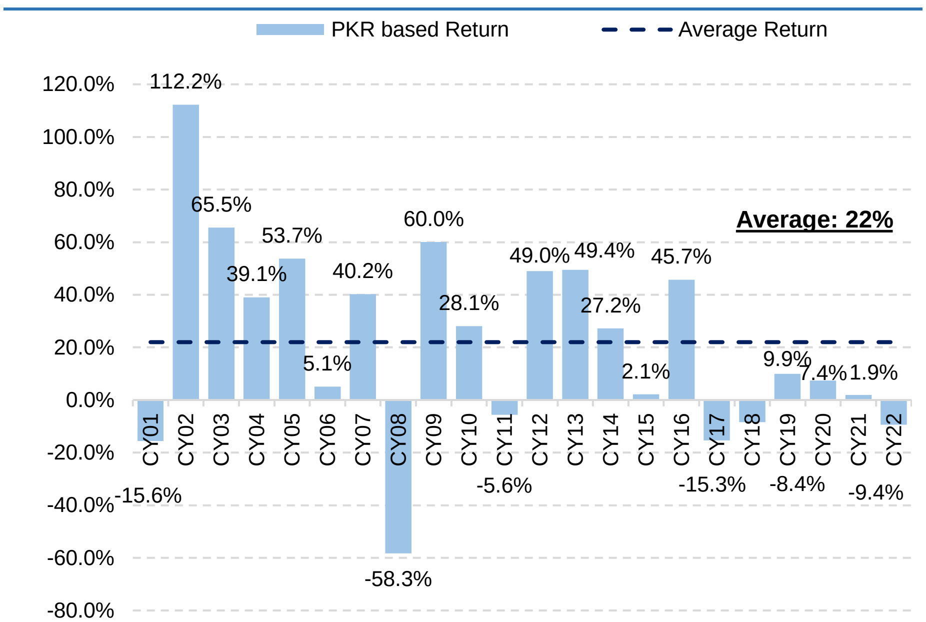
Equity market meltdown of 2022

While nervousness ruled almost all asset classes in 2022: stock market, bond yields, and the currency, we believe that for the past few years, the KSE-100 index returns have not caught up with valuations. There has been an understandable lack of conviction as investor's awaited clarity. The equity bourse posted an exceptionally dismal performance during CY22, eroding positive returns realized by the market in the past three years, to close at 39,669 points (down by 4,927 points, -11% YoY). In USD terms, the return was even more disappointing (-30.4% YoY) given the relentless pressure on the Pak Rupee in the outgoing year.

Having said that, we find it pertinent to highlight that despite the year being relatively disappointing for equity market investors, PSX fared much better in terms of local currency return compared to other international markets. Panic was observed in most stock indexes, which suffered greatly amid uncertainty in the global economic climate stemming from stringent monetary tightening to combat high inflationary readings post commodities' spikes. Without price stability, and stable growth in the labour market, slow down in aggregate demand compounded fears of an imminent recession in the US and Europe. Whereas a dire geo-political scenario, bearing in mind the Russia-Ukraine war and China-Taiwan conflict, further eroded the sentiment.

While global investors sided with caution, market participants of the domestic bourse also took account of the political impasse in Pakistan, which began well before the ex-Premier was removed by a vote of no confidence, but as an aftermath further created polarity in the country. Moreover, a spectrum of economic issues triggered by another external account crisis and an ongoing bout of high CPI, which despite multiple policy rate hikes during the year, also overshadowed any positive news. Some temporary spikes were seen particularly as the landmark agreement of the Reko Dig was reached between the Federal and Baluchistan government with Barrick Gold Corporation, and Pakistan made an exit from the FATF Grey List in Oct'22 after a 4-year stint.

Figure: KSE-100 historical returns (PKR based)



Source (s): PSX, AHL Research

Detailed summary of the year

Although the market commenced on a celebratory note aided by foreign buying, IMF disbursement of USD 1bn tranche, and successful issuance of a USD 1bn Sukuk within the first two months of the year, sentiment shifted quickly amid crumbling global political order. As Russian forces commenced a military operation in Ukraine during the end of Feb'22, worldwide equities quickly recoiled whereas commodities summersaulted to new highs. Shortly after, the domestic political climate heated up as well with the joint opposition submitting a no-confidence motion against the Premier in the National Assembly in Mar'22.

The market made some sweeping swings post that; some temporary spikes were seen particularly as the landmark agreement of the Reko Dig was reached between the Federal and Baluchistan government with Barrick Gold Corporation, and the outgoing government announced a subsidy on petrol and power. However, uncertainty in the subsequent weeks painted the market red, with the Rupee tumbling significantly to almost PKR 188/USD, and the SBP increasing the benchmark policy rate by 250bps to 12.25% in an emergency monetary policy meeting on account of high inflationary concerns.

Following that, as the leader of the opposition in National Assembly was elected as the new Prime Minister unopposed, and the Pak Rupee also demonstrated some recovery in Apr'22, the market posted a relief rally. This however, remained short-lived as derailment in the IMF program and jump in T-Bills yields, signaled further monetary tightening in the backdrop of rising CPI. The currency continued to bleed as the reserves fell to multi-year low levels, the SBP resorted to another rate hike, while political noise took over with the ex-PM threatening to march towards the capital. Slowly but surely, we witnessed fundamentals fade in the background; record high profitability of the KSE-100 index could not do much either.

By mid-year, risks to the external account became more adverse and three credit rating agencies (Moddy's, Fitch and S&P Global) downgraded Pakistan's outlook from neutral to negative. Despite tailspin in economic conditions, a silver lining appeared during Jul'22, with the government reaching a staff level agreement with the IMF. A solid bounce back was witnessed at the bourse amid further reassurance by friendly countries (Qatar and Saudi) of over USD 4bn pledged for investments.

Positivity had just about returned to the index, when devastating floods in the country once again triggered selling at the bourse during Sep'22, with investors taking account of the destruction. It was during the same time that an assurance from the new Finance Minister aided a swift recovery in the PKR and calmed market participants. Albeit, the sentiment could not persist for long after Moody's highlighted increasing risks to liquidity and external vulnerability, and cut Pakistan's sovereign credit rating from B3 to Caa1.

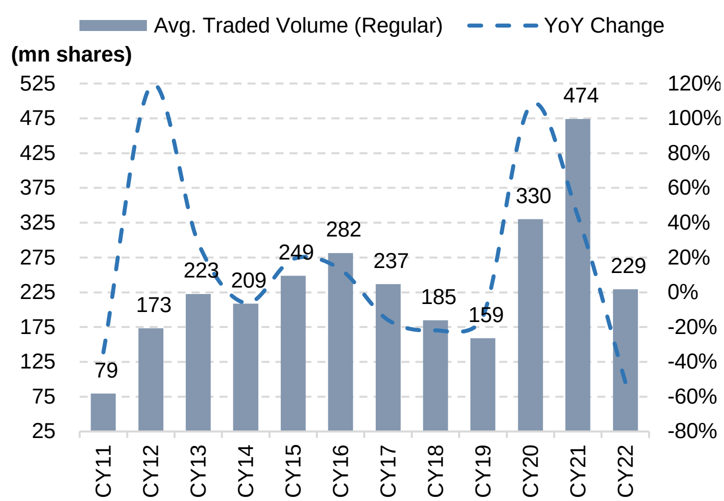
Meanwhile remarks by the US President regarding Pakistan's ability to protect its nuclear assets also irked investors, but it was finally put to rest when a Whitehouse correspondent issued clarification, and Pakistan made an exit from the FATF Grey List in Oct'22 after a 4-year stint.

Euphoria continued in the next month given expectation of an improvement in FX reserves aided by the support of multilateral and bilateral partners. Some jitters were observed in the wake of a surprise 100bps hike by the SBP, however it seemed almost imperative to initiate the IMF's 9th review.

Timely repayment of the Bond in Dec'22 was received with a sigh of relief, yet the market tanked lower by each day as a delay in the IMF's review once again picked up the default debate. Simultaneously, a political quagmire drew attention as the "to dissolve, or not to dissolve assemblies" dilemma took center stage, and plunged the index below the 40,000 level. Whereas stories of stringent pre-requisites for the IMF program did little to lift the mood, as we drew the curtains to 2022.

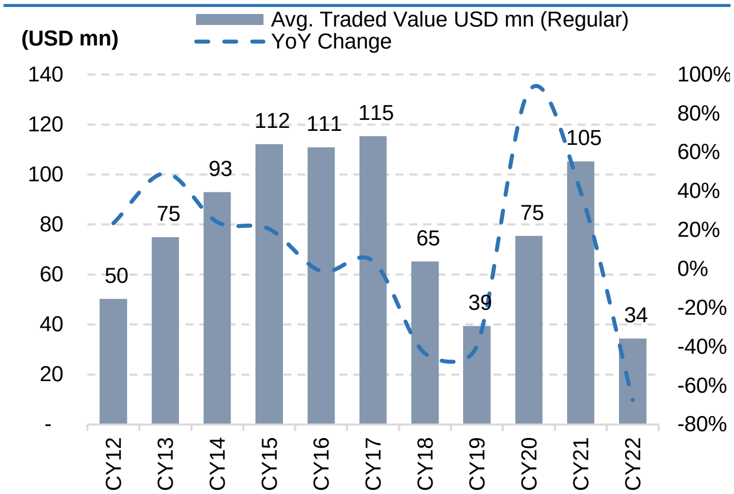
Market fails to garner activity: With the stock market undergoing profound uncertainty, investors chose to remain sidelined. Average traded volume for the year settled at 229mn shares, down by a mammoth 52% YoY, while average value trade shrunk drastically by 67% YoY to USD 34mn.

Historical Average Traded Volume



Source (s): PSX, AHL Research

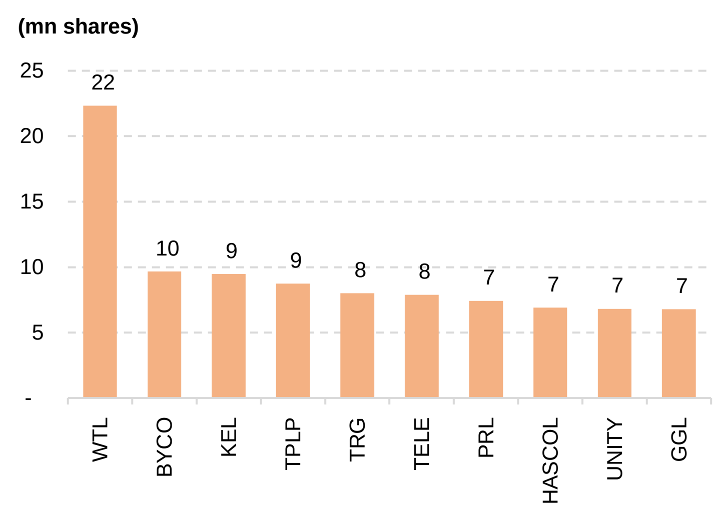
Figure: Monthly Average Traded Value



Source (s): PSX, AHL Research

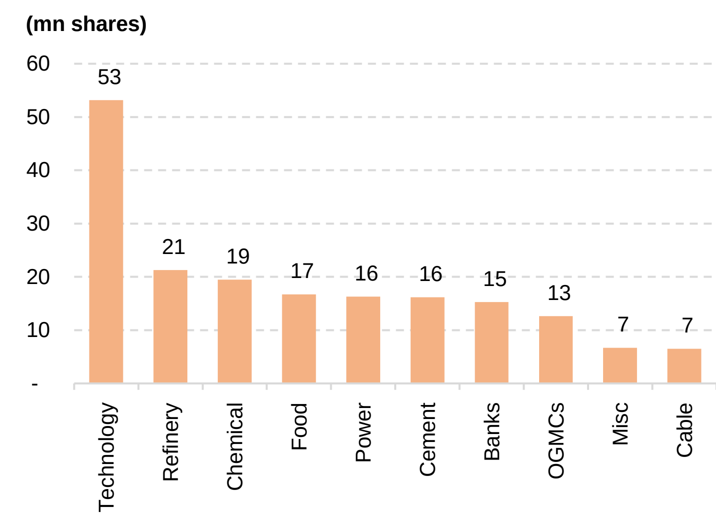
Volume leaders during CY22: Sectors that attracted the most activity during the period were Technology & Communication, Refinery, Chemical, Food & Personal Care and Power registering average volumes of 53mn, 21mn, 19mn, 17mn and 16mn, respectively. Whereas on a scrip-wise basis, volumes were led by WTL (22mn), BYCO (10mn) and KEL (9mn).

Figure: Top Scrip-wise Volume Leaders (CY22)



Source (s): PSX, AHL Research

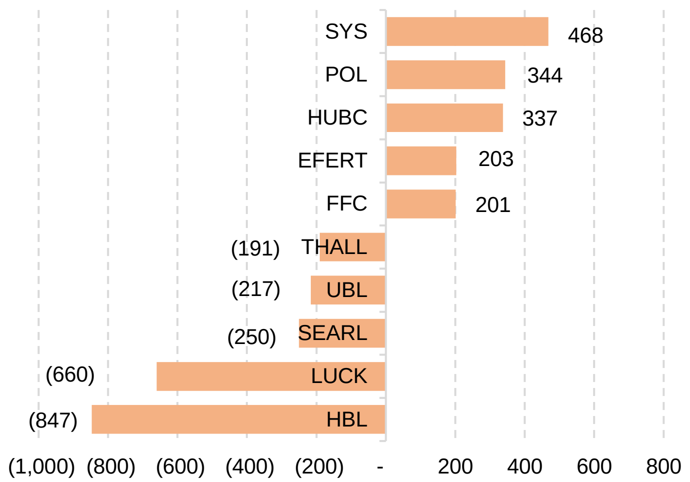
Figure: Top Sector-wise Volume Leaders (CY22)



Source (s): PSX, AHL Research

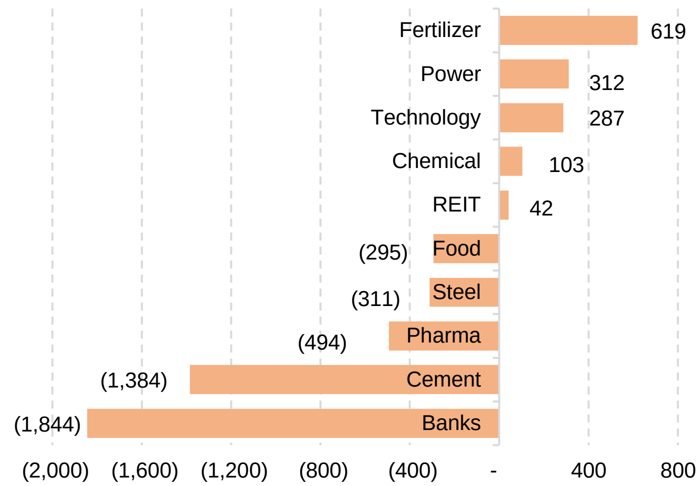
Index contribution (gainers vs. losers): Top negative index contributing sectors remained Banks (1,844pts), Cement (1,384pts), Pharma (494pts), Steel (311pts) and Food Producers (295pts). Whereas key gainers comprised of Fertilizer (619pts) followed by Power (31pts), Technology & Communication (287pts), and Chemical (103pts). Meanwhile, scrip wise top contributions to the downside were HBL (-847pts, 46% of total Banking sector contribution) amid ongoing lawsuit in the US, LUCK (-660pts, 48% of total Cement sector contribution) due to weaker sector dynamics led by demand slowdown coupled with high coal prices, and SEARL (-250pts). Scrip wise positive contributors were i) SYS (468pts) given organic sales growth and USD appreciation which aids the company's Dollar denominated revenue, ii) POL (344pts) on account of high international oil prices, and iii) HUBC (337pts) owed to robust payout post resolution of circular debt.

Figure: Top Scrip-wise Index Contributors (CY22)



Source (s): PSX, AHL Research

Figure: Top Sector-wise Index Contributors (CY22)

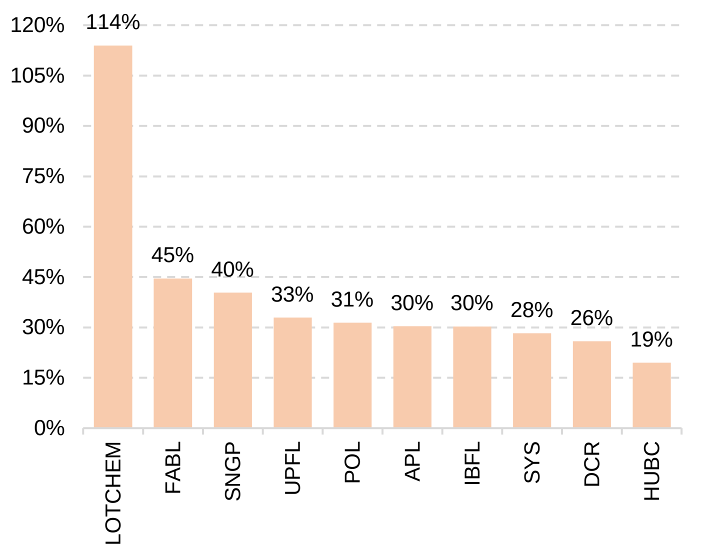


Source (s): PSX, AHL Research

Major Gainers and Losers

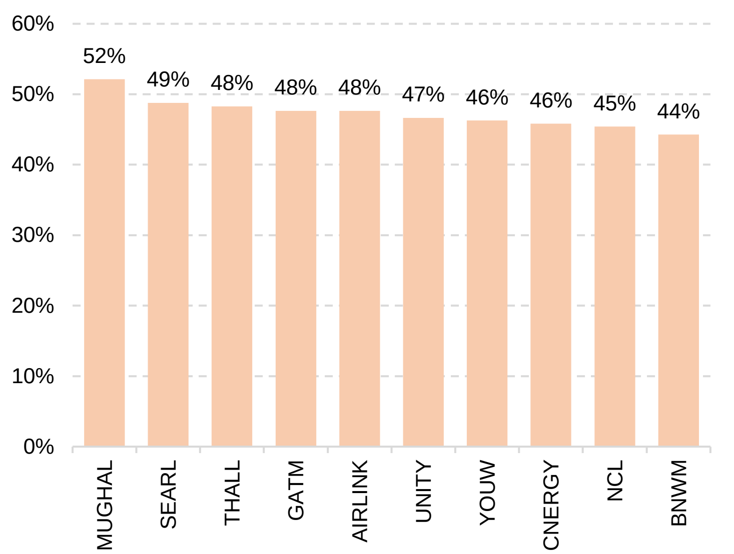
- Scrip-wise performance chart during the year was led by LOTCHEM, FABL and SNGP, each posting significant returns of 114%, 45%, and 40% respectively. On the flip-side, MUGHAL, SEARL and THALL posted the most negative returns (52%, 49% and 48% respectively).
- In terms of sectors, Synthetic & Rayon sector was leaps ahead of the rest, closing the year at +30%, followed by Real Estate (+26%) and Power (+12%). Negative returns were led by Automobile Assemblers (48%), Textile Weaving (46%) and Woolen (44%).

Figure: Scrip wise major gainers (KSE100)



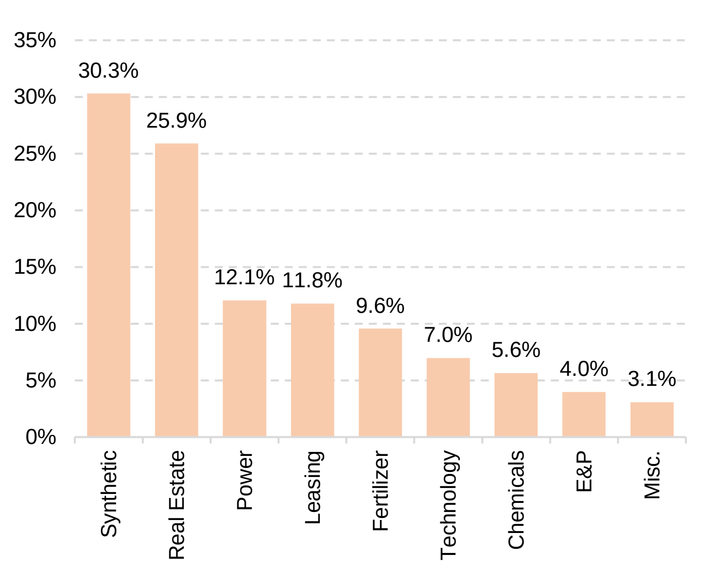
Source (s): PSX, AHL Research

Figure: Scrip wise major loser (KSE100)



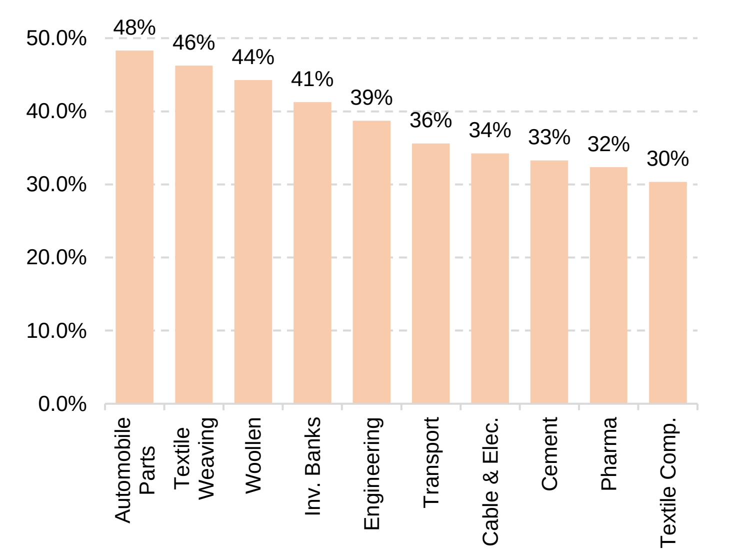
Source (s): PSX, AHL Research

Figure: Sector wise major gainers (KSE100)



Source (s): PSX, AHL Research

Figure: Sector wise major losers (KSE100)



Source (s): PSX, AHL Research

Foreign Investors Portfolio Investment (FIPI)

Global mishaps coupled with domestic political uproar: The war in Ukraine unveiled a rare ambiguity over European energy security and the primary energy supplier of the region: Russia. Immediate global uproar, particularly over fear of supply disruptions, blew up key commodities and rattled stock markets. As a result, a rout of foreign interest was witnessed in all major economies (net selling in the Asia Pacific region settled at a massive USD 60.5bn). Simultaneously, domestic political climate turned murky, with an abrupt end in the tenure of former PM Imran Khan at the hands of his joint opposition. Whereas local fundamentals also showed deterioration amid persistent pressure on the exchange rate coupled with rising price levels led by widening external account deficit. As a result, foreigners remained net sellers during CY22 with outflows from PSX arriving at USD 48.0mn, compared to USD 359mn last year. Pertinently, the quantum of foreign selling has come down significant over the last few years, as the outstanding foreign investment as a percentage of free float market cap has compressed to just 16.7% in 2022 against 29.4% in the last decade.

Sector-wise offloading: Major foreign offloading was witnessed in i) Commercial Banks (USD 127mn) given impact of economic slowdown on Banking NPL's and some compliance issues in large banks, ii) Cement (USD 15mn) owed to demand slowdown coupled with high coal prices, and iii) Fertilizer (USD 13mn) attributable to demand erosions post floods and high fertilizer prices.

Locals absorb foreign selling: On the domestic front, foreign selling was absorbed by Banks / DFIs (USD 137mn), Individuals (USD 133mn), and Companies (USD 74mn) in CY22TD. Whereas main offloading was undertaken by Mutual Funds (USD 181mn) and Insurance Companies (USD 130mn).

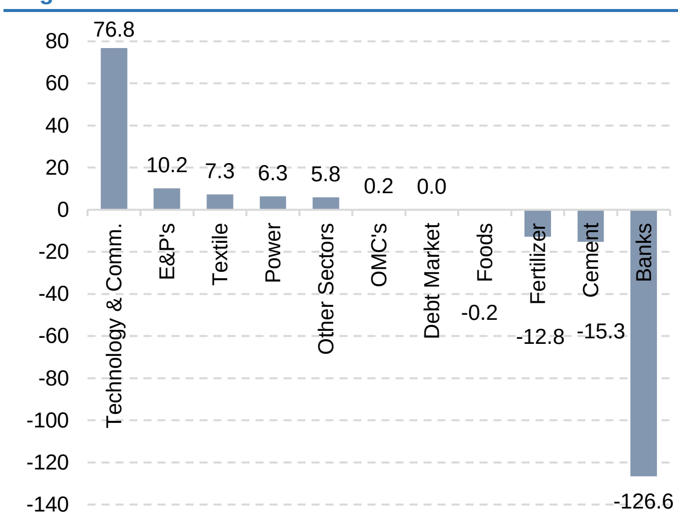
Region sees massive inflows during CY22: Foreign exodus in the region settled at a massive USD 60.5bn during 2022 led by the invasion of Ukraine by Moscow and rising economic tensions engulfing major economies. Major selling was witnessed in Taiwan (USD 44.6bn), India (USD 16.9bn), and South Korea (USD 9.9bn). However, inflows were observed in Thailand (USD 5.7bn), Indonesia (USD 4.0bn), and Malaysia (USD 1.1bn).

Exhibit: LIPI Activity, CY22 (Net, USD mn)

Banks | DFI	137
Individuals	133
Companies	74
Other Org.	34
NBFC	-3
Brokers	-15
Insurance	-130
Mutual Funds	-181
Total	**48**

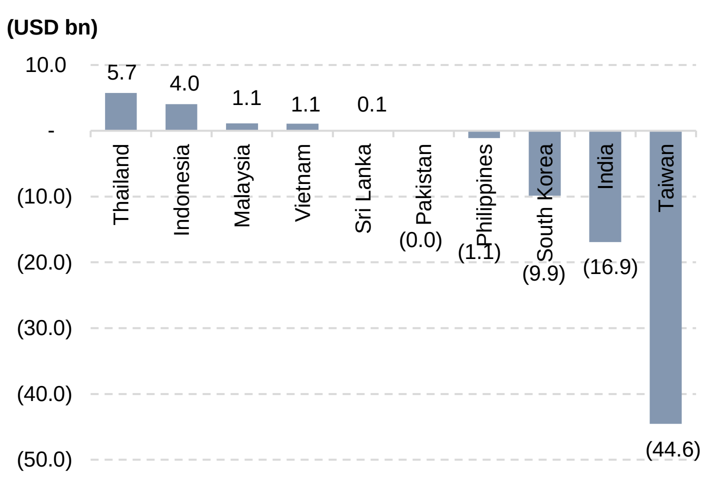
Source (s): NCCPL, AHL Research

Figure: Sector wise FIPI CY22



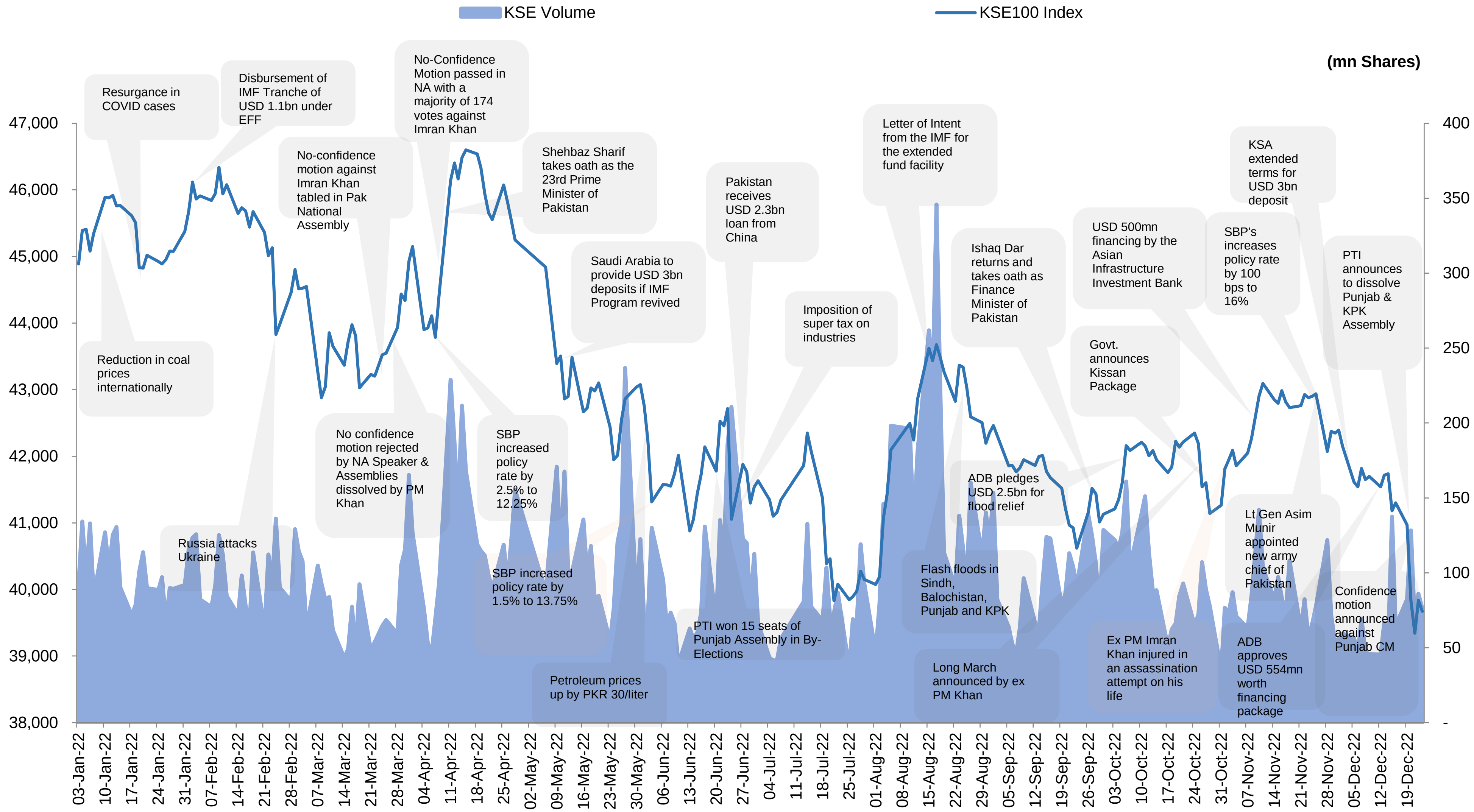
Source (s): PSX, AHL Research

Figure: Regional Portfolio Investment during CY22



Source (s): PSX, AHL Research

KSE100 Event Graph



Commercial Banks

Cheap valuations on offer

Commercial Banks

Cheap valuations on offer

Paving the way through changing dynamics: The out-going year turned out to be a bull-case in terms of profitability of the banking sector in Pakistan. However, this performance was not a smooth ride with rising inflation, demand disruption, high international commodity prices, geo-political situation and other macroeconomic indicators causing impediments to growth of not just banks, but the economy in general. One thing did not change, however: valuations. To-date, banks in Pakistan continue to trade at a steep discount (0.6x - based on P/B, 3.8x based on P/E) to the KSE-100 index, making them a good buy at current levels with fundamentals on track.

Little change expected in IDR: The overall industry deposits currently stand at PKR 22.2trn as at 09-Dec-2022 showing an average growth of 13% CAGR for the past 5-yrs. We have assumed industry deposits to grow at the same pace till CY23. The important thing to be noted here is that the utilization of funds is predominantly being placed in investments, and showing little signs of subsiding despite ADR-related taxes introduced by the government in the FY23 Budget. To highlight, ADR ratio stood at 49% in Nov'22, -25bps YoY | -52bps MoM. IDR clocked-in at 81% in Nov'22, +1238bps YoY | -28bps MoM. As evident from the ratios, despite challenges like slow industrial activity and rising interest rates, advances grew decently during CY22TD, marking an uptick of 11%. Additionally, private sector offtake is yet to pick up, depicting a rise of just 6.9% in 11MCY22, given the level of interest rates prevalent in the economy. Hence keeping growth in ADR subdued.

Testing times for asset quality: The percentage of NPLs over gross advances has been relatively stable during CY17-CY21, averaging at 8.32%. We have assumed a slightly rising trend in NPLs industry wide as advances grow, although generally banks have worked on their risk frameworks and additionally remain cautious with the challenges companies are facing in these tough economic times. We expect banks' to be resilient to a moderate macroeconomic deterioration given sound asset quality metrics. This is also evident from the industry NPL growth of PKR 860bn in CY21 to PKR 898bn as of Sep'22. Moreover, as of Sep'22, the sector's infection ratio arrived at 7.6% (SPLY 8.8 %).

Interest rate cycle reversal to put pressure on NIMs: Banking spreads have consistently declined over the past 10 years, averaging at 5.6% (CY12-CY16), 5% (CY17-CY21) and 4.8% (11MCY22). NIMs are expected to improve slightly in the first half as interest rates are expected to clock hike higher than current levels, before declining in 2HCY23 when SBP shifts focus towards expansionary stance.

Key developments to look forward to in CY23

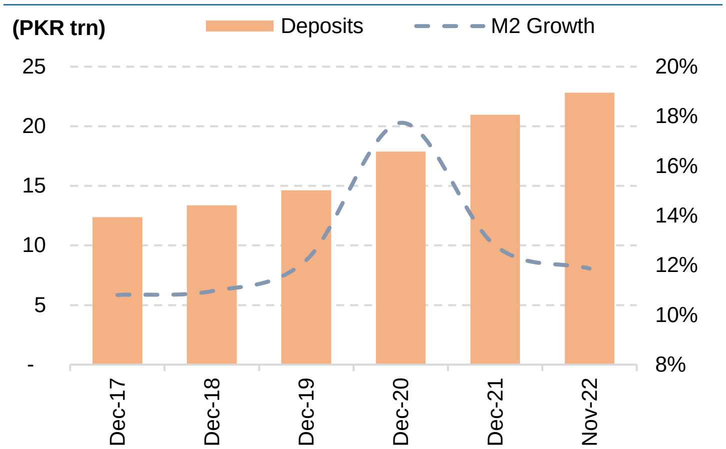
- With headline inflation gradually coming down leading to reversal in the policy rate cycle, we estimate a 300bps policy rate cut in CY23 to 14%, therefore, we project banks' NIMs to come down in the latter half of the year. Banks, as a counter measure, are likely to shift their income mix accordingly, from interest based to non-interest.
- Islamic banks are consistently performing well competing head-on against conventional banks. Moreover, the recent stance of government and other official authorities to promote interest-free banking makes way for further growth in this arena.
- IFRS-9 is expected to be implemented from Jan'23, and as a result, provisioning expenses are estimated to rise as the expected credit loss approach will change

the way impairments are viewed. However, in their corporate briefings, almost all the banks informed that the impact of testing IFRS 9 has been done at their end, and they do not see any major consequence on profitability going forward.

Key Risk (s)

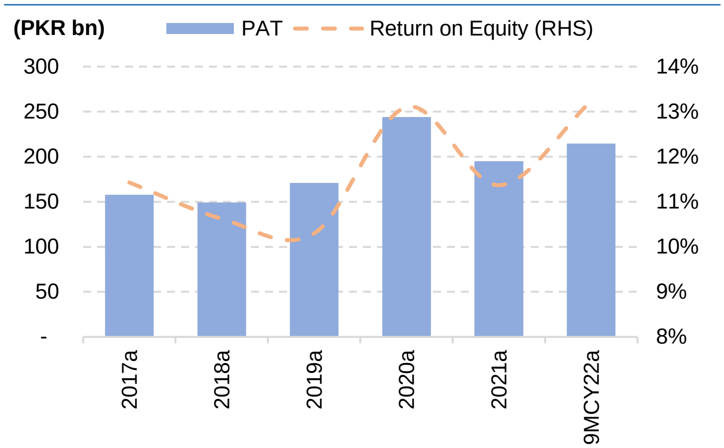
- Further stretch in global economic slowdown and geo-political instability to adversely affect international operations & loan book quality.
- Re-emergence of the Non-Performing Loans amid any deterioration in macros and unfavorable changes in the interest rate environment.
- Weaker-than-expected revival in trade finance activities, due to recession faced by global economies, will weaken the bank's non-interest income. This includes lower trade related income.
- Additional tax in case of ADR falling below 50% will result in higher effective tax for non-compliant banks.
- Reversal of interest rate cycle in 2HCY23 to dent earnings of the banks, likely leading to lower NIMs, going forward.

Figure: Deposits vs. M2



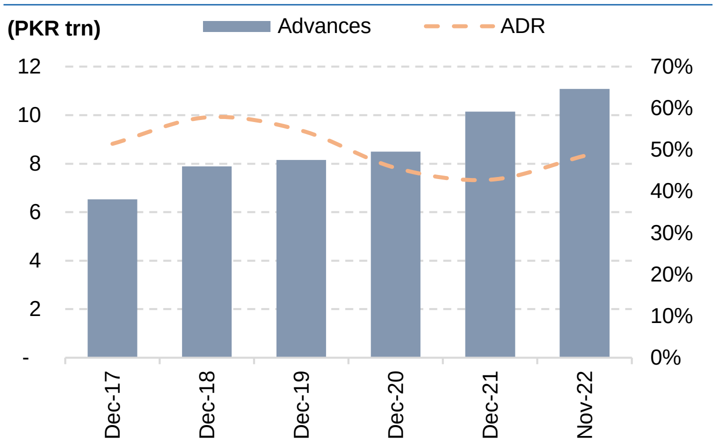
Source (s): SBP, AHL Research

Figure: Profitability Trend of Commercial Banks



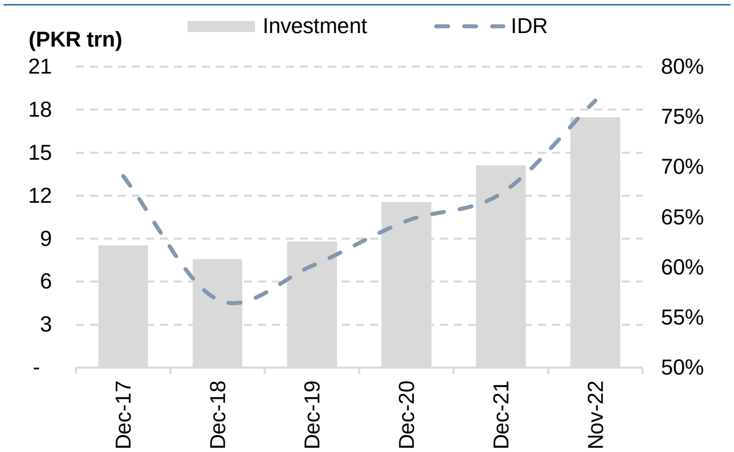
Source (s): SBP, AHL Research

Figure: Advances- Commercial Banks



Source (s): SBP, AHL Research

Figure: Investments- Commercial Banks



Source (s): SBP, AHL Research

United Bank Limited (UBL)

Pivoting around core strengths

Targeting to minimize cost: Bank's focus on increasing the CA portion resulted in an improved average current account to deposit ratio (as at Sep'22) to 44.3% against 42% in 9MCY21. Average CASA slightly increased to 85.8% compared to 85.5% recorded in 9MCY21**.** However, the bank's cost of deposit increased to 5.9% in 9MCY22 as against 3.5% in 9MCY21 due to interest rate hikes in the period under review. Going forward, UBL will be optimizing its branch network through maintaining aggressive acquisition across the target market, which would lead to enhanced 'low cost' deposit growth and increase its market share.

Diversifying portfolio: UBL aims to build a well-diversified portfolio across long term and floating rate assets going forward, seizing trading opportunities. Currently, out of the total investment portfolio of the bank, PKR 483bn is invested in fixed-income PIBs while PKR 481bn is invested in a floating PIB portfolio. Around PKR 306bn is invested in T-Bills, yielding 15.3%. Moreover, the average yield on fixed income PIBs is 11.3% while floating rate PIBs have an average yield of 15.8% as of Sep'22. The weighted average duration of a fixed bond portfolio is ~3 years. On the international investment book, there are no major maturities of Eurobond this year and the portfolio is stratified out to 2025, 2026, 2027, and 2031. Further, the full impact of asset repricing will be also be reflected in the first half of the upcoming year.

Quality asset growth; de-risking strategy continues: The international business has portrayed improvements with the GCC economies seeing a recovery. However, global recession still remains a concern. On the domestic front, the coverage ratio stands at 90%, while the international book is 94% covered of which Bahrain and Qatar are 100% covered. In addition, UBL has also set a priority to improve its ADR ratio which currently stands at 35%. Moreover, during out-going 9Ms, UBL has recorded massive provisioning of PKR 6.8bn, out of which PKR 3.4bn has been booked on international books. Hereon, UBL focuses on the prudent and cautious lending approach to bring down the infection ratio which stands at 10.3% in 9MCY22, one of the highest in the industry.

Digital penetration- laying the foundations for a wider eco system: UBL has set up efforts to enhance its digital penetration across the country. It was able to enhance app registration by 30% YoY leading to increased customer transactions (up by 33% YoY). Payment throughput has reached up to 18tn (jump of 51% YoY). UBL has been able to approach a wider ecosystem through innovation and aims to increase its customer base.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	24.8	20.2	27.4
Dividend per share	PKR	18.0	17.0	20.0
Book value per share	PKR	186.5	180.3	185.5
Price to Earning	x	4.1	5.1	3.7
Price to Book	x	0.6	0.6	0.6
ADR	%	40.7	46.4	48.2
IDR	%	80.7	62.6	63.5
NIMs	%	3.6	4.0	3.7
RoE	%	14.0	11.1	14.9

Source (s): Company Financials, AHL Research

UBL

Summary Data

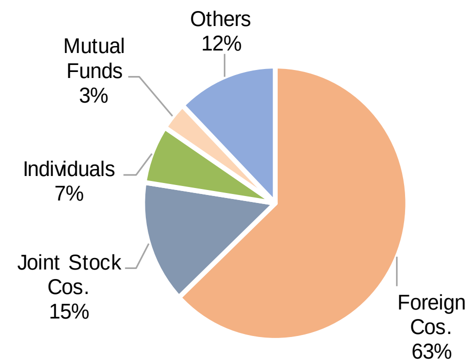
Target Price (Dec'23)	154.9
Last Closing	102.6
Upside (%)	51.0
Shares (mn)	1,224
Free float (%)	40.0
Market Cap. (PKR mn)	125,564
Market Cap. (USD mn)	556

Recommendation BUY

Price Performance

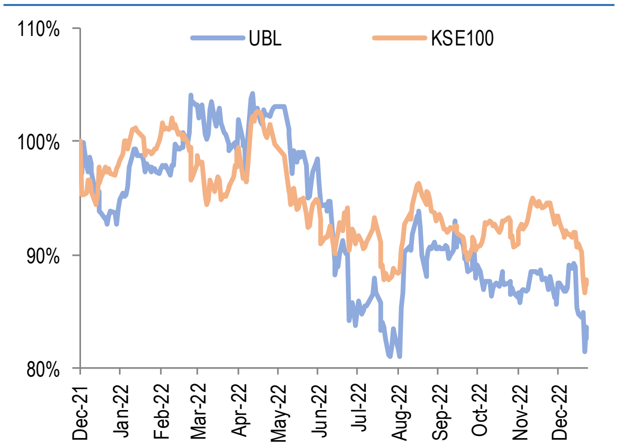
	3M	6M	12M
Return (%)	-6.7	-2.0	-11.6
Avg. Volume (000)	574	653	787
ADTV (mn) - PKR	63	74	100
ADTV (000) - USD	283	331	507
High Price - PKR	112.6	116.5	129.5
Low Price - PKR	101.3	100.7	100.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

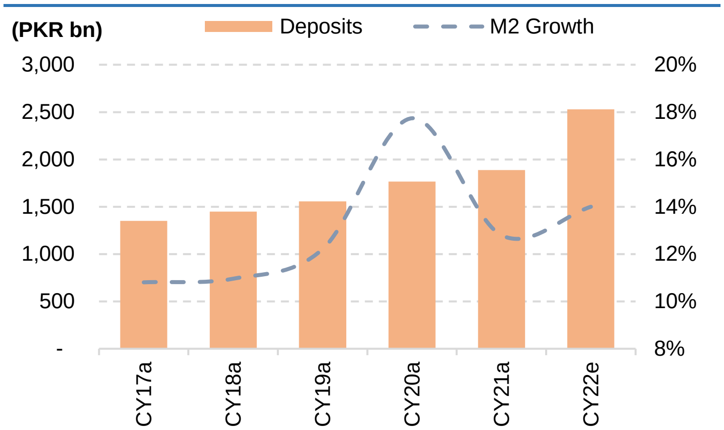
Exhibit: Key Financial Highlights(PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	74,736	92,750	107,846
Non-Mark-up Income	24,321	30,405	32,583
Total Income	99,399	123,579	140,812
Provisioning	(1,449)	13,249	15,242
OPEX	48,681	54,229	66,798
Post Tax Profit	30,622	24,684	33,500

Exhibit: Balance Sheet	CY21a	CY22e	CY23f
Advances	766,781	975,576	1,203,956
Deposits	1,885,772	2,527,354	2,830,636
Investments	1,521,467	1,582,490	1,796,214
Borrowings	565,173	252,735	283,064
Total Equity	228,314	220,737	227,142

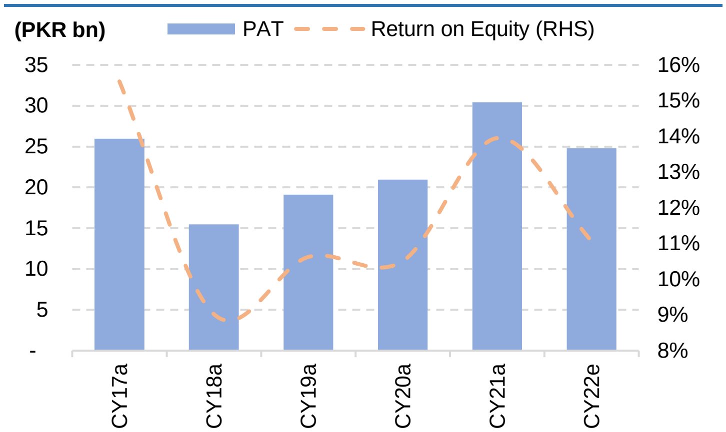
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



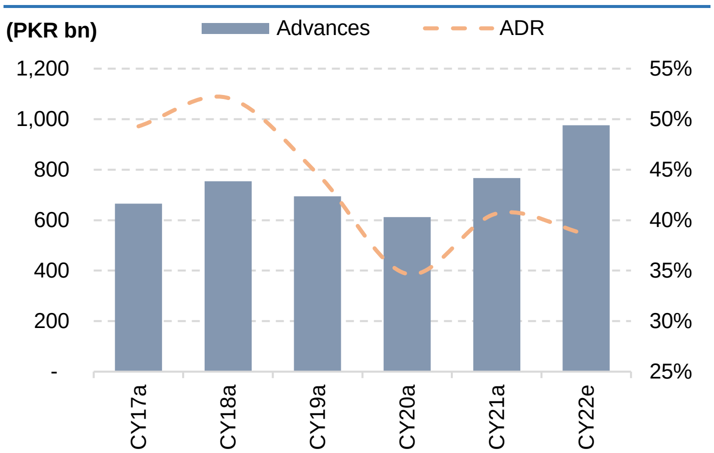
Source (s): SBP, Company Financials, AHL Research

Figure: Profitability Trend



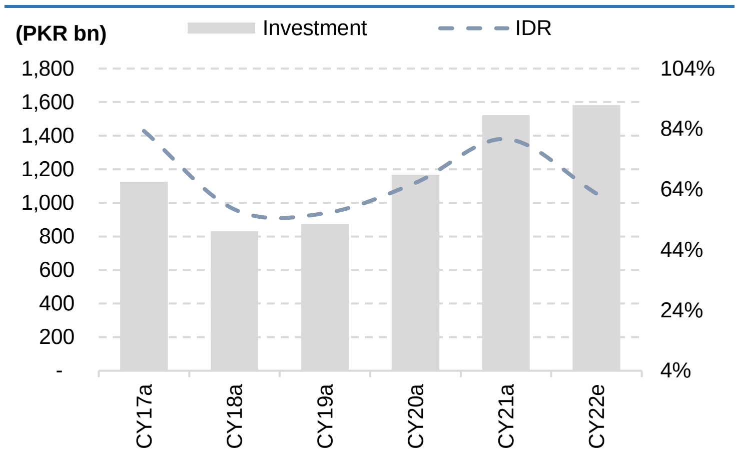
Source (s): Company Financials, AHL Research

Figure: Advances vs. ADR



Source (s): Company Financials, AHL Research

Figure: Investments vs. IDR



Source (s): Company Financials, AHL Research

MCB Bank Limited (MCB)

Strategically growing

Superior deposit mix: MCB has maintained one of the highest CASA in the industry over the years. Going forward, the bank will continue focusing on improving current accounts proportion, which rose to PKR 680bn as at Sep'22 from PKR 563bn as at Dec'21. With this, the bank's CASA improved from 92.2% (Dec'21) to 93.7% (Sep'22), much higher when compared to its peers. In the event of monetary easing which is expected in CY23, these deposits will be re-priced downwards immediately whereas the assets will be re-priced with a lag, thus giving NIMs a support and cushion to the top-line during 2HCY23.

