2018

Pakistan Equity Market Outlook

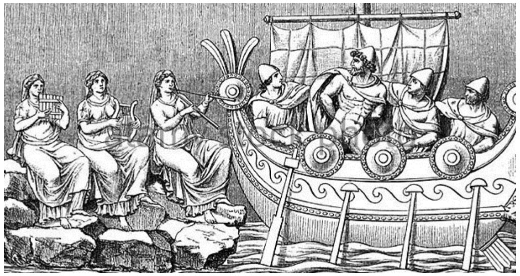
Resisting the Songs of Sirens

IGI Securities
SERVING YOU SINCE 1994

JamaPunji
http://www.jamapunji.pk

Research Entity Number: BRP 009

Foreword



The Legacy Of Siren's Songs

The "Siren song" is part of the poetic collection of Margaret Atwood. Siren's songs are often associated with Homer's The Odyssey, where Odysseus, a hero of Greek mythology, left a legacy of extreme emotional control. While sailing to his home from Troy, Odysseus asked his men to tie him to the mast of the ship, so that on his way he could resist alluring songs of Siren and, contrary to his predecessors, avoid jumping overboard.

In short, he took practical steps to ensure that he had enough emotional control to withstand the stress in the short term and to continue until the end of his journey.

Although, the sailors and Odysseus missed the irresistible songs of Siren, but by doing so they traded a smaller cost to an expensive fall.

Resisting the Songs of Sirens

The proximity of Odysseus story to the current market situation substantiates our standpoint on Pakistan Equity Market as it is often insinuated to investing methodology. The ideology behind the story in relation to investing, describes the peculiar investment pattern whereby investors are lured into stocks having high degree of earnings dispersion, while switching away from companies having quality earnings.

We opine the momentary political and economic uncertainty, should be taken as the Songs of Siren's.

The investment approach here should be to subside and resist these 'songs' and focus should be towards companies having quality and predictable earnings with stable dividends rather than invest in stocks with higher degree of earnings dispersion.

Contents

Summary

- **Politics:** In our view some political rumblings are expected, and when viewed from a country's macro and market context, we consider this risk to be momentary and relatively benign. We remain comfortable with our long-term belief that company fundamentals will eventually play out and assert themselves, irrespective of political noise.
- **Economy:** Rebounding oil price, widening C/a deficit, interest rate cycle reversal, PKR depreciation, growing debt burden and fiscal slippage have all cast a doubt on continuation of robust economic growth seen in recent years. Although improved security situation and CPEC led investment cycle, with completion of early harvest power projects, will help to smooth out supply constraints plaguing the economy, to keep the growth trend intact, yet political instability and external sector woes will be a big hurdle to overcome. Infrastructure spending is likely to continue, despite political instability, as CPEC projects will remain unaffected which will boost construction activity, while energy deficiency will farther improve as in-pipeline projects reach completion. Moreover, rising inflation, due to PKR devaluation, and external sector challenges are expected to translate into a rate hike, which should increase financial sector profitability.
- **Market:** This time around it's different! For 2018, although political and macro headwinds do exist on the horizon, but these are somewhat momentary and in that respect attractive market valuation should be taken as an opportunity. We are comfortable with the distinction 'This time around it's different' as the upside to us looks fairly straightforward – market correction, recovering economic growth and steady corporate earnings outlook. At the same time, we believe much of the economic and political concerns have more or less been factored in by the market, thus the downside risks appear very limited. For 2018, we eye index target of 44,600 implying a return of 10% from its last closing of 40,371 level. We have taken earning growth as our basis for index estimation, which brings 2018F P/E to 8.6x and dividend yield of 5.9%. While we believe earnings growth, cheaper market multiples and long-term investment for case under CPEC USD 62bn project does make current market compelling, but we see near-term political clarity to be decisive for market sentiments to improve and thus potential of re-rating P/E multiples cannot be ruled out.