Changing portfolio mix: The bank continues its risk averse strategy for its loan book evident from the flat advances number through the year. Currently the gross ADR of the bank is at 37% which keeps the bank below the threshold level of ADR-related tax. However, the management has clearly stated that by Dec'22 they expect the Banks ADR to be at 50%. The banks NPLs only increased 4% from Dec'21 to Sep'22. This can be accredited to its prudent lending and strict credit risk management. As at 3QCY22, MCB has recovered ~PKR 8bn out of 28bn. We expect provisioning to increase in the coming year as the bank plans to have an expansive loan strategy. As at Sep'22, the coverage ratio of the bank stood at 85.14% (Dec'21: 90.83%) while NPLs ratio clocked-in at 8.37% (Dec'21: 7.94%). An IDR of 66% (9MCY22) further clarifies the bank's wait and see approach as the current strategy aims at maximizing return from available asset classes (PIBs/T-Bills) till focus on lending resumes. Shift in gov't securities portfolio to floating and short-term instruments shows possible intent of the management to have a liquidity cushion incase lucrative lending opportunity arises. Going forward, we expect MCB's IDR to come down from current levels as our assumption is in line with the management's call of improving ADR by extending loans primarily to existing clientele. However, additional new funds arising from an increase in deposit base are expected to be channeled into investments.

Consistent dividend payout: Since CY18, MCB has maintained a stellar payout ratio of an avg. 82%, which drastically outperforms its peers' avg. payout ratio during the said period – HBL: ~37%, and UBL: ~76%. The stock has offered an avg. DY of 10% since CY16 while HBL has offered an avg. yield of 4.1% and UBL has provided an avg. yield of 9.7%. Overall CAR stands at 21.84% at Sep'22. We understand this high CAR will allow MCB to maintain a healthy dividend payout ratio going forward as well.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	26.3	24.9	32.8
Dividend per share	PKR	19.0	18.5	21.5
Book value per share	PKR	148.6	154.4	164.5
Price to Earning	x	5.6	4.5	3.4
Price to Book	x	1.0	0.7	0.7
ADR	%	44.7	45.5	45.7
IDR	%	69.2	72.3	70.4
NIMs	%	4.0	4.6	4.3
RoE	%	16.9	16.4	20.6

Source (s): Company Financials, AHL Research

MCB

Summary Data

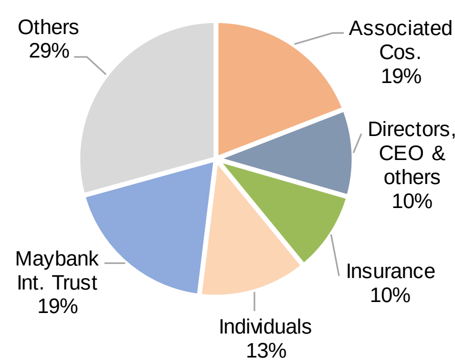
Target Price (Dec'23)	173.3
Last Closing	111.5
Upside (%)	55.4
Shares (mn)	1,185
Free float (%)	35
Market Cap. (PKR mn)	132,122
Market Cap. (USD mn)	586

Recommendation BUY

Price Performance

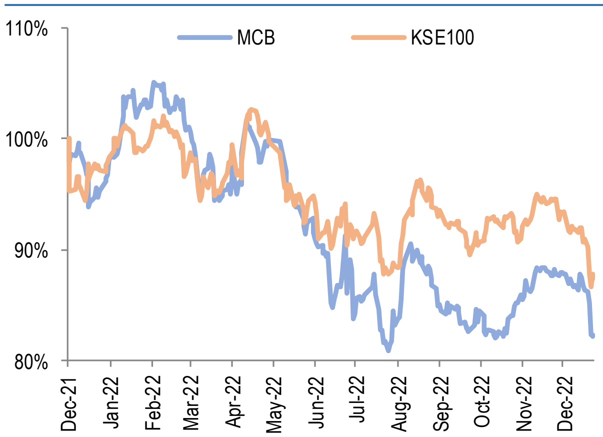
	3M	6M	12M
Return (%)	-0.6	-4.5	-13.3
Avg. Volume (000)	328	394	434
ADTV (mn) - PKR	39	48	59
ADTV (000) - USD	173	219	297
High Price - PKR	120.0	123.8	142.7
Low Price - PKR	111.3	109.8	109.8

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

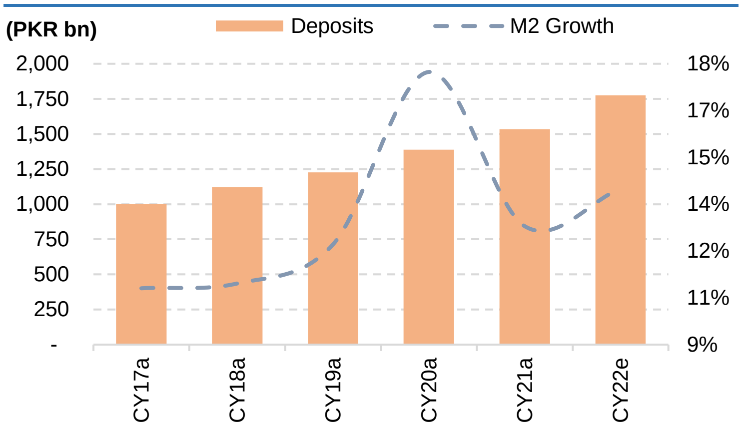
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	68,378	85,696	99,316
Non-Mark-up Income	20,655	29,795	40,896
Total Income	89,033	115,491	140,212
Provisioning	(5,473)	3,672	5,687
OPEX	42,173	53,875	66,362
Post Tax Profit	31,180	29,551	38,853

Exhibit: Balance Sheet	CY21a	CY22e	CY23f
Advances	686,389	807,767	943,818
Deposits	1,534,587	1,774,439	2,064,628
Investments	1,062,569	1,282,039	1,454,168
Borrowings	282,899	327,115	380,611
Total Equity	176,817	182,922	194,926

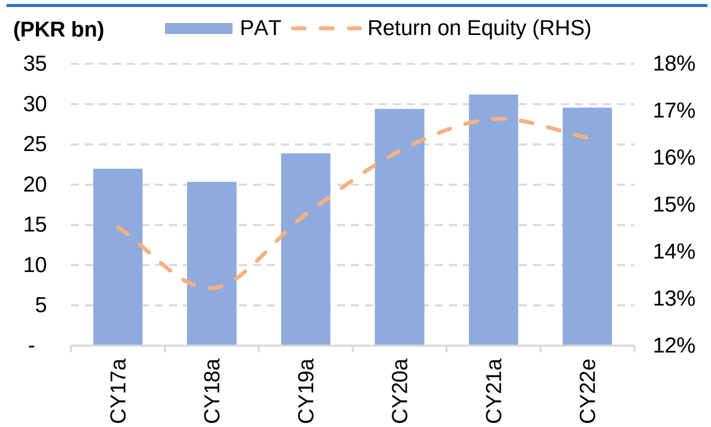
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



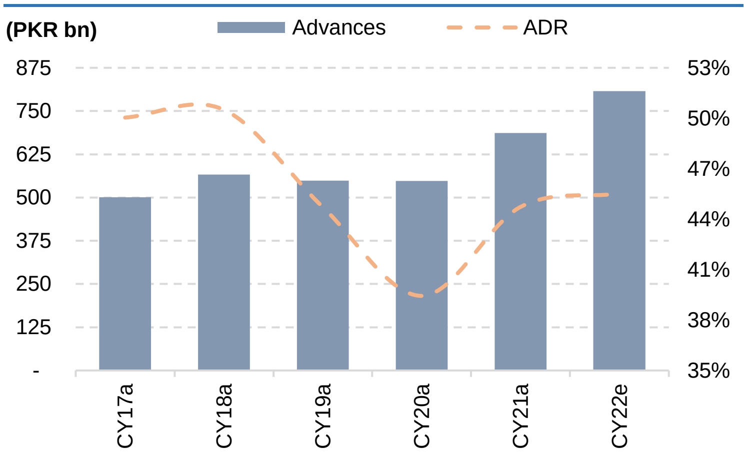
Source (s): SBP, Company Financials, AHL Research

Figure: Profitability Trend



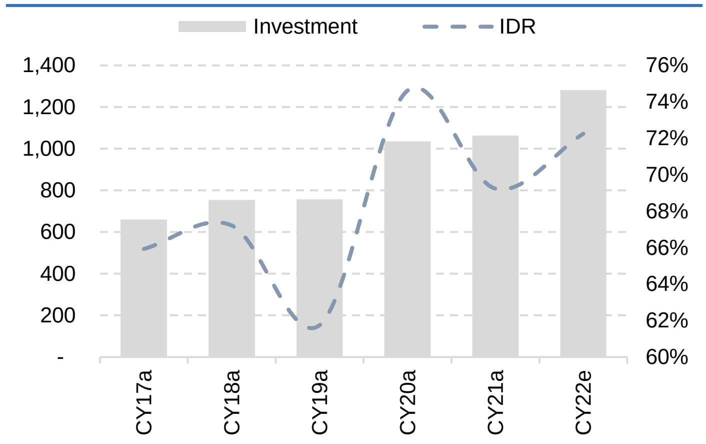
Source (s): SBP, Company Financials, AHL Research

Figure: Advances vs. ADR



Source (s): Company Financials, AHL Research

Figure: Investments vs. IDR



Source (s): Company Financials, AHL Research

Habib Bank Limited (HBL)

Fundamentals intact

Resilient asset quality: HBL has been maintaining a decent asset quality over the years despite economic challenges. HBL recorded an ADR ratio of 50.9% in 3QCY22, on the back of increased advances, which went up to PKR 1.7trn from PKR 1.5trn recorded in Dec'21. Its infection ratio stands at a meager 5.1% against a massive gross advances book of PKR 1.8trn as of 9MCY22. Total provisioning during 9MCY22 has settled at PKR 3.5bn while coverage has been built up, remaining at 101% as of Sep'22. HBL provided PKR 45bn in Agri-financing, which makes 35% market share amongst Commercial Banks, hence, the bank keeps on performing stress testing of its portfolio and does not foresee any major effect of floods on its books.

Improved NIMs supporting profitability: The fixed rate PIB of HBL remained stagnant at PKR 503bn, as the bank mainly focused on investing in floating rate notes and T-bills, with an average duration of 1.1 years and 13.65%, respectively. Given the focus on FRB is beneficial for banks in the current rising interest rate scenario, shorter duration maturity is also key for asset repricing as the interest rate is currently at 16%. NIMs were up to 5.4% in 3QCY22 as lagged asset repricing began to catch up. However, the full impact of fixed-income instrument repricing is yet to be witnessed, with that coming in, NIMs are expected to improve in the upcoming year. In addition, no provision was taken against Pakistan's Eurobond exposure of the bank.

Digital diversification: HBL's core business segments have flourished, as its customer network has grown by 19% to 32.5mn as of Sep'22 compared to 27.4mn (Dec'21). On the digital front, HBL has expanded its E-commerce business and developed a WhatsApp channel for customer support and Payoneer. Furthermore, HBL also initiated programs to support women, like HBL Waapsi**.** In addition, digitalization also supported NII as the bank's Fee and Commission income was up 28% YoY in 9MCY22, clocking in at PKR 22.7bn, mainly on the back of contributions from the cards business, consumer finance, and Konnect.

Concerns remain over lawsuit: In a news report it was reported that HBL faces a secondary liability under Justice against Sponsors of Terrorism Act (JASTA), for aiding and abetting banned terrorist organizations. As we write, the judgment on this case is still awaited. However, the management maintained their stance that the allegations were meritless and the bank was contesting them fully and vigorously. The management highlighted that the court dismissed the primary liability claim and narrowed the case substantially.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	23.9	23.3	32.0
Dividend per share	PKR	7.5	7.0	8.0
Book value per share	PKR	193.4	224.7	249.1
Price to Earning	x	4.9	2.7	1.9
Price to Book	x	0.6	0.3	0.2
ADR	%	44.6	47.7	47.7
IDR	%	57.6	64.3	64.4
NIMs	%	3.8	3.9	3.7
RoE	%	12.7	11.8	13.5

Source (s): Company Financials, AHL Research

HBL

Summary Data

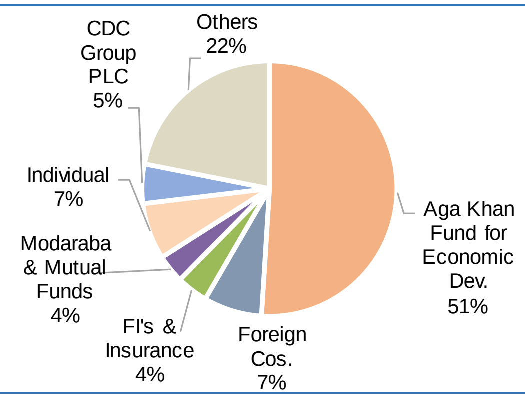
Target Price (Dec'23)	102.4
Last Closing	62.1
Upside (%)	65.1
Shares (mn)	1,467
Free float (%)	50
Market Cap. (PKR mn)	91,018
Market Cap. (USD mn)	403

Recommendation BUY

Price Performance

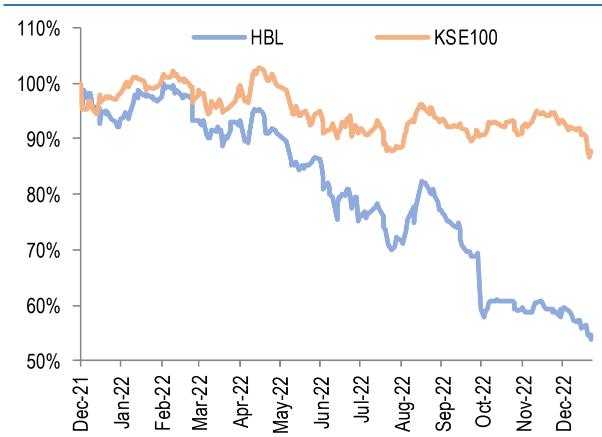
	3M	6M	12M
Return (%)	-21.6	-30.5	-42.7
Avg. Volume (000)	1,495	1,123	1,053
ADTV (mn) - PKR	104	86	97
ADTV (000) - USD	465	385	486
High Price - PKR	79.7	94.8	115.1
Low Price - PKR	62.1	62.1	62.1

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

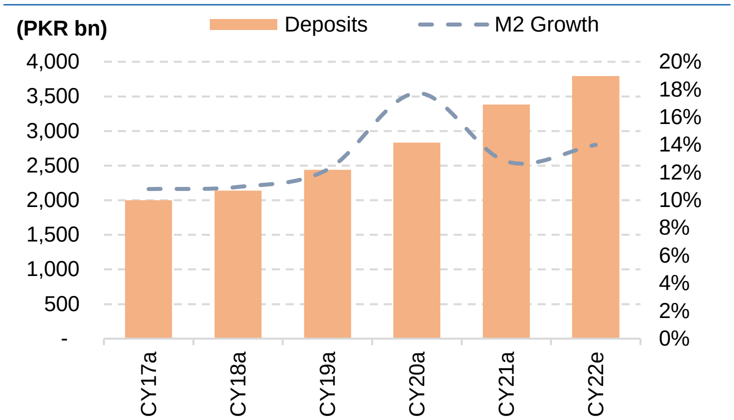
Table: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	131,419	156,924	177,445
Non-Mark-up Income	36,311	48,221	52,978
Total Income	70,115	80,248	95,303
Provisioning	8,087	6,110	12,910
OPEX	97,615	124,897	135,120
Post Tax Profit	35,022	34,204	46,964

Balance Sheet	CY21a	CY22e	CY23f
Advances	1,507,047	1,809,070	2,088,980
Deposits	3,381,998	3,793,847	4,377,869
Investments	1,948,956	2,440,028	2,817,418
Borrowings	436,258	569,077	744,238
Total Equity	283,686	329,542	365,326

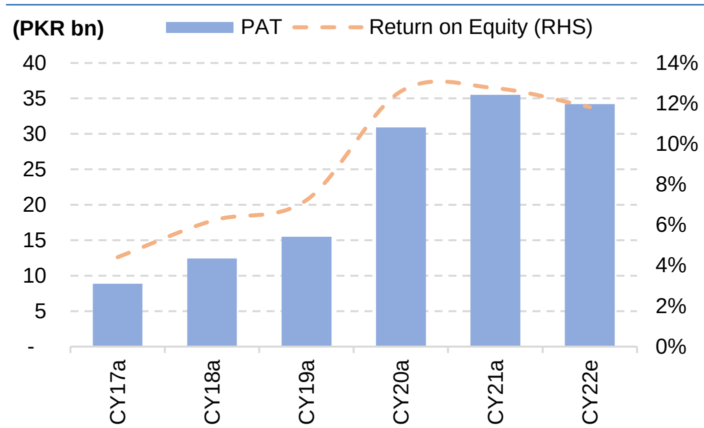
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



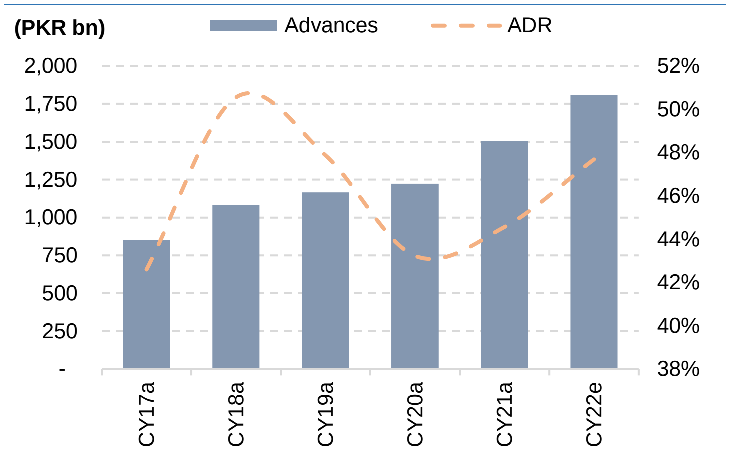
Source (s): SBP, Company Financials, AHL Research

Figure: Profitability Trend



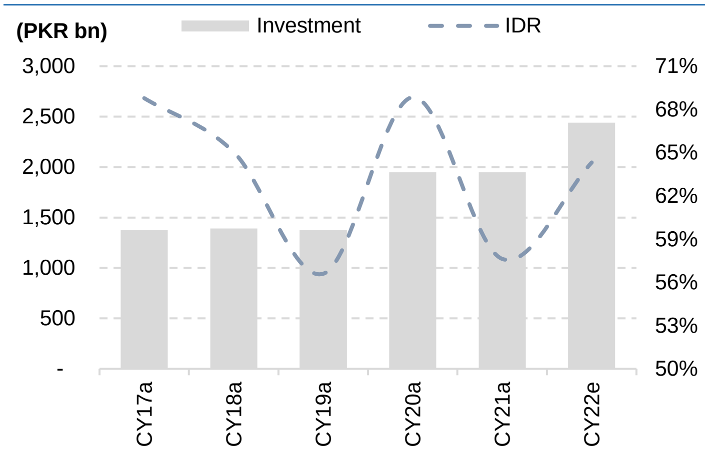
Source (s): Company Financials, AHL Research

Figure: Advances vs. ADR



Source (s): Company Financials, AHL Research

Figure: Investments vs. IDR



Source (s): Company Financials, AHL Research

Bank Alfalah Limited (BAFL)

Laudable on a number of counts

Low-cost Deposits: BAFL deposits grew 34% YoY as at Sep'22, increasing from PKR 1.03trn SPLY to PKR 1.39trn. With this, the current account ratio stands at 42% taking the overall CASA to 74%, hence making BAFL one of the prime beneficiaries in this high interest rate environment. Moreover, 15-17% of the bank's deposits are Islamic and the Bank continues to grow its Islamic Banking division. Currently, 15% of bank's total assets and 31% of branches are Islamic. With focus on low-cost deposits as well as Islamic deposits (with no MDR requirement), top-line of the Bank is likely to witness support, going forward.

Upbeat earnings: The loan book of the bank grew by 15% YoY during 3QCY22. With this the Gross ADR of the bank stands at 57% which places BAFL comfortably above the threshold of penal tax rate. The loan portfolio mainly consists of Textile (22%) and Power (11%) sectors. The asset quality provides much comfort with bank expecting limited provisions to emerge in the near future. Gross infection ratio stands at 3.7% and coverage ratio is above 100%. Moreover, their investment book is also well-positioned as at Sep'22, with 16% of the investment book comprising of Fixed PIBs while the remaining 84% a combination of Floater PIBs and T-Bills. The average repricing of floaters is one month. The average yield of the portfolio is 11.75% with an average duration of 3.5 years.

Expanding reach: The bank has continued its strategy to rapidly expand its branch network. Currently there are 841 branches, where as last year there were 741 branches. So far bank has opened 67 new branches in CY22TD, and it plans to achieve a target of adding (in all) 100 new branches to the network by the end of this year. Furthermore, the bank has placed emphasis on growing its Islamic Network, as mentioned earlier. Although BAFL is expanding its network, it has managed to keep the Cost/Income ratio in check at 46.8% (9MCY22) compared to 59.3% (9MCY21).

Capital concerns addressed: Bank has been consistent with its dividend policy of paying out interim and final dividend which takes the average (3-yr) payout to ~45%. We expect the bank to continue healthy payouts. As far as CAR position is concerned, it currently stands at 14.5% (Sep'22), comfortably above the regulatory limit. Moreover, in its Analyst Briefing the management stated that the Bank will be issuing PKR 7bn worth of Additional Tier-1 instrument soon, which will provide cushion to the overall capital of the Bank.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	8.1	11.0	14.4
Dividend per share	PKR	4.0	5.0	6.5
Book value per share	PKR	57.3	63.4	73.8
Price to Earning	x	4.7	2.8	2.1
Price to Book	x	0.8	0.5	0.4
ADR	%	59%	55%	54%
IDR	%	71%	83%	84%
NIMs	%	3.4%	3.9%	3.9%
RoE	%	16.7	19.9	18.4

Source (s): Company Financials, AHL Research

BAFL

Summary Data

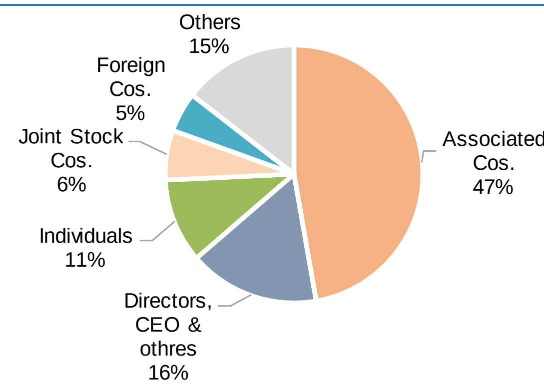
Target Price (Dec'23)	48.0
Last Closing	29.8
Upside (%)	60.8
Shares (mn)	1,777
Free float (%)	35
Market Cap. (PKR mn)	53,013
Market Cap. (USD mn)	235

Recommendation BUY

Price Performance

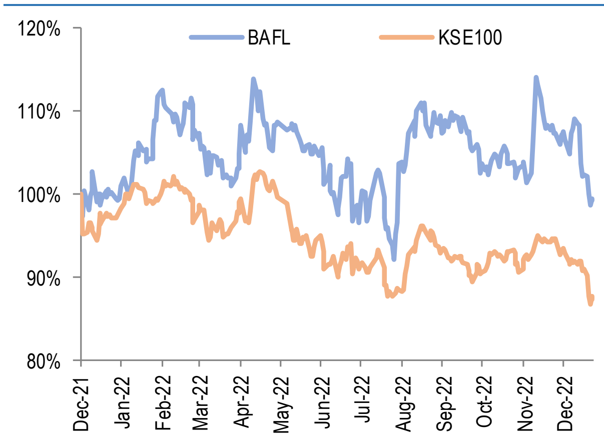
	3M	6M	12M
Return (%)	-5.5	2.6	-0.7
Avg. Volume (000)	2,540	2,001	1,540
ADTV (mn) - PKR	80	64	51
ADTV (000) - USD	357	287	248
High Price - PKR	34.3	34.3	34.3
Low Price - PKR	29.6	27.7	27.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

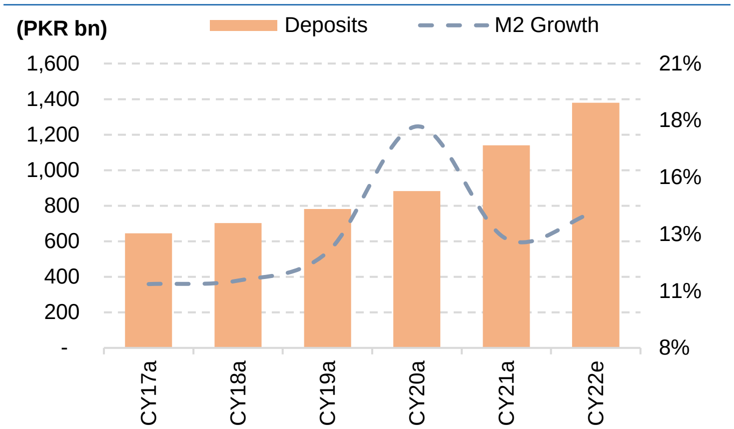
Table: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	46,044	68,948	82,793
Non-Mark-up Income	17,237	23,471	27,912
Total Income	63,281	92,419	110,705
Provisioning	2,312	9,605	10,638
OPEX	37,063	44,347	55,044
Post Tax Profit	14,437	19,618	25,663

Balance Sheet	CY21a	CY22e	CY23f
Advances	673,883	756,329	832,377
Deposits	1,139,010	1,379,581	1,545,130
Investments	811,923	1,145,817	1,300,358
Borrowings	384,109	563,874	613,539
Total Equity	101,874	112,747	131,106

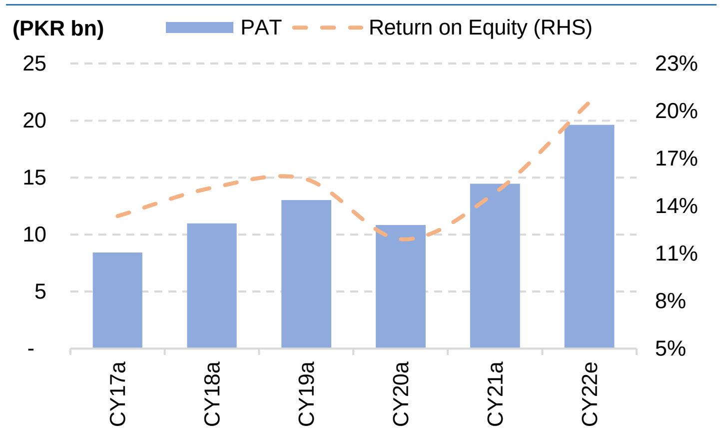
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



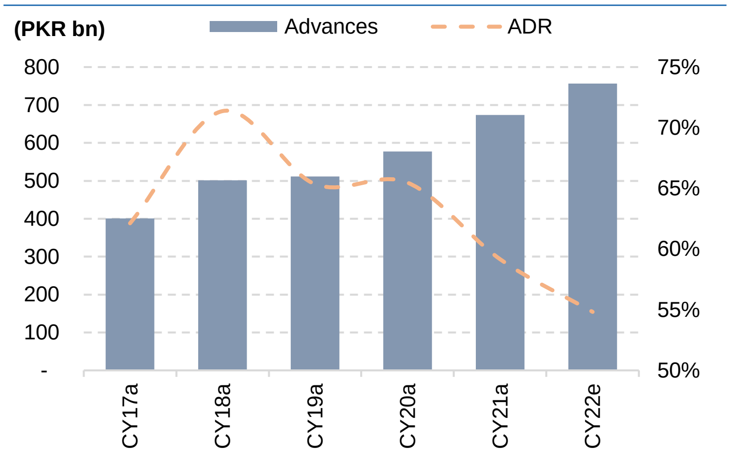
Source (s): SBP, Company Financials, AHL Research

Figure: Profitability Trend



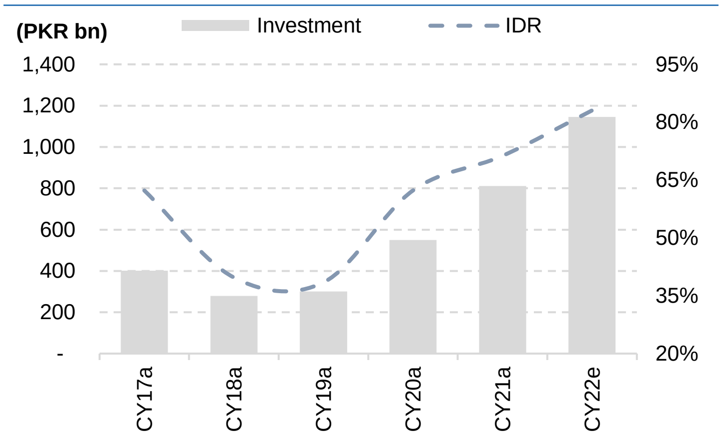
Source (s): Company Financials, AHL Research

Figure: Advances vs. ADR



Source (s): Company Financials, AHL Research

Figure: Investments vs. IDR



Source (s): Company Financials, AHL Research

Meezan Bank Limited (MEBL)

Capitalizing on a booming industry

An exceptional year in terms of earnings: MEBL has been able to benefit from the expanding Islamic banking industry in Pakistan, capturing almost ~7.3% of the deposit share of the total industry and ~32% of Islamic industry. In our view, MEBL will likely dominate the Pakistan Islamic banking although we expect some consolidation in the bank's branch network in the following years to come. Moreover, so far CY22 has turned out to be an exceptional year for the Bank. Improved interest rate scenario along with the bank's ability to keep the cost of deposit low, led to a profit after tax (PAT) of PKR 28bn (+44% YoY) in 9MCY22. As of Sep'22, NIMs stand at 5.4% which the management expects to go up once the full impact of asset repricing is reflected in the upcoming quarters.

Liquidity conundrum solved: Islamic banks of Pakistan have been facing a tough environment previously due to shortages of available Islamic products either for SLR requirement or short-term liquidity management. In recent years, where growth in advances is muted due to risk-averse strategy of banks, excess liquidity and shortage of investment avenues is creating a liquidity drag on the Islamic Banks. However, recent shift of Gov't to Islamic banking and instruments as reflected by auction of government Ijara certificates has, to an extent, resolved the liquidity management problems. MEBL is considered the primary beneficiary of the increasing number of auctions as Sukuks comprise 86% of the total investment book (Sep'22).

Supreme asset quality: The bank's total assets, in tandem with its strong deposit base, grew at a CAGR of 19% during the last 5-years. Despite this growth in assets base, banks advances portfolio remained rather shy, growing by a 5-year CAGR of 12.5%. During the year 9MCY22, bank's advances grew by ~ 41% YoY, which is considerably higher than what it has been in the past (12.5% YoY average growth during CY17-21). The bank's stringent lending policy and its ability to manage credit risk makes it less exposed to Non-Performing Loans as compared to the industry. NPL's to gross advances ratio remains considerably lower at 1.5% as against the industry average of 7.6%. In addition to this, during 9MCY22, the Bank booked in higher provisioning against NPL's (~3.1x higher YoY from SPLY), bringing the banks coverage ratio to 154%.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	15.8	22.3	31.2
Dividend per share	PKR	6.0	7.5	8.5
Book value per share	PKR	50.5	66.3	88.9
Price to Earning	x	8.5	4.6	3.3
Price to Book	x	2.7	1.6	1.2
ADR	%	52.1	53.7	54.6
IDR	%	42.9	62.8	65.1
NIMs	%	5%	6%	6%
RoE	%	34%	38%	40%

Source (s): Company Financials, AHL Research

MEBL

Summary Data

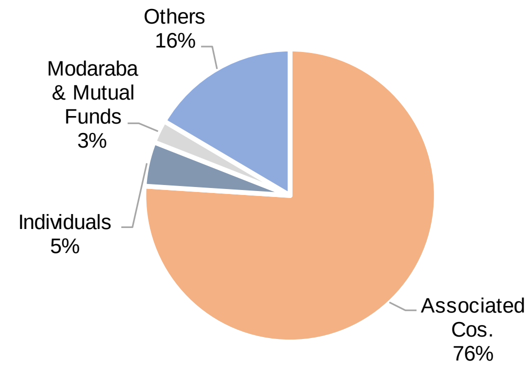
Target Price (Dec'23)	165.2
Last Closing	103.5
Upside (%)	59.5
Shares (mn)	1,790
Free float (%)	25
Market Cap. (PKR mn)	185,280
Market Cap. (USD mn)	821

Recommendation BUY

Price Performance

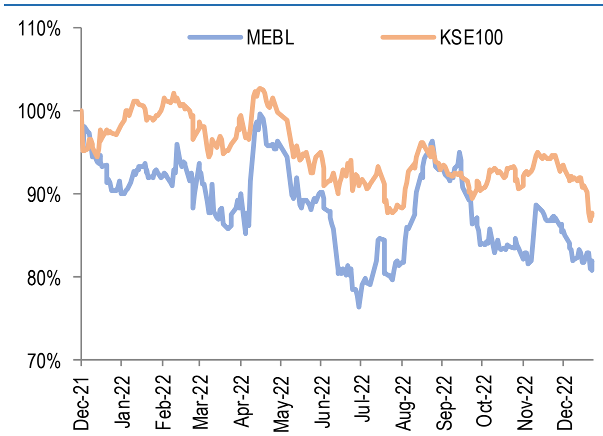
	3M	6M	12M
Return (%)	-6.5	3.0	-11.5
Avg. Volume (000)	857	967	977
ADTV (mn) - PKR	94	111	116
ADTV (000) - USD	419	501	575
High Price - PKR	113.6	123.4	127.8
Low Price - PKR	103.5	97.9	97.9

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

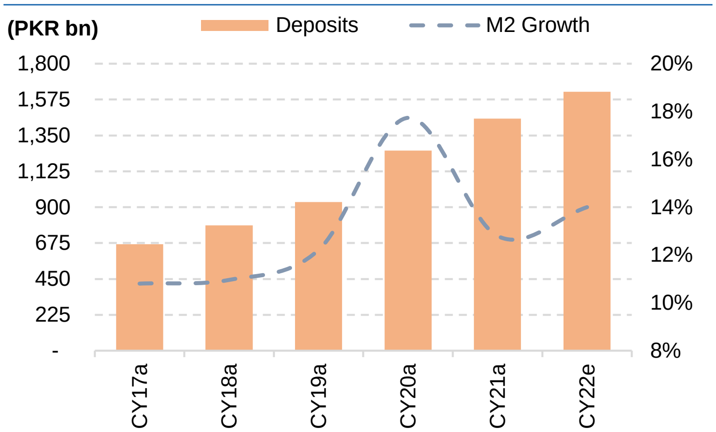
Table: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	68,906	103,698	132,267
Non-Mark-up Income	15,942	16,607	17,888
Total Income	84,848	120,305	150,155
Provisioning	941	3,418	3,742
OPEX	35,930	38,503	48,612
Post Tax Profit	28,228	39,976	55,747

Balance Sheet	CY21a	CY22e	CY23f
Advances	758,086	871,644	994,115
Deposits	1,455,871	1,624,669	1,819,629
Investments	624,333	1,021,091	1,184,363
Borrowings	220,414	446,260	544,512
Total Equity	90,442	118,623	159,158

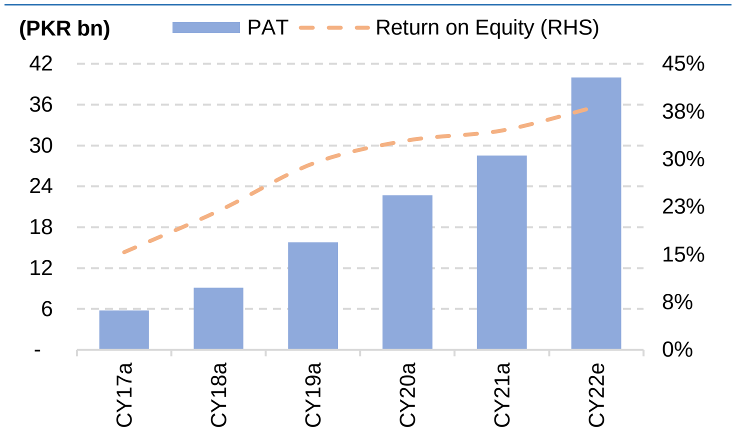
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



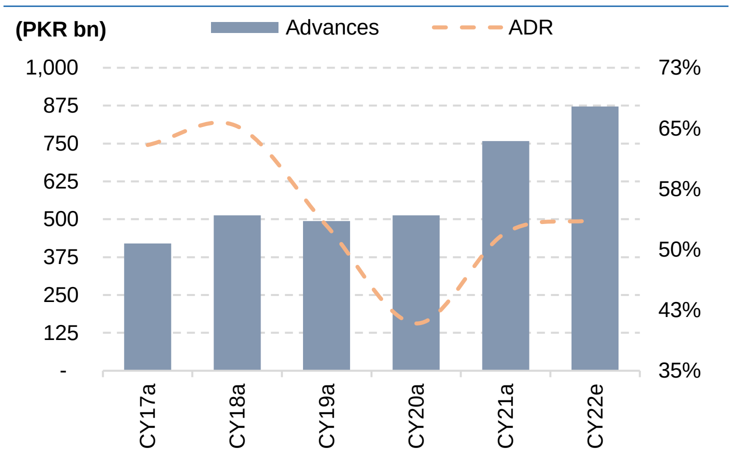
Source (s): SBP, Company Financials, AHL Research

Figure: Profitability Trend



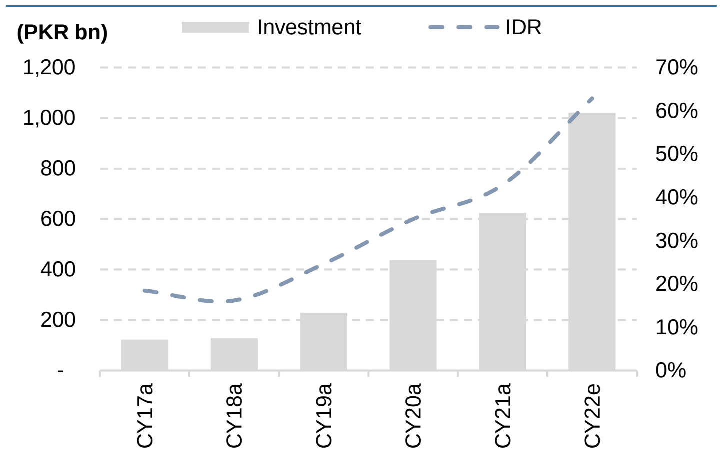
Source (s): SBP, AHL Research

Figure: Advances vs. ADR



Source (s): SBP, AHL Research

Figure: Investments vs. IDR



Source (s): SBP, AHL Research

ARIF HABIB LIMITED

Faysal Bank Limited (FABL)

Leading transformation

Islamic conversion completed: Faysal Bank will begin New Year 2023 as a fully-converted Islamic Bank. To recall, Faysal Bank Limited was incorporated in Pakistan on October 3rd, 1994 as a Public Limited Company under the Companies Ordinance, 1984. As per the information available on their site, their total branch network comprises of 639 branches with 638 Islamic branches and only one conventional branch remaining. During the out-going period, FABL crossed the PKR 1.0trn mark in total assets backed by strong deposit mobilization and borrowings. Bank's unwavering perseverance to increase its CASA ratio has been successful, keeping its cost of deposit low. FABL's CA ratio increased by 27% over Dec'21 and we expect this to continue in later quarters. With this, CASA mix improved to 80% from 75% at Dec'21. Moreover, with FABL's re-entry into the Islamic league, it becomes exempted from the Minimum Deposit Rate (MDR) requirement, hence helping boost the top-line.

Impressive top-line growth: Even precursory view of 9MCY22 banking sector results reveals a massive growth in interest income. Reasons being bank's increasing exposure in high yielding instruments leading to 93% YoY jump in income from investments during 9MCY22. For FABL, Sep'22 ending quarter tells a similar story where investments in Sukuk shot up significantly. To put things in perspective, the bank increased its Sukuk exposure to PKR 284bn from PKR 141bn back in Dec'21. Secondly, industry advances have inched up as well during 9MCY22, which for a bank like Faysal having a strong retail presence and aggressive lending history, should bode well for the bank's interest earning yield. This combined with a healthy non-interest income, should bring about a + 38% YoY growth in total income for CY23F.

Record year with unprecedented growth: FABL will be closing CY22 on a high note, breaking its own records, we believe. It is expected to post the highest ever earnings of PKR 7.4/share (9MCY22: PKR 5.15/share) with unprecedented pay-out of PKR 9/share (9MCY22: PKR 6/share). Currently, CAR of the bank stands at a comfortable level of 17.37% as against 17.53% as at Dec'21. However, with teething challenges erupting in the upcoming year (first year of conversion), we believe, FABL may consider conserving their capital and normalizing their payout in order to focus more on branch expansion and diversifying their portfolio while keeping a check on their bottom-line.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	5.5	7.4	10.4
Dividend per share	PKR	1.5	9.0	2.0
Book value per share	PKR	43.6	41.9	49.0
Price to Earning	x	4.2	3.4	2.4
Price to Book	x	0.6	0.6	0.5
ADR	%	62%	63%	64%
IDR	%	55%	57%	57%
NIMs	%	3.8%	5.1%	5.7%
RoE	%	13%	17%	23%

Source (s): Company Financials, AHL Research

FABL

Summary Data

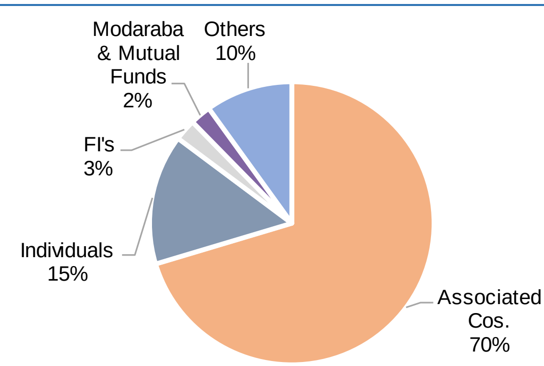
Target Price (Dec'23)	42.3
Last Closing	25.3
Upside (%)	67.0
Shares (mn)	1,518
Free float (%)	25
Market Cap. (PKR mn)	38,413
Market Cap. (USD mn)	170

Recommendation BUY

Price Performance

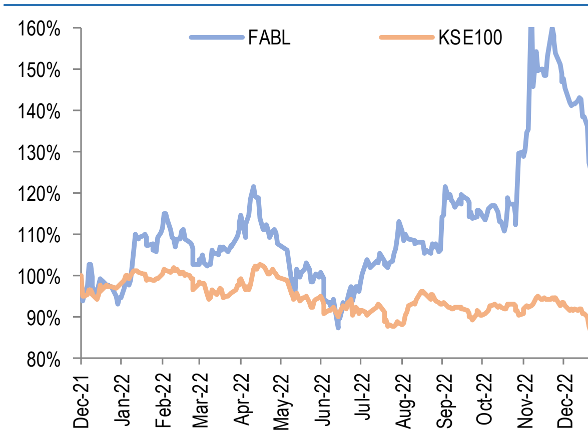
	3M	6M	12M
Return (%)	17.9	42.5	37.7
Avg. Volume (000)	1,616	1,347	997
ADTV (mn) - PKR	46	37	27
ADTV (000) - USD	207	166	129
High Price - PKR	31.5	31.5	31.5
Low Price - PKR	20.9	17.8	16.5

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

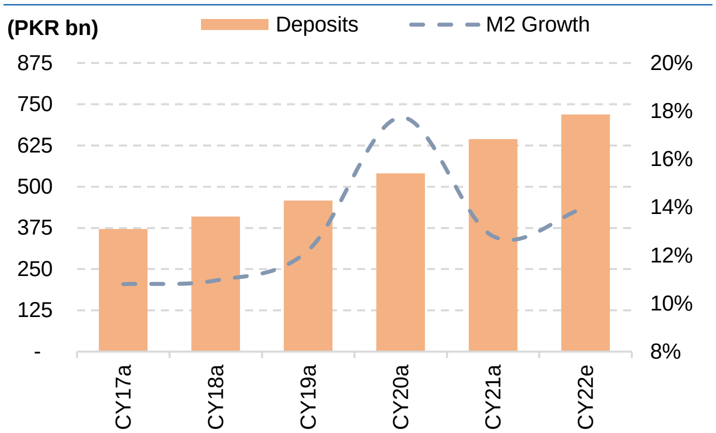
Table: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Mark-up Income	25,839	41,402	52,569
Non-Mark-up Income	8,916	11,468	13,504
Total Income	34,755	52,870	66,074
Provisioning	45	1,464	3,917
OPEX	21,076	29,468	34,466
Post Tax Profit	8,353	11,188	15,783

Balance Sheet	CY21a	CY22e	CY23f
Advances	396,295	456,072	517,757
Deposits	644,040	718,712	804,957
Investments	357,249	407,652	460,406
Borrowings	111,190	164,017	190,366
Total Equity	66,130	63,660	74,407

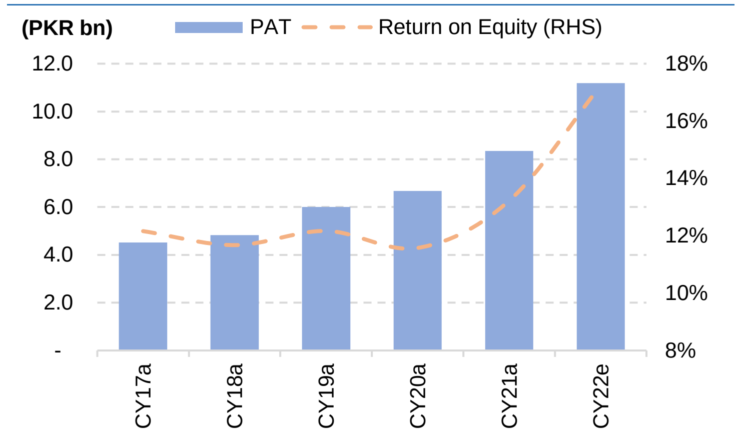
Source (s): Company Financials, AHL Research

Figure: Deposits vs. M2



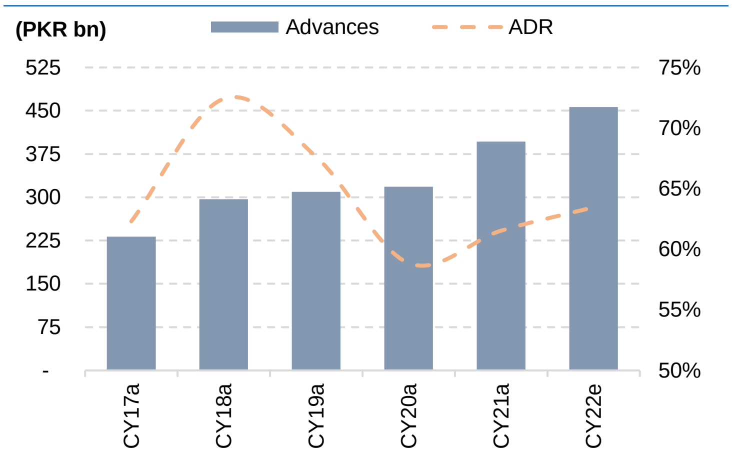
Source (s): SBP, AHL Research

Figure: Profitability Trend



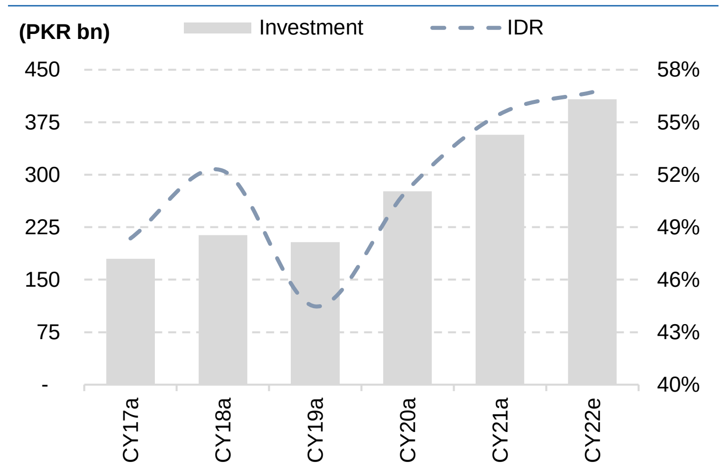
Source (s): Company Financials, AHL Research

Figure: Advances vs. ADR



Source (s): Company Financials, AHL Research

Figure: Investments vs. IDR



Source (s): Company Financials, AHL Research

Fertilizer

Silver lining in the mist

Fertilizers

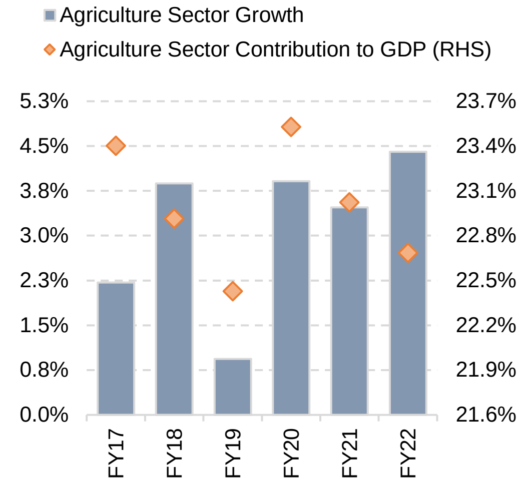
Silver lining in the mist

- **Agriculture performance & fertilizer offtake:** In FY22, the agriculture sector's contribution to GDP of Pakistan was 22.7% against 23.0% in FY21, with agriculture sector posting a growth of 4.4% YoY. For FY23, agriculture sector is projected to grow by a lower quantum as compared to FY22 at 1.71% YoY owed to lower cotton production due to devastation caused by floods.
- **Fertilizer offtake:** Urea dispatches for CY22 are estimated to clock in at 6.4mn tons, showing a growth of 2.4% YoY despite floods. Meanwhile, DAP offtake is anticipated to settle at 1.2mn tons (down by 37%), owing to higher DAP prices and higher availability of channel inventory during the year. For CY23, we forecast urea offtake to remain stable at 6.4mn tons level, while DAP offtake to arrive at 1.5mn tons.
- **Urea Prices:** During CY22, average urea prices surged by 23% YoY to PKR 2,246/bag compared to an average price of PKR 1,805/bag during CY21. Manufacturers increased the prices of urea given cost-push inflation, abolishment of output sales tax, and higher transportation cost. The manufacturers may opt to increase the urea prices again in CY23 in a likely event of revision in feed and fuel gas prices. Additionally, international urea prices have come down to USD 507/ton in Dec'22 compared to USD 970/ton in Dec'21 (down by 47% YoY) due to higher energy prices and weak demand amid global inflationary pressure.
- **DAP prices**: During CY22 phosphate prices surged to reach new highs, triggered by the Russia Ukraine war and subsequent hike in international commodities prices. Albeit, phosphate prices climbed from USD 1,330/ton in Dec'21 to USD 1,715/ton in Sep'22. However, since Oct'22, the price of phosphoric acid has come down to USD 1,150/ton. On the domestic front, local DAP prices are set at PKR 9,900/bag in Dec'22 vis-à-vis PKR 8,351/bag in Dec'21. To recall, in Sep'22, local DAP price had reached PKR 14,000/bag, however, DAP prices were reduced after government negotiated with the DAP manufacturers alongside decline in international phos acid prices.
- **Mari gas project in the pipeline:** Fertilizer manufacturers entered into an agreement with Mari Petroleum Company Limited (MARI) for a project to ensure maintenance of gas production at required delivery pressure from Habib Rahi Limestone (HRL) reservoir. The project pertains to the development of pipeline infrastructure and the installation of compressors within the Mari Gas field. As per our understanding, it is expected to complete within two years with an estimated CAPEX size of PKR 10bn – PKR 12bn.
- **Outlook:** The government has increased the support price of wheat during the ongoing Rabi season. Furthermore, with the gas tariff hike to PKR 430/mmbtu and PKR 1,837/mmbtu, respectively, urea prices are likely to jump by PKR 368/bag, we view. Furthermore, local DAP prices will closely follow international prices. Also, post floods, the government had announced a Kissan Package worth PKR 1.8tn, which includes interest-free loans, allocation of urea subsidy worth PKR 30bn for small farmers, and lifting of duty on second tractors.

Key Risk (s)

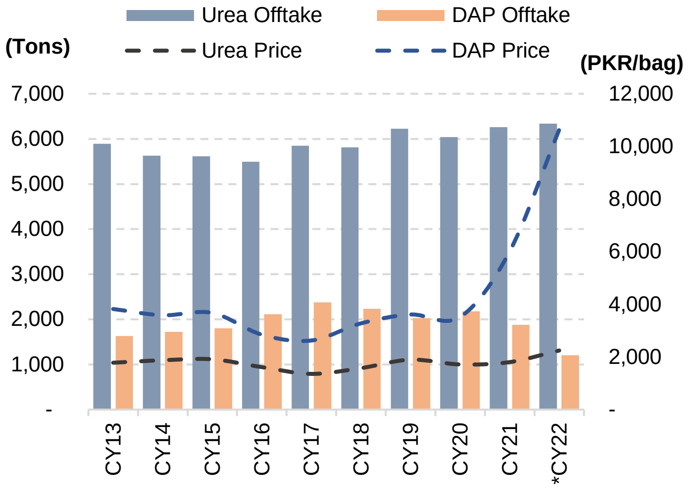
- Hike in gas tariff and failure to pass on the impact to end consumers.
- Massive jump in DAP prices
- Natural disasters such as floods can adversely affect fertilizer sales.

Figure: Agriculture Sector Growth



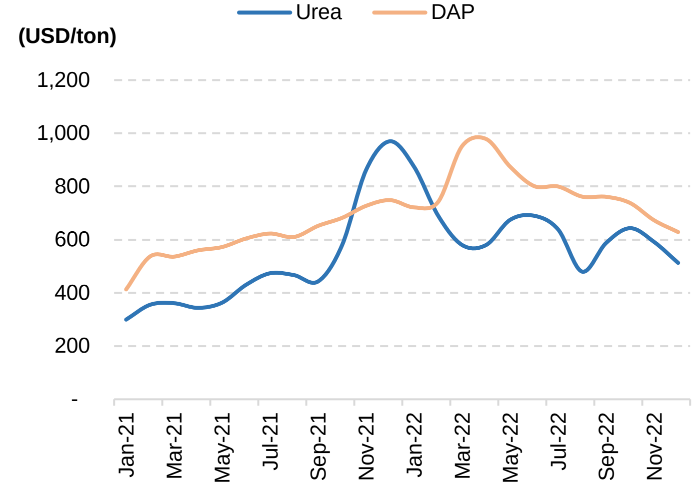
Source (s): PBS, AHL Research

Figure: Urea and DAP offtake and prices



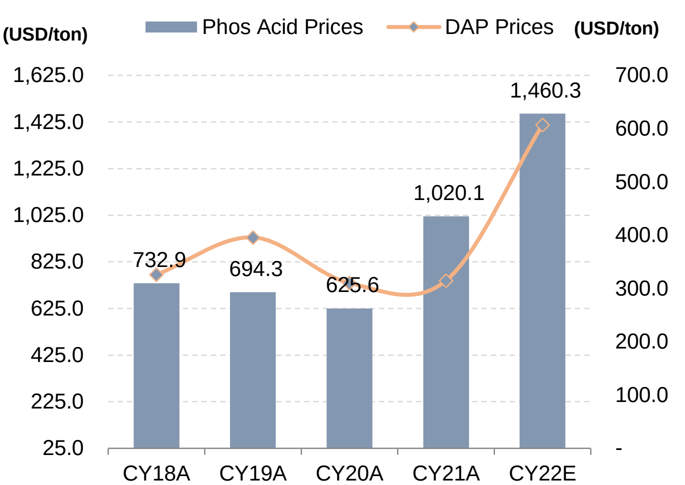
Source (s): NFDC, AHL Research *estimated

Figure: International Urea and DAP prices



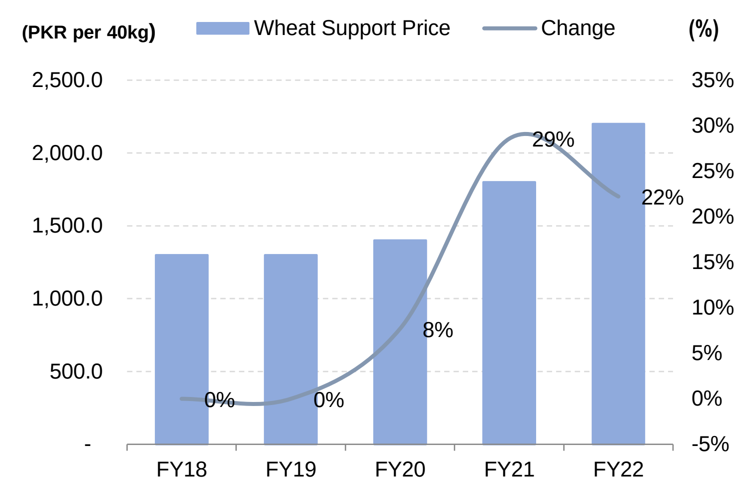
Source (s): Bloomberg, AHL Research

Figure: Phosphoric Acid price in relation to DAP prices



Source (s): Bloomberg, AHL Research *estimated

Figure: Support Price of Wheat



Source (s): Pakistan Economic Survey, AHL Research

Fauji Fertilizer Company Limited (FFC)

Diversification creating value

- **5-yr earnings CAGR of 9.8%:** We anticipate the company's profitability to grow at a 5-Yr CAGR of 9.8%, arriving at PKR 24.37/share in CY25, taking into consideration company's diversified portfolio of business in banking, energy and FMCG sectors. For CY23 and CY24, we expect earnings to clock-in at PKR 16.76/share and PKR 21.84/share, respectively. Key growth driver for the company is higher margins in core business, tagged with dividend income from AKBL, FFBL, FFCEL, FWEL I and FWEL II.
- **Urea offtake to remain stable:** The urea and DAP sales in CY22 are estimated at 2.4mn tons and 0.1mn tons, respectively. We project stable urea sales (average of 2.5mn tons and 122% utilization level during last 5 years), to settle at 2.5mn tons in CY23. In addition, DAP offtake of the company is expected at 0.2mn tons during CY23.
- **Foundation Wind Energy Ltd I and II:** After the acquisition of 100% and 80% stakes in Foundation Wind Energy Ltd I and II, respectively, these companies have announced dividend income of PKR 450mn in CY22. In 10MCY22, Foundation Wind Energy Ltd I and II generated around 102 GWh and 109 GWh, respectively, with each of them having an availability factor of 98%. We expect these companies to continue to announce dividends, going forward.
- **Thar Energy to add further value:** Thar Energy Limited, a 330 MW local coal-based power plant, where FFC has a 30% stake, achieved its COD in 4QCY22. We estimate an earnings contribution of PKR 1.41/share on an annualized basis from CY23 and a contribution of PKR 3.08/share to our target price. Furthermore, during CY22, the company has increased investment in TEL by PKR 1.3bn.
- **Receivable pending from government:** The company's subsidy receivable and GST refunds from the government currently stand at PKR 7.0bn and PKR 18bn, respectively. The company is in talks with the government to settle the funds, which is expected to be resolved soon.
- **Future plans:** The company is currently in the initial stage for coal gasification project, which will use Thar coal to meet the gas requirements of the company. Furthermore, a long-term plan to develop a new DAP plant is in the pipeline. The company is seeking commitment from the government for the availability of gas supply before it can proceed with the project. With this project, the company will be able to produce 1mn tons of DAP. In addition to this, the company is seeking to collaborate with an international supplier of phosphoric acid.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	17.2	16.8	21.8
Dividend per share	PKR	14.5	13.0	17.0
Book value per share	PKR	37.3	41.1	46.0
Price to Earning	x	5.8	6.0	4.6
Price to Book	x	2.7	2.4	2.2
Dividend Yield	%	14.5	13.0	17.0
Net Margins	%	20.2	18.5	18.3

Source (s): Company Financials, AHL Research

FFC

Summary Data

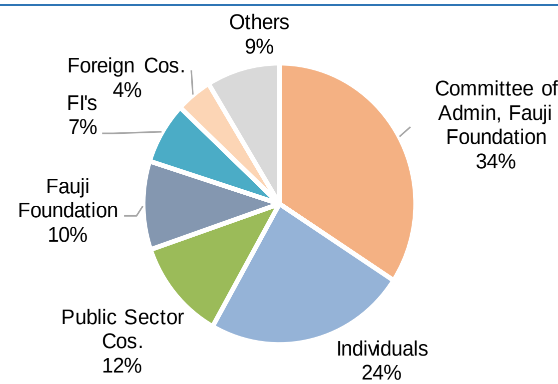
Target Price (Dec'23)	135.6
Last Closing	100.1
Upside (%)	35.4
Shares (mn)	1,272
Free float (%)	55
Market Cap. (PKR mn)	127,402
Market Cap. (USD mn)	565

Recommendation BUY

Price Performance

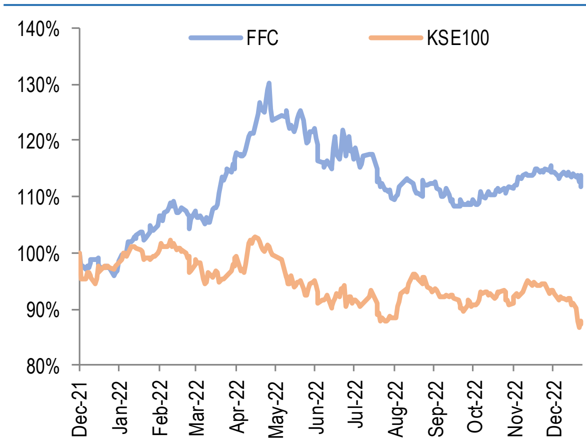
	3M	6M	12M
Return (%)	2.8	-4.8	14.7
Avg. Volume (000)	487	539	717
ADTV (mn) - PKR	50	56	78
ADTV (000) - USD	222	253	397
High Price - PKR	103.7	108.3	116.8
Low Price - PKR	97.4	97.0	86.1

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



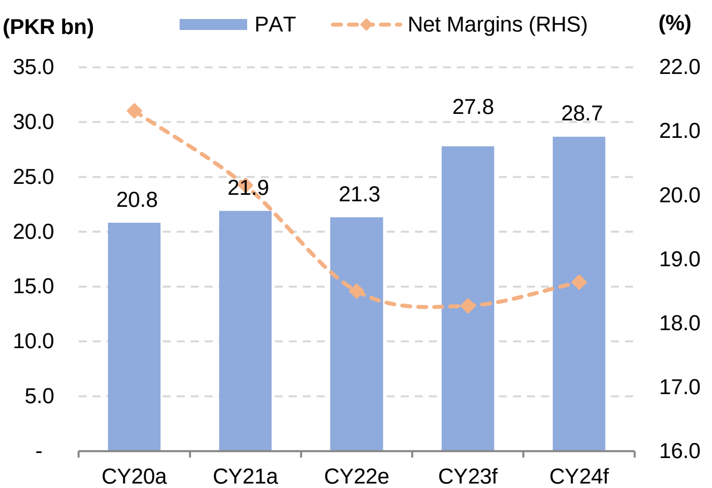
Source: Bloomberg, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Sales	108,651	115,230	152,075
Gross Profit	38,879	43,087	55,810
Operating Profit	7,919	13,134	14,923
Finance Cost	2,292	5,314	8,509
Post Tax Profit	21,896	21,318	27,789
Balance Sheet	**CY21a**	**CY22e**	**CY23f**
Shareholder's Equity	47,514	52,319	58,480
Trade and Other Payables	62,481	69,906	84,610
Total Liabilities	153,492	155,187	165,907
Current Assets	126,270	130,110	147,085
Non-Current Assets	74,737	77,395	77,303
Total Assets	201,007	207,506	224,388

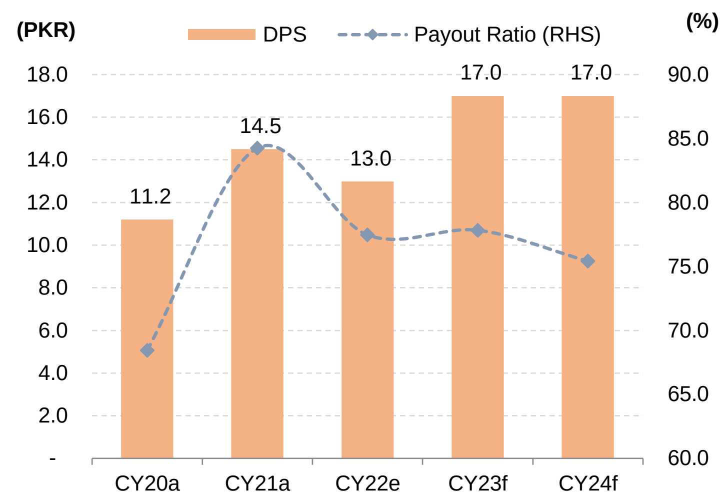
Source (s): Company Financial, AHL Research

Figure: FFC's Profitability



Source (s): Company Financials, AHL Research

Figure: Dividend payout



Source (s): Company Financials, AHL Research

Engro Corporation Limited (ENGRO)

Diversified Portfolio

- **Earnings to grow at a 5-year CAGR of 10%:** We project the company's 5-year profitability CAGR to grow by 10%. For CY23 and CY24 we anticipate earnings to arrive at PKR 62.8/share and PKR 69.2/share, respectively. This is projected on the back of: 1) resurgence of optimal urea demand post floods in the fertilizer business tagged with availability of capacity post-BMR of the base plant of EFERT, 2) contribution from Engro Powergen Thar Power Limited (EPTPL) and Sindh Engro Coal Mining Company (SECMC), which has been operational since the past three years, and 3) stable business operations from Elengy terminal based on USD based revenue stream.
- **Three years of Thar projects:** As per estimates, SECMC has provided 2.4mn tons of coal to mine mouth power plant namely Engro Power Thar Limited (EPTL), which led to the production of around 2,655 GWh electricity with its 660MW plants in Sep'22. We forecast earnings contribution in CY23 of PKR 23.71/share and PKR 1.83/share from EPTL and SECMC, respectively. Phase II of SECMC reached completion during CY22, which increased the mining capacity to 7.6mn tpa. Meanwhile, work on phase III is in progress and the commercial operations date is expected in CY23.
- **Engro Enfrashare:** Engro Enfrashare has been able to secure 3,900+ orders for the tower. The company is targeting to achieve 5,000+ towers by 2024 (ahead of the previous target of 2025). Furthermore, the business outlook remains robust given the surge of data usage in Pakistan while mobile network operators seek to improve service quality and availability. Moreover, the market share in the build-to-suit towers segment increased to 61% in 9MCY22, while colocation tenants settled at 439 during the period vis-à-vis 183 in SPLY.
- **Other businesses:** EFERT's profitability is expected to display growth in CY23 due to the absence of drastic floods dampening urea and DAP sales and hefty supertax. In addition to this, EFERT has increased base plant's capability of producing 950k ton p.a of urea after undergoing BMR. With this, the productivity of the plant will improve. Meanwhile, the earnings from EPCL are expected to decline due to lower PVC margins. Moreover, EPCL is conducting a FEED study for the expansion of VCM by 300K tons per annum, with a completion time estimated to be 12 months. In terminal business, Engro Elengy is expected to continue to have a higher throughput (carrying momentum from CY22). However, Engro Vopak's marine LPG imports are anticipated to remain in check due to imports via the Taftan border. Furthermore, EPQL's operations are expected to remain stable. Whereas, FCEPL business is expected to remain steady.
- **Future investments:** Feasibility study for the propane dehydrogenation (PDH) and polypropylene (PP) project has been completed, and a decision regarding this project will be made based upon findings. The project upon completion will have the capacity to produce 28k tons per annum of PDH. In addition to this, company's Engro Energy is in the process of developing the first Renewable Energy Park in Pakistan. Phase I of the project will have a capacity of 400MW. At present, the company is undergoing a feasibility study for this project. Albeit, the company has sufficient liquidity, standing at PKR 48bn as of Sep'22.

ENGRO

Summary Data

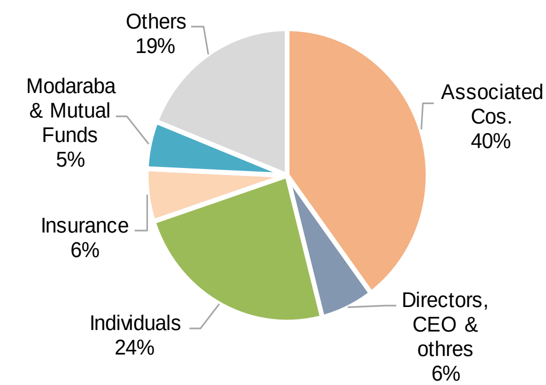
Target Price (Dec'23)	373.8
Last Closing	259.2
Upside (%)	44.2
Shares (mn)	576
Free float (%)	55
Market Cap. (PKR mn)	149,336
Market Cap. (USD mn)	662

Recommendation BUY

Price Performance

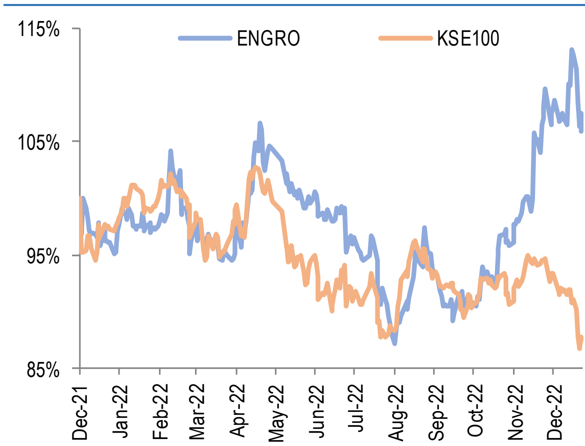
	3M	6M	12M
Return (%)	17.5	11.2	10.2
Avg. Volume (000)	594	456	409
ADTV (mn) - PKR	153	115	107
ADTV (000) - USD	682	514	525
High Price - PKR	276.7	276.7	276.7
Low Price - PKR	220.5	213.2	213.2

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	*PKR*	48.5	39.5	62.8
Dividend per share	*PKR*	25.0	35.0	40.0
Book value per share	*PKR*	421.4	446.5	479.8
Price to Earning	*x*	5.6	6.6	4.1
Price to Book	*x*	0.6	0.6	0.5
Dividend Yield	*%*	9.2	13.5	15.4
Net Margins	*%*	9.0	7.9	12.2

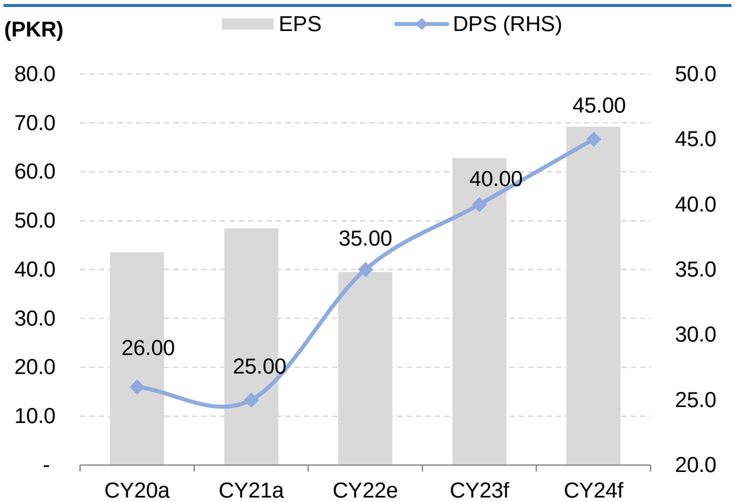
Source (s): Company Financials, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Sales	311,587	288,563	296,131
Gross Profit	99,455	106,197	93,934
Other Income	12,222	5,613	5,915
Other Expenses	10,354	5,855	7,404
Post Tax Profit	27,942	22,743	36,207
Balance Sheet	**CY21a**	**CY22e**	**CY23f**
Shareholder's Equity	242,800	257,242	276,416
Trade and Other Payables	96,257	132,751	140,335
Total Liabilities	401,521	494,978	498,112
Current Assets	264,146	308,615	306,995
Non-Current Assets	380,175	443,605	467,533
Total Assets	644,321	752,220	774,528

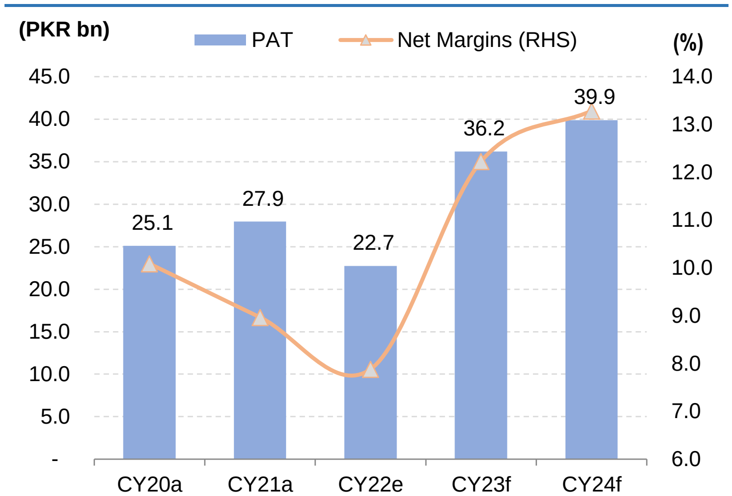
Source (s): Company Financial, AHL Research

Figure: EPS versus DPS



Source (s): Company Financials, AHL Research

Figure: ENGRO's Profitability margin



Source (s): Company Financials, AHL Research

Oil & Gas Exploration & Production

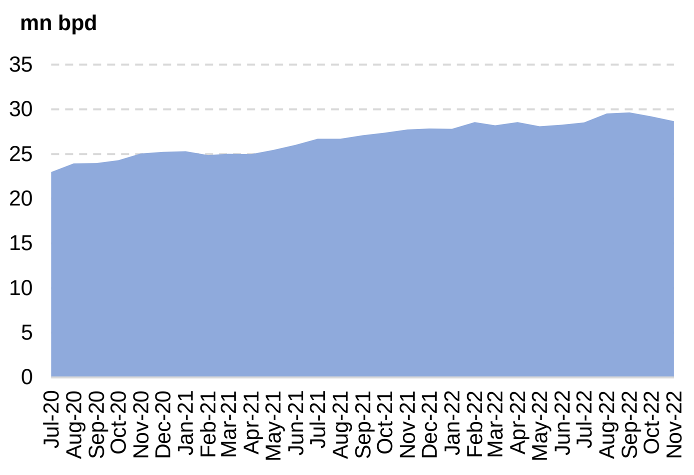
Enticing valuations

Exploration and Production

International oil price outlook

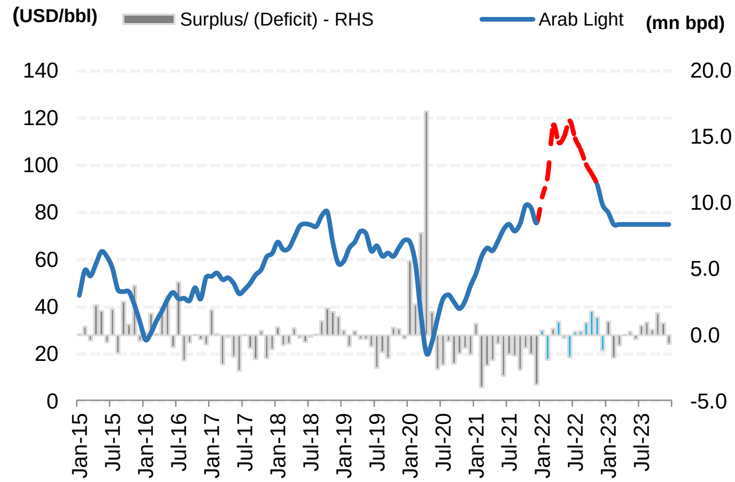
- **Spill-over effect of Russia and Ukraine War:** Oil demand, and therefore oil price, saw a major resurgence in FY22, touching a 14-yr high level (Arab Light settled at USD 134/bbl in Mar'22). This massive jump came majorly due to geopolitical unrest (Russia-Ukraine war), sharp decline in COVID-19 cases, pent-up demand and economic revival, and oil supply cuts by OPEC+. Moreover, with Russia invasion of Ukraine in Feb'22, North American and European countries announced a series of sanctions on Russia, which included a ban on the export of oil, however, countries such as India and China imported oil at discounted rates. Furthermore, US remained in talks with Iran for the resumption of its Nuclear Deal, which could not reach any outcome. The US President Biden requested OPEC+ (during a visit to Saudi Arabia in Aug'22) to increase production levels given the high global inflationary readings, with oil coming down temporarily. However, OPEC+ increased production by only 0.1mn b/d in Sep'22, defying expectations of a massive addition to oil production. Albeit, once economies worldwide entered a recessionary phase and surge was witnessed in COVID-19 cases in China, oil prices showed weakness. Following that, OPEC+ reduced oil production by 2mn bopd in Nov'22, in order to support oil prices. Pertinently, the G7 put a price cap of USD 60/bbl on Russian oil during Dec'22. Despite this, China purchased Russian oil at a multi-month low discount after resuming economic activity in the outgoing month.
- **Production cuts:** Keeping in view higher oil prices due to Russia and Ukraine war, major world economies witnessed a surge in inflation. With the countries showing early signs of recession, demand is depicted to undergo a decline, resulting in Arab Light to climb down to USD 84/bbl at present, against its high of USD 134/bbl in Mar'22. The OPEC+ curtailed oil production by 2m b/d in Nov'22, whereas it is considering another production cuts in the next meeting (which will be held in Jun'23), if oil prices continue to fall after the materialization of oil price cap on Russian exports.
- **Demand outlook:** In CY23, world oil demand is anticipated to grow by 1.01 mb/d to 100.83 mb/d by EIA. Major contributor for the jump is anticipated to be demand from China (+0.60mb/d YoY), Asian countries (+0.35 mb/d YoY) and United States of America (+0.15 mb/d YoY).
- **Supply outlook:** The non-OPEC oil supply growth for CY23 is expected to settle at 66.54 mb/d, depicting a growth of 0.68 mb/d YoY mainly due to growth from OECD countries (+1.45 mb/d YoY). Moreover, supply by OPEC is expected to jump up by 0.40 mb/d to 34.51mb/d in CY23 versus 34.11 mb/d in CY22.
- **Oil price outlook:** In our view, oil prices are expected to average around USD 87/bbl in FY23, USD 75.00/bbl in FY24. Key factors to watch out for oil price outlook include 1) global slowdown amid crumbling economic conditions, 2) outcome of the Russia and Ukraine war, 3) slowdown in China due to resurgence in COVID-19 outbreak, and 4) Possible exit of UAE from OPEC.

Figure: OPEC Crude Oil Production



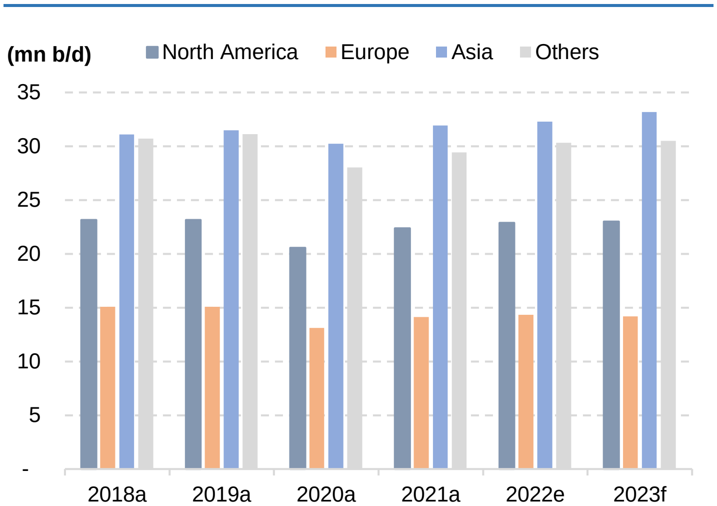
Source (s): EIA Short Term Energy Outlook, AHL Research

Figure: World Oil Balance and Arab Light Price



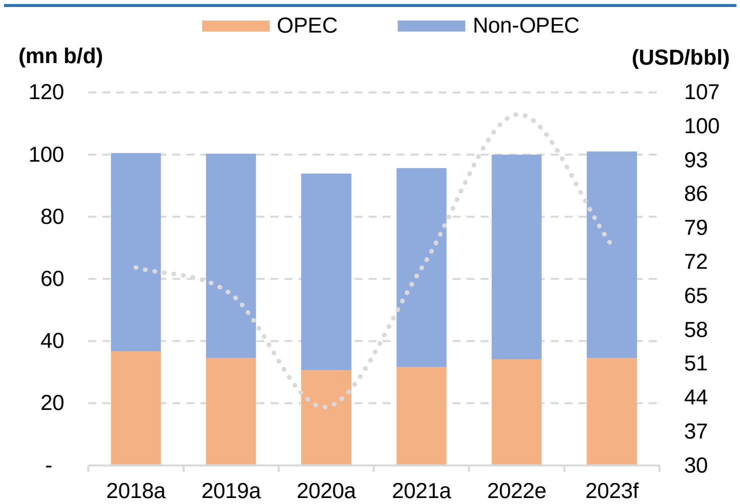
Source (s): EIA Short Term Energy Outlook, AHL Research

Figure: Crude Oil Consumption Worldwide



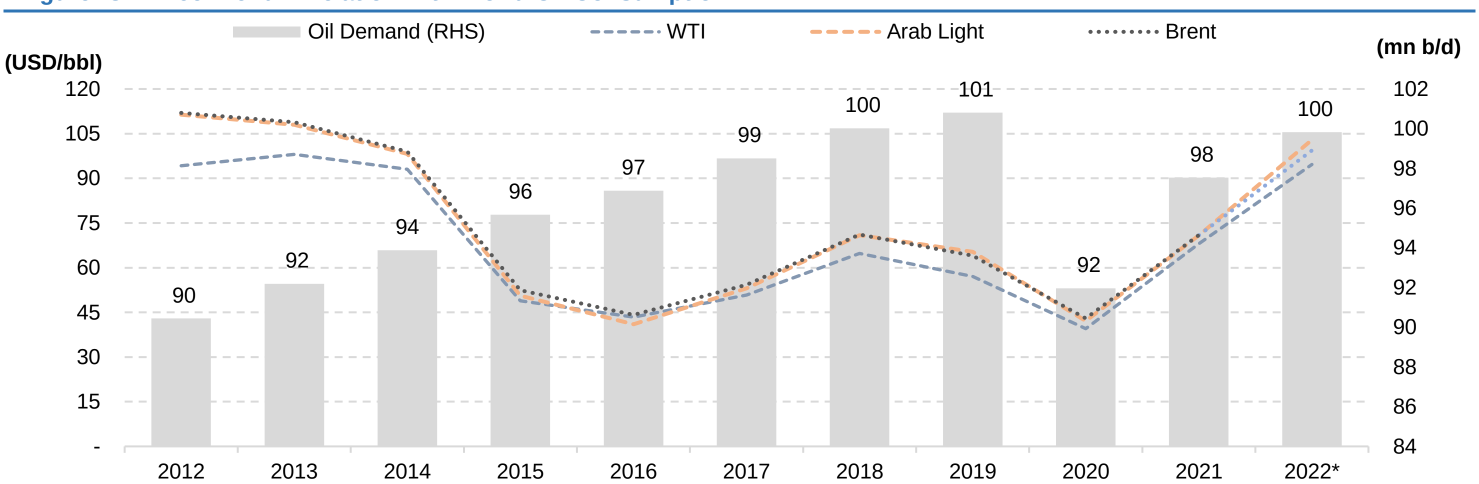
Source (s): EIA Short Term Energy Outlook, AHL Research

Figure: OPEC and Non-OPEC Production



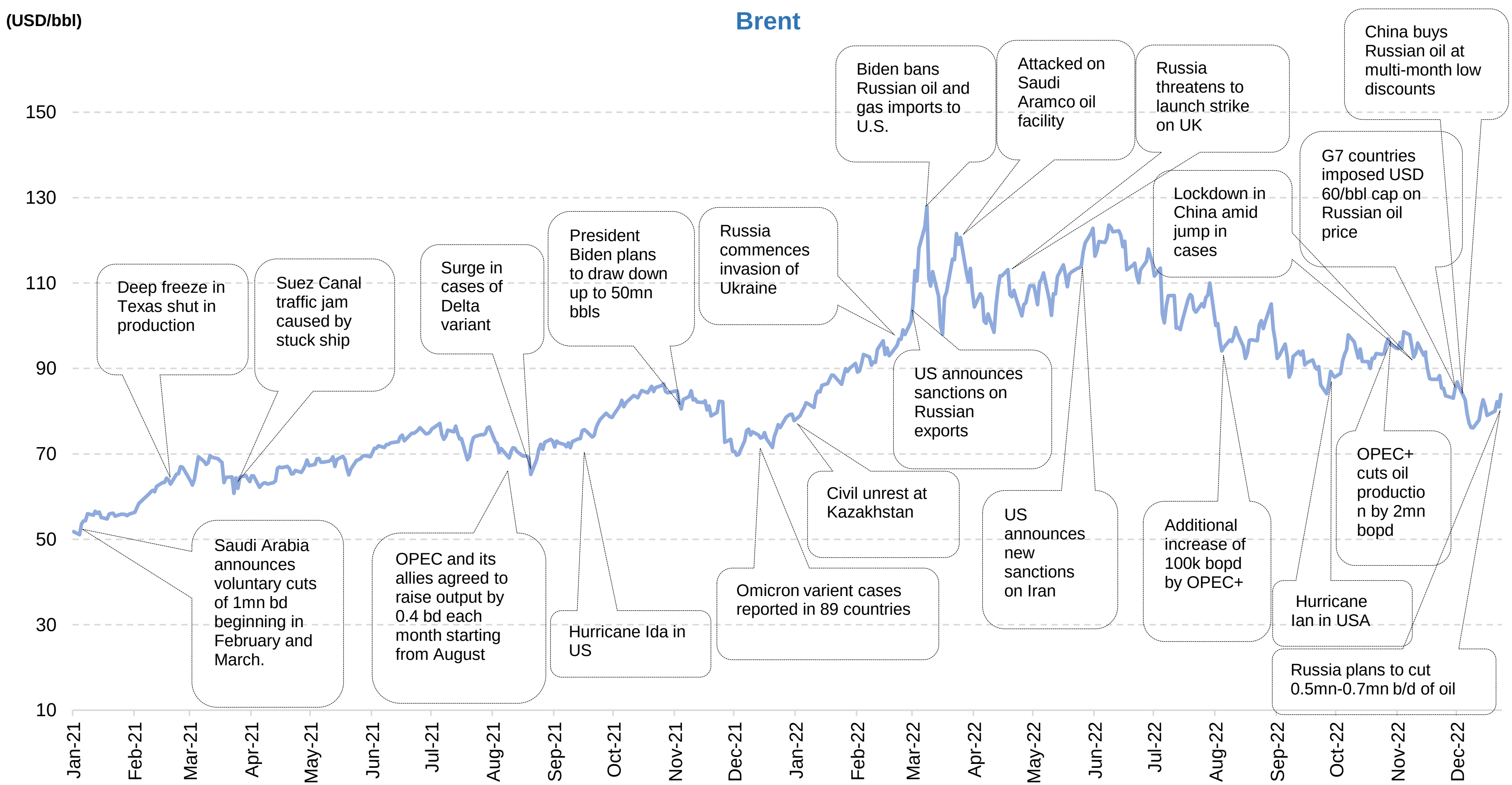
Source (s): EIA Short Term Energy Outlook, AHL Research

Figure: Oil Price Trend in relation with World Oil Consumption



Source (s): EIA Short Term Energy Outlook, Bloomberg, AHL Research *Estimated

Oil Event Graph

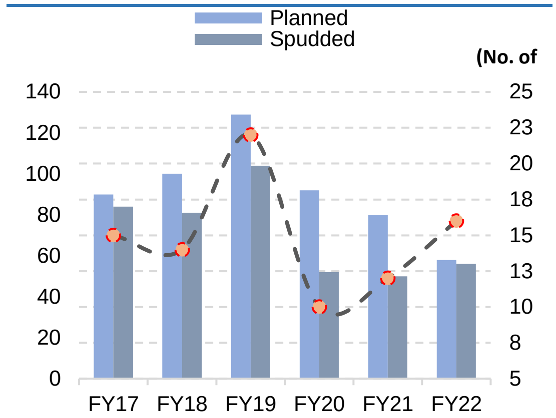


Exploration and Production

Enticing valuations

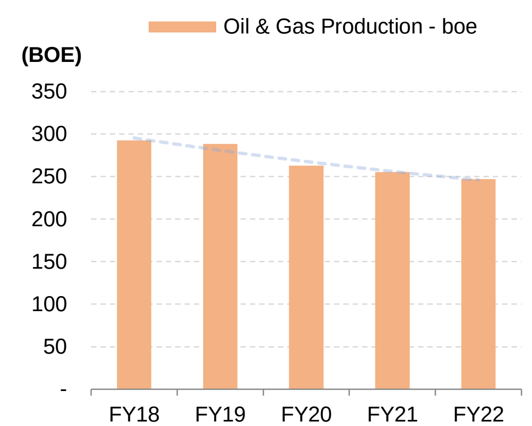
- **Pakistan's oil and gas production:** During FY22, Pakistan's oil production declined by 2.8% YoY to settle at 73,436 bopd against 75,530 bopd during FY21. Meanwhile, gas production tumbled by 3.3% YoY to arrive at 3,390 mmcfd in FY22 vis-à-vis 3,504 mmcfd in FY21. The decline in oil and gas production is attributable to natural decline at major oil and gas fields. For FY23, with new discoveries set to come online along with development projects undertaken by major oil and gas producers, we expect the natural decline to be mitigated.
- **Exploration targets:** The local E&P companies spud a total of 56 wells out of 58 planned wells during FY22, which consists of 27 exploratory and 29 development/appraisal wells. Out of the wells drilled, 16 yielded oil & gas discoveries. For FY23, 65 wells (24 exploratory and 41 development/appraisal wells) are planned to be spud by local E&P companies.
- **Circular Debt Issue and Resolution:** Overdue circular debt of E&P companies such as OGDC and PPL has ballooned up by PKR 770bn as of Sep'22. The total receivables of OGDC as of Sep'22 clocked-in at PKR 492bn, which includes overdue amount of PKR 423bn (PKR 393bn in Jun'22) on account of circular debt. These receivables are due from SSGC, SNGP and oil refineries worth PKR 177bn, PKR 156mn and PKR 90bn, respectively. Whereas, PPL's receivables during Sep'22 settled at PKR 404bn, in which trade debts stood at PKR 348bn. This comprises of receivables from gas utility companies such as SNGP and SSGC at PKR 203bn and PKR 172bn, respectively. To recall, during FY22, the circular debt climbed up faster due absence of gas tariff hike. However, in Dec'22, the government has formed a committee for the settlement of circular debt. This committee is considering various proposals and is expected to finalize a report soon.
- **Reko Diq Mining Project:** OGDC, PPL and GHPL entered into a framework agreement with the Federal Government, Government of Balochistan, and Barrick Gold Corporation for extraction of copper and gold reserves from Reko Diq, which is one of the world's largest undeveloped copper gold deposits. The mining field has a life of over 40 years. In this project OGDCL, PPL and GHPL will have a 25% equity collectively (8.33% share each). Furthermore, each of these companies will invest up to USD 398mn in the project within 3-4 years. The construction period is expected to be 4 years from the financial close. Recently, the E&P companies have negotiated and signed the definitive agreement.
- **Trading at cheap valuations:** The AHL E&P sector is currently trading at a PER of 2.3x based on FY23 earnings expectation compared to a PER of 3.8x of the KSE-100 Index and a five-year historical PER of 5.7x of the sector.