IGI Securities
SERVING YOU SINCE 1994

Politics

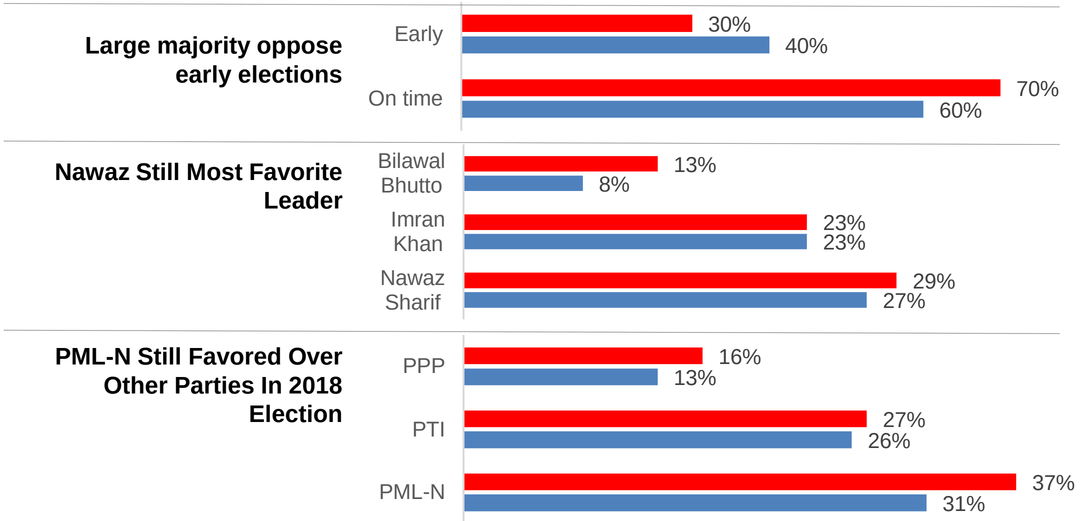
2017 Littered With Political Uncertainties

- **Country's oncoming general election will be an important barometer for the market sentiment:** The ruling party PML-N since forming government back in 2013, has exhibited some degree of political instability and uncertainty. However, since *"Panama Paper"* surfaced the media, put the then Prime Minister (PM) Nawaz Sharif in a tight spot with opposition demanding disqualification. This eventually led to PM's ouster in mid 2017 through the judgement passed by the apex court of Pakistan, only to be replaced later in Aug-17 by fellow party member Shahid Khaqan Abbasi.
- Since the appointment of Shahid Khaqan Abbasi the party has been stuck with the apex court over what can be termed as ongoing accountability cases, with opposition ever demanding dissolution of parliament and early election. Ambiguity over whether the election would be held on time or not, along with ongoing accountability cases shadowed market sentiments and remain a flash point of political risk in the country.
- **Delimitation bill provides much needed clarity on election schedule:** Fast forward, the government lately managed to develop a point of agreement with the opposition forces with respect to schedule of elections. Only recently the delimitation amendment passed by the Parliament further asserts government's determination to conduct elections on time. The Election Commission of Pakistan (ECP) has been asked to provide final publication of delimitation by 3rd of May-17. Although the final date of election is yet to be announced, but given current parliamentary term ends by 31st May 2017 and provided government manages to meet the timeline, general elections will be held before 30th Jul-17.

Politics

Political Rumblings to Keep Markets Jittery

- **Likely Outcome:** It's just too early to comment on how political landscape will span out in next year. However, market survey conducted by `both Gallup Pakistan and Pulse Consultants does provide some useful insight.



- **Politics undermining pro-growth reform agenda, not exactly!** In our view some political rumblings are expected, and when viewed from a country's macro and market context, we consider this risk to be momentary and relatively benign. We remain comfortable with our long-term belief that company fundamentals will eventually play out and assert themselves, irrespective of political noise. Key long-term factors, CPEC and socio-economic improvement forms our basis of belief.