Figure: Planned/Spudded Wells & Discoveries



Source (s): PPIS, AHL Research

Figure: Pakistan's Oil & Gas Production



Source (s): PPIS, AHL Research

Key risk (s)

- Sharp appreciation of PKR against USD
- Drastic decline in oil prices.
- Inability to bring new discoveries online.
- Unfavorable outcome of the windfall levy case in the court of law.

Exploration and Production

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

Code	Current Price	TP Dec-23	Upside (%)	Stance	EPS (PKR) 2023	EPS (PKR) 2024	DPS (PKR) 2023	DPS (PKR) 2024	P/E (x) 2023	P/E (x) 2024	DY (%) 2023	DY (%) 2024
PPL	57.5	100.4	74.7	Buy	26.6	21.5	2.90	2.10	2.2	2.7	5%	4%
OGDC	73.0	127.8	75.0	Buy	28.6	27.9	5.75	5.75	2.6	2.6	8%	8%
MARI	1,544.1	2,331.2	51.0	Buy	376.8	309.1	188.00	155.00	4.1	5.0	12%	10%
POL	398.7	489.3	22.7	Buy	77.8	75.9	62.00	58.00	5.1	5.3	16%	15%

With USD 55/bbl in FY23 and going forward

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

Code	Current Price	TP Dec-23	Upside (%)	Stance	EPS (PKR) 2023	EPS (PKR) 2024	DPS (PKR) 2023	DPS (PKR) 2024	P/E (x) 2023	P/E (x) 2024	DY (%) 2023	DY (%) 2024
PPL	57.5	104.5	81.9	Buy	28.4	25.8	3.10	2.50	2.0	2.2	5%	4%
OGDC	73.0	131.4	80.0	Buy	31.9	32.2	6.50	6.50	2.3	2.3	9%	9%
MARI	1,544.1	2,496.2	61.7	Buy	379.8	381.9	190.00	191.00	4.1	4.0	12%	12%
POL	398.7	523.8	31.4	Buy	85.3	84.6	68.00	65.00	4.7	4.7	17%	16%

With USD 65/bbl in FY23 and going forward

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

Code	Current Price	TP Dec-23	Upside (%)	Stance	EPS (PKR) 2023	EPS (PKR) 2024	DPS (PKR) 2023	DPS (PKR) 2024	P/E (x) 2023	P/E (x) 2024	DY (%) 2023	DY (%) 2024
PPL	57.5	110.7	92.7	Buy	32.3	30.4	3.50	3.00	1.8	1.9	6%	5%
OGDC	73.0	137.7	88.7	Buy	39.4	36.6	8.00	7.50	1.9	2.0	11%	10%
MARI	1,544.1	2,597.1	68.2	Buy	386.5	473.3	193.00	237.00	4.0	3.3	12%	15%
POL	398.7	550.8	38.2	Buy	102.0	94.1	82.00	72.00	3.9	4.2	21%	18%

With USD 87/bbl in FY23 and USD 75/bbl in FY24

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

Code	Current Price	TP Dec-23	Upside (%)	Stance	EPS (PKR) 2023	EPS (PKR) 2024	DPS (PKR) 2023	DPS (PKR) 2024	P/E (x) 2023	P/E (x) 2024	DY (%) 2023	DY (%) 2024
PPL	57.5	111.6	94.1	Buy	32.0	32.4	3.50	3.10	1.8	1.8	6%	5%
OGDC	73.0	138.5	89.8	Buy	38.7	40.4	7.75	8.25	1.9	1.8	11%	11%
MARI	1,544.1	2,777.5	79.9	Buy	385.9	482.6	193.00	241.00	4.0	3.2	12%	16%
POL	398.7	590.6	48.1	Buy	100.5	101.9	65.00	80.00	78.0	3.9	16%	20%

With USD 85/bbl in FY23 and going forward

Case-5: Oil Prices Assumption (USD/bbl) and Fair Values

Code	Current Price	TP Dec-23	Upside (%)	Stance	EPS (PKR) 2023	EPS (PKR) 2024	DPS (PKR) 2023	DPS (PKR) 2024	P/E (x) 2023	P/E (x) 2024	DY (%) 2023	DY (%) 2024
PPL	57.5	114.8	99.8	Buy	33.8	35.3	3.70	3.40	1.7	1.6	6%	6%
OGDC	73.0	142.2	94.8	Buy	42.1	44.5	8.50	9.25	1.7	1.6	12%	13%
MARI	1,544.1	2,910.6	88.5	Buy	388.9	526.0	194.00	263.00	4.0	2.9	13%	17%
POL	398.7	623.6	56.4	Buy	108.0	110.4	86.00	85.00	3.7	3.6	22%	21%

With USD 95/bbl in FY23 and going forward

Oil & Gas Development Company Limited (OGDC)

In the driving seat

- **Production & developmental projects:** The company's oil and gas production witnessed a decline of 4.3% and 5.2% YoY, respectively in FY22 owing to natural decline at Nashpa, Chanda, Qadirpur, Rajian and KPD-TAY followed by ATA at eight producing fields. In a bid to mitigate the fall in production, the company has injected 10 fields to the production stream. Furthermore, the company completed Qadirpur and Maru-Reti compression projects during 1QFY23. Moreover, electric submersible pumps have been installed at Pasakhi-2 and Pasakhi North-3 which have started to bring in additional oil production of 1,080 bopd. Furthermore, the company undertook 89 workover jobs at major fields in order to halt natural decline. Additionally, the company is working on development projects such as Dakhni Compression (COD: Nov'23), KPD-TAY (COD: Mar'24) and Uch Compression (COD: May'24). These projects upon completion will be able to enhance oil and gas production. Consequentially, we project oil and gas production to increase by 4% and 15% YoY in FY23.

- **Planned operations & activities:** In FY23, the company plans to spud 24 wells (11 exploratory, 11 development and 2 re-entry wells). In FY22, OGDC spud 13 wells (7 Exploratory and 6 development wells). The exploratory activities resulted in 7 oil and gas discoveries (which have a potential to produce 4,250/bbls and 47/mmcfd). Furthermore, the company won four exploration blocks at the bidding round held in Oct'22. Meanwhile, activities are underway at the Abu Dhabi offshore block 5 exploration with appraisal plan for drilling of three wells for pre-existing discoveries has been sanctioned by ADNOC.

- **Resolution of Circular Debt:** OGDC's total receivables have swelled up to PKR 492bn, which consists of overdue receivables of PKR 423bn (as of Sep'22) relating to the circular debt. That being said, receivables are pending from SSGC, SNGP and oil refineries amounting to PKR 177bn, PKR 156mn and PKR 90bn, respectively. In case of resolution of circular debt, we expect the company's payout to improve and multiple to re-rate. In addition to this, gas tariff hike will likely to slow down the quantum of circular debt and will enable the company to undergo capital intensive projects, which could include drilling in challenging onshore and offshore blocks. Moreover, the company may also consider to acquire other international blocks.

- **Significant discovery at Wali-01 Well:** The company's newly discovered field - Wali is expected to have 2P reserves of 13mn bbls of oil and 219 bcf of gas. Meanwhile, the field has a production potential of 2,850 bopd of oil and 37 mmcfd of gas.

- **Reserve life:** As per PPIS's Oil & Gas Reserve Report for Jun'22, OGDC's reserve life is expected to be 19 years. The company's oil and gas reserves stand at 89mn bbls and 6,533 bcf, respectively as per Jun'22 reserves.

- **Trading at the cheapest PE multiple:** The stock is currently trading at an implied oil price of USD 46.55/bbl (ex-cash and cash balances) as compared to current Arab Light Price of USD 83.49/bbl with FY23 PER of 1.9x and P/B of 0.3x along with a dividend yield of 13%. We expect the company to post a net profit of PKR 39.39/share and PKR 36.58/share in FY23 and FY24, respectively.

OGDC

Summary Data

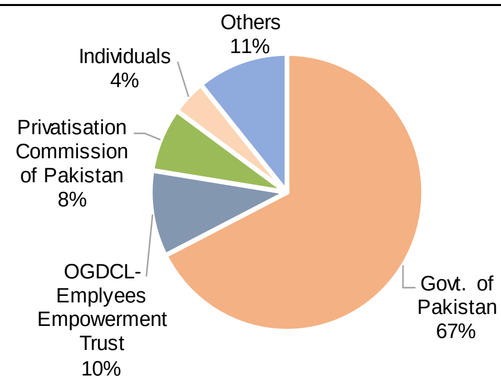
Target Price (Dec'23)	137.7
Last Closing	73.0
Upside (%)	88.7
Shares (mn)	4,301
Free float (%)	15
Market Cap. (PKR mn)	313,882
Market Cap. (USD mn)	1,391

Recommendation BUY

Price Performance

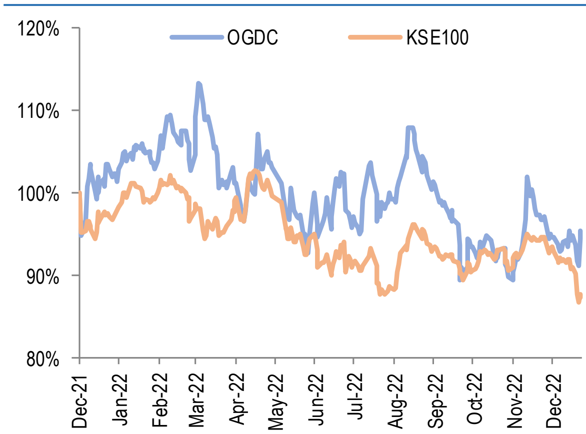
	3M	6M	12M
Return (%)	5.4	-2.6	-7.7
Avg. Volume (000)	2,196	2,322	2,411
ADTV (mn) - PKR	163	182	198
ADTV (000) - USD	729	822	994
High Price - PKR	78.0	82.6	86.7
Low Price - PKR	68.4	68.4	68.4

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	31.1	39.4	36.6
Dividend per share	PKR	7.3	9.3	8.5
Book value per share	PKR	203.5	230.8	258.6
Price to Earning	x	2.5	1.9	2.0
Price to Book	x	0.4	0.3	0.3
Dividend Yield	%	9.2	12.7	11.6
Net Margins	%	39.9	36.4	34.6

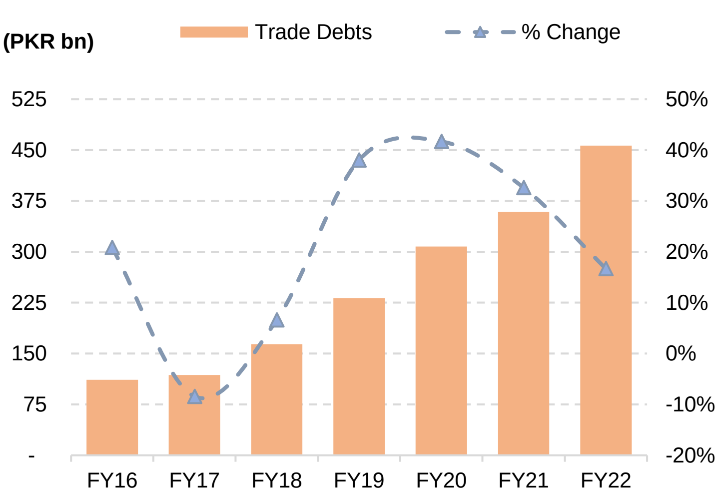
Source (s): Company Financials, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	335,464	465,855	454,881
Gross Profit	216,916	311,648	296,885
Other Income	46,571	23,602	15,946
Finance Cost	2,340	4,212	3,878
Post Tax Profit	133,784	169,420	157,333
Balance Sheet	**FY22a**	**FY23e**	**FY24f**
Shareholder's Equity	875,393	992,710	1,112,244
Trade and Other Payables	139,066	194,982	176,743
Total Liabilities	254,590	270,503	253,777
Current Assets	778,537	911,611	999,511
Non-Current Assets	351,446	351,602	366,510
Total Assets	1,129,983	1,263,213	1,366,021

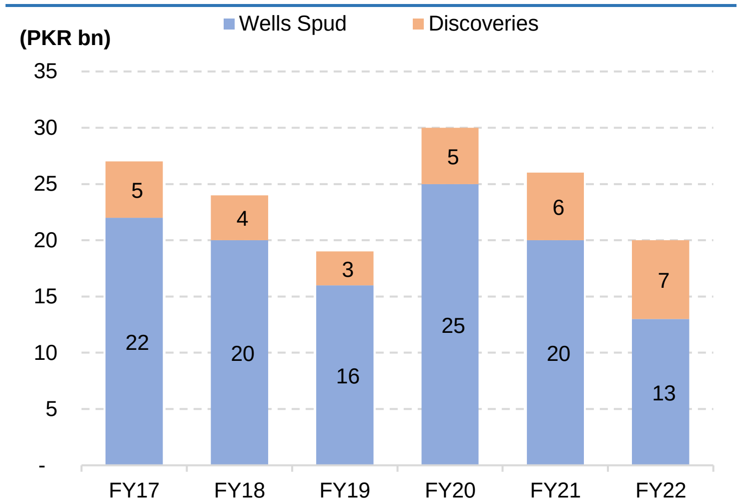
Source (s): Company Financial, AHL Research

Figure: OGDC's Trade Debts



Source (s): Company Financials, AHL Research

Figure: Hydrocarbon Discoveries against Wells Spud



Source (s): Company Financials, AHL Research

Pakistan Petroleum Limited (PPL)

Circular debt resolution to unlock value

- **Update on production & development projects:** The Company's oil and gas production witnessed a decline of 11% and 5% YoY, respectively in FY22. The fall in production was owed to lower offtake from the Kandhkot Gas field and a natural decline at major fields such as Nashpa, Adhi, Sui and Tal Blocks. The company is taking certain measures to deal with the natural decline. Workovers and optimization at Sui field is being undertaken to arrest the decline. This includes compressor modification for existing SML compressors at Sui. Alongside this field, installation/upgradation at Gambat, Kirthar and Tal fields is also planned, which will ensure smooth production from these fields continues. At GENCO-II, lower offtake resulted in a dip in production from Kandhkot. In order to cater to this issue, the company is planning to re-allocate gas to other sectors. The company's Dhok Sultan Oil Facility became operational in 4QFY22, which will improve oil production. The production from Latif South-1 was added to the production line towards the end of 4QFY22, which is currently producing 1,800 bbls of oil and 3 mmcfd of gas. For FY23, we expect oil production to climb up by 4% YoY, while gas production is anticipated to depict a meagre decline of 0.3% YoY.
- **Bottom-line to arrive at PKR 32.35/share in FY23:** We expect profitability at PKR 32.35/share and PKR 30.41/share in FY23 and FY24, respectively, amid i) PKR depreciation, and ii) stable oil prices (expected at USD 87/bbl on average in FY23 and USD 75/bbl in FY24). The stock is trading at an implied oil price of USD 50.15/bbl (ex-cash and cash balances) against Arab Light Price of USD 83.49/bbl with FY23 PER of 1.8x and P/B of 0.3x along with a dividend yield of 8%.
- **Circular debt issue:** The company's circular debt, which is mostly due to the gas sector, has reached an alarming level. The receivables position stood at PKR 404bn (as of Sep'22) which translates to cash of ~PKR 148.4/share., whereas overdue receivables amount to PKR 348bn as at Sep'22. The resolution of the circular debt will reduce the company's financial strain, improve dividend payout and aid multiple re-rating.
- **Exploration at Abu Dhabi Block:** The consortium under the name Pakistan International Oil Limited (PIOL) undertook seismic activities at the block in FY22, the evaluation of which is in progress. In this consortium, PPL serves as an operator with a 25% stake. Meanwhile, as a consortium operator, PPL plans to drill the first ever well at the block towards the end of FY23. Furthermore, the consortium submitted an appraisal plan for five undeveloped pre-existing discoveries to ADNOC, which the group has approved.
- **Outlook on future operations:** For FY23, the company plans to spud seven exploratory and nine development wells. In addition to this, the company farmed-in Baska and Eastern Offshore Indus Block-C, after which the company now has a stake of 82.5% and 100%, respectively. Meanwhile, at a bidding round held in Apr'22 and Oct'22, the company was awarded eight new blocks. In addition to domestic activities, the company is exploring and evaluating options across Middle East, Africa and Far East regions for new exploration and production opportunities.

PPL

Summary Data

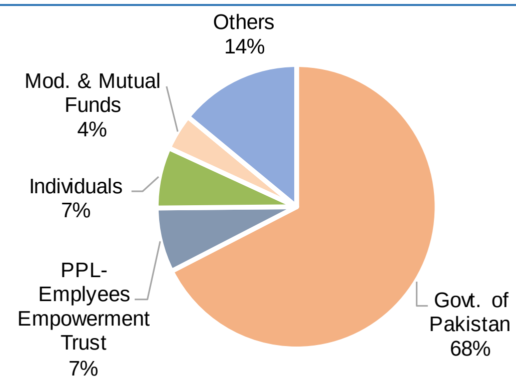
Target Price (Dec'23)	110.7
Last Closing	57.5
Upside (%)	92.7
Shares (mn)	2,721
Free float (%)	25
Market Cap. (PKR mn)	156,374
Market Cap. (USD mn)	693

Recommendation BUY

Price Performance

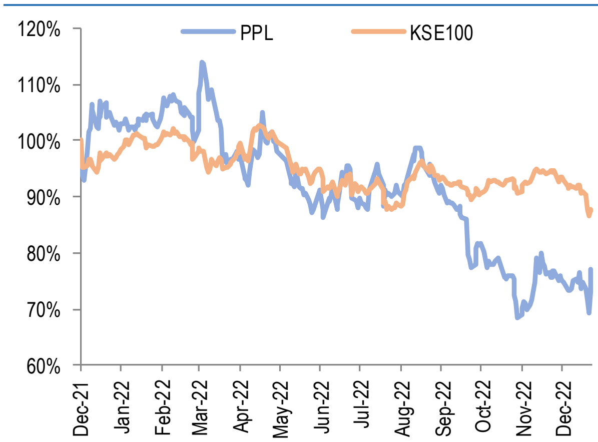
	3M	6M	12M
Return (%)	-0.5	-14.2	-26.6
Avg. Volume (000)	2,215	1,925	1,651
ADTV (mn) - PKR	126	119	111
ADTV (000) - USD	562	536	549
High Price - PKR	61.1	73.7	85.2
Low Price - PKR	51.1	51.1	51.1

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	19.7	32.3	30.4
Dividend per share	PKR	2.0	4.5	4.0
Book value per share	PKR	159.8	185.2	209.6
Price to Earning	x	3.4	1.8	1.9
Price to Book	x	0.4	0.3	0.3
Dividend Yield	%	3.0	7.8	7.0
Net Margins	%	26.5	33.8	32.7

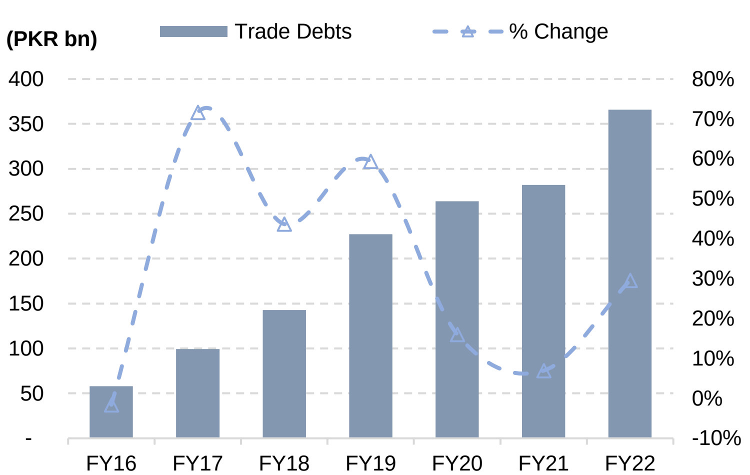
Source (s): Company Financials, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	202,199	260,514	253,178
Gross Profit	131,608	177,036	168,892
Other Income	14,186	9,489	4,705
Finance Cost	1,249	1,914	2,240
Post Tax Profit	53,546	88,017	82,747
Balance Sheet	**FY22a**	**FY23e**	**FY24f**
Shareholder's Equity	434,875	503,845	570,267
Total Liabilities	190,070	216,081	236,722
Current Assets	446,840	507,938	560,671
Fixed Assets	137,953	146,753	152,627
Non-Current Assets	143,999	152,799	158,672
Total Assets	590,839	660,737	719,343

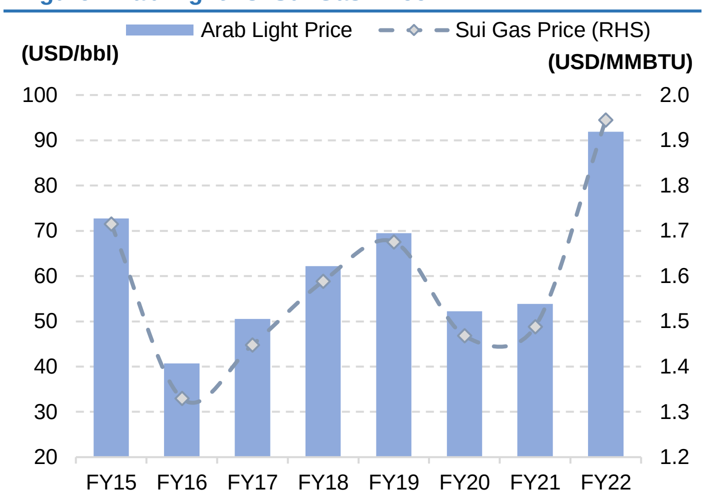
Source (s): Company Financial, AHL Research

Figure: PPL's Trade Debt



Source (s): Company Financials, AHL Research

Figure: Arab Light vs. Sui Gas Price



Source (s): OGRA, Bloomberg, AHL Research

Mari Petroleum Company Ltd. (MARI)

Unlocking full potential

- **Earnings to clock-in at PKR 386.16/share in FY23:** Earnings are anticipated to climb up at a 3-Yr CAGR of 38%. We expect the company to post a net profit of PKR 386.16/share and PKR 470.39/share in FY22 and FY23, respectively. Major reasons behind this growth are i) attractive pricing for incremental production from MGF under Petroleum Policy 2012, and ii) completion of Sachal Gas Processing Complex (which will bring in incremental 90 mmcfd of gas by FY23).
- **Reserve life of 18 years:** As per PPIS's Oil & Gas Reserves Reports for Jun'22, reserve life for MARI is estimated to be 18 years. In terms of gas reserves, the largest field - Mari Gas Fields (MGF's) - reserve life is projected to be 18 years, with the field's reserves settling at 4,842 bcf in Jun'22.
- **Oil & gas production update:** Oil and gas production of MARI jumped up by 0.3% and 5% YoY, respectively during FY22. During FY22, the gas production commenced from Iqbal, and Hilal. Meanwhile, during FY23 we forecast gas production to remain stable despite incremental gas production from SGPC during FY23, offsetting the lower production in 1HFY23 due to extended ATA at EFERT's EnVen plant followed by ATA at FFC's plant-1. In FY23, the gas production is expected to climb up by 20% YoY, respectively. We expect the gas production to achieve a 3-Yr CAGR of 10%.
- **SGPC project:** In FY22, the company completed Phase 1 and 3 (which is also called HRL swing volume project) of the Sachal Gas Processing Complex and started to supply 60mmcfd of gas to SNGPL. Meanwhile, for phase 2 of the project, construction and commissioning activities are ongoing and will be completed towards the end of 2QFY23, bringing in an additional 90mmcfd of gas to the production system.
- **Major discovery at Bannu West:** The newly discovered Bannu West (which is the first ever discovery in North Waziristan) underwent a post acid test. Results of this showed a flow rate of 50mmcfd of gas and 300bopd condensate. Currently, installation of production facility and infrastructure development is being carried out. As per company estimates, the production from the field is expected to come online within 8-10 months. Moreover, another exploration well and two appraisal wells are planned for future.
- **Future outlook:** During FY23, MARI has planned to spud 9 exploratory, 3 appraisal, and 4 development wells. In addition to this, MARI drilled the first ever horizontal well "Mari-122H", which tested at a rate of 21 mmcfd of gas. MARI plans to bring this well in early production. Alongside this, MARI plans to drill more horizontal wells in order to extend HRL gas plateau. Furthermore, the company was awarded five new exploration blocks in bidding rounds held in 2022. Moreover, MARI farmed into Margalla and Bela West Block during FY22, increasing the company's stake to 30% and 39%, respectively. Additionally, MARI has also entered into an agreement with Fertilizer companies such as FFC, EFERT and FATIMA for development of a project, the purpose of which is maintenance of gas production at required delivery pressure from Habib Rahi Limestone Reservoir.

MARI

Summary Data

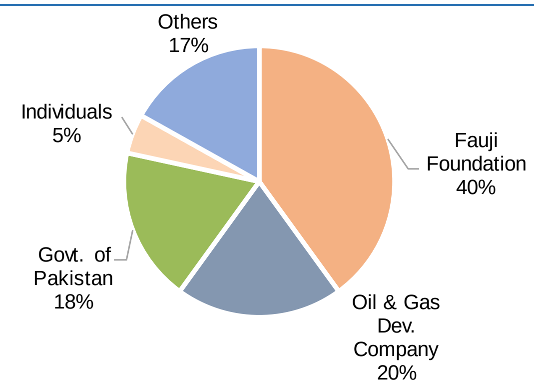
Target Price (Dec'23)	2,597.1
Last Closing	1,544.1
Upside (%)	68.2
Shares (mn)	133
Free float (%)	20
Market Cap. (PKR mn)	205,981
Market Cap. (USD mn)	913

Recommendation BUY

Price Performance

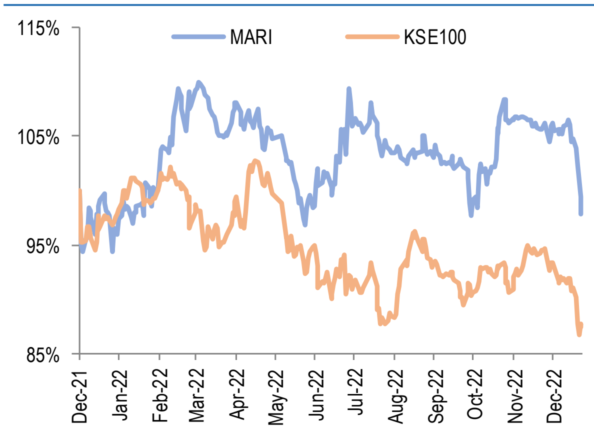
	3M	6M	12M
Return (%)	-4.2	-5.3	-0.1
Avg. Volume (000)	29	30	29
ADTV (mn) - PKR	48	50	48
ADTV (000) - USD	213	224	237
High Price - PKR	1,710.2	1,724.8	1,733.6
Low Price - PKR	1,540.8	1,540.8	1,488.9

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	247.8	386.5	473.3
Dividend per share	PKR	124.0	193.0	237.0
Book value per share	PKR	866.1	980.9	1,174.4
Price to Earning	x	7.0	4.0	3.3
Price to Book	x	2.0	1.6	1.3
Dividend Yield	%	7.1	12.5	15.3
Net Margins	%	34.8	34.5	31.2

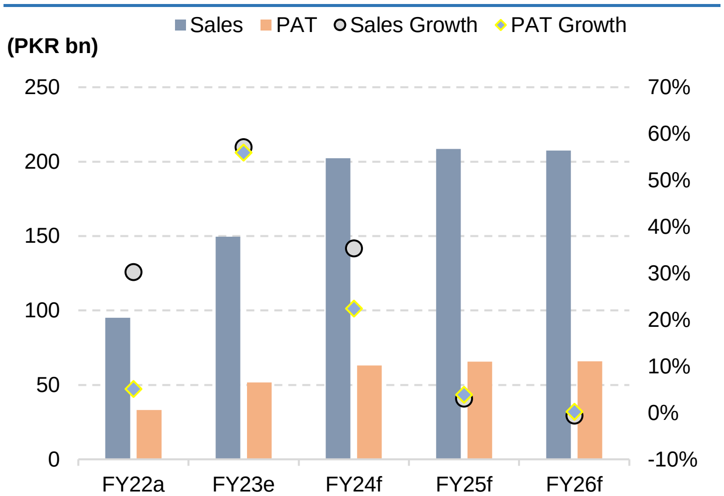
Source (s): Company Financials, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	95,134	149,496	202,390
Gross Profit	65,732	99,094	122,698
Operating Profit	48,613	75,595	89,354
Finance Cost	4,483	4,740	4,276
Post Tax Profit	33,063	51,562	63,135
Balance Sheet	**FY22a**	**FY23e**	**FY24f**
Shareholder's Equity	115,534	130,859	156,674
Trade and Other Payables	23,681	38,013	48,473
Total Liabilities	34,853	54,281	64,018
Current Assets	85,463	85,950	106,597
Non-Current Assets	64,924	99,190	114,095
Total Assets	150,386	185,140	220,692

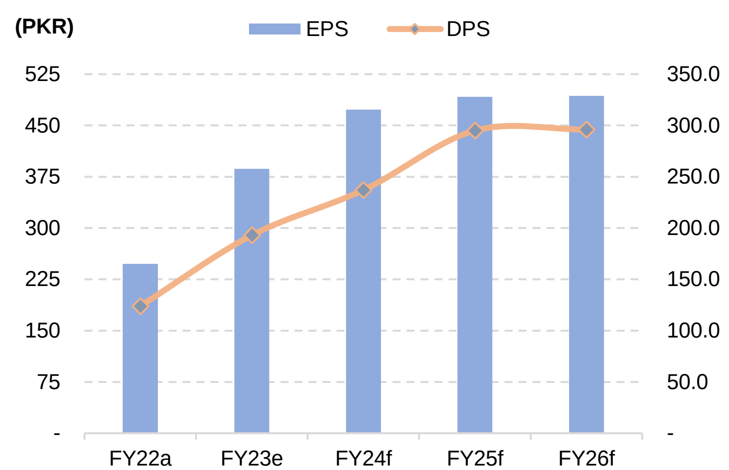
Source (s): Company Financial, AHL Research

Figure: Sales in relation to Earnings



Source (s): Company Financials, AHL Research

Figure: EPS in relation to DPS



Source (s): Company Financials, AHL Research

Cements

New coal mitigation plan to the rescue

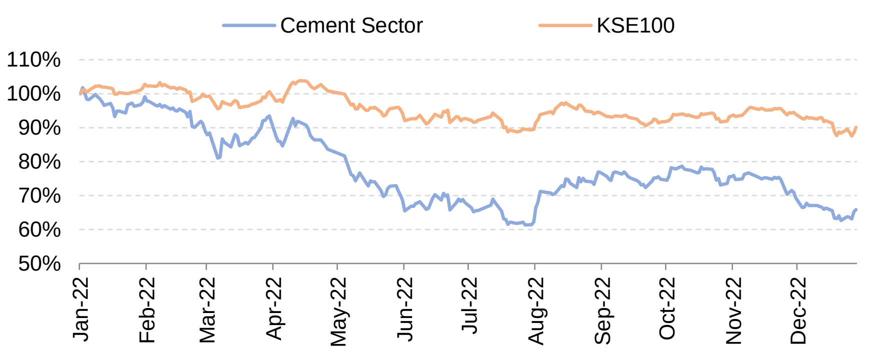
Cement Sector

New coal mitigation plan to the rescue

- **Recap of FY22:** Cement dispatches during FY22 settled at 52.84mn tons (-8% YoY) given a 1% YoY cut in domestic offtake to 47.65mn tons as the government / SBP rolled back incentives offered during the initial COVID outbreak, interest rates went up, cement prices rose drastically as manufacturers passed on costs (primarily higher coal prices in the backdrop of a commodity super cycle, PKR depreciation, and higher energy tariff), which together with low public sector led demand given a tight fiscal situation, could not aid cement demand this year. Meanwhile, exports too continued to underperform; 44% YoY decline during FY22 to 5.20mn tons was attributable to slow down in sea-based exports to Bangladesh and Sri Lanka together with liquidity issues in the neighboring Afghan market eroding exports from Pakistan. Further dissection revealed that deterioration in North region's offtake during FY22 arrived at 7% YoY to 40.34mn tons with local offtake compressing by 3% YoY to 39.43mn tons amid weak demand ensuing from construction activity and government projects, while exports dwindled by a significant 65% YoY to 0.91mn tons. Whereas South-based dispatches underwent a dip of 12% YoY to 12.50mn tons owed to a 36% slowdown in exports to 4.29mn tons. However, domestic demand in the South market remained shielded, growing by 9% YoY in FY22 to 8.21mn tons, as many housing projects remained on track.

  While cement dispatches tumbled, domestic players were also subject to a shock on the costing side with coal prices touching an all-time high of USD 460/ton in Mar'22 (more details later). In addition, the Pak Rupee lost major ground against the USD to close at 204.85/USD against PKR 157.54/USD in Jun'22. Imported inflation amid weakness on the external account fueled by the commodity super cycle further exacerbated, also caused a significant rise in costs across the board. As a result, cement prices too had to adopt with the times; jumping to near record high levels of PKR 1,023/bag against PKR 640/bag at the end of last year. That said, smart inventory management (switch to alternate coal, such as Afghan and local coal from Darra Adam Khel and Umar Kot, amongst others), as well as consistent price hikes throughout the year allowed KSE-100 index cement manufactures to achieve a profitability growth of 28% YoY to PKR 54,666mn (a historic high). This remains impressive as corporates were faced by many economic challenges during the year, but more so as they bore the brunt of a hefty super tax levy to the tune of 10% in FY22. Albeit, despite the stunning earnings growth, the sector underperformed the market, posting a return of -45% against -12% return of the KSE-100 index in FY22 attributable to overplayed risk themes.

Exhibit: Cement sector vs KSE-100 index return

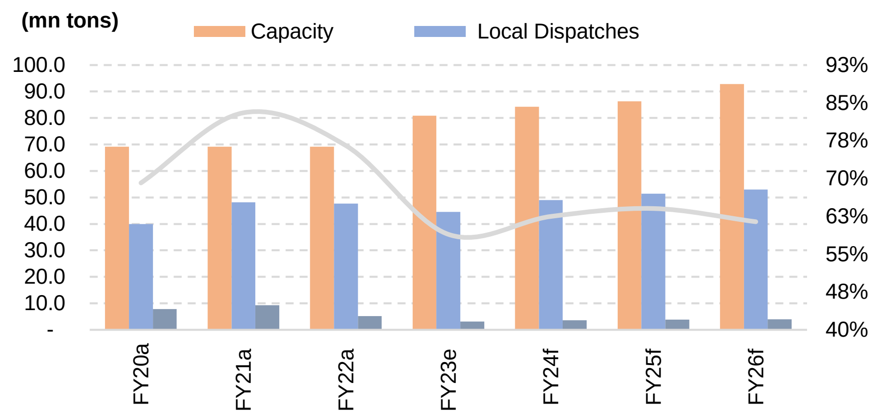


Source (s): PSX, AHL Research

- **Another year of slowdown in offtake expected:** Pakistan is once again at a very interesting juncture whereby we have to adopt policies to bring down inflation to moderate levels, at the risk of slowing down the economy. A similar trend is been observed in major global economies on the back of an elongated commodity super cycle. As a result, demand erosion has been put in place given lower real disposable income and tighter financial conditions. Whereas the 2022 floods in Pakistan have also inevitably worsened the offtake position; domestic dispatches dipped by 34% YoY during the first two months of the fiscal year. Justifiably, a rebound was witnessed in the following months as activity resumed, with local cement sales displaying a dip of 17% YoY in 1HFY23. Moreover, we believe commencement of a rehabilitation process in the second half would further cushion the overall drop. Our estimates suggest that total dispatches will observe a decline of 10% YoY to 47.64mn tons in FY23 with local offtake settling at 44.56mn tons (down by 7% YoY). We project a 7% reduction in North, while dispatches in the South region are expected to undergo a downturn of 5% as more destruction was observed in this region post floods, hence attracting more funds for rehabilitation.

  On the exports front, global conditions have yet to improve, although some recovery is being witnessed in North based exports to Afghanistan. We forecast total exports to come down by 41% YoY to 3.08mn tons (52% decline in South, while a 12% jump in North exports is foreseen), recovering slightly from the 51% YoY dip in 6MFY23.

Figure: Cement Offtake and Utilization



Source (s): AHL Research

We have prepared a sensitivity with respect to offtake assumptions for FY24 in a table for all companies operating under the AHL cement universe. Please check the table below.

Exhibit: Sensitivity for offtake

	FY24f EPS (PKR)					
	LUCK	MLCF	FCCL	DGKC	KOHC	ACPL
Base Case local offtake (tons)	8,793,708	5,090,550	5,298,435	4,595,541	3,153,268	1,925,269
Scenario1: Increment by 100,000 tons	35.08	4.90	2.26	3.05	22.71	6.95
Scenario 2: Increment by 50,000 tons	35.19	4.81	2.22	2.92	22.31	6.12
Base Case EPS	**35.30**	**4.71**	**2.18**	**2.80**	**21.92**	**5.28**
Scenario 3: Reduction by 50,000 tons	35.41	4.62	2.14	2.67	21.52	4.45
Scenario 4: Reduction by 100,000 tons	35.52	4.52	2.09	2.54	21.13	3.62

Source (s): AHL Research

- **The rise and fall of coal:** The cement sector has had a tumultuous past few months. While domestic manufacturers had already been prepared for high coal prices given the tense Russia-Ukraine conflict, the levels seen however, were certainly unprecedented once a war broke out. However, it is pertinent to highlight that the factors that caused prices to surge, emerged long before the war in Europe, and were only aggravated by the sanctions on Russia. From a supply crunch witnessed last year, to the European rush for energy alternatives this year, commodity prices have gone through the roof.

China's ban of Australian coal in late 2020, as the latter pushed for an investigation into the origins of the coronavirus, triggered a spike in the commodity. It was however, the evolving Chinese power policy which played an active part in fueling coal prices. The country tried to revive industrial production last year by putting a cap on electricity prices. As global commodity prices went up, this caused the power utility companies in China to either post losses or curb production, which further deteriorated the power crunch. Following this, China had to procure coal on an urgent basis prior to the winter season last year, which caused the commodity price to mount up further. It became evident that a change in Chinese policy was much needed i.e., allowing local power producers to charge higher fuel prices, which became effective in the subsequent months. Much to the displeasure of the Chinese government, this signaled higher Chinese demand which again translated to even higher commodity prices.

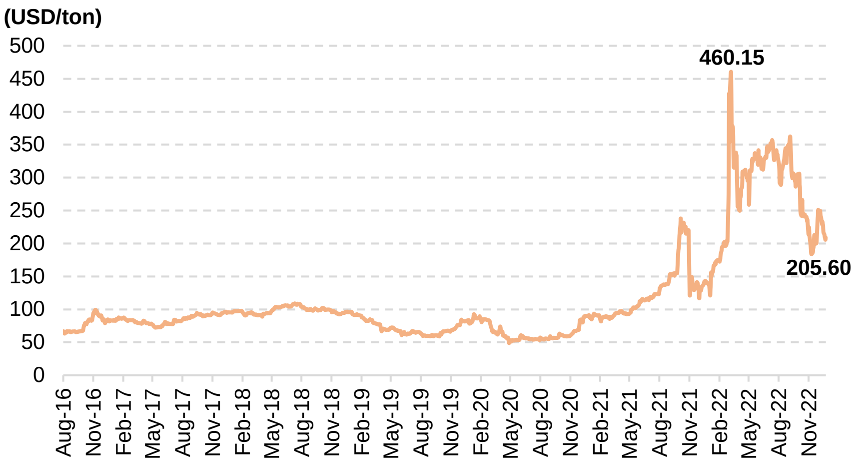
This coincided with the Russian invasion of Ukraine in Feb'22. As the military operation began, a potential loss in coal exports by Russia to the European Union gave rise to supply concerns. It was feared that Russia, one of the world's largest coal-producing countries, will be shunned due to post-war sanctions. Consequentially, prices sky-rocketed to record levels. Coal (RB2) rose sharply to breach its previous all-time high mark of USD 456/ton, to close at USD 460/ton on March 8th, 2022.

Although the war lingers, prices have since cooled off. Initial correction was owed to talks of resolution in Europe, and a fresh outbreak of COVID-19 in China which threatened its demand outlook. For a few months, coal traded between USD 300-350/ton, down from its high, as surge in inflationary readings in major European countries and North America was expected to curb demand world over.

Though the recent dip seen in the South African coal to under USD 200/ton in Nov'22 was owed to quashing of the belief that Russian supplies will be removed from the market in the aftermath of the war. In fact, Russian coal exports have managed to hold up, with a shift in market. Buyers in China and India have replaced lost sales to Japan and South Korea, with initial discounts also gradually tapering off, restoring the confidence in Russian supply. As a result, prices of Australian and South African coal, as well as coal delivered to Europe, have come swiftly down. At present RB2 hovers at USD 208/ton.

Please find below a chart that chronicles the direction of international coal (RB2) prices.

Figure: Trend of international coal prices



Source (s): Bloomberg, AHL Research

Although, prices may have come down, they still remain well above the year earlier levels. Moreover, it is likely that prices of major energy commodities will remain elevated in the backdrop of global political tensions and the rolled over demand and supply gap. However, we believe these levels are not sustainable in the long term. Especially for a commodity like coal, which is becoming vastly unpopular due to concerns over its carbon emissions leading to pollution.

That said, it seems unlikely that coal would display an all-out crash to come down to levels seen in 2021 (under USD 70/ton) since a stagflation scenario is also building up with global economies slowing down by still heavily reliant on energy, which will keep prices of energy producing commodities relatively high.

From a domestic focal point, cement manufacturers have mitigated their exposure to the South African coal by making a switch to coal sourced from Afghanistan, Tajikistan, Indonesia, Mozambique, and the local market in DarRa Adam Khel. This has been a game changer as South African coal became unviable while local and Afghan coal gradually became part of the coal mix used by cement players, particularly in the North region.

To highlight, future coal contracts of Richard Bay RB2 for Jan'23 are currently hovering at USD 186/ton, at a steep 60% discount from its all-time high of USD 460/ton, which translates to a landed price of PKR 47,000/ton. In comparison, in Mar'22, landed price of RB2 touched over PKR 100,000/ton, whereby no local players were relying on it since Afghan coal was available at PKR 35,000/ton (trading at a positive delta of 65% to RB2), while local coal was 14% cheaper than Afghan coal (PKR 30,000/ton) at the time.

To recall, Afghan coal touched a high of PKR 58,000/ton (for North based plants) last month while local coal from Darra Adam was being traded at PKR 40,000/ton. Meanwhile coal imported from Mozambique and Indonesia was being procured at USD 170-190/ton (FOB) i.e., landed cost of PKR 45-50,000/ton by manufacturers in South, but not a very notable quantity due to quality issues.

Albeit, since the massive dip in RB2 coal, Afghan, Darra and Umar Kot coal has also corrected to PKR 45,000/ton, PKR 30,000/ton and PKR 25,000/ton, respectively.

Moreover, international freight costs on coal import have also come down to USD 20/ton after peaking to USD 30/ton in the past few months.

Therefore, local players have once again started importing coal from Mozambique and Indonesia, particularly manufacturers in South. Given this, we have used a different mix for each cement company, based on plant location, inventory levels and quality of coal available. In general, we have assumed imported coal mix to average at USD 190-200/ton (FOB) during the remainder of FY23, whereas Afghan coal average for the year is estimated at over PKR 48,000/ton with local coal average projected at ~PKR 36,000/ton.

We have prepared a sensitivity with respect to coal assumptions for FY24 in a table for all companies operating under the AHL cement universe. Please find the table below.

Exhibit: Sensitivity for coal prices

	FY24f EPS (PKR)					
	LUCK	MLCF	FCCL	DGKC	KOHC	ACPL
Base Case Coal Prices (PKR/ton)	45,534	40,810	44,984	44,731	42,330	44,366
Scenario1: Increment by PKR 5,000/ton	23.62	2.50	1.33	-3.24	15.54	-2.23
Scenario 2: Increment by PKR 2,500/ton	29.46	3.58	1.74	-0.17	18.80	1.61
Base Case EPS	**35.30**	**4.71**	**2.18**	**2.80**	**21.92**	**5.28**
Scenario 3: Reduction by PKR 2,500/ton	41.14	5.82	2.58	5.79	25.31	8.97
Scenario 4: Reduction by PKR 5,000/ton	46.97	6.92	3.00	8.86	28.55	12.76

Source (s): AHL Research

- **Major expansions to reach conclusion in FY23:** The latest expansionary cycle in the cement industry will reach climax during the ongoing year, with 15.11mn tons of capacity being added in FY23 (+22%) against the existing capacity of 69.16mn tons. Given the scheduled expansions, a total of 23.66mn tons can be added to the sector by the end of CY25.

Pertinently, four plants having a combined capacity of 9.36mn tons have already commissioned, namely Bestway Cement's Greenfield expansion of 2.16mn tons in Mianwali (Punjab), followed by Askari Cement's (now merged with Fauji Cement) 1.95mn tons Brownfield expansion in Nowshera (KPK), Maple Leaf's 2.10mn tons Brownfield expansion at Mianwali (Punjab), and Lucky's 3.15mn tons Brownfield expansion at Pezu (KPK).

Others to follow this year include Flying cement (2.31mn tons; Khushab, Punjab) in Jan'23, Attock cement (1.28mn tons; Hub, Baluchistan) in Jun'23, and Bestway cement (3.16mn tons; Hattar, KPK) in Jun'23. Meanwhile some expansions have faced delays and we expect them to come online starting with Fauji cement (2.05mn tons; DG Khan, Punjab) in Jul'24, followed by Kohat cement (3.50mn tons; Khushab, Punjab) in Dec'25, and Cherat cement (3.00mn tons; DI Khan, KPK) in Dec'25. Please find the table below.

Exhibit: Cement expansions

Company	Expansion Size*	Type	Investment (PKR bn)	Timeline
Bestway Cement	2.16	Greenfield	31.00	Oct'22
Askari Cement	1.95	Brownfield	27.00	Oct'22
Maple Leaf	2.10	Brownfield	22.00	Nov'22
Lucky Cement	3.15	Brownfield	30.00	Dec'23
Flying Cement	2.31	Brownfield	14.00	Jan'23
Attock Cement	1.28	Brownfield	18.00	Jun'23
Bestway Cement	2.16	Brownfield	24.00	Jun'23
Fauji Cement	2.05	Greenfield	35.00	Jul'24
Kohat Cement	3.50	Greenfield	42.00	Dec'25
Cherat Cement	3.00	Greenfield	40.00	Dec'25
Total	**23.66**		**283.00**	

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

- **High prospects of lower prices, war or no war:** Although cement manufacturers insist that prices will not face any downwards pressure, despite addition of new capacities, we have reason to believe that during the second half of FY23, cement prices will witness a notable decline in the North region. Some may call it a price war as new capacities come online and players fight for market share, but we also cite the drastic cut in coal costs as sufficient rationale behind the same.

Multiple factors support our hypothesis. First off, coal from all sources has shown tremendous weakness. For North-based players, Afghan coal came down from its peak of PKR 58,000/ton to PKR 45,000/ton at present which translates to savings of PKR 91/bag. Moreover, for those manufacturers that are consuming coal from Darra Adam, savings of PKR 70/bag have been observed as prices are hovering at PKR 30,000/ton currently after touching PKR 40,000 last month, meanwhile coal from Umar Kot is even cheaper at between PKR 20-000-30,000/ton. Whereas South-based players, that procured imported coal at around USD 250/ton (FOB) until last month, will save at least PKR 92/bag as prices have come down to USD 200/ton. It appears that cement manufacturers will deem it fit to partially pass on this impact, if not completely, in the next quarter as they accumulate low-cost coal inventory.

This will also be a good signal for the cement market as apart from the general slowdown in the economy, a key culprit behind how quickly demand for cyclical sectors displayed erosion has been poor affordability of consumers. This was triggered by higher prices of end products (including cement), and compressed incomes as high inflationary pressure could not sustain disposable incomes. Therefore, price cuts can revive the stalled construction activity seen currently.

Moreover, cement demand is already expected to be slow this year which can compel manufacturers to capture the already shrunk market, particularly as new capacities come online. A perfect opportunity for this will surface in the second half whereby we expect demand to bounce back, which will shield the profitability of the sector with higher offtake somewhat compensating for the slashed prices. Our demand outlook for the remainder year is hinged upon Pakistan concluding IMF’s ninth review and the Dec’22 bond being settled successfully. Following that, as other bilateral and multilateral sources send aid for Floods and provide other monetary support, cement and cyclical demand will be cushioned via the commencement of a rehabilitation process.

In addition, as Dollar inflows improve and cement prices come down sharply, we view economic activity, particularly construction demand, to pick up. This will also coincide with certain pre-election expenditures that the government might want to undertake.

In the North region, we view a cut of PKR 100/bag from current levels in 2HFY23 with the same level to hover during FY24. Whereas we expect this to keep the prices in South locked at current levels over second half of the ongoing year as well as the following year. This will also restore the differential in prices between the North and South, as currently prices have become nearly indistinguishable in both the regions.

Since we have cut prices in North, we prepared a sensitivity with respect to cement prices for FY24 in a table for all companies operating in North under the AHL cement universe. Please check the impact of changes in prices in North in the table below.

Exhibit: Sensitivity for cement prices

	FY24f EPS (PKR)				
	LUCK	MLCF	FCCL	DGKC	KOHC
Base Case Retention Prices (PKR/bag)	568.34	615.66	595.07	597.31	546.52
Scenario1: Increment by PKR 50/bag	45.40	6.93	3.33	6.72	30.81
Scenario 2: Increment by PKR 25/bag	40.35	5.82	2.76	4.84	26.38
Base Case EPS	**35.30**	**4.71**	**2.18**	**2.80**	**21.92**
Scenario 3: Reduction by PKR 25/bag	30.25	3.59	1.61	0.75	17.51
Scenario 4: Reduction by PKR 50/bag	25.20	2.45	1.05	-1.12	13.05

Source (s): AHL Research

Outlook for profitability: Incorporating the aforementioned in our forecasts, we believe earnings of the sector would witness an uptick of 24.2% in FY23.

Key Risk (s)

1. Cement price cut scenario to play out in a more aggressive way and / or elongated period of time.
2. Slower rebound in cement demand.
3. Uptick in international coal prices also rendering higher coal prices in Afghanistan, Mozambique and local market.
4. Hike in the domestic policy rate and / or delay in reversal of the same to augment the finance cost of leveraged companies in the sector.
5. Slowdown in the economy with need for higher tax revenue to force the government to impose more taxes on industries.
6. Jump in energy costs (higher than anticipated grid tariff and augmented gas prices to curb profitability of companies).

Lucky Cement Limited (LUCK)

Ace player

Our top pick in the AHL cement universe is Lucky Cement Limited (LUCK), which offers an upside of 69% from last closing to our Dec'23 sum-of-the-parts based target price of PKR 728/share. Dynamic portfolio of the company is expected to provide a natural hedge against hiccups in cyclical operations (cement, automobile), with forward earnings CAGR over the next three years forecast at a solid 26%.

- **New cement line at the cusp of commencing operations:** LUCK's new 3.15mn tons brownfield expansion at North is expected to begin operations from next month, echoing the company's status as the largest cement manufacturer in the country with a total capacity of 15mn tons. Pertinently, this PKR 30bn expansion will be most efficient in terms of investment per ton (at USD 48/ton) compared to industry average of USD 62/ton. Whereas the company also attained the lowest debt to equity ratio of just 33:67. LUCK secured PKR 10bn under the subsidized TERF and LTFF schemes of the State Bank, also making it the best positioned cement player during the rising interest rate scenario.
- **Further investment in fuel efficiency:** LUCK is one of the few companies in the sector that do not rely on the national grid. This translates to LUCK being one of the lowest cost manufacturers in the country. The company is further investing in its energy efficiency by putting up a 15MW Waste Heat Recovery (WHR) plant and a 34MW solar power plant alongside the new line at Pezu, in addition to installing a 25MW solar power plant at its South site by Mar'23. Current power mix is 80% Thermal (185MW) and 20% WHR (46MW). Once these come online, the power mix will be Thermal 62% (185MW), Solar 20% (60MW) and WHR 18% (55MW).
- **LEPCL to move past initial teething issues:** The company's fully owned 660MW coal power plant achieved its COD in Mar'22, incurring a massive CAPEX of USD 850mn with USD 210mn equity contribution and USD 640mn debt contribution. Although it faced initial teething issues, posting a loss during 1QFY23, the company is expected to move past these issues soon. We expect profitability from the power plant to average over PKR 30bn over the next five years and contribute a mammoth PKR 12bn to unconsolidated earnings. This project contributes PKR 218/share to our Dec'23 target price. Apart from this, the portfolio consists of an automobile assembling company (Kia and Peugeot vehicles), phone business (Samsung), Wind power plant, and overseas cement operations in DR Congo and Iraq.

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	47.3	40.1	35.3
Dividend per share	PKR	-	-	10.0
Book value per share	PKR	397.5	422.1	457.4
Price to Earning	x	9.7	10.7	12.2
Price to Book	x	1.2	1.0	0.9
Dividend Yield	%	-	-	2.3
Net Margins	%	18.9	14.2	10.3

Source (s): Company Financials, AHL Research

LUCK

Summary Data

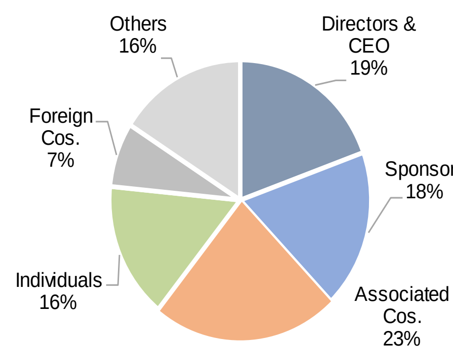
Target Price (Dec'23)	727.9
Last Closing	429.9
Upside (%)	69.3
Shares (mn)	323
Free float (%)	35
Market Cap. (PKR mn)	139,029
Market Cap. (USD mn)	616

Recommendation BUY

Price Performance

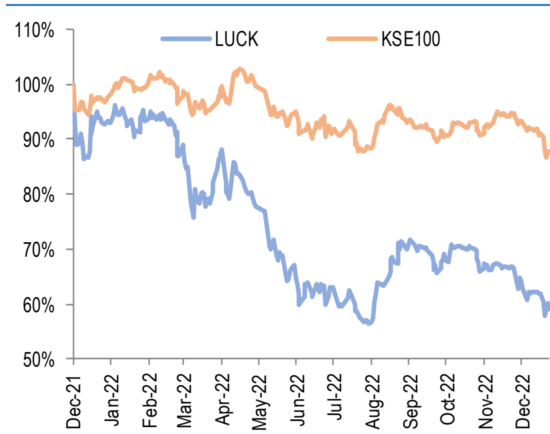
	3M	6M	12M
Return (%)	-10.4	-1.4	-37.1
Avg. Volume (000)	396	552	447
ADTV (mn) - PKR	194	267	231
ADTV (000) - USD	861	1,210	1,129
High Price - PKR	516.8	523.4	701.3
Low Price - PKR	422.2	411.9	411.9

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

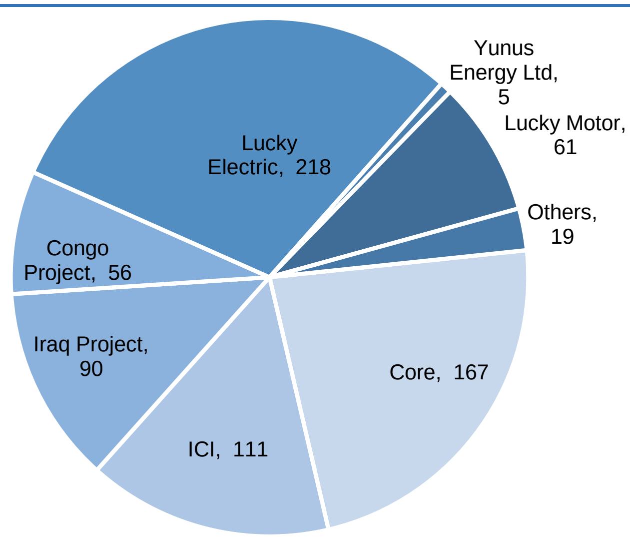
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	81,094	91,444	111,018
Gross Profit	22,552	25,244	20,644
Operating Profit	16,275	18,260	12,923
Finance Cost	4,765	5,188	5,650
Post Tax Profit	15,299	12,951	11,414

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	128,540	136,492	147,906
Trade and other Payables	23,191	21,762	26,421
Total Liabilities	56,422	64,989	61,387
Current Assets	44,816	48,874	60,987
Non-Current Assets	140,147	152,607	148,305
Total Assets	184,962	201,481	209,293

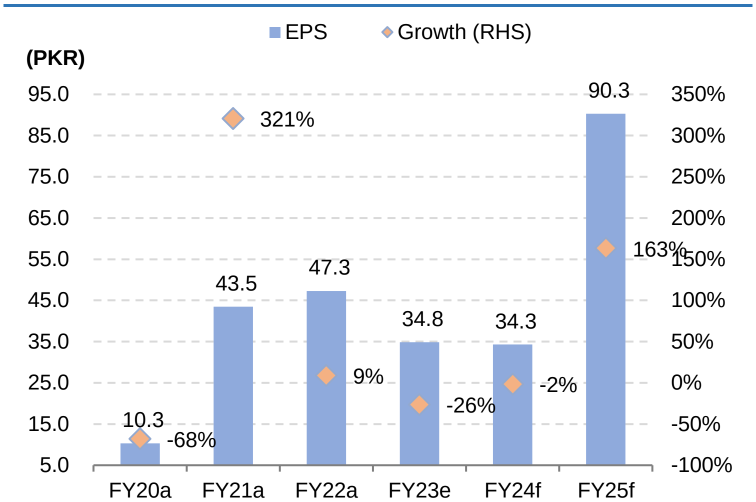
Source (s): Company Financial, AHL Research

Figure: LUCK: SoTP Valuation



Source (s): Company Financials, AHL Research

Figure: LUCK: Unconsolidated earnings



Source (s): Company Financials, AHL Research

Maple Leaf Cement Factory Limited (MLCF)

Golden State of mind

Our Dec'23 target price for MLCF is set at PKR 35.45/share. Our liking for the stock stems from i) addition of a new 2.1mn tons Brownfield plant rendering MLCF to become the largest player in North with all lines of 7.7mn tons at one site, ii) rave-worthy fuel mix with switch to the Local and Afghan coal, which is trading at a positive delta against imported coal, and iii) efficient power mix with the company relying mostly on captive generation. The stock is trading at an attractive FY23 PE ratio of 4x and offers an upside of 64% from last closing; we recommend BUY.

- **Timely expansion:** MLCF recently commissioned a grey clinker line of 7,000 metric tons per day (2.1mn tons p.a.) by Chengdu Design & Research Institute, China in Nov'22. Despite weathering multiple COVID-19 waves, the company remained one of the first few players to bring its expansion online. Not only will this plant bring in new efficiencies in the company, it will also give MLCF a prime mover advantage in the ongoing expansionary phase whilst also improving its presence in North as the largest player with all lines of 7.7mn tons at one place.
- **Ideal coal mix:** Smart policy making and timely procurement of Afghan and local coal by the management, has sheltered MLCF from the tornado in commodity (South African coal) prices. To recall, the company first began testing Afghan coal at its plant during May / Jun'21. Although Richards Bay coal prices shot up, MLCF remained shielded. Currently, RB2 is hovering at USD 208/ton (~PKR 53,000 per ton). In comparison, Afghan coal trades at a positive delta of 21% at present while PET coke costs 30% less, and local coal costs 47% less in comparison to RB2. The company is consuming a hefty 70% of local coal in its mix at present, with the remainder majorly comprising of Afghan coal. Pertinently, the company has 3-5 months of low-cost coal inventory in hand. Hence, this provides a natural hedge against the exponentially high imported coal and freight costs.
- **Solid fuel efficiency:** Maple is one of the most power efficient companies in the country currently, relying almost completely on its captive generation to power its plant operations. The company has a 25MW Waste Heat Recovery (WHR) plant, a 40MW coal power plant, a 15.8MW dual-fired (FO + gas) plant, and a 12.5MW solar plant. Pertinently, MLCF has been running its captive coal plant on Afghan coal and faced no problems thus far, which has materially saved power costs in the ongoing scenario. As a result, margins of the company are one of the highest in the sector.

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	4.1	5.6	4.7
Dividend per share	PKR	-	-	-
Book value per share	PKR	38.5	44.7	49.5
Price to Earning	x	6.6	3.9	4.6
Price to Book	x	0.7	0.5	0.4
Dividend Yield	%	-	-	-
Net Margins	%	9.4	9.7	7.9

Source (s): Company Financials, AHL Research

MLCF

Summary Data

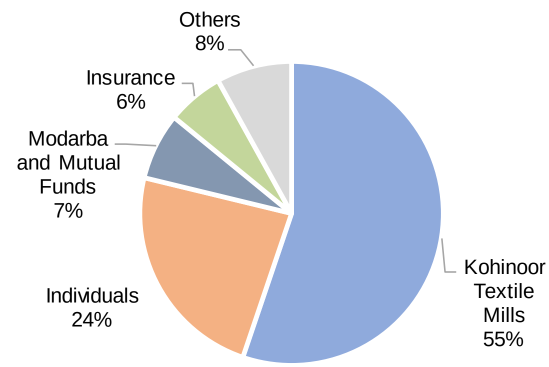
Target Price (Dec'23)	35.5
Last Closing	21.7
Upside (%)	63.7
Shares (mn)	1,073
Free float (%)	45.0
Market Cap. (PKR mn)	23,259
Market Cap. (USD mn)	103

Recommendation BUY

Price Performance

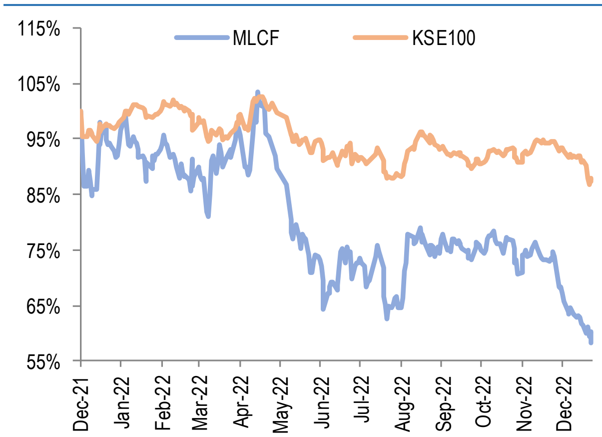
	3M	6M	12M
Return (%)	-20.3	-16.5	-38.2
Avg. Volume (000)	2,505	3,015	3,455
ADTV (mn) - PKR	67	83	105
ADTV (000) - USD	301	374	529
High Price - PKR	29.1	29.4	38.4
Low Price - PKR	21.7	21.7	21.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

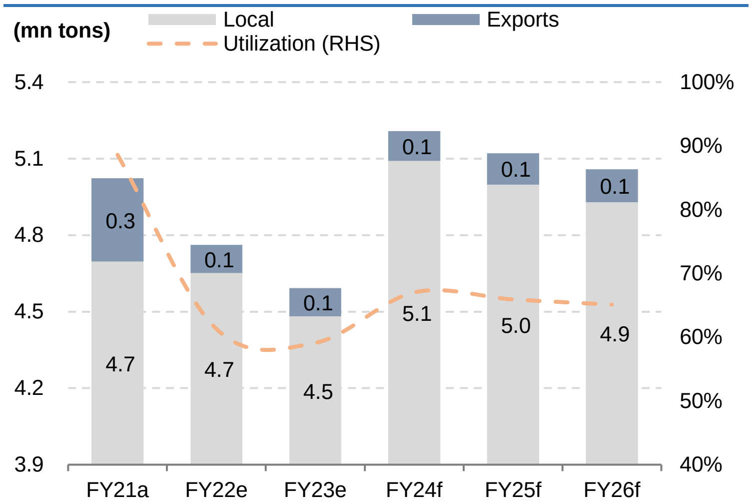
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	48,520	59,886	61,420
Gross Profit	13,239	14,955	13,144
Operating Profit	10,778	12,029	10,091
Finance Cost	1,658	2,538	1,790
Post Tax Profit	4,553	5,536	4,881

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	42,287	47,572	52,079
Trade and other Payables	9,644	10,439	10,656
Total Liabilities	40,180	37,947	31,967
Current Assets	20,899	24,170	25,463
Non-Current Assets	61,568	61,350	58,584
Total Assets	82,467	85,519	84,046

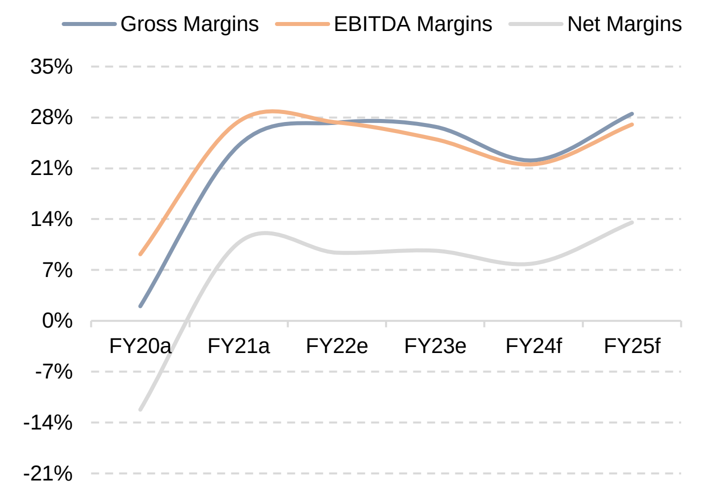
Source (s): Company Financial, AHL Research

Figure: Cement dispatches and utilization



Source (s): Company Financials, AHL Research

Figure: Margins: Trends and forecast



Source (s): Company Financials, AHL Research

Fauji Cement Company Limited (FCCL)

Merger of dreams

Our Dec'23 target price for Fauji Cement Company Limited (FCCL) is set at PKR 17.5/share, whereby the stock offers a return of 53% from last closing. The company is on the verge to capture the third highest market share in the industry, given its merger with Askari Cement Limited coupled with a cumulative addition of 4mn tons in the ongoing expansionary cycle, which will take up the capacity by nearly 64% to over 10mn tons. The company is also investing in improving its fuel and power efficiency by installing new waste heat recovery (WHR) and solar power plants, as well as using alternative coal sources (Afghan / local).

- **The big three:** FCCL's amalgamation with Askari cement last year enhanced the capacity by 87% to 6.43mn tons. Whereas post commissioning of Askari's new 1.95mn tons p.a. Nizampur line in Oct'22, and FCCL's planned Greenfield expansion at DG Khan of 2.05mn tons scheduled to come online in Jul'24, the company is on its way to become the third largest player in the cement sector. FCCL is spending a mammoth PKR 62bn on these expansions, with a projected debt to equity of 64:36. While the company has managed to secure a substantial 44% of the debt portion (~PKR 17bn) through State Bank's subsidized schemes: TERF and LTFF, it is expected to result in annual cost savings of PKR 2.2bn / 0.90 per share based on current borrowing rates. With a noteworthy market share of 11%, and as the second largest player in North, we anticipate FCCL to have significant influence in the sector.
- **Continuous improvement in fuel and power:** FCCL has a few power projects under pipeline, which should further improve the companies fuel efficiency. To start off, the company has enhanced the capacity of its captive solar power plant from 15MW to 20MW at the Jhang Bahtar plant, commissioned another 8.6MW solar power plant at the Wah plant very recently, and intents to add another 11.5MW solar power plant at the Nizampur site in the last quarter of the ongoing year. Whereas it also has 3 waste heat recovery (WHR) plants: 21MW at Jang Bahtar, 7.5MW at Wah, and 12MW at Nizampur. Apart from this, FCCL has a 21.7MW gas captive power plant. We expect these to save on average nearly 350mn KwH units over the next three years, resulting in average annual savings of PKR 7bn (PKR 3.04/share), based on current grid tariff of PKR 32/KwH.

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	3.3	3.2	2.2
Dividend per share	PKR	-	-	-
Book value per share	PKR	26.5	27.9	30.1
Price to Earning	x	4.3	3.5	5.3
Price to Book	x	0.5	0.4	0.4
Dividend Yield	%	-	-	-
Net Margins	%	13.1	11.7	7.8

Source (s): Company Financials, AHL Research

FCCL

Summary Data

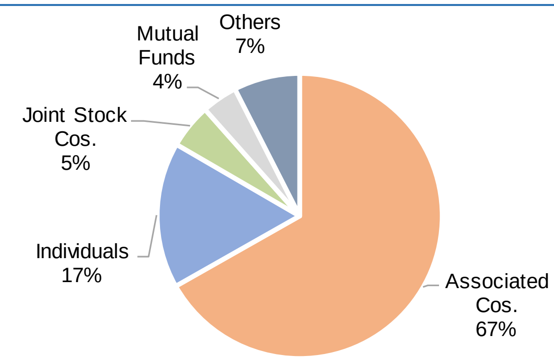
Target Price (Dec'23)	17.5
Last Closing	11.5
Upside (%)	53.0
Shares (mn)	2,453
Free float (%)	35.0
Market Cap. (PKR mn)	28,085
Market Cap. (USD mn)	124

Recommendation BUY

Price Performance

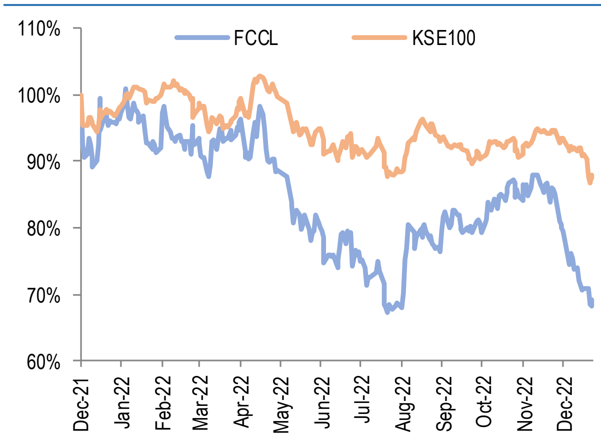
	3M	6M	12M
Return (%)	-14.1	-8.1	-29.1
Avg. Volume (000)	2,795	2,990	2,919
ADTV (mn) - PKR	38	40	41
ADTV (000) - USD	170	180	207
High Price - PKR	14.8	14.8	17.0
Low Price - PKR	11.5	11.3	11.3

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



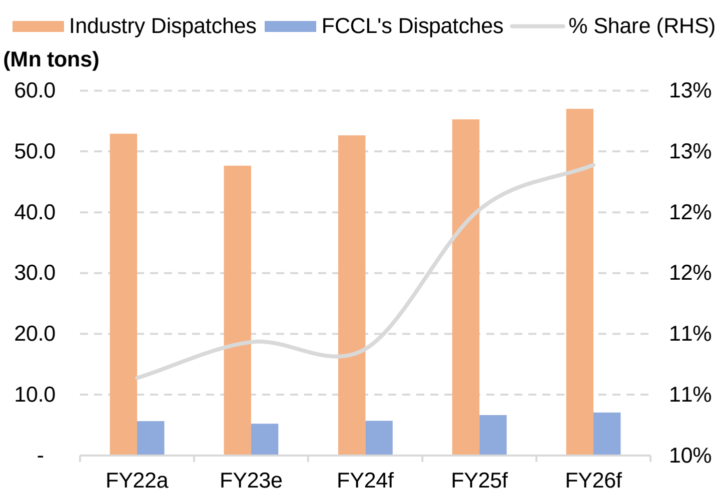
Source: Bloomberg, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	54,243	67,993	68,406
Gross Profit	14,399	16,130	12,051
Operating Profit	12,561	14,082	9,925
Finance Cost	456	1,318	1,341
Post Tax Profit	7,113	7,955	5,339
Balance Sheet	**FY22a**	**FY23e**	**FY24f**
Shareholder's Equity	57,736	68,417	73,755
Trade and other Payables	6,917	6,826	7,417
Total Liabilities	55,962	58,010	74,312
Current Assets	28,217	29,272	28,044
Non-Current Assets	85,481	97,155	120,023
Total Assets	113,698	126,427	148,067

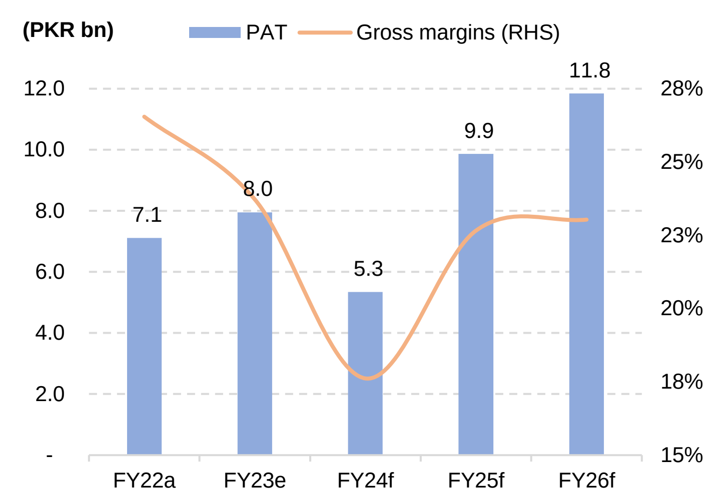
Source (s): Company Financial, AHL Research

Figure: Growing market share amid merger and expansion



Source (s): Company Financials, AHL Research

Figure: Earnings at a glance



Source (s): Company Financials, AHL Research

Power Generation

Resolving and reforming

Power Generation

Resolving and reforming

Pakistan has been facing the chronic problem of Circular Debt (CD) in its power sector for the past several years. This issue has worsened with the increase in electricity generation capacity in recent years. As of Jun'22, the quantum of CD has reached approx. PKR 2,253bn (Jun'21: PKR 2,280bn, out of which ~PKR 800bn is parked with Power Holding (Pvt.) Limited (PHPL), whereas the remaining PKR 1,452bn are payables to Independent Power Producers [(IPPs)/ Generation Companies (GENCOs)].

There are five primary reasons for accumulation of circular debt, which include: i) poor sector governance, ii) delays in the tariff determination and notification, iii) delays in fuel price adjustment (FPA), iv) poor revenue recovery from government and private consumers and v) excessive Transmission and Distribution (T&D) losses.

In July 2019, the Circular Debt (CD) Management Plan 2019 was laid out with the IMF, aimed at reducing growth in CD from PKR 491bn (in FY19) to PKR 130bn (FY20) and sequentially to PKR 80bn (FY21). The government has paid a total of PKR 385bn out of which PKR 225bn was paid to IPPs of PP-1994 and the remaining PKR 160bn was paid to PP-2002 in two tranches. Moreover, ECC recently approved the payment of PKR 93bn to Government Power Plants (GPPs) on the same payment terms as agreed with IPPs.

Moreover, we believe, the following steps can help address the issue of circular debt:

a) Timely tariff notification
b) Improvement in recovery ratios
c) Improving system efficiencies & reducing T&D losses
d) Debt servicing of Power Holding (Pvt.) Limited loans
e) Timely payments of subsidies
f) Unbundling or divestment/privatization of distribution companies

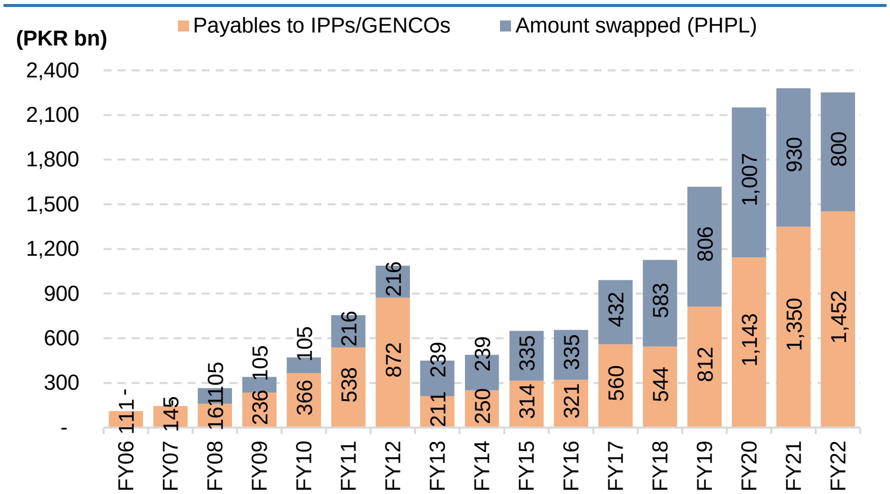
Exhibit: Govt. Guarantees Stock (Power Sector)

	PKR bn
Jun-19	1,562
Jun-20	1,961
Jun-21	1,999
Sep-21	2,055

Source (s): MoF Debt Policy Statement, AHL Research

In the past 16 years, the stock of circular debt has grown with a CAGR of 21% from PKR 111bn (Jun'06) to PKR 2,253bn (Jun'22).

Figure: Power Sector Circular Debt



Source (s): PIDE, NEPRA State of Industry Report 2022, AHL Research

Transmission and Distribution Losses

The investment in the transmission and distribution infrastructure is not complemented by the equivalent investment in the generation capacity. This lack of investment has created constraints in the transmission system which lead to the underutilization of efficient power plants. The constraints in the transmission system include: i) overloading of transmission lines, ii) insufficient transformation capacity, and iii) outages of transmission lines.

During FY22, the allowed T&D losses for the Distribution Companies (DISCOs) were 13.41% whereas actual losses were 17.13%. Due to the difference of 3.72%, the financial loss on this account has been worked out around PKR 113bn. During FY22, the recoveries remained at 90.51% which incurred a loss of PKR 230bn of the billed amount. The total impact of T&D and recovery loss amounted to PKR 343bn which was added to the circular debt.

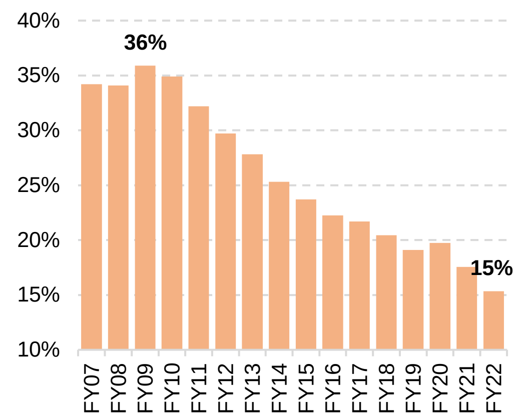
The privatization of DISCOs will help to reduce the T&D losses of the system and we have a practical example of K-Electric Limited, where the company reduced to 15.3% during FY22 compared to 35.9% back in FY09. To recall, in 2009 the Abraaj group took charge of K-Electric Limited (Formally, Karachi Electric Supply Company) and began to turn around the company, resultantly the T&D losses reduced to 15.3%.

The losses at distribution level can be reduced by doing the following:

a) Unbundling of DISCOs i.e. splitting the larger DISCOs into smaller units.
b) There is a need to upgrade the infrastructure of the DISCOs at the earliest basis.

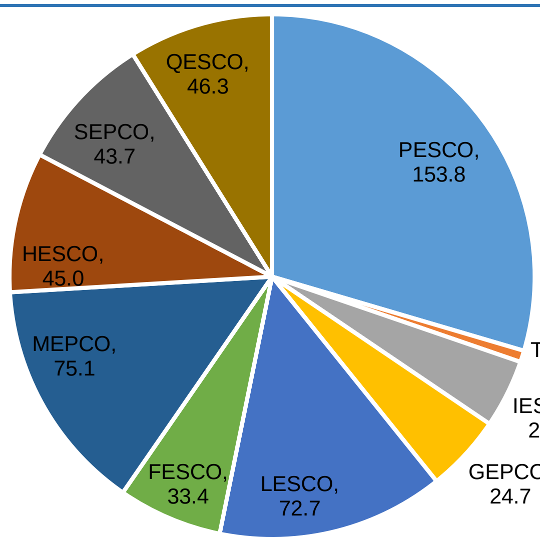
A High Voltage Direct Current (HVDC) transmission line has been constructed to transmit 4,000 MW of electricity from Matiari to Lahore. The HVDC line achieved CoD at Sep'21 and 11,560 GWh electricity was transmitted till Jun'22 and its utilization factor remained at 36%. The capacity payment during this period (Sep'21-Jun'22) were PKR 49bn.

Figure: Trend of T&D Losses of KEL



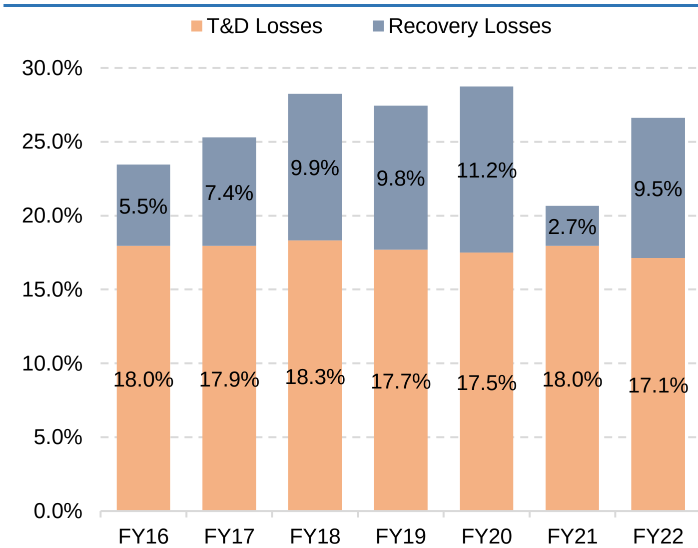
Source (s): Company Financials, AHL Research

Figure: Transmission & Distribution Losses (FY22, PKR bn)



Source (s): NEPRA State of Industry Report 2022, AHL Research

Figure: Trend of T&D and Recovery losses



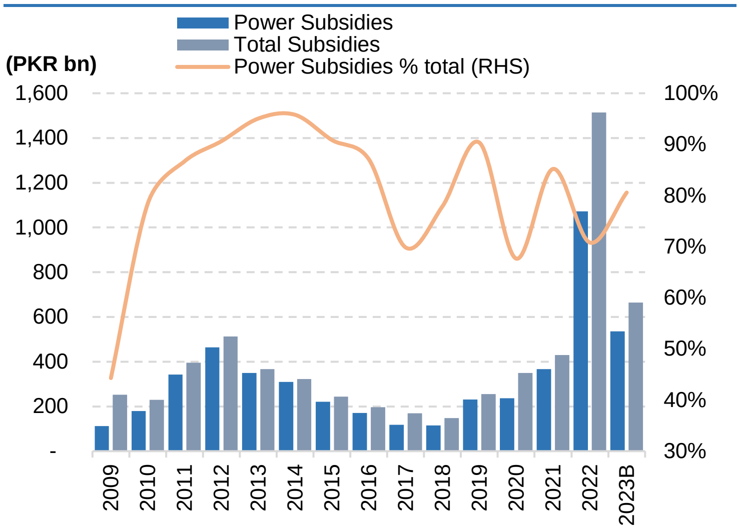
Source (s): NEPRA State of Industry Reports, AHL Research

Power Sector Subsidies

To fund the tariff differential and actual cost of power generation, the government have to chip in subsidies. The amount of power subsidies reached PKR 1,072bn during FY22 which was 71% of the total subsidies provided by the government and 20% of the overall fiscal deficit of FY22. Since FY07, the government has paid over PKR 3.4trn on account of power subsidies. These subsidies to the power sector are not sustainable given the fiscal constraints of the government.

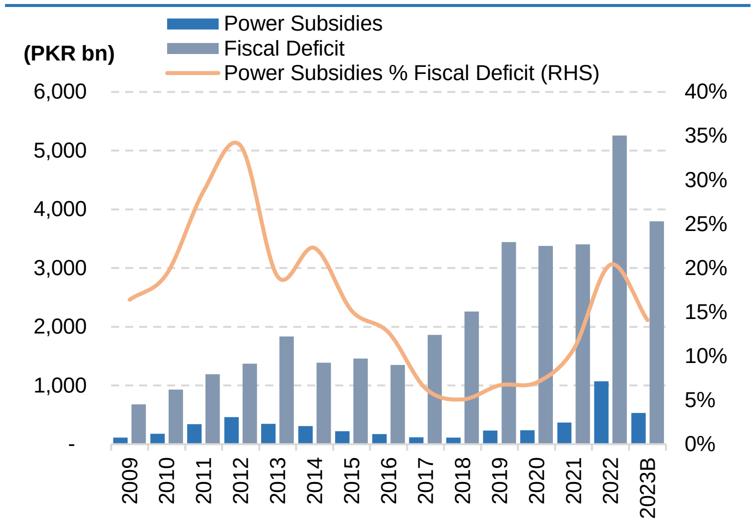
As of Jun'22, a total amount of PKR 83bn is payable to DISCOs on account of subsidies.

Figure: Power Subsidies and Total Subsidies



Source (s): MoF, AHL Research

Figure: Power Subsidies and Fiscal Deficit



Source (s): MoF, AHL Research

Rising Capacity Payments

Due to the addition of power plants (~18K MW since 2016) and PKR depreciation, the capacity payments have gone up to PKR 864bn (PKR 6.22/KWh) as at FY22 end compared to PKR 275bn (PKR 2.72/KWh) during FY16.

During FY22, a cumulative capacity of 4,488 MW was added to the system taking the total capacity (CPPA-G) to 40,813 MW. However, in order to reduce the impact of growing capacity payments, the government signed new agreements with the 46 IPPs and their dollar indexation was removed from their return on equity. As a result of this amendment, hundreds of billions are expected to be saved in the next twelve (12) years. To highlight, the China Power Economic Corridor (CPEC) based power plants (cumulative capacity 8,913 MW) are not part of this agreement.

The demand for electricity depends on multiple factors such as variation in usage during day and night time as well as seasonality factors. In Jun'22, the peak demand was 28,253 MW compared to the peak demand of 15,962 MW in Dec'21. The variation in demand is majorly driven by domestic consumers who consume around ~49% of total power demand. To minimize the impact of growing capacity payments, growth in power demand is necessary to evenly distribute it on higher number of units.

Exhibit: Capacity addition during FY22

Power Plant	Fuel	MW
Trimmu	RLNG	1,263
KANUPP-III	Nuclear	1,145
Karot Hydropower	Hydel	720
Lucky Electric	Coal	660
Wind (12 plants)	Wind	600
Zhenfa Power	Solar	100
Total		**4,488**

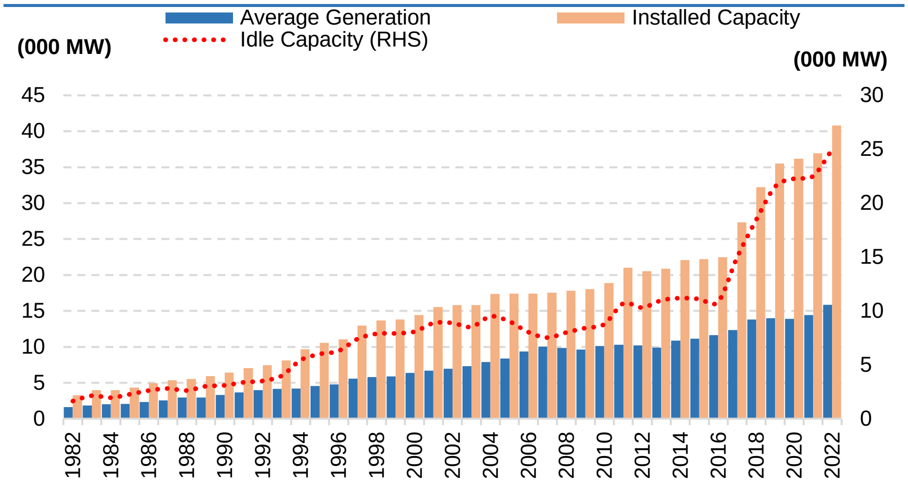
Source (s): NEPRA SoI Report 2022, AHL Research

Exhibit: Category wise sales (FY22)

Category	% Share
Domestic	48.5%
Industrial	27.3%
Agricultural	8.9%
Commercial	7.4%
Bulk Supply	3.3%
Public Lighting	0.3%
Others	4.4%
Total	**100.0%**

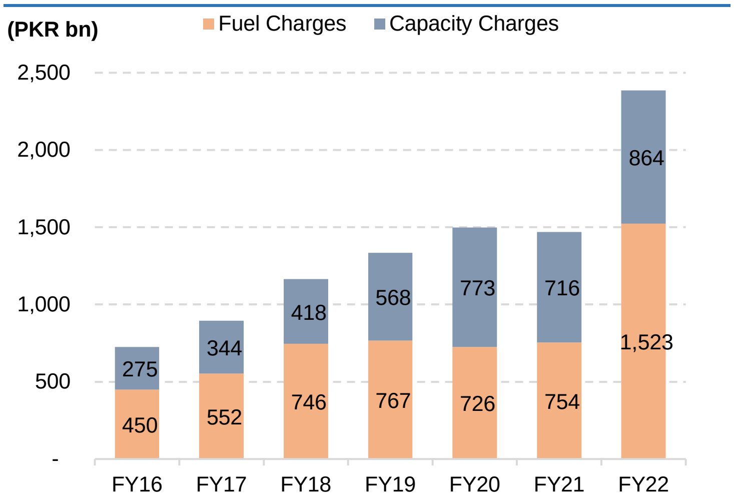
Source (s): NEPRA SoI Report 2022, AHL Research

Figure: Trend of Installed Capacity and Generation



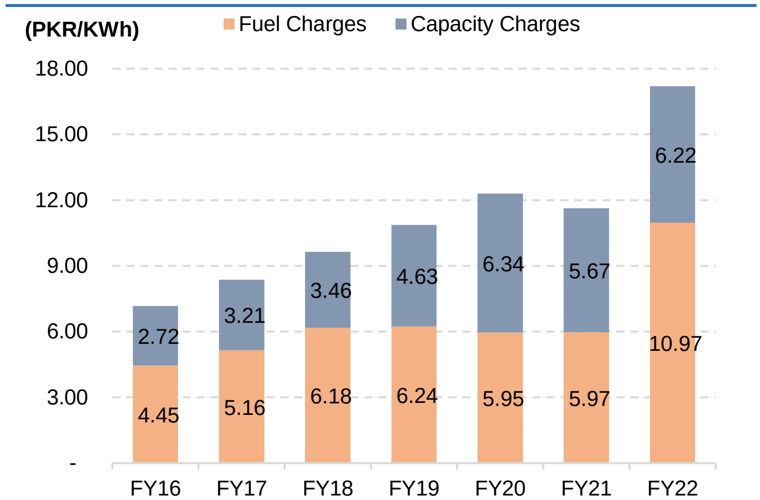
Source (s): NTDC, NEPRA State of Industry Report 2022, AHL Research

Figure: Trend of Fuel and Capacity Charges



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

Figure: Trend of Fuel and Capacity Charges



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

Addition of local coal-based plants to reduce cost of power generation

Due to the rise in commodity prices along with PKR depreciation, the cost of power generation increased and touched a high of PKR 14.7/KWh during Jun'22, however it declined to PKR 9.0/KWh during Oct'22. During 5MFY23, the imported fuel based power generation was ~30% of the total generation compared to 45% during FY22.