The survey was conducted by Gallup and Pulse Consultant with 3,000+ respondents, and its results was available by Nov-17. Link

Economy

Economic concerns to gradually ease-off

- **Growth**: Rebounding oil price, widening C/a deficit, interest rate cycle reversal, PKR depreciation, growing debt burden and fiscal slippage have all cast a doubt on continuation of robust economic growth seen in recent years. Although improved security situation and CPEC led investment cycle, with completion of early harvest power projects, will help to smooth out supply constraints plaguing the economy, to keep the growth trend intact, yet political instability and external sector woes will be a big hurdle to overcome.
- Infrastructure spending is likely to continue, despite political instability, as CPEC projects will remain unaffected which will boost construction activity, while energy deficiency will farther improve as in-pipeline projects reach completion. Moreover, rising inflation, due to PKR devaluation, and external sector challenges are expected to translate into a rate hike, which should increase financial sector profitability.
- **Headline inflation may not be that pronounced**: Inflation has remained subdued in 5MFY18, clocked in at +3.6%YoY with food inflation up by +2.4%YoY and non-food inflation up by +5.1%. Although PKR depreciation will lead to significant rise in headline inflation, yet we believe it will remain within the bounds of SBP target because of administrated food and energy prices, at least until the time of election.
- **Rate hike likely:** Although inflation is expected to remain within target, major impetus for the anticipated rate hike comes from the need to arrest aggregate demand, which has risen 8.5% in FY17, driving the worsening trade deficit.
- **External Accounts**: With 5MFY18 current account up by ~89%YoY, we expect deficit to post record number in FY18 due to ever widening trade deficit and limited support from FDI and remittances, denting FX reserves. Although PKR depreciation and other policy measures may lead to some relief in the remainder of FY18, yet the magnitude of deficit will require return to IMF, in our view. However, multilateral and commercial borrowing can be used as last resort as a short term measure until election cycle ends.

Economy

Economic concerns will gradually ease-off

Exhibit: GDP growth, Fiscal Bal. & CAB

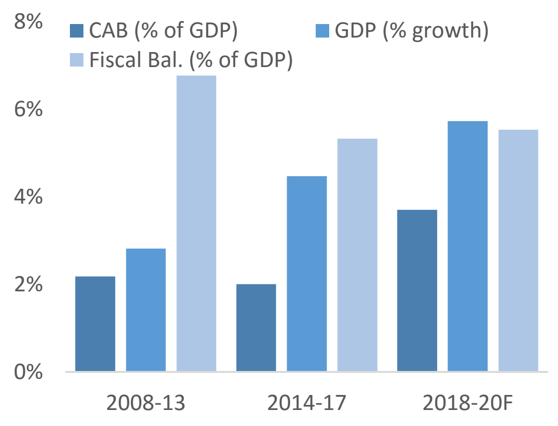


Exhibit: Debt and liabilities as a percentage of GDP

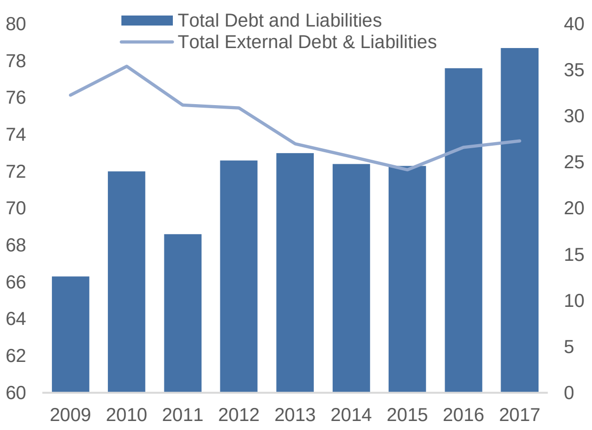


Exhibit: Band of core inflation for remainder of FY18E

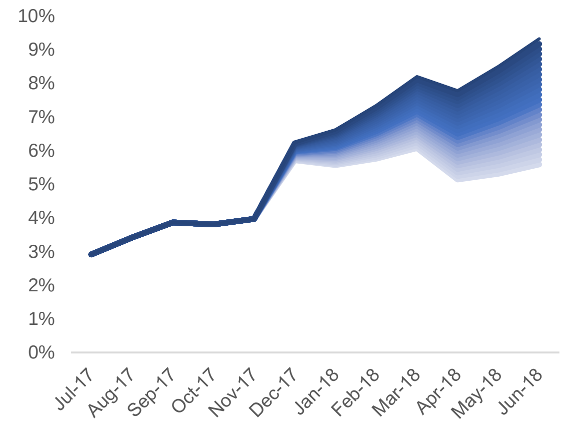


Exhibit: 3M moving average of real interest rates

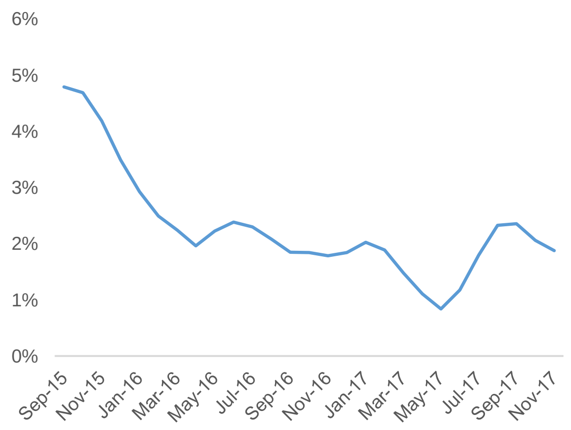
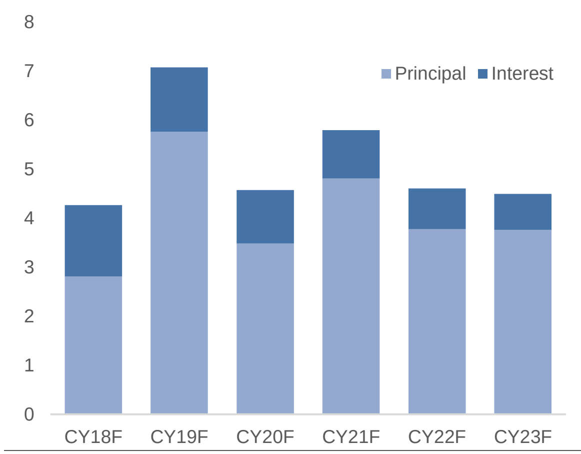


Exhibit: External Debt repayments (USDbn)



IGI Securities
SERVING YOU SINCE 1994

Economy

Widening C/a deficit and financing requirements

- **One of the key risks on the macro side during 2017 was country's rising trade imbalance:** C/a deficit for 5MFY18 reached almost USD 6.4bn roughly (~4.5% of the GDP) and with the rising investments in respect of CPEC, C/a deficit is expected to reach all time high. However, the worrying factor is country's low FX reserves, which in case of any financing or commodity price shock would not be sufficient enough to ward-off the impact on overall economy. Only recently the economic situation has further exacerbated with sharp PKR deprecation against the USD.
- To put things in perspective, the deficit touched USD ~14bn in FY08 which was followed by sizeable PKR depreciation, rampant inflation and subsequent rise in interest rate hikes. The country rushed to IMF for bailout which was later met by harsh measures and followed by low GDP growth. Given the current trajectory of external accounts, C/a deficit is expected to cross well above USD ~15bn (4.7%age of the GDP) mark in FY18 after recording USD 12.1bn (4.1%) in FY17 and 5Yr average of 1.8% of the GDP.
- The pressing issue remains, the inability to match or to narrow the gap between overall outflows with inflows. However, given that these concerns are related to overall structural weaknesses, which are predominately due to country's supply side blockages, an early fix is hard to come by. Policy changes, which the government did opt for earlier this year by introducing certain anti-dumping duty and trade negotiations with trading partners as well as increasing consumption tax, will serve temporarily and are unlikely to bring about material positive impact on overall economy. As such, for a given consumption-based economy, rising consumption tax and trade tariff will only lead to higher domestic price level, suppressing overall investment cycle.
- **However, the country's recent trade balance reveals deviation from its historic trend**: Much of the imports, this time around, constitute higher proportion of capital-intensive rather than consumption based goods. Total machinery imports bill during the year rose by almost ~11.5% to USD 7.9bn, while on the other hand, lower oil prices helped alleviate some pressure off the external sector from rising domestic demand of petroleum goods. Both these imported goods relate to on-going investment cycle under the umbrella of CPEC which revolves around infrastructure build-up and subsequent easement in economy's supply side bottlenecks.