As of Oct 01, 2022, Hub Power's subsidiary, Thar Energy Limited (TEL) achieved a commercial operational date (CoD), taking a total coal-based generation to 5,610 MW. Shanghai Electric (1,320 MW) and ThalNova (330 MW) has also added to the system in Dec'22. This will take the total coal-based capacity to 7,260 MW (Local coal-based: 3,300MW, International Coal based: 3,690MW). The addition of the local coal-based power plants will reduce the annual fuel cost by ~PKR 373bn (PKR 2.56/KWh) by replacing the costly source of power generation (FO, Fuel cost: PKR 24.2/KWh) and also reduce the dependence on imported fuel and save the foreign exchange.

In addition to this, Nuclear based generation (2,200 MW) was also added to the system which has also contributed to the decline in the overall cost of power generation.

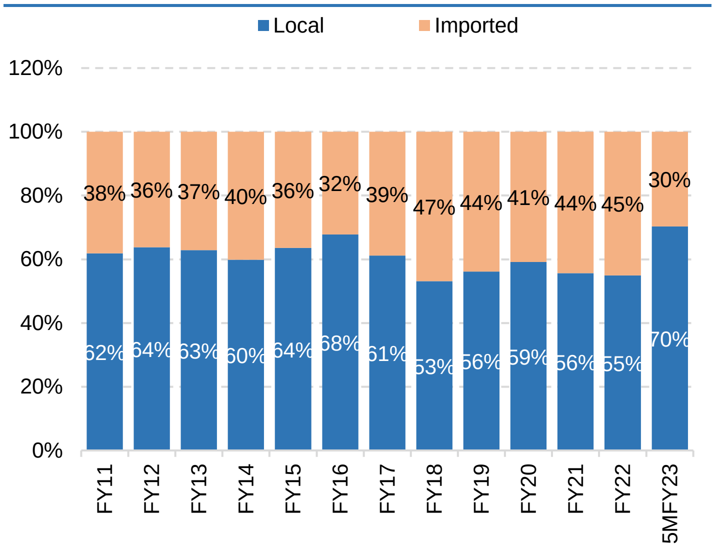
Recently, a plan to install 10,000 MW solar-based plants has been prepared by the government. The installation will be made on GENCOs sites and rooftops of the government departments. This will also help reduce the overall fuel bill and reliance on imported fuel. This is an additional plan committed in the last Integrated Generated Capacity expansion Plan (IGCEP) 2021-30.

Exhibit: Capacity and fuel cost of coal power plants

Commissioned Coal IPPs	Capacity (MW)	Fuel Cost (PKR/KWh)
Engro Power Thar	660	3.32
Thar Energy Limited	330	3.24
Lucky Electric Power	660	15.83
Port Qasim	1,320	19.39
Sahiwal Power	1,320	30.31
China Power Hub	1,320	32.62
Total / Average	**5,610**	**17.45**
Upcoming Coal IPPs		
Thal Nova Power Thar (Pvt) Ltd.	330	na
Shanghai Electric	1,320	na
Total	**1,650**	

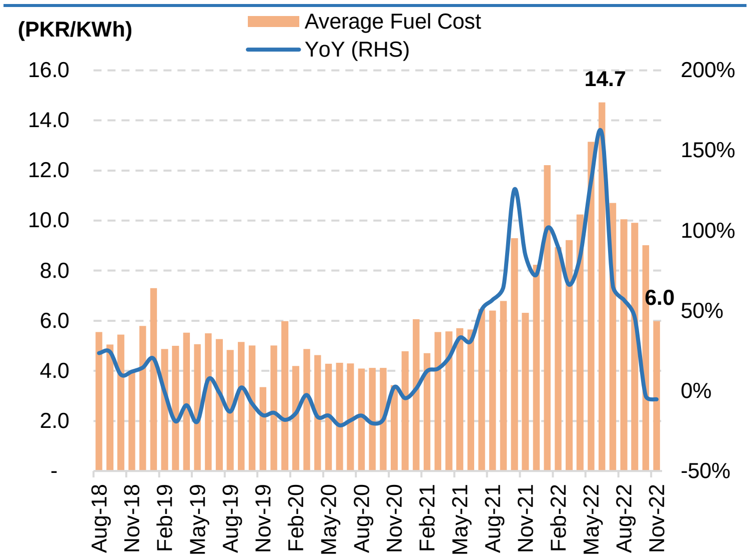
Source (s): NTDC, NEPRA, AHL Research

Figure: Local and imported fuel-based power generation



Source (s): NEPRA, AHL Research

Figure: Trend of fuel cost



Source (s): NEPRA, AHL Research

Further tariffs hike on the cards

In addition to the resolution of Circular Debt, the government increased the tariff by PKR 7.91/KWh in three phases during CY22. This incremental tariff is applicable to all power companies across Pakistan, including KE. This impact has been passed on to all residential consumers except the ones having monthly consumption of less than 200 units, which remain protected through subsidy. In case further rise in tariff happens, it will help IPPs to improve their cash flows.

Despite a hefty increase in electricity tariff in Jul'22, since then, PKR 700bn has piled up on account of numerous factors including 1) lower than expected power generation growth, 2) PKR depreciation (NEPRA tariff was set at a parity of PKR 200/USD, 3) lower recovery ratio at 83% as compared to last year average of 93%, and 4) higher T&D losses at 17.5% as compared to 15.0% during last year. We believe the gov't will pass on 50% of this amount (PKR 350bn) by increasing the power tariff by another PKR 6.2/kWh in Jan'23 (also recommended by the IMF), while the remaining amount will be adjusted in the FY24 tariff, where we believe that due to addition of low fuel cost based power plants including Thar coal (Shanghai, Thar Energy, Thal Nova), full impact of the nuclear power plant, the commencement of Nelum Jhelum, fuel cost is expected to decline significantly and the remaining amount will be adjusted against it.

Exhibit: Tariff Structure

Generation	i) Capacity Charges ii) Energy Charges
Transmission	Use of System
Distribution	i) Distribution Margin ii) T&D Losses iii) Prior Year Adjustmenst

Source (s): AHL Research

Competitive Trading Bilateral Contract Market (CTBCM); a move from the single-buyer and multiple-buyer market

The power sector operates as a single-buyer market model, where CPPA (G) buys power from electric power generation companies (Water and Power Development Authority (WAPDA), IPPs, and GENCOs) and sells it to DISCOs. In Nov'22 NEPRA approved the design and implementation roadmap for the CTBCM. Under this model, existing PPAs between IPPs and National Transmission & Dispatch Company (NTDC)/CPPA (G) will be replaced by bilateral contracts between each IPP distribution company. As per the new PPAs signed with IPPs (2002 and 1994), their Take-or-Pay contract will be changed into Take-and-Pay once CTBCM will be fully functional.

NEPRA has granted the market operator license under the CTBCM to the CPPA (G). The market operator will be responsible to administer its operations, standards of practice, and business conduct of market participants in accordance with the market commercial code approved by the Authority.

Key Risk (s)

- Rising circular debt may prolong the liquidity crisis and keep the payout muted of IPPs
- Delay in electricity tariff notification
- Higher transmission and distribution losses
- Lower recovery ratio

The Hub Power Company Limited (HUBC)

Coal power plants to spur valuations

- **Addition of coal power plants to support earnings growth:** Thar Energy Limited (TEL) achieved commercial operation date (CoD) in Oct'22 while ThalNova has also added to the system during Dec'22. Both plants are local coal-based power plants and each plant has a capacity of 330 MW. We expect the addition of two new coal-based power plants will contribute PKR 7.8/share to HUBC's target price while earnings contribution is estimated at PKR 3.24/share and PKR 1.67/share, respectively to HUBC's FY24 earnings. We expect HUBC to witness 47% YoY earnings growth and settle at PKR 32.3/share in FY23e and PKR 36.8/share in FY24f.
- **Government committed to resolving circular debt issue:** The government showed serious commitment to resolve liquidity issues in the power sector and paid PKR 385bn (Nov'20 stock) in two tranches. The CPEC-based IPPs are also facing the same issue and receivables of China Power Hub Generation Company (CPHGC), an associate of HUBC, have increased to PKR 70bn (as of Aug'22). Additionally, the ECC has approved the change of the title of the revolving account as per the proposal of the finance ministry.
- **Local coal plants are higher in merit order:** Being the cheaper source of power generation (local coal-based cost PKR 3.25/KWh compared with 24.2/KWh of FO and 20.3/KWh of RLNG), local coal power plants are higher in the merit order list. The TEL was placed at the 2nd number (as of 16th Dec'22) in merit order. The plants with higher numbers in merit order are expected to be given preference for payments. We expect these plants to continue ranking over others in the merit order and therefore, be given preference for payments.
- **Diversifying into the Oil and Gas Exploration sector:** The Prime International Oil and Gas Company Ltd (Prime) entered into four Sales and Purchase agreements with Eni International B.V, Eni Oil Holdings B.V, Eni UK Limited, and Eni ULX Ltd for the purpose of acquiring Eni's business in Pakistan. Prime is a 50-50 joint venture between Hub Power Holdings Limited (a fully owned subsidiary of The Hub Power Company Limited) and Eni's Employee Buy-out-Group. The change of control in respect of the ENI transaction has been approved by the Federal Cabinet and the Director General Petroleum Concession along with other relevant authorities. Completion of the ENI transaction will be achieved pursuant to the requisite regulatory process. The addition of ENI will have an annualized earnings impact of ~PKR 2.98/share on HUBC's earnings. However, we have not incorporated this in our valuations.
- **Outlook and Recommendations:** We have BUY call for the stock with Dec'23 ending target price of PKR 119.7/share. The stock is providing a lucrative dividend yield of 23.9% based FY24f dividend per share of PKR 15.0. HUBC is currently trading at FY24f P/E and P/B of 1.7x and 0.5x, respectively.

HUBC

Summary Data

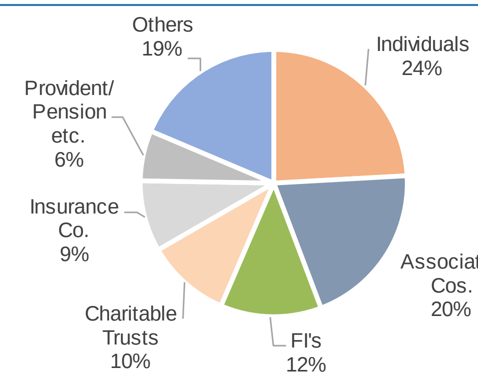
Target Price (Dec'23)	119.7
Last Closing	62.9
Upside (%)	90.3
Shares (mn)	1,297
Free float (%)	75
Market Cap. (PKR mn)	81,578
Market Cap. (USD mn)	362

Recommendation **BUY**

Price Performance

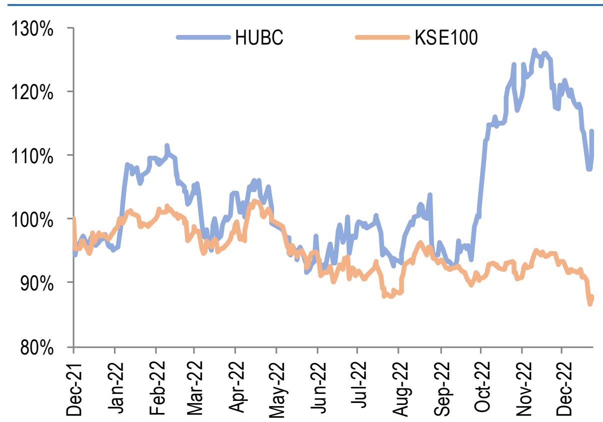
	3M	6M	12M
Return (%)	21.5	20.1	17.0
Avg. Volume (000)	3,336	2,528	1,983
ADTV (mn) - PKR	232	174	139
ADTV (000) - USD	1,036	781	672
High Price - PKR	70.0	70.0	70.0
Low Price - PKR	51.8	51.2	50.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	*PKR*	21.9	32.3	36.8
Dividend per share	*PKR*	6.5	22.0	15.0
Book value per share	*PKR*	96.8	109.9	135.1
Price to Earning	*x*	3.1	1.9	1.7
Price to Book	*x*	0.7	0.6	0.5
Dividend Yield	*%*	9.5	35.0	23.9

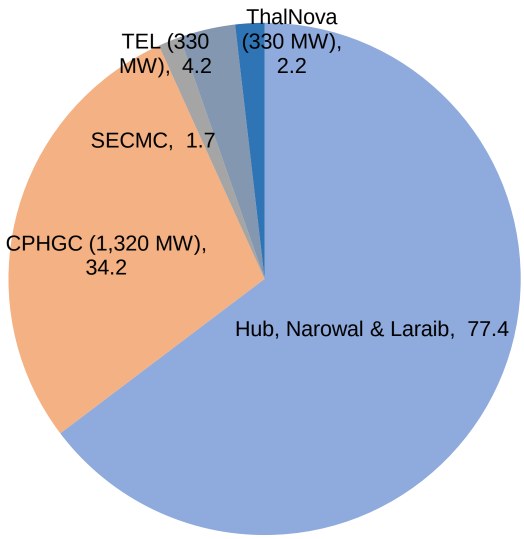
Source (s): Company Financials, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	97,158	94,419	64,622
Gross Profit	33,103	42,453	41,904
Operating Profit	33,800	43,048	40,988
Finance Cost	7,928	11,918	7,810
Post Tax Profit	28,472	41,866	47,729
Balance Sheet	**FY22a**	**FY23e**	**FY24f**
Shareholder's Equity	125,502	142,610	175,307
Total Liabilities	189,650	168,735	139,254
Current Assets	124,795	116,338	114,953
Non-Current Assets	190,357	195,008	199,607
Total Assets	315,153	311,346	314,561

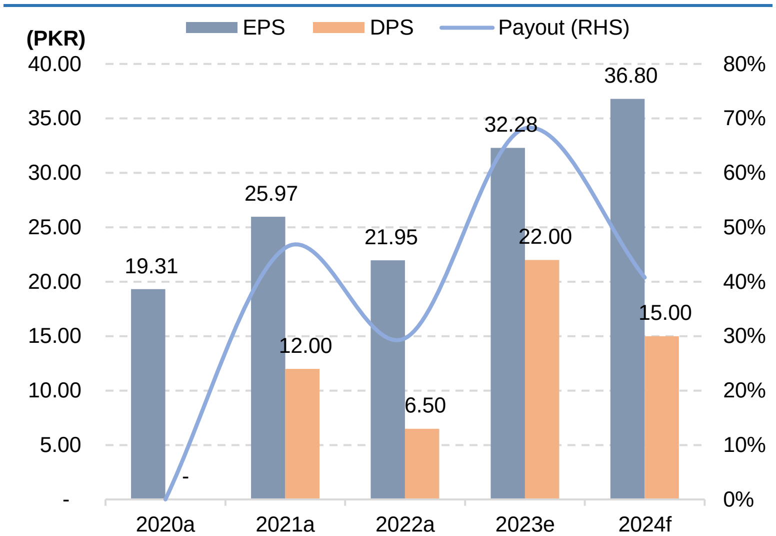
Source (s): Company Financial, AHL Research

Figure: HUBC - Sum of the Parts Valuation



Source (s): Company Financials, AHL Research

Figure: Trend of fuel cost



Source (s): NEPRA, AHL Research

Oil & Gas Marketing Companies

Saved 'Margin'ally

Oil Marketing Companies

Saved 'Margin'ally

- **Volumes to remain suppress in FY23:** The petroleum sales volumes have shown a strong growth of 17%(3-Yr CAGR) of 17% owed to: i) economic growth post COVID-19, ii) jump in automobile sales, iii) increase in agriculture yields, and iv) higher reliance on FO-based power generation. However, during FY23TD, the sales volumes witnessed a decline amid: i) drastic floods which affected mobility during 1QFY23, ii) economic slowdown, iii) surge in petroleum prices and, iv) lower FO-based power generation. Hence, MS, HSD, and FO sales declined by 16%, 24%, and 26% YoY during 5MFY23. With this, we expect volumes of MS and HSD to decline by 15% YoY each in FY23, however, recover in FY24 posting a growth of 8% YoY.
- **OMC margins revision:** In Oct'22, Economic Coordination Committee and Cabinet approved revision of OMC margins of MS and HSD to PKR 6.00/ltr each from PKR 3.68/ltr. Albeit, we expect this to have an annualized impact of PKR 28.12/share, PKR 18.88/share, and PKR 12.33/share on PSO, APL, and SHEL, respectively. On 30th Nov'22, OGRA notified jump in OMC margins of MS and HSD by PKR 4.00/ltr and PKR 5.00/ltr, respectively.
- **De-regulation of Petroleum Prices:** Initially, the government had set a target to put de-regulation into effect during 2QFY23, with OGRA leading the entire process. It was decided to conduct partial deregulation in the first phase where IFEM were being regulated while in the second phase, deregulation was planned to be fully implemented. It is pertinent to note that the government is still in consultation stage with both OMCs and refineries, after which a final decision will be made.
- **Petroleum Prices:** The international oil prices during FY22 witnessed a massive jump on account of: i) resumption of economies worldwide post COVID-19 and, ii) Ukraine and Russia War. The impact of this was witnessed in the form of surge in ex-refinery prices of MS and HSD prices reaching a high of PKR 224.77/ltr and PKR 270.29/ltr, respectively. The jump in ex-refinery prices led to significant inventory gain for the OMCs which would be the opposite case in 2023 given downward trend in the international oil prices.

Key Risk (s)

- Sharp decline in ex-refinery prices may result in massive inventory loss.
- Disruption of the petroleum supply chain
- Availability of smuggled fuel from Iran

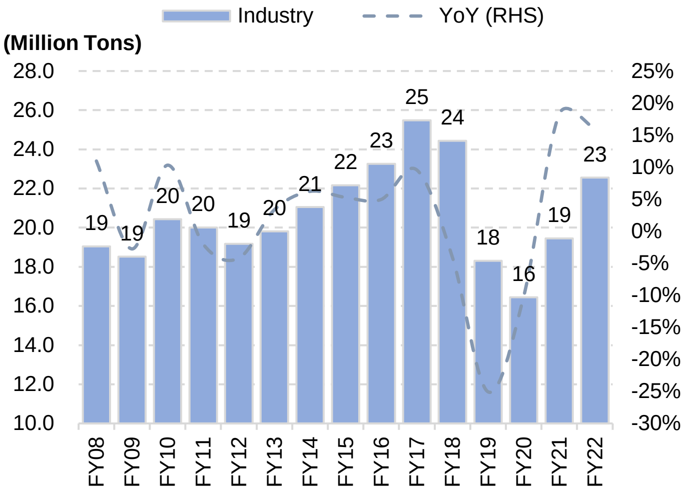
Gas utilities: A national treasure

- **Continuous decline in indigenous gas reserves:** Domestic gas production has been depleting persistently over the years. As per PPIS data, gas production has dipped by 13% from 3,892mmcfd in FY12 to 3,390mmcfd in FY22 (3,503mmcfd in FY21). This was due to a significant decline in some large gas fields, since 2012, including Qadirpur (-320mmcfd), Zamzama (-395mmcfd), Bhit and Badhra (-356mmcfd), Manzalai (-230mmcfd), Sawan (-173mmcfd), and Sui (-143mmcfd). Although some new discoveries have also been witnessed in the last decade such as Sharf, Mardankhel, and Rehman, they have not been able to make up for the natural depletion in other gas fields.

- **RLNG procurement an undeniable challenge:** Gas crisis in Pakistan has been an annual challenge for a long time. Against domestic production, gas demand has been estimated at nearly 6,000mmcfd, which translates to a shortage of over 2,000mmcfd per annum. To mitigate the same, Pakistan has been importing LNG since 2015. Due to tight market conditions post COVID-19, Pakistan managed to import over 1,000mmcfd of LNG in FY22, down by 7% YoY. However, gas supply disruptions globally in the aftermath of the Russian invasion of Ukraine, has further derailed the equilibrium and caused prices to skyrocket. Although long term LNG contracts have been the saving grace, the country has had major trouble obtaining spot cargos amid very high prices in the backdrop of depleting FX reserves. In 5MFY23, Pakistan has only procured 43 cargos vis-à-vis 56 in SPLY, implying a 25% decline in LNG import to just 832mmcfd. This suggests more frequent load shedding in the ongoing winter season for industries, as the government would prioritize maximum supply for households. From the focal point of domestic gas utilities, this implies diversion of expensive gas in the system to households, therefore augmenting receivables from the government, and invariably increasing pressure on cashflows. Hence, the need for new infrastructure for the import of gas remains crucial.

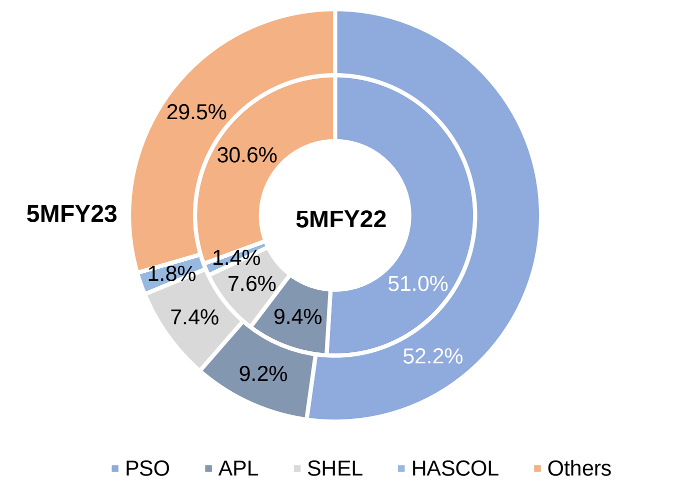
- **Risks:**
  - Potential clearance of gas circular debt will relieve cashflows.
  - Delay in gas tariff determination and notification will further add to the gas circular debt (which has mounted over PKR 1.6trn), and cause cashflow problems.
  - OGRA is waiting for guidelines from the government for the execution of WACOG (weighted average cost of gas) to incorporate RLNG price in the national cost of gas, and unless that comes through, possibility of implementing WACOG remains unlikely.
  - Augmented UFG levels can erode earnings of gas companies.
  - High interest rates to exacerbate the companies' borrowing costs.
  - Significant changes in the State Bank's policy rate to translate into a change in WACC, which is used to calculate the companies' return on assets.

Figure: Historical Trend of Petroleum products' sales



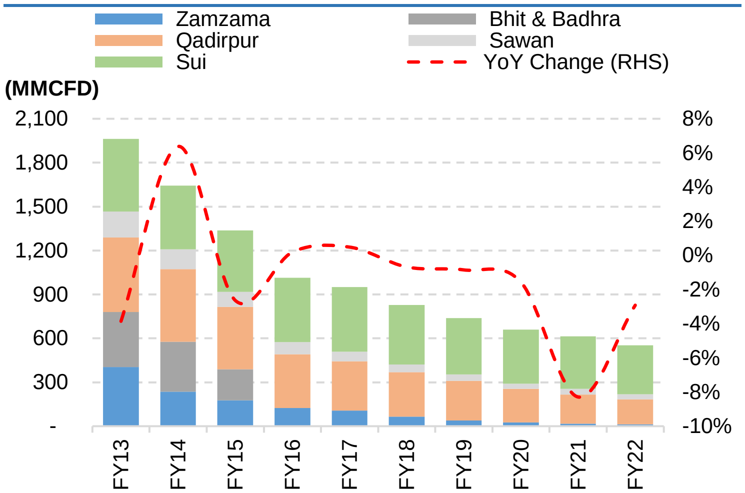
Source (s): OCAC, AHL Research

Figure: Market share of OMC companies



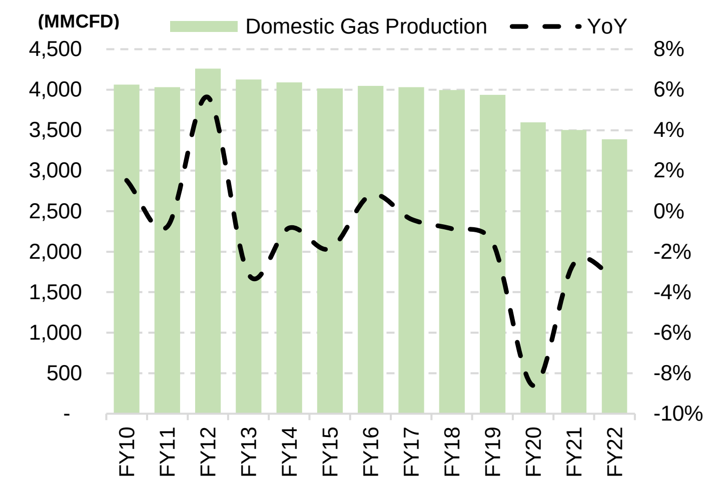
Source (s): OCAC, AHL Research

Figure: Field wise gas production



Source (s): PPIS, AHL Research

Figure: Trend of domestic gas production



Source (s): PPIS, AHL Research

Sui Northern Gas Pipelines Limited (SNGP)

Heating up the country

Our DCF-based Dec'23 target price for Sui Northern Gas Pipelines Limited (SNGP) is set at PKR 68.4/share. At current levels, the scrip offers an upside of 88%, we recommend BUY. Our conviction on the scrip stems from i) re-rating of WACC to higher levels owed to a massive jump in interest rates, and ii) lower levels of disallowed UFG (forecast at ~PKR 4.7bn over the next 5 years compared previous 5-year average of PKR 7.1bn) led by significant improvement in gas losses post implementation of OGRA's UFG control target. We also highlight the proposal to resolve the gas circular debt issue as well as construction of the Russia-Pakistan pipeline as major upside triggers for the scrip, although we are yet to incorporate them.

- **Upwards revision in WACC:** SNGP operates under a guaranteed fixed return covenant (WACC of 16.6% applicable on assets at present), set by the Regulator. Although fixed for 3 years, the WACC automatically re-sets if it changes by +2% or -2%. Given a drastic jump in SBP's policy rate this year, and hence the 6 months KIBOR used to determine the cost of debt, the differential in WACC has been breached by over 5%. Therefore, since it becomes applicable from the following year's determination, we estimate the WACC for FY24 at 20.6% (average of the year of application and prior year). With expected rate cuts next year, new WACC of 17.7% will then become applicable in FY26. We estimate a positive impact of a 1% jump in WACC at a massive PKR 1.3bn (EPS: PKR 2.09) per annum.
- **UFG curtailment plan shows promising results:** The Regulator had formed a 3-year plan to curtail gas losses of SNGP. As a result, the company began robustly investing in technology and digitization (new transformation and distribution systems). Moreover, better UFG mapping through the new GIS (Geographic Information System), to be completely installed within 12 months, will help identify leakages and gas theft and further curtail UFG. Therefore, we forecast UFG volume in the next 5 years to average at 26,000mmcf (disallowed UFG of PKR 4.7bn) against 43,000mmcf (PKR 7.1bn) in the past 5 years.
- **Resolution of the mounting gas circular debt:** Gas sector circular debt, at over PKR 1.6trn at present, has surged due i) delays in tariff determination and notifications, and ii) insufficient revenue recovery from the government and private consumers. The resolution by payment from the govt to gas utilities, will not only improve the gas utilities balance sheet position, the companies will also stop demanding massive hikes in gas prices going forward.

Exhibit: Ratio Analysis

		FY21a	FY22e	FY23f
Earnings per share	*PKR*	17.3	20.1	16.8
Dividend per share	*PKR*	7.0	8.0	6.0
Book value per share	*PKR*	54.0	67.1	75.9
Price to Earning	*x*	2.8	1.7	2.2
Price to Book	*x*	0.9	0.5	0.5
Dividend Yield	*%*	14.4	23.4	16.5
Net Margins	*%*	1.5	1.2	0.8

Source (s): Company Financials, AHL Research

SNGP

Summary Data

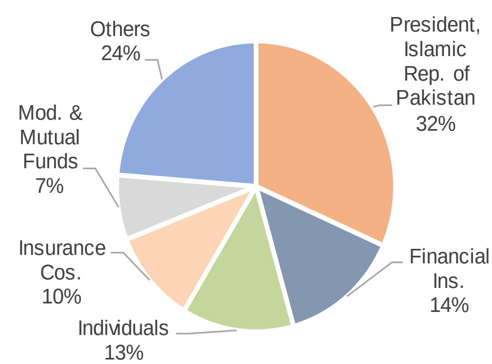
Target Price (Dec'23)	68.4
Last Closing	36.3
Upside (%)	88.2
Shares (mn)	634
Free float (%)	45
Market Cap. (PKR mn)	23,028
Market Cap. (USD mn)	102

Recommendation BUY

Price Performance

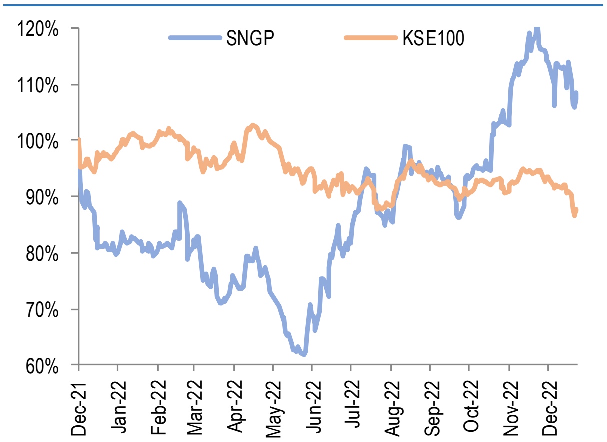
	3M	6M	12M
Return (%)	26.0	36.9	33.4
Avg. Volume (000)	2,297	2,734	2,157
ADTV (mn) - PKR	83	98	75
ADTV (000) - USD	373	447	361
High Price - PKR	40.6	40.6	40.6
Low Price - PKR	28.8	26.5	20.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



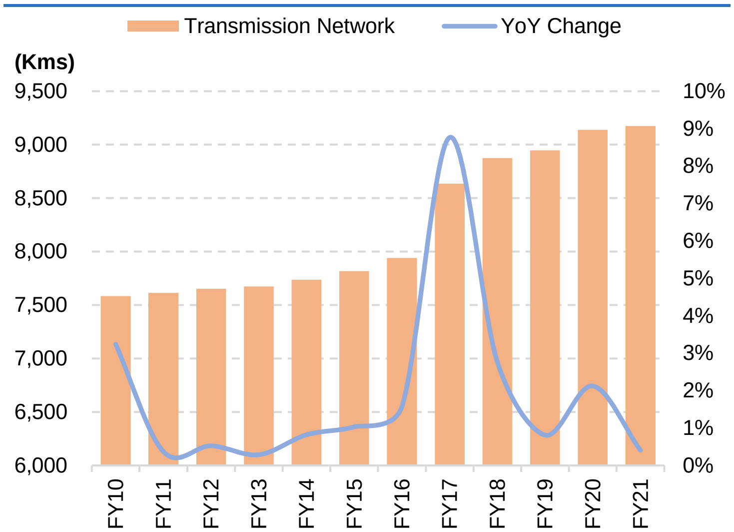
Source: Bloomberg, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY21a	FY22e	FY23f
Net Sales	757,627	1,058,460	1,321,877
Gross Profit	52,852	69,276	56,138
Operating Profit	55,880	71,600	58,671
Finance Cost	40,037	50,666	42,779
Post Tax Profit	10,987	12,770	10,648
Balance Sheet	**FY21a**	**FY22e**	**FY23f**
Shareholder's Equity	34,220	42,550	48,124
Trade and other Payables	528,309	785,995	989,148
Total Liabilities	883,840	1,175,537	1,369,425
Current Assets	665,330	952,255	1,139,782
Non-Current Assets	252,730	265,832	277,768
Total Assets	918,060	1,218,087	1,417,549

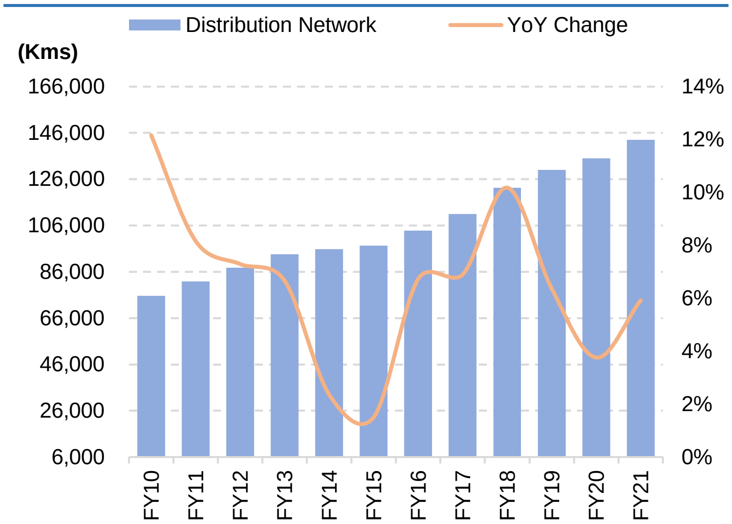
Source (s): Company Financial, AHL Research

Figure: Transmission Network



Source (s): Company Financials, AHL Research

Figure: Distribution Network



Source (s): Company Financials, AHL Research

Pakistan State Oil Company Limited (PSO)

Defending profit margins

- **Circular Debt Issue:** In order to resolve the power circular debt, issue the government paid two tranches worth PKR 385bn to IPPs on 1994 and 2002 power policy in FY22. For resolution of gas circular debt, the government is considering various proposal at this point in time. PSO's trade debts as of Sep'22 stood at PKR 458bn, out of which PKR 345bn is overdue receivables in terms of circular debt. From the overdue receivables, major amount is due from SNGP and Northern Power Generation Company Limited which arrived at PKR 254bn and PKR 70bn, respectively. In the event of the resolution of circular debt, the company's cash flows will expand, enabling the company to cut down reliance on short borrowings and to conduct expansion plans. Furthermore, the company's late payment surcharge is estimated to be PKR 150bn as of Jun'22, which translates in after-tax impact of PKR 227/share.

- **Production and Market share:** During 5MFY23, PSO's white oil sales declined by 21% YoY to 3.56mn tons (MS 1.40mn and HSD 1.55mn tons) compared to 3.57mn tons while market share increased to 52.2% from 51.0% in 5MFY23. We expect the sales of PSO to recover in 2HFY23, taking FY23 white oil sales to 7.29mn tons, down by 15% YoY. Whereas, in FY24, we foresee the white oil sales of PSO to climb up by 8% YoY to arrive at 7.87mn tons.

- **Earnings to settle at PKR 39.16/share in FY23:** The fiscal year 2022 was an unprecedented year that witnessed massive jump in ex-refinery prices owed to higher international oil prices. The surge in ex-refinery prices resulted in massive inventory gains for the company. Keeping in view the slowdown in global economies, oil prices have witnessed a declining trend (hovering around USD 81/bbl). With this, the company is now witnessing inventory losses. Meanwhile, a revision in OMC margins is expected to mitigate some of these losses. We project revision in OMC margins to have an annualized earnings impact of PKR 28.12/share on PSO. Hence, we expect the bottom-line in FY23 and FY24 to clock-in at PKR 39.16/share and PKR 71.60/share, respectively.

- **Other Developments:** During FY22, the company added 112.5K tons of new storage for MS and HSD at Machike, Zulfiqarabad Oil Terminal and Juglot. Moreover, 44K tons of existing storage was rehabilitated. With this, the company's total storage has reached to 1.1mn tons. Currently, the company is developing 90K tons of storage at Faisalabad, Faqirabad and Mehmoodkot, which is projected to reach completion by FY23. Furthermore, during FY22, the launch Euro-5 compliant 95 Ron coupled with the addition of three EV charging stations. Moreover, the company has signed a throughput agreement with PAPCO for white oil pipeline multi-grade project.

- **Outlook and Recommendations** We have BUY call for the stock with Dec'23 ending target price of PKR 206.7/share. PSO is currently trading at FY23f P/E and P/B of 3.4x and 0.3x, respectively with a dividend yield of 8%.

PSO

Summary Data

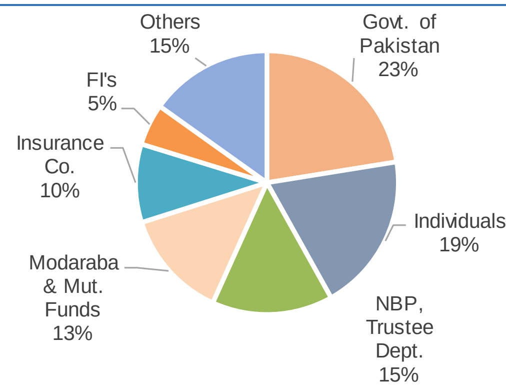
Target Price (Dec'23)	206.7
Last Closing	132.6
Upside (%)	55.8
Shares (mn)	469
Free float (%)	45
Market Cap. (PKR mn)	62,257
Market Cap. (USD mn)	276

Recommendation — BUY

Price Performance

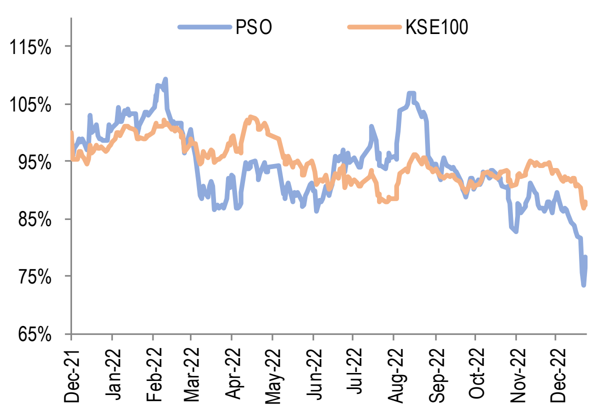
	3M	6M	12M
Return (%)	-12.0	-16.1	-20.9
Avg. Volume (000)	628	895	901
ADTV (mn) - PKR	95	151	154
ADTV (000) - USD	426	687	766
High Price - PKR	158.4	181.4	185.1
Low Price - PKR	124.4	124.4	124.4

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	*PKR*	183.7	39.2	71.1
Dividend per share	*PKR*	10.0	10.0	10.0
Book value per share	*PKR*	459.3	478.5	524.6
Price to Earning	*x*	0.9	3.4	1.9
Price to Book	*x*	0.4	0.3	0.3
Dividend Yield	*%*	5.8	7.5	7.5
Net Margins	*%*	3.5	0.7	1.0

Source (s): Company Financials, AHL Research

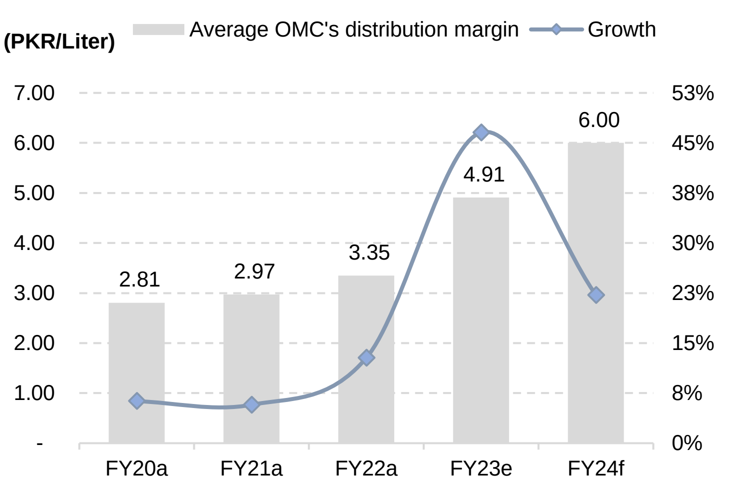
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	2,451,581	2,608,012	3,329,550
Gross Profit	160,995	53,005	79,748
Other Income	24,813	23,939	24,413
Finance Cost	4,721	12,968	14,622
Post Tax Profit	86,223	18,384	33,360

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	215,649	224,644	246,267
Trade and Other Payables	495,289	362,031	460,480
Total Liabilities	683,805	541,702	631,796
Current Assets	845,830	707,728	813,082
Non-Current Assets	53,624	58,617	64,981
Total Assets	899,454	766,346	878,063

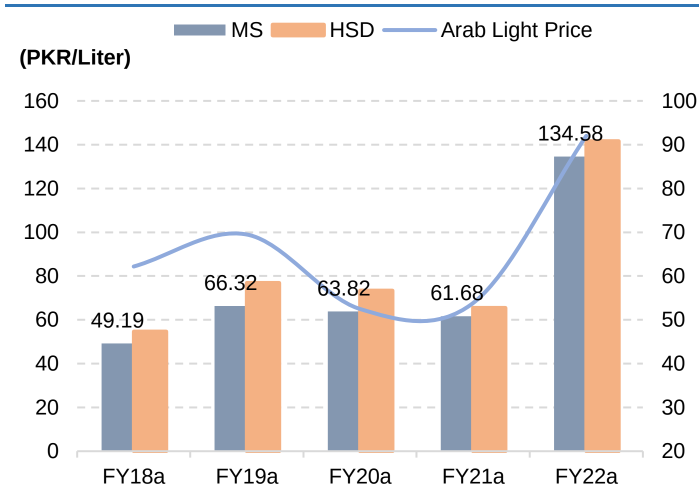
Source (s): Company Financial, AHL Research

Figure: Average OMC's distribution margin

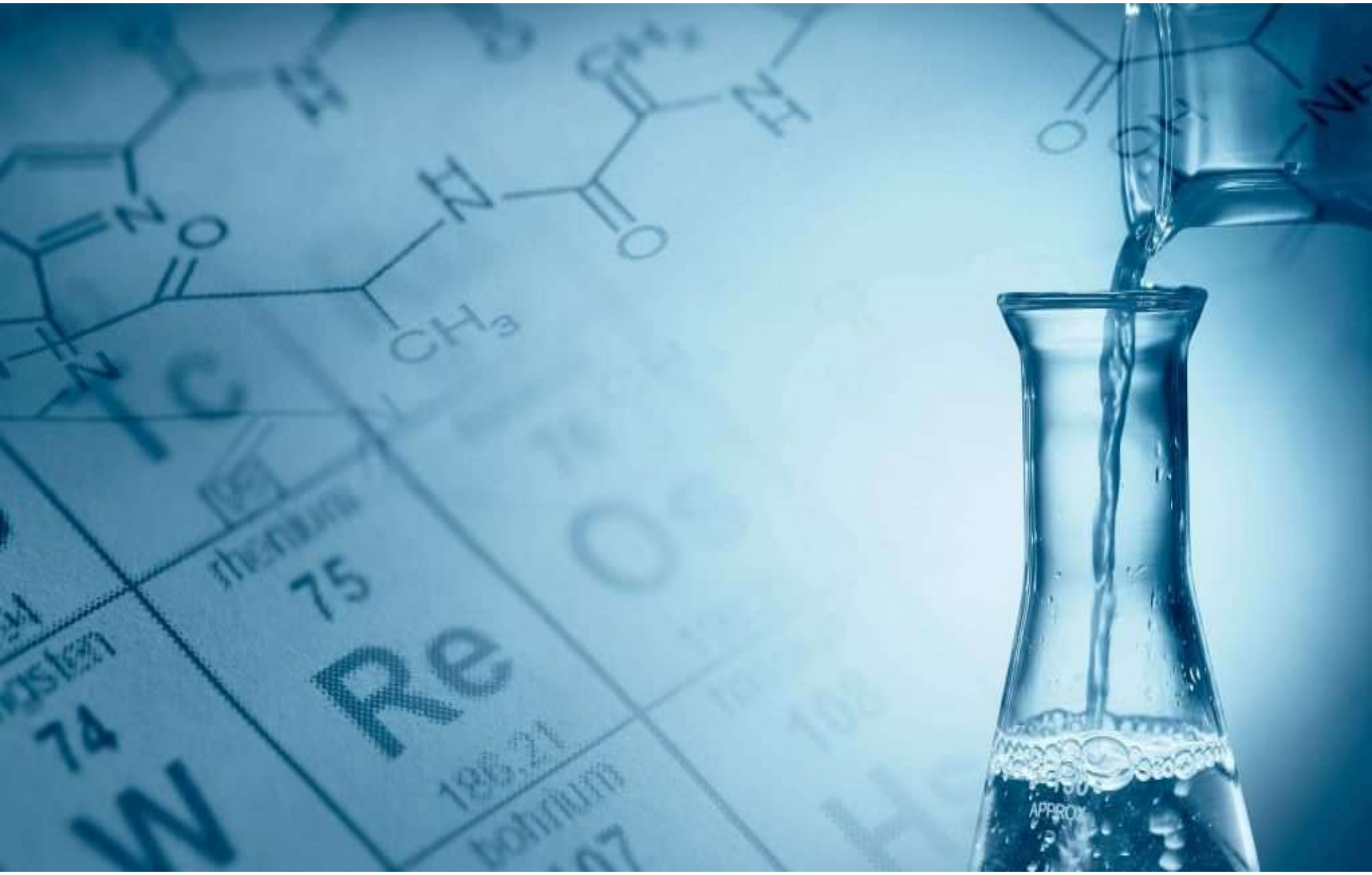


Source (s): OGRA, AHL Research

Figure: MS & HSD ex refinery price in relation to oil price



Source (s): OGRA, Bloomberg, AHL Research



Chemical

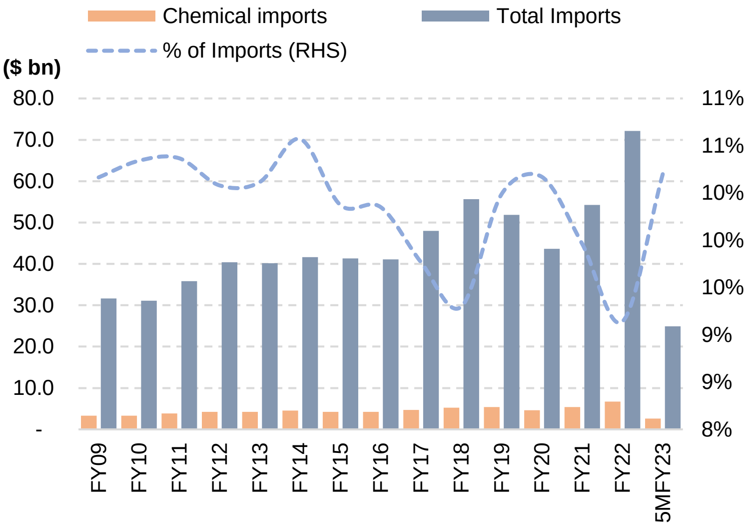
Economic slowdown and energy issues

Chemicals

Economic slowdown and energy issues

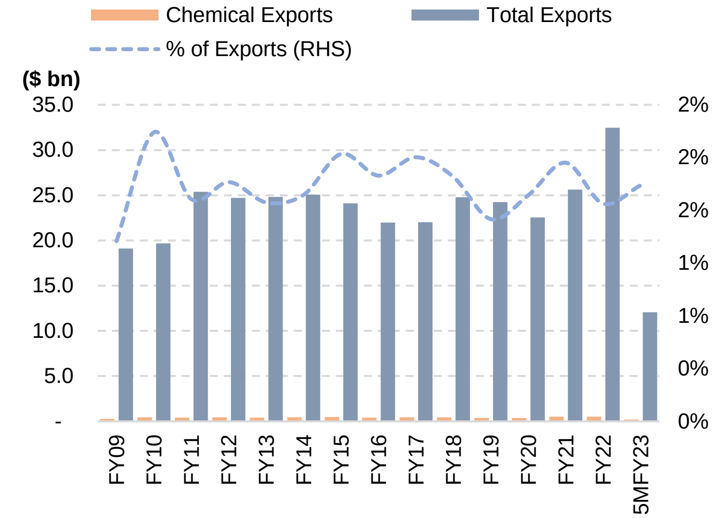
- **Economic slowdown to drag demand:** The demand for chemical products is significantly correlated to the aggregate demand of the economy as evident from the growth figures of the sector during FY21 and FY22 which stood at 21% and 19%, respectively while the real Gross Domestic Product (GDP) growth clocked-in at 5.7% (FY21) and 6.0% (FY22). The share of the chemical sector in imports and exports is ~11% and ~2%, respectively. During FY23, the GDP growth is expected to slow down to 1.8%, and in line with that, the demand for chemical products is also expected to remain low.

Figure: Share of chemical imports in total imports



Source (s): SBP, AHL Research

Figure: Share of chemical exports in total exports

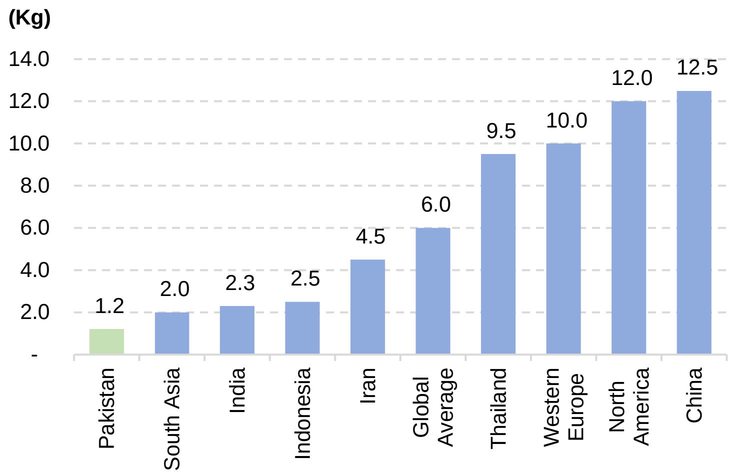


Source (s): SBP, AHL Research

- **Unresolved energy issues to increase the cost of production:** The manufacturing process of chemical products is energy intensive. Pakistan is facing a shortage of gas for couple of years now due to rising demand and depleting gas reserves. Different producers are using different types of energy sources like coal, Re-Gasified Liquefied Natural Gas (RLNG), and local gas. Gas is used for in-house electricity generation (Captive) and for the manufacturing process as well. Recently, Sui Southern Gas Company Limited (SSGC) cut the gas supply for three (3) months starting from Dec'22 until Feb'23. To meet this shortfall, some manufacturers have already contracted with SSGC for purchase of RLNG. The cost of RLNG (PKR ~3,318/mmbt) is much higher than local gas (PKR 1,087/mmbtu). It will be a challenge for the manufacturers to pass on the full impact of the higher cost of production in declining demand conditions.

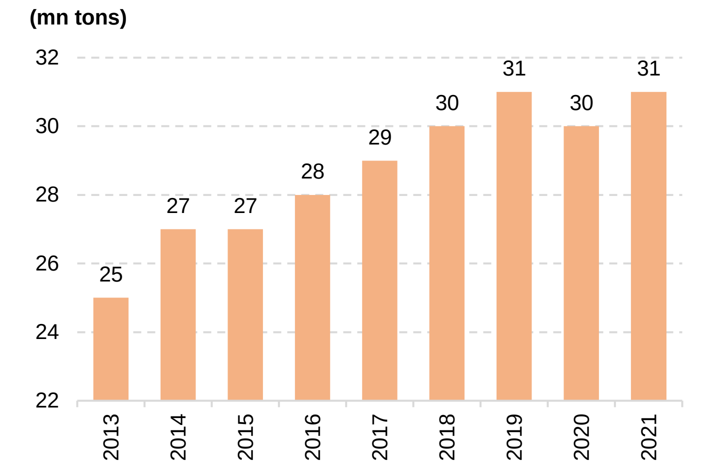
- **Polyvinyl chloride (PVC) demand is expected to remain low:** The sales of PVC have increased by 12% YoY to 171K tons during 9MCY22, compared to an increase of 28% YoY to 208K tons during CY21. This indicates that the demand for PVC has slowed down due to a decline in economic activity and a rise in inflation in the country. The main purpose of using PVC in construction activities is the quality and cost-effectiveness of construction materials, due to which majority of PVC production is consumed by the construction sector. The decline in the growth of PVC is triggered by ii) a ban on subsidized loans and iii) a cut of funds in the Public Sector Development Program due to a rising fiscal deficit.

Figure: Pakistan PVC consumption is the lowest in the region (Per Capita)



Source (s): EPCL Annual Report 2021, AHL Research

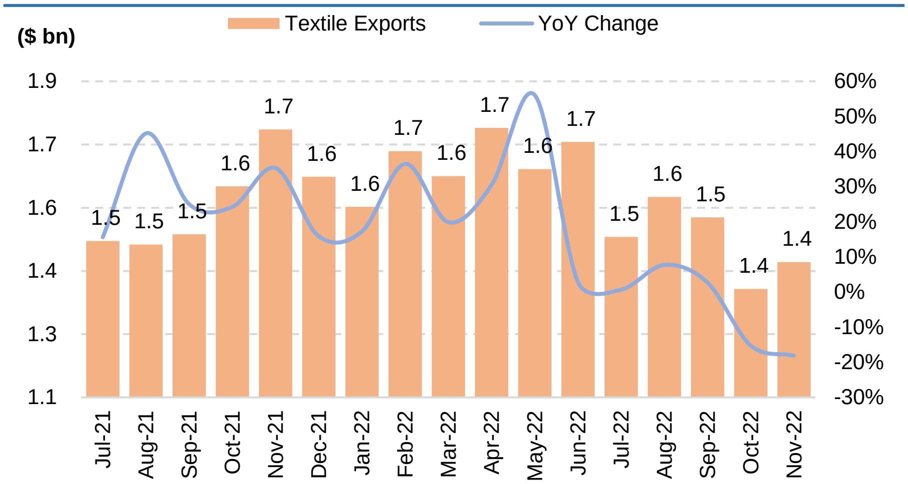
Figure: PVC demand of Asia has grown at 3% CAGR



Source (s): EPCL Annual Report 2021, AHL Research

- **Decline in textile exports will keep the PTA and PSF demand low:** The demand for Purified Terephthalic Acid (PTA) and Polyester Staple Fiber (PSF) is expected to remain low given the decline in textile exports. Many countries are facing a surge in inflation, which led developed markets into a recessionary phase. The impact of this could reflect in Pakistan's export figures, we believe. In 5MFY23, textile exports witnessed a plunge of 5% YoY, settling at USD 7.4bn. We believe the demand for PTA and PSF is likely to be on the lower side during FY23.

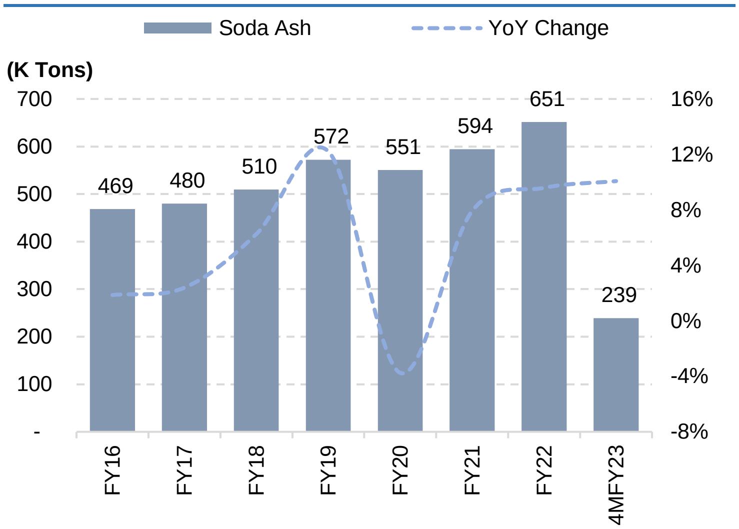
Figure: Textile exports decreased by 18% YoY to USD 1.4bn during Nov'22



Source (s): PBS, AHL Research

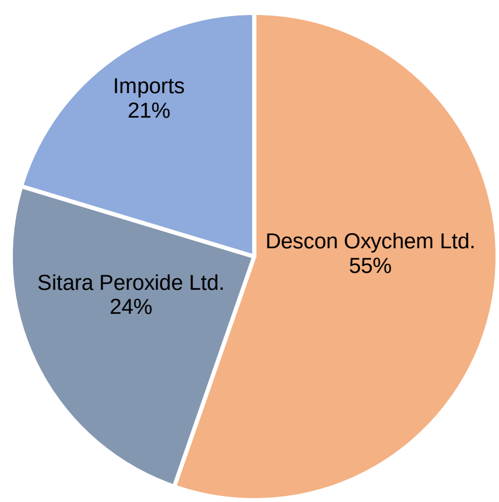
- **Downstream expansion to lead to higher Soda Ash demand:** The local demand for Soda Ash is ~590K tons per annum and there are two local players in this segment, ICI Pakistan and Olympia chemicals. ICI Pakistan has already increased its production capacity to 500K tons per annum and a 60K tons expansion is in progress. The local production of Soda Ash has increased by 10% YoY to 239K tons during 4MFY23. The rise in production is triggered by increase in demand from the downstream industry, mainly the glass industry which is going through expansionary phase. ICI Pakistan and Tariq Glass are expected to set up a float glass manufacturing facility having a capacity of 1,000 tons/day. The Soda Ash market also has an export potential as the country's exports have increased by a CAGR of 19% during the last five years (FY22: 61K tons).
- **Hydrogen Peroxide- Expansion expected:** The local demand for hydrogen peroxide is ~75K tons per annum of which ~60K is locally produced while the remaining quantity is imported. Out of the total demand, 72% of demand is North based while the South comprises 28% of the total country demand. Around 80% demand for Hydrogen Peroxide comes from textile industry which is used for bleaching. Textile contributes ~64% of the total exports of the country and hydrogen peroxide is one of the key raw materials for the textile industry. With the declining textile exports (-5% YoY during 5MFY23), we view the demand for Hydrogen Peroxide will also remain low. Engro Polymer & Chemicals Limited (EPCL) has also announced to set up of a Hydrogen Peroxide plant with a capacity of 28K tons which is expected to come online in 2023. EPCL is located in the South region of the country so it will replace the imported market which is ~15K tons per annum

Figure: Soda Ash production increased by 10% YoY



Source (s): Pakistan Bureau of Statistics, AHL Research

Figure: Market share composition of Hydrogen Peroxide



Source (s): Sitara Peroxide Ltd Corporate Briefing 2022, AHL Research

Key Risk (s)

- Lower than expected demand due to the economic slowdown
- Lower than expected exports amid a slowdown in global economies.

Engro Polymer & Chemicals Limited (EPCL)

Lower PVC margins whilst higher gas prices

- **Lower demand dampens PVC margins:** After making a high of USD 1,285/ton (in Oct'21), the PVC margins are currently hovering around USD 380/ton. This decline in PVC margins is due to lower PVC prices on the back of subdued demand from the downstream construction sector amid rising inflationary pressure. The demand in China also decreased due to lower demand from end users amid prolonged monsoon season and extended COVID-related restrictions. We view, that demand from China and India is expected to improve which will lead to marginal jump in PVC prices from current levels resulting in margins to settle at around USD 400/ton in CY23.
- **Subdued growth in PVC demand:** The pace of growth in local demand for PVC slowed down to 12% during CY22TD as compared to 28% which was recorded during 2021. The decline in growth has been due to rising inflationary pressure and slowdown in the construction activities. However, we view that EPCL will manage to sell all its production because of import restrictions and shifting preference of users to local PVC over imported PVC.
- **Gas supply issues to increase the cost:** Due to the prevailing gas shortage in the country, EPCL is also affected adversely due to gas supply constraints. To manage this issue EPCL has entered into an interim agreement with SSGC for the supply of RLNG till 28th Feb'23. Currently, EPCL is being charged PKR 1,087/mmbtu while the Nov'22 rate of RLNG notified by OGRA is PKR 3,318/mmbtu (USD 14.81/mmbu). Going forward, we have assumed the company will rely on RLNG for three (3) months and if the company absorbs the full impact of higher gas prices, the earnings are expected to decline by PKR 1.82/share.
- **Diversification into the Hydrogen Peroxide market:** The local demand for hydrogen peroxide is ~75K tons per annum of which ~60K is locally produced while the remaining quantity is imported. Out of the total demand, 72% of demand is North based while remaining comes from South region. EPCL has also announced to set up a Hydrogen Peroxide plant with a capacity of 28K tons with an expected capital expenditure of USD 30-35mn. This facility is expected to come online in 2023. EPCL is located in the South region of the country so it is likely to replace the imported market which is ~15K tons per annum. The addition of the Hydrogen Peroxide business is expected to contribute PKR 1.1/share to the CY24 earnings of EPCL.
- **Outlook and Recommendations:** We have a HOLD call for the stock with Dec'23 ending target price of PKR 45.5/share and CY23f P/E and P/B of 3.1x and 1.3x, respectively. Also, the gas supply issue and operation of company on RLNG poses big threat to company's margins and profitability.

Exhibit: Ratio Analysis

		CY21a	CY22e	CY23f
Earnings per share	PKR	16.6	13.7	7.6
Dividend per share	PKR	16.3	12.5	5.3
Book value per share	PKR	33.0	33.6	35.3
Price to Earning	x	3.3	3.1	5.6
Price to Book	x	1.6	1.3	1.2
Dividend Yield	%	30.1	29.3	12.3
Net Margins	%	21.5	15.8	9.6

Source (s): Company Financials, AHL Research

EPCL

Summary Data

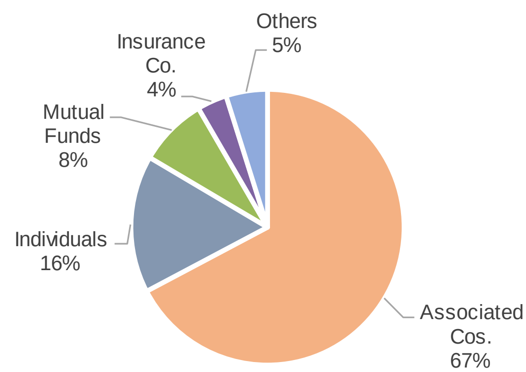
Target Price (Dec'23)	45.5
Last Closing	42.7
Upside (%)	6.5
Shares (mn)	909
Free float (%)	35.0
Market Cap. (PKR mn)	38,802
Market Cap. (USD mn)	172

Recommendation HOLD

Price Performance

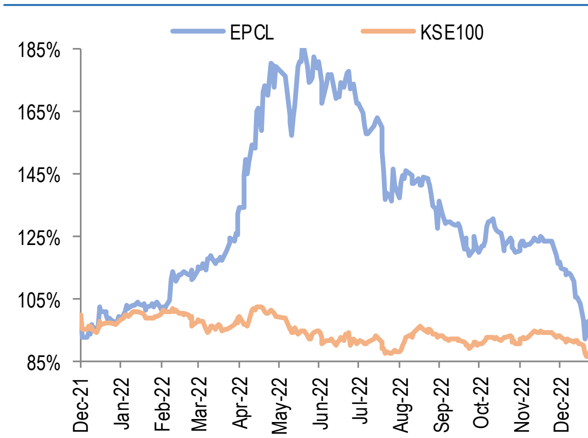
	3M	6M	12M
Return (%)	-17.9	-43.3	-1.0
Avg. Volume (000)	1,381	1,892	2,144
ADTV (mn) - PKR	74	116	145
ADTV (000) - USD	330	521	728
High Price - PKR	57.1	77.8	81.9
Low Price - PKR	40.4	40.4	40.4

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Key Financial Highlights (PKR mn)

Income Statement	CY21a	CY22e	CY23f
Net Sales	70,022	78,981	72,112
Gross Profit	24,036	25,414	15,752
Operating Profit	21,891	22,158	13,126
Finance Cost	1,904	2,830	2,752
Post Tax Profit	15,061	12,460	6,951
Balance Sheet	**CY21a**	**CY22e**	**CY23f**
Shareholder's Equity	29,968	30,551	32,114
Trade and other Payables	11,552	10,819	8,890
Total Liabilities	47,998	48,397	39,131
Current Assets	33,421	34,215	29,539
Non-Current Assets	44,545	44,733	41,706
Total Assets	77,966	78,948	71,245

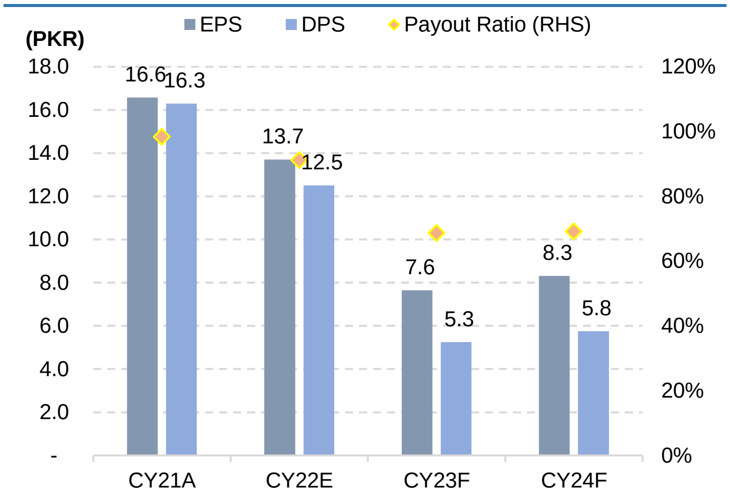
Source (s): Company Financial, AHL Research

Figure: PVC Margins Sensitivity

	PVC Margins*	EPS (PKR)		TP Dec'23
		2023	2024	
Case 1	350	5.21	4.35	20.83
Case 2	375	6.43	5.67	29.52
Case 3	400	7.65	7.00	38.11
Base Case^	**400**	**7.65**	**8.32**	**45.51**
Case 5	425	8.86	8.33	46.62
Case 6	450	10.08	9.65	55.11
Case 7	475	11.30	10.97	63.57

Source (s): Company Financials, Bloomberg, AHL Research, *International ^In the base case, USD 400/ton for CY23 and USD 425/ton beyond that.

Figure: Earnings to remain low due to lower PVC Margins



Source (s): Company Financials, AHL Research

Automobile Assemblers

Tough times ahead

Automobile Assemblers

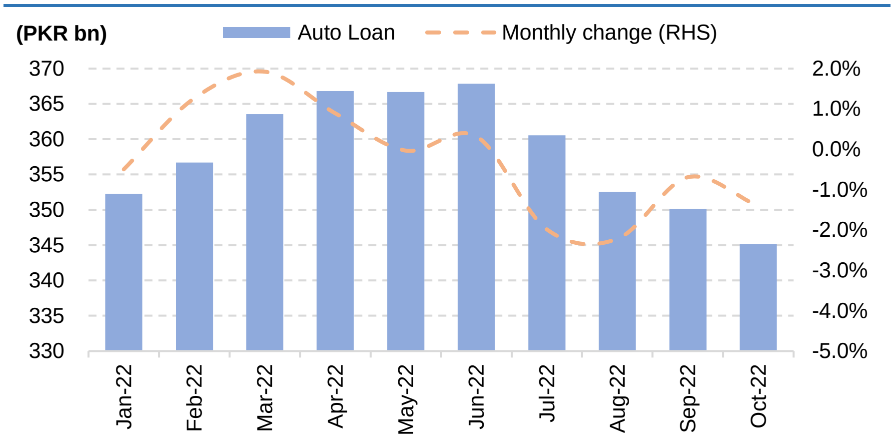
Tough times ahead

Shrinking volumes: Pakistan auto stocks have been underperformers in the past few months amid rising economic woes. With the onset of FY23, we witnessed a volumetric decline in sales of Passenger Car and LCVs to 66,458 units in 5MFY23 as against sales of 108,635 units in 5MFY22, down by 39% YoY. This massive slowdown was mainly due to: i) limited imports of CKD units allowed by SBP resulting in supply chain constraints for automobile assemblers, ii) higher car prices affecting consumer affordability, iii) increased commodity prices (i.e. steel prices), iv) increased auto financing rate amid uptick in interest rate, v) PKR depreciation against the greenback and, iv) GDP growth slowing down (6.0% in FY22 to 2% in FY23E). Albeit, we believe that volumes will slightly recover in 2HCY23 but close the year at a dip. While the outlook for profitability remains bleak for the remaining part of FY23, we believe the following year will be relatively better for auto assemblers.

Exchange rate depreciation damaging profitability: The depreciation of PKR against greenback remains a big concern for auto assemblers, as PKR depreciated by 27% over the last year. The sales orders booked on the prices prior to the free fall of the currency, had to be fulfilled despite the higher costs, to maintain customer satisfaction, resulting in a hit on operating profit. This currency volatility is likely to dent the profitability of the OEMs going forward, until localization levels improve; currently at 50% - 70%.

Auto financing bottomed down: With decades' high inflation, we saw the State Bank of Pakistan increasing the policy rate to 16%, along with the imposition of stringent policies to limit rising auto loans. This resulted in auto financing declining by 4.2% FY23TD. Therefore, we believe that due to the high-interest rate environment, sales volume will remain down by ~35% in FY23E.

Figure: Trend of auto loan



Source (s): SBP, AHL Research

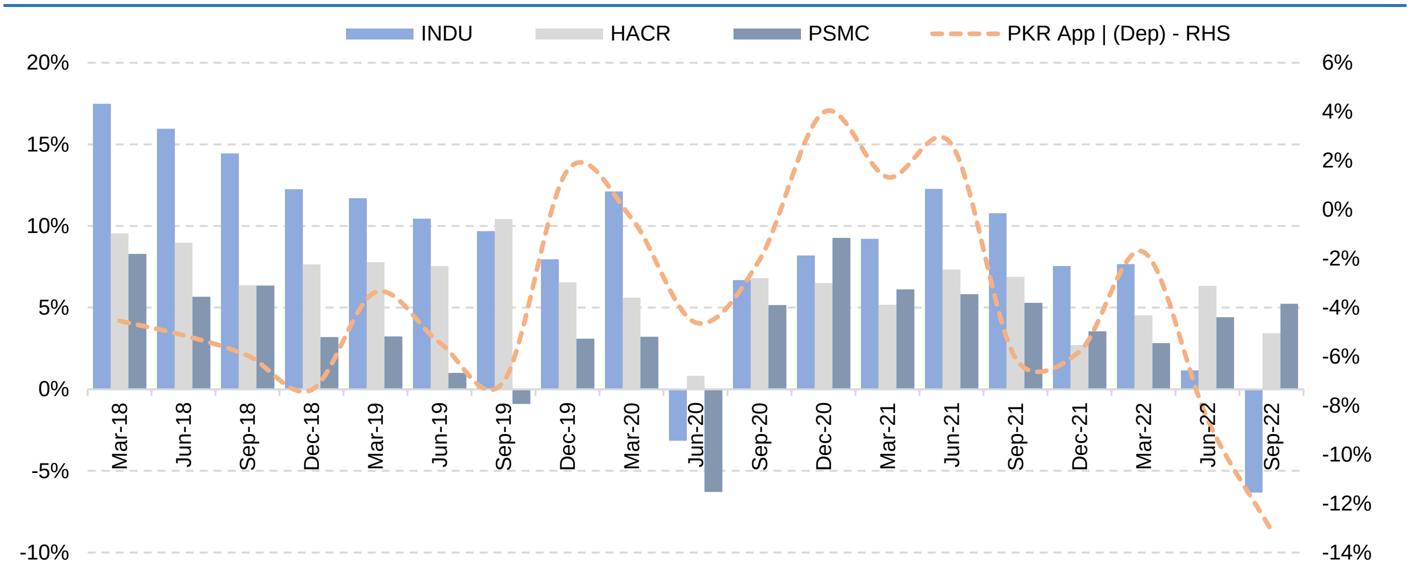
Lifting up import restrictions: Tough times called for tough measures; we saw the country's exchange reserves depleting to alarming levels. Hence, the incumbent Government and other authorities resorted to imposing restrictions on automobile imports in 2HCY22, resulting in a disruption in the auto sector supply chain. The lower inventory levels for assemblers led to a shortfall in production and sales, leading to a 26-month low of 11.6K units in Aug'22. Albeit, in a recent update, the government has removed the condition of prior approval for import from SBP for the Auto sector, however, we believe that the import curtailment will remain on the sector at least till Jun'23.

On-money market vanished: Due to the supply chain disruption, the delivery time to end customers went up from 3 months to approximately 9-10 months, which gave room to dealers to charge a premium on the new models. However, this on-money market did not last long as the affordability of customers went massively down amid higher inflationary pressure, hence, vehicles began to trade at a discount in the secondary market.

Key Risk (s)

- Import restriction remains in place and keeps haunting the profitability of the sector.
- Exchange rate volatility affecting the cost of production.
- Additional taxes and duties to cover the fiscal deficit.

Figure: Gross margins of auto assemblers vs USD/PKR appreciation / (depreciation)



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

Indus Motor Company Limited (INDU)

Leader to survive

Augmented prices to recover gross margins: We witnessed volumetric sales of INDU plunge by 51% YoY in 5MFY23 mainly on the back of SBP's import restriction and Rupee devaluation. Margins of the company went drastically down and ended up in the negative territory, at -6.3% in 1QFY23 compared to 10.8% in SPLY. This massive drop was on the back of the higher cost of production amid higher exchange rate volatility. However, we expect margins to improve in 2HFY23 as the impact of prices that were increased in Jul'22 is yet to be reflected in the company financials.

Massive short-term investment: INDU, has a strong cash and cash equivalents position (PKR 102bn), which provides the company as edge over other OEMs. In fact, other income of INDU has provided a cushion against operational losses. The company recorded notable returns on its short-term investments amid higher interest rates; In 1QFY23, INDU's other income arrived at PKR 5.2bn, up by 152% YoY. With this, we expect the other income in FY23 to clock-in at PKR 14.6bn, providing support to the overall profitability.

Hybrid technology to drive sales in the mid to long term: In its recent briefing, the management confirmed that irrespective of the economic downturn, it will continue to develop its hybrid assembly plant. It is expected that the 12th generation of Corolla, the flagship model, is going to launch in FY25, which we believe would give tough competition in the Sedan segment to all competitors operating in the OEM segment.

Lower multiples depicting a potential upside: The company is trading at FY24 PE(x) of 7.59x, whereas, the launch of Corolla 12th generation earlier than expected will attract significant interest given the quantum of units sales the company managed to sell each time historically with the launch of Corolla. We have a BUY stance on the company with Dec'23 price target of PKR 1,218/share

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	201.0	98.0	131.2
Dividend per share	PKR	93.8	46.0	61.0
Book value per share	PKR	687.2	739.1	809.4
Price to Earning	x	5.7	10.2	7.6
Price to Book	x	1.7	1.3	1.2
Dividend Yield	%	8.2	4.6	6.1
Net Margins	%	5.7	4.5	4.8

Source (s): Company Financials, AHL Research

INDU

Summary Data

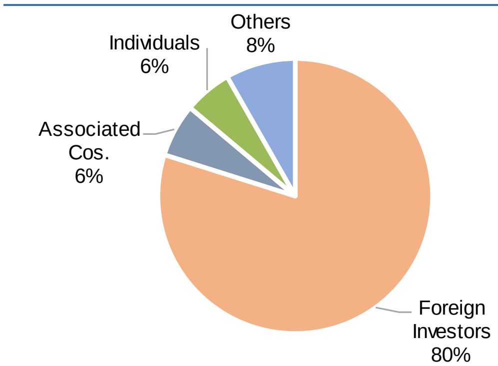
Target Price (Dec'23)	1,218.0
Last Closing	996.7
Upside (%)	22.2
Shares (mn)	79
Free float (%)	18
Market Cap. (PKR mn)	78,341
Market Cap. (USD mn)	347

Recommendation BUY

Price Performance

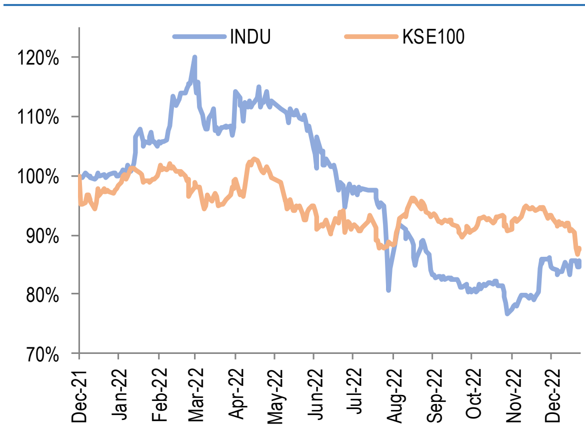
	3M	6M	12M
Return (%)	5.7	-9.5	-14.2
Avg. Volume (000)	9	14	19
ADTV (mn) - PKR	8	13	22
ADTV (000) - USD	37	59	111
High Price - PKR	1,002.1	1,145.8	1,395.7
Low Price - PKR	893.7	893.7	893.7

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

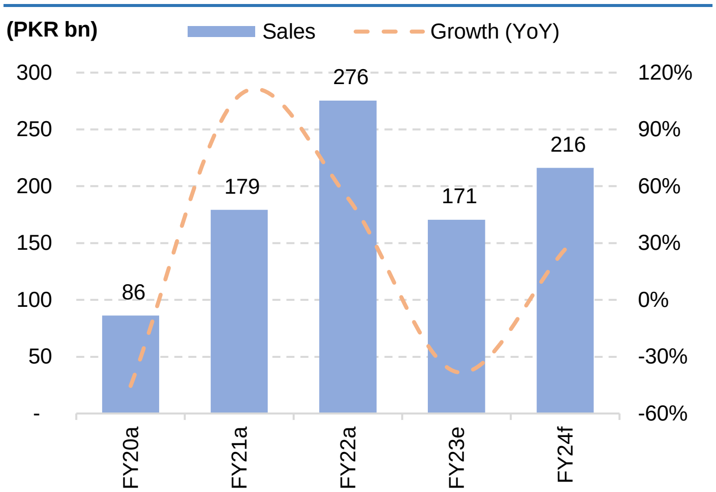
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	275,506	170,598	216,267
Gross Profit	18,404	1,655	9,812
Operating Profit	14,062	(2,428)	4,875
Finance Cost	114	189	303
Post Tax Profit	15,802	7,701	10,316

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	54,011	58,096	63,618
Trade and Other Payables	42,260	36,250	37,541
Total Liabilities	159,954	112,050	94,025
Current Assets	190,132	140,290	120,349
Non-Current Assets	23,834	29,857	37,294
Total Assets	213,965	170,146	157,643

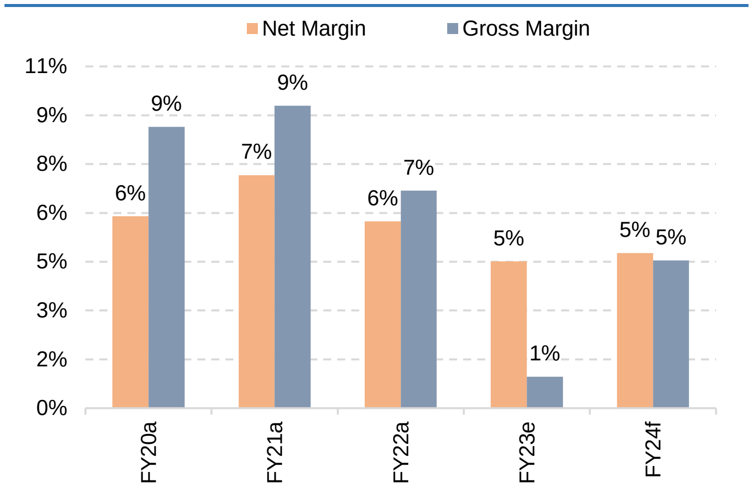
Source (s): Company Financial, AHL Research

Figure: Sales vs. Growth (YoY)



Source (s): Company Financials, AHL Research

Figure: Net Margin vs. Gross Margin



Source (s): Company Financials, AHL Research

Honda Atlas Cars (Pakistan) Limited (HCAR)

Bleak outlook

Sales of new models remained disappointing: HCAR launched its new flagship Civic in Mar'22; however, it could not garner a great reception, with sales down by 17.2% in METD23 compared to SPLY. In addition, with its recent launch of HRV, the company merely sold 464 units of BRV and HRV combined in the month of Nov'22. We expect this subdued demand in the following year as well and do not see any new launches in the coming calendar year. Moreover, with KIA and Hyundai making a strong mark in the SUV segment, it is likely to continue giving tough competition to the newly launched HRV and BRV.

No production days: The company's supply chain has been disrupted leading to plant shutdown and a record of non-production days as a result of the Government's administrative measures of minimizing the import of CKD kits and raw materials. In Oct'22 alone, the plant remained shut for straight eleven days. As a result, the market share of HCAR shrank to 11% on a volumetric basis as per the latest numbers released by PAMA.

Economic slowdown to keep volumes under pressure: With the overall economic slowdown, we witnessed a 40% YoY decline in 5MFY22 in demand, despite the launch of the much-awaited Honda Civic and HRV. The skyrocketing inflation has massively hit consumer affordability, forcing the company to defer the purchase of higher-end models and switch towards lower-end models/brands.

Major dent on profitability: Despite a massive 41% hike in HCAR prices during CY22TD, HCAR earnings are set to witness a major decline of 79% YoY during ME23 to PKR 3.9/share (PKR 17.58/share in ME22). We expect the net margins to fall to 0.5% in ME23F compared to 2.32% in ME22. To recall, HCAR recorded profitability of PKR 1.91/share during 6MME23 against PKR 13.1/share posted in SPLY. This mammoth decline in earnings came on the back of lower gross margins, as the company struggled to pass on the impact of currency depreciation and higher commodity prices to the end customer.

Weak Fundamentals warrants SELL: The company is trading at ME24 PE(x) of 10.39 indicating an overpriced PE multiple given the current circumstances. Also, with the lowest localization level among peers (excluding new entrants), the company is expected to struggle with its margins and profitability going forward. We have a SELL stance on the company with Dec'23 target price of PKR 109/share implying a downside of 19.6% from current levels.

Exhibit: Ratio Analysis

		ME22a	ME23e	ME24f
Earnings per share	PKR	17.6	3.9	13.1
Dividend per share	PKR	7.0	2.0	5.0
Book value per share	PKR	139.8	141.7	149.7
Price to Earning	x	11.8	34.7	10.4
Price to Book	x	1.5	1.0	0.9
Dividend Yield	%	3.4	1.5	3.7
Net Margins	%	2.3	0.5	1.5

Source (s): Company Financials, AHL Research

HCAR

Summary Data

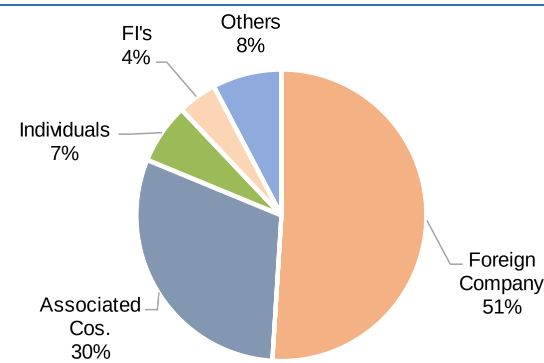
Target Price (Dec'23)	109.0
Last Closing	135.6
Upside (%)	(19.6)
Shares (mn)	143
Free float (%)	20
Market Cap. (PKR mn)	19,357
Market Cap. (USD mn)	86

Recommendation SELL

Price Performance

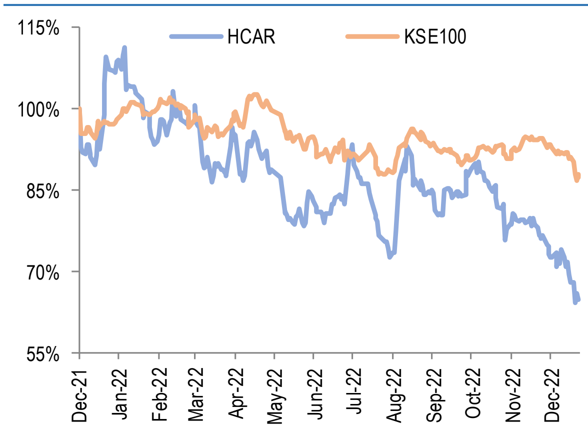
	3M	6M	12M
Return (%)	-22.6	-21.3	-40.0
Avg. Volume (000)	115	118	158
ADTV (mn) - PKR	18	20	30
ADTV (000) - USD	81	91	158
High Price - PKR	188.0	194.7	232.1
Low Price - PKR	134.3	134.3	134.3

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

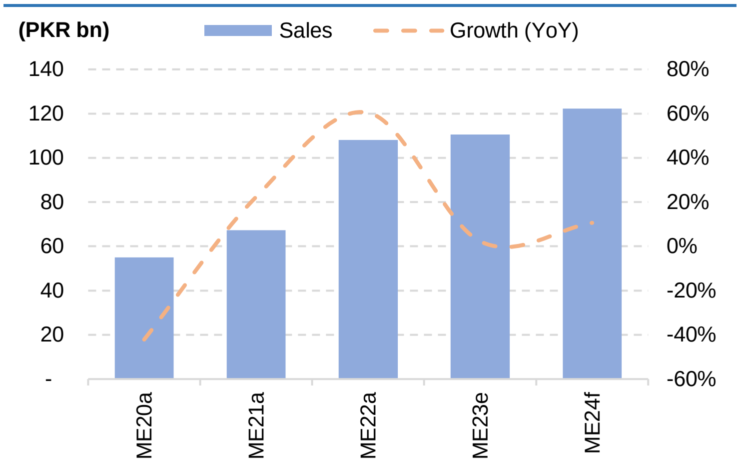
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	ME22a	ME23e	ME24f
Net Sales	108,048	110,499	122,245
Gross Profit	5,578	6,332	7,352
Operating Profit	3,370	3,947	4,637
Finance Cost	116	180	462
Post Tax Profit	2,510	557	1,864

Balance Sheet	ME22a	ME23e	ME24f
Shareholder's Equity	19,961	20,232	21,382
Trade and Other Payables	45,543	39,424	40,987
Total Liabilities	50,302	45,164	46,302
Current Assets	59,315	53,700	55,704
Non-Current Assets	10,948	11,650	12,050
Total Assets	70,263	65,350	67,754

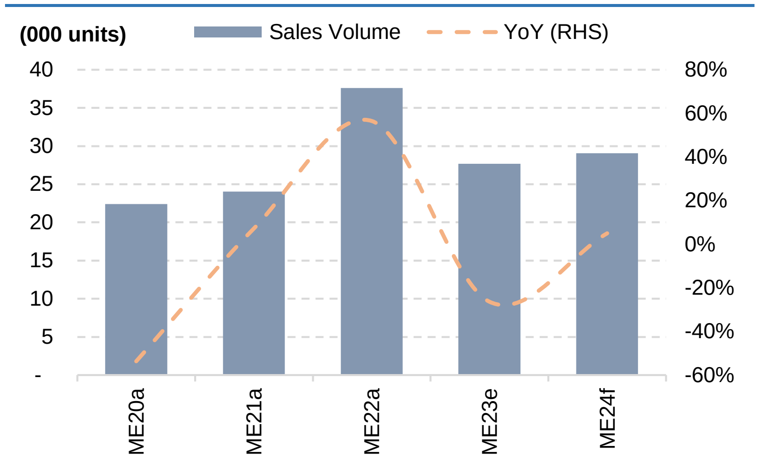
Source (s): Company Financial, AHL Research

Figure: Sales vs. Growth (YoY)



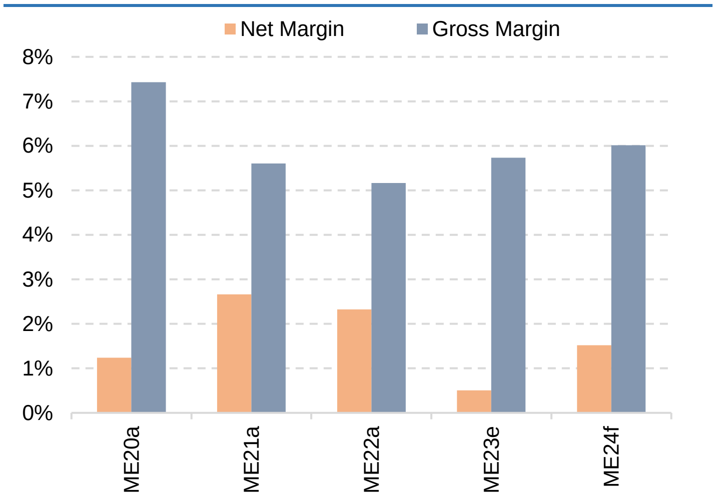
Source (s): Company Financials, AHL Research

Figure: Sales Volumes



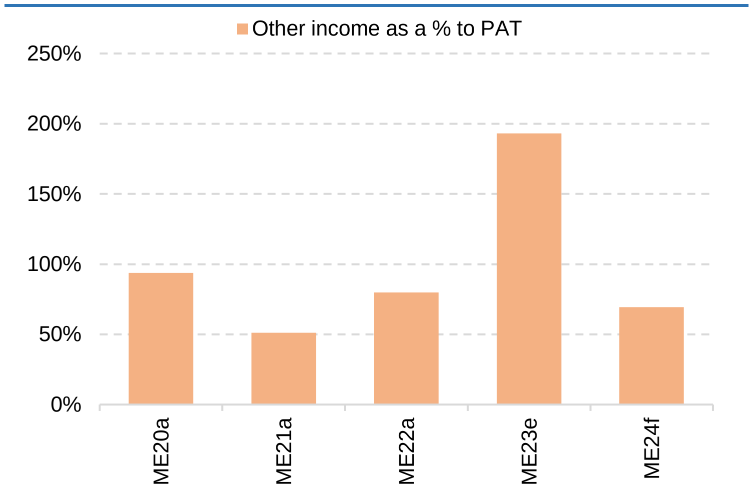
Source (s): Company Financials, AHL Research

Figure: Net Margin vs. Gross Margin



Source (s): Company Financials, AHL Research

Figure: Other Income



Source (s): Company Financials, AHL Research

Engineering

The game of margins

Engineering

The game of margins

- **Demand weakness to roll over another year:** The domestic steel sector, while widely known to mirror the cement sector, managed to outperform in the past year in terms of offtake growth. In FY22, where cement demand remained static (-1% YoY), PBS data suggests that domestic steel production rose by 23% YoY to 9.90mn tons – a historic high (last record of 9.44mn tons was observed in FY18). In particular, long steel (rebars) production rose by a massive 33% YoY to 6.36mn tons (an all-time high compared to previous record of 5.19mn tons in FY18). Whereas flat steel production grew by 7% YoY to 3.54mn tons during FY22.

While cement and construction demand may have slowed down, we believe key demand driver behind the aforementioned growth in flat steel was the automobile sector, which posted a remarkable surge during FY22 fueled by robust consumer financing amid low interest rate environment coupled with introduction of new vehicles. Sales of Cars, LCVs, Vans & Jeeps in FY22 posted a growth of 54% YoY, while an 18% jump was witnessed in the demand for Tractors, Buses and Trucks.

Whereas the robust growth in long steel demand was supported by the local production of many new engineering tools and parts, previously being imported, by local steel players as part of their diversification policy. This includes manufacturing of wire rods and specialized billets (amongst others), for various industries. While a major chunk long steel still goes to the construction industry, local steel players have become very innovative in the products they offer. This diversification has not only enabled them to compress operating risk of the business, it has also opened up new avenues of exports growth.

However, we do highlight that since the beginning of the ongoing year, both cement and automobile demand has shrunk noticeably, (cement by 21% in 6MFY23 and autos by 39% YoY in 5MFY23), due to floods and overall economic slowdown. Overall economic slowdown coupled with decline in demand of cement and steel has marginally diluted domestic steel demand as well, which has compressed by 1% YoY in 4MFY23 given a 4% decline in long steel (rebars) demand. Meanwhile, flat steel demand has held up; growing by 5% YoY during the same period.

In the backdrop of weakness in the general manufacturing industry as well as retail construction and housing demand, we believe listed long steel players will post a 15-20% YoY decline in offtake during FY23 (1QFY23: ~40% dip in dispatches due to excessive monsoon rains and flooding). Post this period though, we believe once Pakistan secures external financing and commences the rehabilitation process, and work takes off on some large-scale projects such as construction of the Hyderabad-Sukkur Motorway, together with recovery in the economy improving housing demand, dispatches could potentially exhibit a notable jump in FY24.

Steel prices have come off their peak: It was established last year that initial post COVID jump in prices of metals and commodities was not just a pent-up jerk, and did not appear transitory in nature. Therefore, despite effects of major government spending stimulus packages wearing off, prices remained downwards sticky. However, the unexpected invasion of Ukraine by Russia triggered a new round of spike in global commodities, which touched their highs in Mar'22 when the war broke out.

High commodity prices translated to a significant pressure from imports which, alongside the already depleting domestic economic conditions, manifested into another external account crisis. As a result, PKR lost significant ground against the greenback, CPI touched an all-time high (on FY23 average basis), and the SBP's policy rate was hiked to the highest level since 1998 this year. Apart from this, higher energy tariffs in the wake of upwards revision in fuel prices, also hammered companies. Therefore, it can safely be concluded that it has been a challenging year for industries. With major businesses facing brutal inflationary pressure, manufacturers were left with no choice but to indispensably raise prices of local products in order to keep earnings afloat.

The domestic steel sector was no exception. International scrap prices reached unparalleled levels of USD 650/ton in Mar'22 from USD 400/ton a year earlier, whereas HRC (China FOB) hovered at nearly USD 950/ton against USD 700/ton in SPLY. Given a lag of a quarter for prices to reflect raw material costs (transit period), flat as well as long steel made their highs in Jul'22. Rebar prices rose from PKR 151,000/ton in Jul'21 to nearly PKR 240,000/ton in Jul'22, a hefty 59%. During the same time, CRC (1 mm) prices made a high of PKR 242,550/ton in Jul'22 from PKR 185,500/ton at the beginning of FY22, while prices of galvanized steel sheets (1 mm) went from PKR 197,850/ton to PKR 249,900/ton.

Albeit, international commodities showed respite soon after as the expected disruption in supply chains post imposition of sanctions on Russia, did not materialize. Most European economies realized that they may not find alternatives for certain metals and commodities immediately, which forced them to continue procuring from Russia. Meanwhile, Russia also found new buyers in China and India to make up for some of the lost supply to Europe.

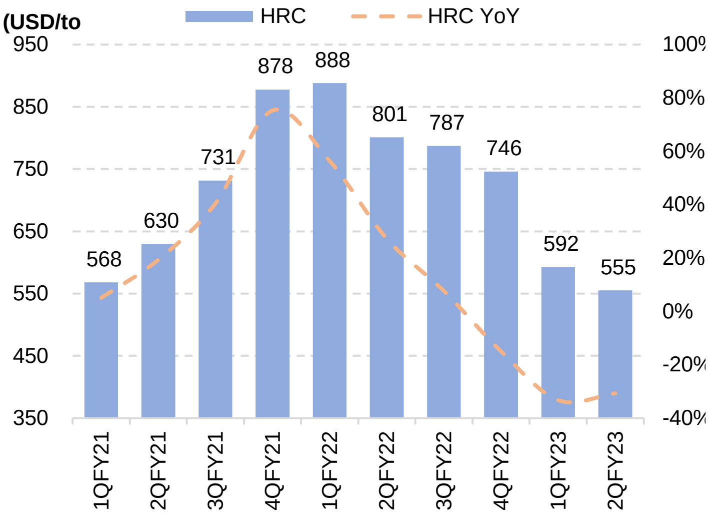
By virtue of the above, steel raw material prices also depicted a downwards trajectory. International scrap prices displayed a massive decline from USD 650/ton to between USD 380-410/ton, whereas HRC prices tumbled from USD 950/ton to under USD 650/ton at present. This prompted a reversal in local steel prices. Since Jul'22 to date, rebar prices have come down to PKR 215,500/ton in North (-PKR 25K from high of PKR 240k per ton) and PKR 218,900/ton in South (-PKR 23K since high). Pertinently, the cut was due to demand weakness post floods. In the flat steel space, prices have shed nearly PKR 28K/ton from the highs, with CRC prices at PKR 214,500/ton and galvanized sheet prices at PKR 221,900/ton currently.

- **Sectoral headwinds to erode sector-wide profitability:** We do highlight that local players (both flat and long) have raised prices in the last two weeks, on account of PKR depreciation. Moreover, on a full year basis, given the stunning decline in raw materials, we believe margins may not face any major downside, despite expected PKR depreciation. However, sectoral headwinds to the likes of slower overall offtake, augmented electricity tariff, as well as elevated financial charges led by significant monetary tightening this year, will erode earnings.

Key Risk (s)

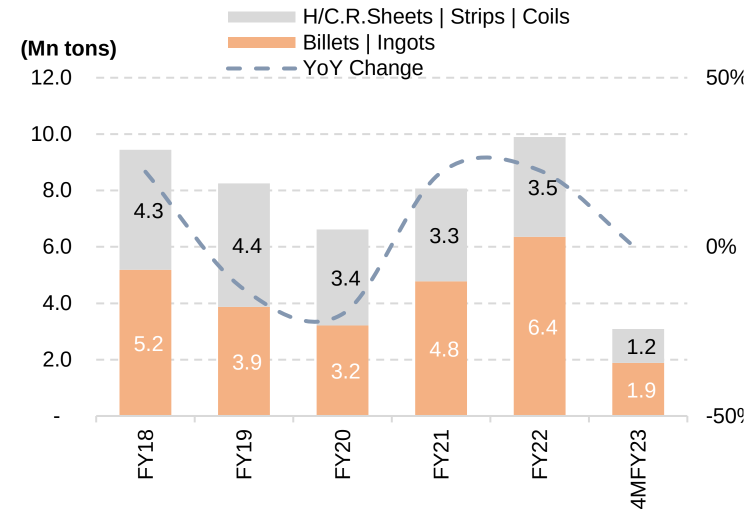
- Continued weakness in construction demand will keep steel demand dull. Slower than expected demand can potentially reduce the ability of players to pass on costs and further dent profitability.
- Delay in monetary policy easing will exacerbate earnings of the sector

Figure: Trend of HRC prices



Source (s): Bloomberg, AHL Research

Figure: Trend of steel products production



Source (s): PBS, AHL Research

Agha Steel Limited (AGHA)

The Margin Leader

Agha steel Industries Limited (AGHA) is our top pick in the AHL steel universe with our Dec'23 target price of PKR 18.3/share, offering an upside of 54%. We believe the company with continue posting unparalleled margins in the domestic steel space, despite strong headwinds engulfing the sector, given i) use of virgin scrap given the ability of the electric arc furnace to purify it and produce high-margin products, and ii) new MI.DA. plant set to bring in significant cost efficiencies (COD: Jun'23), augment the rolling capacity by 400k tons and render the AGHA to be the largest re-roller in the country. We forecast the company to post a 5-yr forward earnings CAGR of 26%.

- **Superior technology:** The domestic rebar industry produces steel through induction furnaces, which appear pale in comparison to AGHA's electric arc furnace. Amongst other variables, the company possesses superior technology to purify virgin steel (remove sulfur, phosphorus and other impurities), which makes it more efficient since i) virgin scrap is cheaper (delta varies between USD 80-200/ton), ii) it is not subjected to any duties, and iii) it allows the company to manufacture low carbon specialized billets, a high margin product. These cater to the wire rod industry and give AGHA an edge over its competitors.
- **Innovation to the core:** AGHA's upcoming MI.DA. Rolling mill will put the company on the global map amongst other technologically advanced steel manufacturers. Its current capacity for rolling is set at 250k tons per annum whereas it has a melting capacity of 450k tons/annum. Once the ongoing expansion reaches conclusion (COD: Jun'23), the company's rolling capacity will clock-in at 650k tons – largest nameplate capacity in the country. Pertinently, MI.DA. (a 400k tons micro mill by Danieli, Italy) is a continuous rolling mill, which will eliminate the casting process. Its continuous uninterrupted production cycle, and the extreme compactness of the plant size (49% less space needed), makes it one of the most cost-efficient rebar plants in the world.
- **Margins galore:** Given the introduction of MI.DA. and the benefits it will bring to the company, alongside volumetric growth, diversification to new high margin products as well as continued reliance on virgin scrap, AGHA's margin should tower over its competitors. We forecast them to arrive at 23.5% in the next 5 years (FY23-27) against 22.6% in the prior 5years.

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	3.1	1.5	2.2
Dividend per share	PKR	-	-	-
Book value per share	PKR	25.9	27.4	29.6
Price to Earning	x	5.1	7.8	5.5
Price to Book	x	0.6	0.4	0.4
Dividend Yield	%	-	-	-
Net Margins	%	7.2	3.5	3.7

Source (s): Company Financials, AHL Research

AGHA

Summary Data

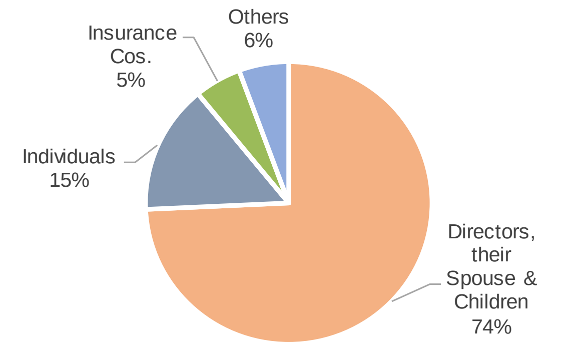
Target Price (Dec'23)	18.3
Last Closing	11.9
Upside (%)	54.2
Shares (mn)	605
Free float (%)	25
Market Cap. (PKR mn)	7,186
Market Cap. (USD mn)	32

Recommendation BUY

Price Performance

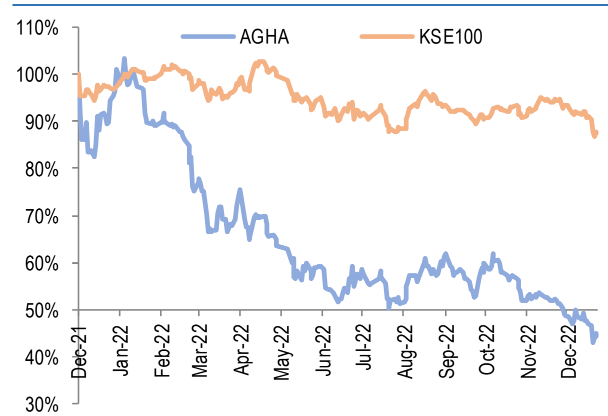
	3M	6M	12M
Return (%)	-15.8	-19.2	-50.5
Avg. Volume (000)	184	235	370
ADTV (mn) - PKR	3	4	7
ADTV (000) - USD	12	16	35
High Price - PKR	16.6	16.6	27.6
Low Price - PKR	11.5	11.5	11.5

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

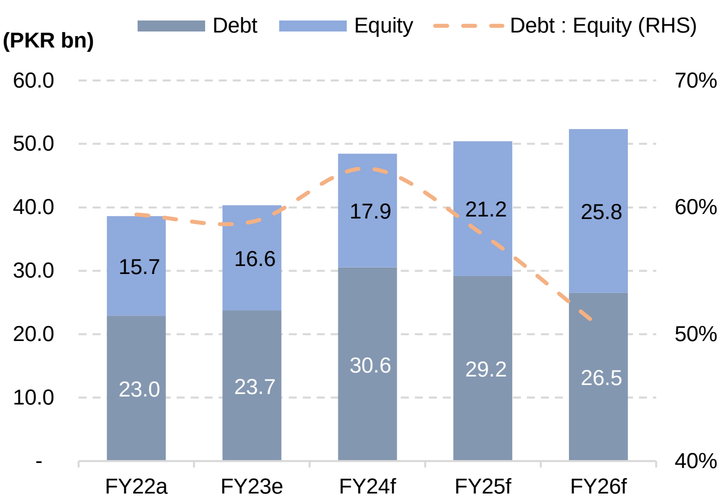
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	25,648	26,156	35,702
Gross Profit	5,490	5,636	7,908
Operating Profit	4,424	4,756	6,667
Finance Cost	2,136	3,613	4,721
Post Tax Profit	1,855	926	1,304

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	15,666	16,592	17,896
Trade and other Payables	1,129	1,030	1,395
Total Liabilities	25,812	26,498	33,677
Current Assets	21,802	22,330	29,702
Non-Current Assets	19,675	20,759	21,870
Total Assets	41,477	43,089	51,572

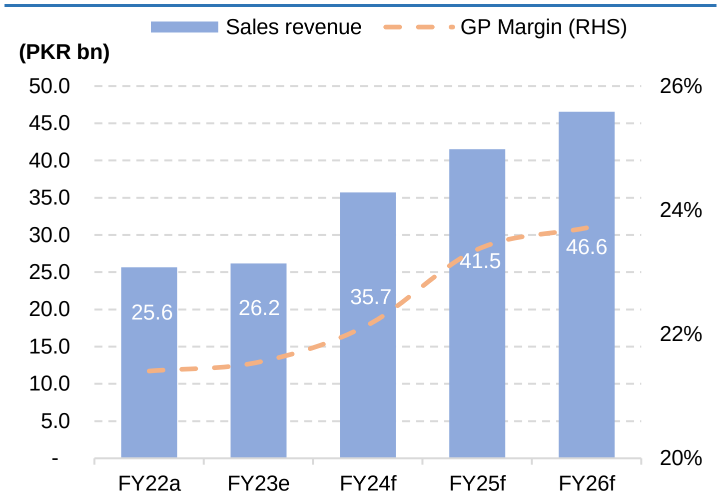
Source (s): Company Financial, AHL Research

Figure: Debt to Equity



Source (s): Company Financials, AHL Research

Figure: Revenue Growth



Source (s): Company Financials, AHL Research

Technology & Communication

USD denominated revenue galore

ARIF HABIB LIMITED

HUM Network Limited (HUMNL)

Tuned to entertain

- Our Dec'23 target price for Hum Network Limited (HUMNL) is set at PKR 9.95/share, offering a noteworthy upside of 75% from current levels. Our conviction in the stock is hinged upon i) consistent growth in the company's digital audience whereby earnings are USD denominated, ii) solid brand presence in the domestic TV / entertainment business, and iii) augmented income from the company's news channel in lieu of revised advertisement rates post improvement in distribution and ranking. Currently the stock is trading at an attractive FY24F PER of 2.3x.
- **Digital media income to drive topline:** Hum TV has the third largest drama channel account on YouTube, with over 24mn subscribers. This has altogether opened up a massive revenue stream for the company. HUMNL generates USD denominated income from its social media monetization based on its growing number of subscribers, views per video, and duration of views. Higher views then also attract advertisement revenue. Given the fast pace of internet penetration and the persistent growth of subscribers on social media in the country, we forecast the company's subscription income to achieve a 3-yr forward CAGR of 27%.
- **Hum TV – The TRP champion:** Hum Network's flagship TV channel – Hum TV – has acclimated itself with the times. As per Aurora, Hum TV remains the third largest channel in terms of ranking and market share in the country, whereby some its shows have broken many TRP records in the past few years. Moreover, initiatives such as award shows in foreign countries have also warmed up overseas Asian communities to its content. As a result, we forecast advertisement revenue from the channel to grow at a 3-yr forward CAGR of 15% by FY25.
- **Hum News – A top tier channel now:** The company has persistently invested in its news network staff and outreach, since its launch in 2018. As a result, ranking of the channel has jumped up from 16 in 2018 to number 5 at present, rendering it to be a Tier 1 channel, which has significantly improved its cost per rating point (CPRP). We project advertisement revenue from Hum News to grow at a 3-yr forward CAGR of 34%.
- **Enticing media takeover:** Board of the company has authorized the management to explore the opportunity to acquire Tower Sports (Private) Limited, which holds licenses for Ten Sports and Ten Sports 2 and over see's sales and distribution of the aforementioned channels. The management will also explore the feasibility to potentially acquire Sphere Ventures (Private) Limited, which deals with kids' content. While not yet part of our valuations, we believe this can materially improve earnings forecast.

HUMNL

Summary Data

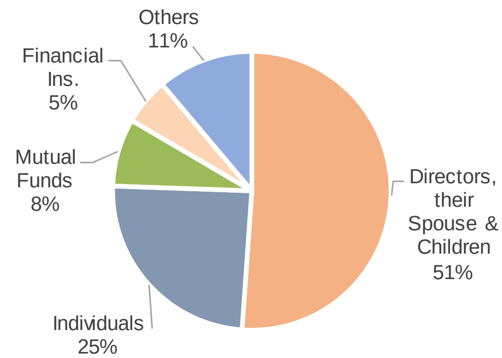
Target Price (Dec'23)	10.0
Last Closing	5.7
Upside (%)	75.2
Shares (mn)	1,134
Free float (%)	42
Market Cap. (PKR mn)	6,441
Market Cap. (USD mn)	29

Recommendation BUY

Price Performance

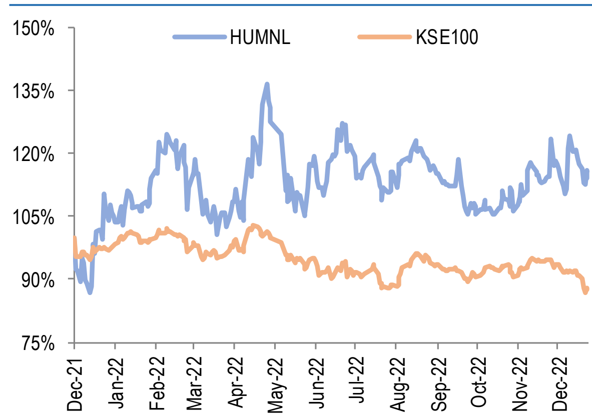
	3M	6M	12M
Return (%)	8.0	-5.3	3.5
Avg. Volume (000)	3,907	3,582	6,742
ADTV (mn) - PKR	22	21	40
ADTV (000) - USD	99	93	209
High Price - PKR	6.2	6.3	6.8
Low Price - PKR	5.2	5.2	5.0

Shareholding Pattern



Source: Company Financials, AHL Research

Relative Performance



Source: Bloomberg, AHL Research

Exhibit: Ratio Analysis

		FY22a	FY23e	FY24f
Earnings per share	PKR	1.5	1.5	1.9
Dividend per share	PKR	0.5	0.8	1.0
Book value per share	PKR	5.5	5.5	6.4
Price to Earning	x	4.8	3.7	3.0
Price to Book	x	1.3	1.0	0.9
Dividend Yield	%	7.0	13.2	17.6
Net Margins	%	21.6	21.3	23.1

Source (s): Company Financials, AHL Research

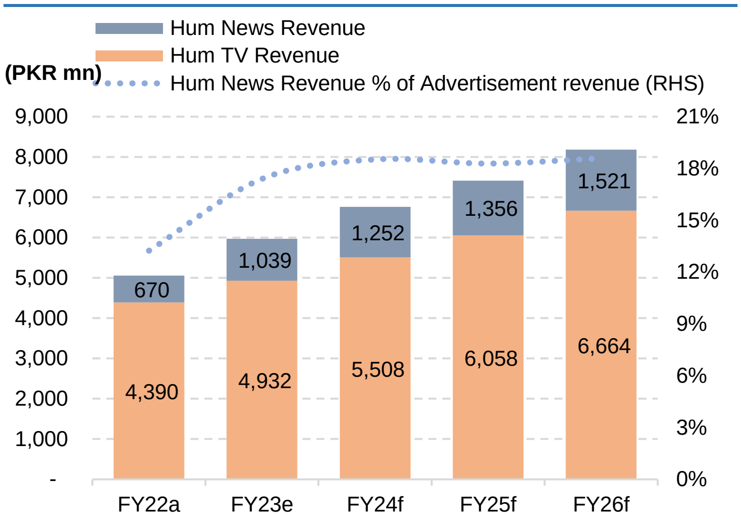
Exhibit: Key Financial Highlights (PKR mn)

Income Statement	FY22a	FY23e	FY24f
Net Sales	6,545	8,066	9,430
Gross Profit	2,832	3,568	4,313
Operating Profit	1,622	2,083	2,549
Finance Cost	75	62	12
Post Tax Profit	1,416	1,720	2,180

Balance Sheet	FY22a	FY23e	FY24f
Shareholder's Equity	5,188	6,246	7,292
Trade and other Payables	1,308	1,170	1,331
Total Liabilities	1,943	1,429	1,589
Current Assets	5,274	6,007	7,236
Non-Current Assets	1,856	1,668	1,645
Total Assets	7,131	7,675	8,881

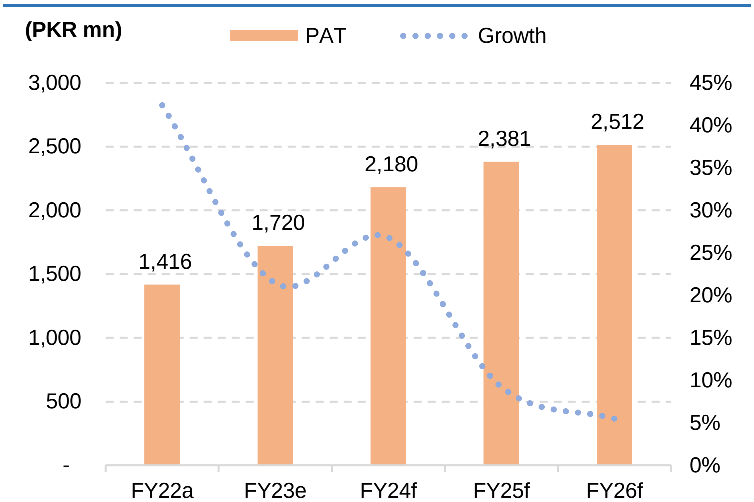
Source (s): Company Financial, AHL Research

Figure: Revenue Breakup



Source (s): Company Financials, AHL Research

Figure: Earnings Growth



Source (s): Company Financials, AHL Research

Alpha Stocks

Tariq Glass Industries Limited (TGL)

Tariq Glass Industries Limited deals in production and sale of glass containers, tableware, opal glass and float glass. Most of the company's sales come from domestic while the company exports to Sri Lanka, Saudi Arabia, Afghanistan and others. During FY22, the company completed the rebuilding of one of the tableware furnaces, which increased the production capacity from 140 MT p.d to 200 MT p.d. Another tableware glass has been closed and is under rebuilding process, meanwhile, rebuilding float glass unit-1 (with 550 MT p.d capacity) is about to reach completion and is awaiting approval from the SBP for import of spares. Meanwhile, the company has installed and commissioned New Spectrum Mirror Coating line, High Speed Double Gob Press Machine and Six Colours Pad Printing Production Line, which will result in efficient production and improve quality of the products. Keeping in view curbs on import of tableware glass by the SBP, we expect demand for local glass to continue. With the upgradation of plants and new projects, the company will be able to fill the gap of import tableware and float glass products.

Key Financials

		FY22	FY21	LTM
Earnings per share*	PKR	24.1	12.3	19.4
Price to Earning	x	3.4	6.0	3.4
Price to Book	x	1.1	1.2	0.8
Dividend Yield	%	2.5%	16.3%	3.1%
Return on Equity	%	31.6%	19.9%	24.8%

Source (s): Company Financials, AHL Research *@ 172mn shares

TGL

Last Closing	65.0
Shares (mn)	172.2
Free float (%)	40.0
Market Cap. (PKR mn)	11,185.7
Market Cap. (USD mn)	49.6

Price Performance

	3M	6M	12M
Return (%)	(25.4)	(19.0)	(23.0)
Avg. Volume (000)	323.2	482.4	515.7
ADTV (mn) - PKR	27.8	44.8	49.2
ADTV (000) - USD	123.2	198.5	246.0
High Price - PKR	91.7	104.1	107.4
Low Price - PKR	11.0	11.0	10.9

Source (s): Company Financials, AHL Research

Pakistan National Shipping Corporation (PNSC)

PNSC is involved in the transportation of dry bulk and liquid cargoes globally. The company has eight oil tankers that ship petroleum products from the Middle East to Pakistan via seaport for local consumption. This includes two recently added oil tankers, which have increased the company's liquid cargo weight capacity by 214,246 MT. In addition to oil tankers, the company also has five bulk carriers for dry cargos. Despite global challenges, the company managed to supply liquid and dry cargos to Pakistan without much delay. In addition to this, the company outperformed in terms of income earned from shipping since most of the revenues of the company are fixed at global freight indices. We expect oil tankers and dry cargos business to grow post robust growth in FY23 with the addition of new oil tankers.

Key Financials (Consolidated)

		FY22	FY21	LTM
Earnings per share*	PKR	42.8	17.2	78.8
Price to Earning	x	1.1	3.8	1.3
Price to Book	x	0.1	0.2	0.3
Dividend Yield	%	11.0%	4.6%	4.9%
Return on Equity	%	13.3%	6.1%	21.8%

Source (s): Company Financials, AHL Research *@ 132mn shares

PNSC

Last Closing	101.1
Shares (mn)	132.1
Free float (%)	8.8
Market Cap. (PKR mn)	13,351.6
Market Cap. (USD mn)	59.4

Price Performance

	3M	6M	12M
Return (%)	60.6	124.6	99.2
Avg. Volume (000)	82.4	64.6	44.4
ADTV (mn) - PKR	8.2	5.6	3.4
ADTV (000) - USD	36.8	24.9	16.0
High Price - PKR	118.1	118.1	118.1
Low Price - PKR	11.0	-	-

Source (s): Company Financials, AHL Research

Descon Oxychem Limited (DOL)

Descon Oxychem Limited is into manufacturing, procuring, and selling hydrogen peroxide and allied products. The company, being the local market leader of hydrogen peroxide, supplies chemicals to textile, food, beverage, industrial, and consumer sectors. With the government increasing emphasis on exports, we expect DOL to be the key beneficiary given its core customer is the textile industry. In 2020, the company undertook capacity expansion. The expansion has resulted in incremental volumes, boosting the company's revenue from local and international markets. We expect this trend to continue, going forward. At present, the company has planned to expand business in UAE for the purpose of sales and marketing of products, in-line with the goal of increasing its footprint outside Pakistan. With this strategy, the company will be able to mitigate the impact of fluctuations in domestic prices and/or demand. Furthermore, with the restriction of imports in place by SBP and the continuous devaluation of PKR against USD, the demand for local hydrogen peroxide is likely to increase. With the availability of excess capacity, the company is expected to meet the local demand comfortably.

Key Financials

		FY22	FY21	LTM
Earnings per share*	PKR	2.7	1.6	5.5
Price to Earning	x	5.3	14.7	4.0
Price to Book	x	1.1	2.0	1.3
Dividend Yield	%	14.0%	4.3%	9.1%
Return on Equity	%	20.0%	13.5%	33.6%

Source (s): Company Financials, AHL Research *@ 175mn shares

DOL

Last Closing	22.0
Shares (mn)	175.0
Free float (%)	30.0
Market Cap. (PKR mn)	3,850.7
Market Cap. (USD mn)	17.1

Price Performance

	3M	6M	12M
Return (%)	15.1	50.3	8.5
Avg. Volume (000)	469.3	441.2	287.2
ADTV (mn) - PKR	11.3	9.9	6.3
ADTV (000) - USD	51.1	44.7	29.5
High Price - PKR	26.4	26.4	26.4
Low Price - PKR	11.0	11.0	10.9

Source (s): Company Financials, AHL Research

BankIslami Pakistan Limited (BIPL)

BankIslami Pakistan Limited (BIPL) is a full-fledged Islamic Bank which is operating with 340 branches including 80 sub-branches, offering Shariah compliant services ranging from Corporate & Commercial Financing, SME & Agriculture Financing, Consumer Financing, Trade Finance, Retail Banking, Investment Banking, Treasury Services, Digital Delivery Channels and Cash Management and Employee Banking Services. Being an Islamic Bank, bank enjoys no minimum cost of deposits, providing cushion to their top-line. Moreover, with further hike in interest rates is expected in 1HCY23, the bank's profitability is likely to improve in CY23. Furthermore, JS Bank Limited has submitted an intention to acquire more than 51% voting shares of BankIslami Pakistan Limited.

Key Financials (Consolidated)

		CY21	CY20	LTM
Earnings per share*	PKR	1.8	1.4	2.8
Price to Earning	x	6.9	8.5	5.1
Price to Book	x	0.6	0.6	0.6
Dividend Yield	%	-	-	-
Return on Equity	%	8.9%	7.5%	12.0%

Source (s): Company Financials, AHL Research @ 1,109mn shares

BIPL

Last Closing	14.3
Shares (mn)	1,108.7
Free float (%)	30.0
Market Cap. (PKR mn)	15,832.3
Market Cap. (USD mn)	70.2

Price Performance

	3M	6M	12M
Return (%)	32.8	31.4	8.3
Avg. Volume (000)	1,244.2	828.0	701.6
ADTV (mn) - PKR	17.0	10.9	9.0
ADTV (000) - USD	76.3	49.1	44.0
High Price - PKR	15.5	15.5	15.5
Low Price - PKR	10.6	10.5	10.2

Source (s): Company Financials, AHL Research

Systems Limited (SYS)

Systems Limited is listed as a tech company that is primarily involved in software development, software trading, and business process outsourcing services. The company has subsidiaries namely TechVista Systems, Systems Arabia LL,C and Systems Venture. In addition to this, the company has an associate company E-Processing Systems B.V. The majority of the company's business comes from digital services (76%), while the remaining business comes from managed services (14%) and BPO (10%). In terms of region, most of the business comes from the Middle East (~45%) and North America (~29%). The company during CY22 launched operations in Egypt, South Africa, Singapore, and Australia. Furthermore, about 80% of the company's revenue is in terms of USD. Meanwhile, the company's costs are in terms of the Pak Rupee. The company continues to lock more contracts in terms of USD, which will increase company revenues in terms of the greenback, while the ongoing devaluation of PKR against USD will further augment company's profitability. Moreover, the company is only liable to pay super tax on domestic sales¸ given income from exports is exempted from this tax. In addition to this, the company will continue to add more business in its subsidiaries. During CY22, the company acquired a 100% stake in two new businesses:

- NDC Tech: An IT and consulting business with a presence in 17+ countries with 75+ banking clients. With the acquisition, SYS will be able to offer end-to-end IT services for the banking sector locally and internationally.
- Treehouse Consultancy: An IT solutions firm providing high-end solutions using direct channel and third-party channel. The newly acquired business will strengthen SYS's position in Middle East.

During CY22, the company's associate company E-Processing Systems was successful in getting funds worth USD 11mn for OneLoad Project from Sarmayacar and Sharooq Partners. The new product offering, which has EMI License, is expected to launch soon.

Key Financials

		CY21	CY20	LTM
Earnings per share*	PKR	11.4	7.6	20.1
Price to Earning	x	33.2	25.2	24.3
Price to Book	x	10.5	7.6	7.6
Dividend Yield	%	1.3%	1.8%	1.0%
Return on Equity	%	31.7%	30.2%	31.3%

Source (s): Company Financials, AHL Research *@ 290mn shares

SYS

Last Closing	486.8
Shares (mn)	290.3
Free float (%)	57.5
Market Cap. (PKR mn)	141,309.1
Market Cap. (USD mn)	626.3

Price Performance

	3M	6M	12M
Return (%)	26.8	49.2	30.1
Avg. Volume (000)	481.7	447.7	418.5
ADTV (mn) - PKR	219.1	186.7	162.5
ADTV (000) - USD	985.3	843.0	795.0
High Price - PKR	514.9	514.9	514.9
Low Price - PKR	373.5	324.7	299.0

Source (s): Company Financials, AHL Research

Pak Elektron Limited (PAEL)

Pak Elektron Limited manufactures, assembles, and distributes electrical goods. The company operates in two divisions:

- The appliance division (which contributes ~51% to the total revenue) consists of refrigerators, air conditioners, deep freezers, microwave ovens, water dispensers, LED TVs, washing machines and other smaller domestic appliances. Moreover, the company increased the capacity of refrigerators/deep freezers, microwave ovens, and washing machines by 14%, 40%, and 91% YoY, respectively in CY21. Therefore, the company can fulfill the demand for locally manufactured appliances with the incremental capacity available. Furthermore, the company has a market share of 15%, 24%, and 27% in deep freezers, refrigerators, and water dispensers. We expect the market share in these products to further swell up. By CY25, the company plans to further add new capacities to existing refrigerators, deep freezers, and air conditioners units.
- The power division (which contributes ~49% to the total revenue) comprises of power transformers, distribution transformers, grid station, switch gears, and energy meters. The company has a leading market share of 90% in power transformers; in energy meters, distributor transformers, and switch gears, the market share is 19%, 25%, and 73%, respectively. During 9MCY22, energy meter, power transformers and distribution transformers have witnessed healthy growth of 4%, 17%, and 92% YoY. The government's Ministry of Energy and Power is focusing on expanding transmission and distribution infrastructure and developing of smart metering infrastructure. For this purpose, WAPDA has awarded tenders for power transformers and distribution projects to PAEL, which will keep sales robust in CY23. Furthermore, the ongoing housing society projects will also support sales growth.

PAEL

Last Closing	12.2
Shares (mn)	856.0
Free float (%)	50.0
Market Cap. (PKR mn)	10,460.5
Market Cap. (USD mn)	46.4

Price Performance

	3M	6M	12M
Return (%)	(19.4)	(24.9)	(34.5)
Avg. Volume (000)	3,284.7	3,501.4	3,849.8
ADTV (mn) - PKR	52.9	57.3	65.0
ADTV (000) - USD	238.7	261.0	324.9
High Price - PKR	17.5	17.5	21.0
Low Price - PKR	12.2	12.9	12.9

Source (s): Company Financials, AHL Research

Key Financials

		CY21	CY20	LTM
Earnings per share*	PKR	1.8	0.2	2.0
Price to Earning	x	9.4	124.1	6.3
Price to Book	x	0.4	0.7	0.3
Dividend Yield	%	-	-	-
Return on Equity	%	4.5%	0.7%	4.3%

Source (s): Company Financials, AHL Research *@856mn shares

Recommendation Summary

Code	Company	Price	TP	Upside	Stance	EPS (PKR)				DPS (PKR)				P/E (x)		DY (%)		P/B (x)		ROE (%)		Indices
		23-Dec-22	Dec-23	(%)		2021	2022	2023	2024	2021	2022	2023	2024	2023	2024	2023	2024	2023	2024	2023	2024	
Exploration & Production																						
PPL	Pakistan Petroleum Ltd.	57.5	110.7	92.7	Buy	19.3	19.7	32.3	30.4	3.50	2.00	4.50	4.00	1.8	1.9	7.8	7.0	0.3	0.3	18.8	15.4	KSE100, KSE30, KMI & MSCI
OGDC	Oil and Gas Dev Co.	73.0	137.7	88.7	Buy	21.3	31.1	39.4	36.6	6.90	7.3	8.0	7.5	1.9	2.0	11.0	10.3	0.3	0.3	18.4	14.9	KSE100, KSE30, KMI & MSCI
POL	Pakistan Oilfields Ltd.	398.7	550.8	38.2	Buy	47.1	91.4	102.0	94.1	50.00	70.00	82.00	72.00	3.9	4.2	20.6	18.1	2.1	1.9	55.0	47.1	KSE100, KSE30, KMI & MSCI
MARI	Mari Petroleum Ltd	1,544.1	2,597.1	68.2	Buy	235.7	247.8	386.5	473.3	141.00	124.00	193.00	237.00	4.0	3.3	12.5	15.3	1.3	1.1	35.9	36.6	KSE100, KSE30, KMI & MSCI
Commercial Banks																						
UBL	United Bank Ltd.*	102.6	154.9	51.0	Buy	24.8	20.3	27.4	31.9	18.00	18.00	20.00	23.00	3.7	3.2	19.5	22.4	0.6	0.5	15.0	16.7	KSE100, KSE30 & MSCI
BAFL	Bank Alfalah*	29.8	48.0	60.8	Buy	8.1	11.0	14.4	16.6	4.00	5.00	6.50	7.50	2.1	1.8	21.8	25.1	0.4	0.3	21.0	20.7	KSE100 & MSCI
MCB	MCB Bank Ltd.*	111.5	173.3	55.4	Buy	26.3	24.9	32.8	37.1	19.00	19.00	22.00	23.00	3.4	3.0	19.7	20.6	0.7	0.6	20.6	21.7	KSE100, KSE30 & MSCI
HBL	Habib Bank Ltd.*	62.1	102.4	65.1	Buy	23.9	23.5	32.0	36.8	7.50	6.75	7.00	8.00	1.9	1.7	11.3	12.9	0.2	0.2	13.5	14.0	KSE100, KSE30 & MSCI
ABL	Allied Bank Ltd.*	63.0	101.1	60.5	Buy	15.3	16.0	21.1	24.0	8.00	8.00	10.00	12.00	3.0	2.6	15.9	19.0	0.4	0.4	15.7	15.5	KSE100
NBP	National Bank of Pakistan.*	24.1	34.7	43.6	Buy	13.4	12.2	15.4	17.5	-	2.00	2.50	3.00	1.6	1.4	10.4	12.4	0.1	0.1	9.9	10.4	KSE100
AKBL	Askari Bank Ltd.*	20.1	29.6	47.5	Buy	7.7	12.0	14.9	17.0	-	-	2.00	2.50	1.3	1.2	10.0	12.5	0.2	0.2	21.2	19.5	KSE100
BOP	The Bank of Punjab*	4.7	6.7	41.5	Buy	4.2	3.2	4.1	4.8	-	-	0.50	0.75	1.2	1.0	10.6	15.9	0.2	0.2	16.8	17.7	KSE100
MEBL	Meezan Bank Ltd.*	103.5	165.2	59.5	Buy	15.8	22.3	31.2	35.8	6.00	7.50	10.00	12.00	3.3	2.9	9.7	11.6	1.2	0.9	40.1	35.1	KSE100, KSE30 & KMI
FABL	Faysal Bank Ltd.*	25.3	42.3	67.0	Buy	5.4	7.4	10.4	12.1	1.50	8.00	2.50	3.00	2.4	2.1	9.9	11.9	0.5	0.4	22.9	22.4	KSE100
Fertilizer																						
ENGRO	Engro Corporation*	259.2	373.8	44.2	Buy	48.5	39.5	62.8	69.2	25.00	35.00	40.00	45.00	4.1	-	15.4	17.4	0.5	0.5	13.7	-	KSE100, KSE30, KMI & MSCI
FFBL	Fauji Fert. Bin Qasim	14.3	16.1	13.0	Hold	4.9	3.1	1.2	2.8	-	-	-	-	11.6	5.1	-	-	0.7	0.6	6.3	13.0	KSE100 & KMI
EFERT	Engro Fertilizer	77.9	92.0	18.2	Buy	15.8	9.5	13.3	13.5	16.50	10.50	15.00	15.50	5.9	5.8	19.3	19.9	2.7	3.1	43.0	49.5	KSE100, KSE30, KMI & MSCI
FFC	Fauji Fertilizer Co.	100.1	135.6	35.4	Buy	17.2	16.8	21.8	22.5	14.50	12.98	17.00	17.00	4.6	4.4	17.0	17.0	2.2	1.9	50.2	46.3	KSE100, KSE30 & MSCI
FATIMA	Fatima Fertilizer Co.	34.0	na	na	na	8.8	na	na	na	3.50				**Group Company: No estimates are given**								KSE100 & KMI
AHCL	Arif Habib Corp. Ltd.	34.0	na	na	na	18.3	8.5	na	na	3.00	4.00			**Group Company: No estimates are given**								KSEALL
Cement																						
LUCK	Lucky Cement Ltd.	429.9	727.9	69.3	Buy	43.5	47.3	40.1	35.3	-	-	-	10.00	10.7	12.2	-	2.3	1.0	0.9	9.8	8.0	KSE100, KSE30, KMI & MSCI
LUCK	Lucky Cement Ltd.*	429.9	727.9	69.3	Buy	70.7	91.2	118.5	137.4	-	-	-	10.00	3.6	3.1	-	2.3	0.6	0.5	17.5	17.2	KSE100, KSE30, KMI & MSCI
FCCL	Fauji Cement Co.	11.5	17.5	53.0	Buy	1.4	2.9	3.2	2.2	-	-	-	-	3.5	5.3	-	-	0.4	0.4	16.6	7.5	KSE100 & KMI
ACPL	Attock Cement Ltd.	58.4	77.9	33.5	Buy	8.1	8.2	9.1	5.3	4.00	3.50	-	-	6.4	11.1	-	-	0.4	0.4	6.8	3.8	KSEALL & KMI
DGKC	D.G. Khan Cement Co.	47.6	68.4	43.7	Buy	8.5	6.8	5.3	2.8	1.00	1.00	-	-	9.1	17.0	-	-	0.3	0.3	3.1	1.7	KSE100, KSE30 & KMI
KOHC	Kohat Cement Co.	138.0	194.7	41.0	Buy	17.4	25.0	32.3	21.9	-	-	-	-	4.3	6.3	-	-	0.8	0.7	21.3	12.2	KSE100 & KMI
MLCF	Maple Leaf Cement.*	21.7	35.5	63.7	Buy	3.6	4.2	5.6	4.7	-	-	-	0.25	3.9	4.6	-	1.2	0.5	0.4	13.2	10.0	KSE100, KSE30 & KMI
POWER	Power Cement	4.5	na	na	na	0.3	(0.4)	na	na	-	-			**Group Company: No estimates are given**								KMI
Oil & Gas Marketing																						
PSO	Pakistan State Oil	132.6	206.7	55.8	Buy	62.1	183.7	39.2	71.1	15.00	10.00	10.00	10.00	3.4	1.9	7.5	7.5	0.3	0.3	8.4	14.2	KSE100, KSE30, KMI & MSCI
APL	Attock Petroleum Ltd.	294.4	394.6	34.0	Buy	39.5	149.0	62.2	45.6	27.00	45.00	19.00	14.00	4.7	6.5	6.5	4.8	0.9	0.9	19.9	13.6	KSE100 & KMI
SNGP	Sui Northern Gas Pipeline Ltd.	36.3	68.4	88.2	Buy	17.3	20.1	16.8	24.1	7.00	8.00	6.00	9.00	2.2	1.5	16.5	24.8	0.5	0.4	149.7	249.7	KSE100 & KMI
Automobile Assemblers and Parts																						
PSMC	Pak Suzuki Motor Co.	133.7	160.0	19.7	Buy	32.6	(29.3)	(1.4)	36.4	6.50	-	-	6.00	(96.5)	3.7	-	4.5	0.5	0.4	(0.5)	11.7	KSE100 & KMI
INDU	Indus Motor Co.	996.7	1,218.0	22.2	Buy	163.2	201.0	98.0	131.2	103.50	93.75	46.00	61.00	10.2	7.6	4.6	6.1	1.3	1.2	13.7	17.0	KSE100 & MSCI
HCAR	Honda Atlas Cars (Pak)	135.6	109.0	(19.6)	Sell	12.6	17.6	3.9	13.1	4.52	7.00	2.00	5.00	34.8	10.3	1.5	3.7	1.0	0.9	2.8	9.0	KSE100 & KMI
MTL	Millat Tractors Ltd.	499.6	548.6	9.8	Hold	49.7	46.7	30.5	51.2	100.00	65.00	31.00	51.00	16.4	9.8	6.2	10.2	8.3	8.3	50.4	84.8	KSE100, KSE30, KMI & MSCI
Power Generation & Distribution**																						
HUBC	Hub Power Company*	62.9	119.7	97.9	Buy	26.0	21.9	32.3	36.8	12.00	6.50	22.00	15.00	1.9	1.7	35.0	23.9	0.6	0.5	31.2	30.0	KSE100, KSE30, KMI & MSCI
NCPL	Nishat Chu. Power Ltd.	13.3	19.0	43.6	Buy	6.8	6.8	9.1	8.7	-	10.00	2.00	2.00	1.5	1.5	15.1	15.1	0.2	0.2	13.2	11.5	KSEALL
NPL	Nishat Power Limited	17.0	21.1	24.4	Buy	7.6	9.4	9.5	8.4	1.50	4.50	4.00	2.00	1.8	2.0	23.5	11.8	0.2	0.2	11.6	9.6	KSEALL
Textile Composite																						
NML	Nishat Mills Ltd.	52.9	72.1	36.3	Buy	16.8	29.3	21.9	30.1	4.00	4.00	4.50	6.00	2.4	1.8	8.5	11.3	0.2	0.2	9.5	12.3	KSE100 & KMI
NCL	Nishat (Chunian) Ltd.	23.1	32.7	41.4	Buy	23.3	31.1	4.5	12.0	5.00	7.00	1.00	4.00	5.1	1.9	4.3	17.3	0.2	0.2	4.6	12.2	KSE100
FML	Feroze1888 Mills Ltd.	64.5	91.8	42.3	Buy	10.8	8.5	9.0	11.5	3.43	4.27	5.00	6.00	7.2	5.6	7.8	9.3	0.8	0.7	11.6	13.8	KMI
ILP	Interloop Ltd.	57.6	84.7	47.0	Buy	6.7	13.2	15.5	16.3	2.50	4.00	6.00	6.50	3.7	3.5	10.4	11.3	1.4	1.1	42.0	34.7	KSE100
Chemicals																						
LOTCHEM	Lotte Chemical Pak Ltd.									**Coverage Restricted due to Advisory Mandate**												KSE100
EPCL	Engro Polymer & Chem.	42.7	45.5	6.5	Hold	16.6	13.7	7.6	8.3	16.30	12.50	5.25	5.75	5.6	5.1	12.3	13.5	1.2	1.1	22.2	22.9	KSE100, KSE30, KMI & MSCI
ICI	ICI Pakistan Ltd.*	630.0	890.2	41.3	Buy	60.3	91.7	115.3	112.5	40.00	35.00	20.00	20.00	5.5	5.6	3.2	3.2	1.2	1.0	26.1	19.6	KSE100 & KMI
Engineering																						
ASTL	Amreli Steels Ltd.	17.8	24.0	34.9	Buy	4.61	4.46	3.09	4.35	-	-	-	-	5.7	4.1	-	-	0.3	0.3	5.8	7.7	KSEALL
AGHA	Agha Steel Industries Ltd.	11.9	18.3	54.2	Buy	3.37	3.07	1.53	2.16	-	-	-	-	7.8	5.5	-	-	0.4	0.4	5.7	7.6	KSEALL
ASL	Aisha Steel Mills Ltd.	7.4	na	na	na	6.9	1.2	na	na	2.00	-			**Group Company: No estimates are given**								KSEALL
Technology & Communication																						
HUMNL	Hum Network Limited.	5.7	10.0	75.2	Buy	0.9	1.2	1.5	1.9	-	0.50	0.75	1.00	3.7	2.9	13.2	17.6	1.0	0.9	30.5	32.6	KSEALL

Source: Bloomberg, AHL Research, *Earnings Consolidated Basis,**upside is total return

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 Arabia
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
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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* Upside for Power Generation Companies is upside plus dividend yield.

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

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

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