IGI Securities
SERVING YOU SINCE 1994

Economy

Deficit to be Financed through a Combination of Rising FDI and Debt Accumulation

- Up until Nov-17, although portfolio investments have recorded an outflow of USD 146mn (compared to an inflow of USD 1.1bn last year), but it has been substituted with higher growth in FDI of USD 1.1bn (65%), primarily received from China, which kept overall foreign inflows to approximately USD 1.0bn in 5MFY18 (compared to last year USD 1.8bn). On secondary income source, remittances have been some cause of concern in yester year due to economic slowdown witnessed in MENA regions but some improvement is visible in 5MFY18 remittances number - up by +1.3% to USD 8.0bn.
- But nevertheless, the absolute size of FDI and PI funding is dwarfed compared to bulging trade deficit, which reached USD 12.1bn in 5MFY18 and has worsened since PKR depreciation, wherein, required additional funding is to be fulfilled either through debt from international institutions or borrowing from domestic banking system.
- During the year, Pakistan has obtained nearly ~USD 5.2bn (Eurobond, Sukuk, long-term and short-term) from foreign commercial banks, securing about ~65% of its external financing requirement of nearly ~USD 8.0bn (budgetary estimates) in the outgoing year. Moreover, at the same time we see widening fiscal deficit due to nearing election cycle to further add to funding worries. Hence, a rising twin deficit along with already elevated debt level (~69% debt/GDP) will not only restrain the country's reach to fetch newer loans at lower rates in international market, but could also hurt country’s sovereign rating. With this in mind, we foresee government borrowing requirement to be largely met through domestic banks. Although, banking system is flushed with liquidity, yet we see private sector credit taking a hit from the crowding out effect.
- **But this all makes sense:** Historically, high GDP growth in Pakistan has mostly been accompanied by high current account deficits as Pakistan has failed to generate enough savings to finance its own growth. Even now, Pakistan’s saving rate is at 13.1% . Financing growth and rising debt levels are not a concern as far as the use of these borrowed funds seep into country’s future growth. This time we suspect is rather different from before. As mentioned, country’s capital intensive import bill, rising FDI along with improving security situation is indicative of overall bullish economic growth outlook. Arguably, this situation comes with risks which include a) commodity price shock, b) degradation of diplomatic relations with donor countries, and c) any dent in sentiments related to CPEC funding.

Economy

Exhibit: Rising proportion of machinery imports

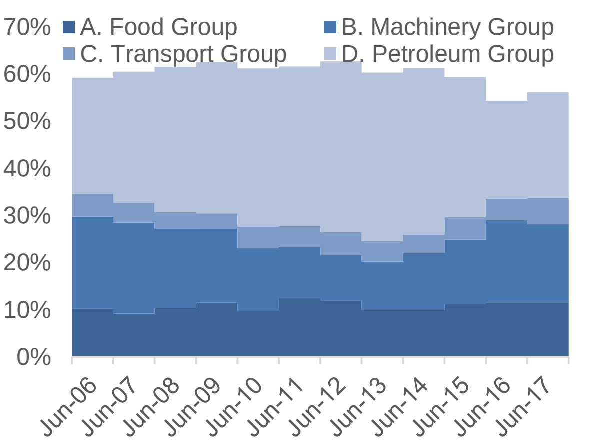


Exhibit: Trade terms sourcing the rise in CAB (USD bn)

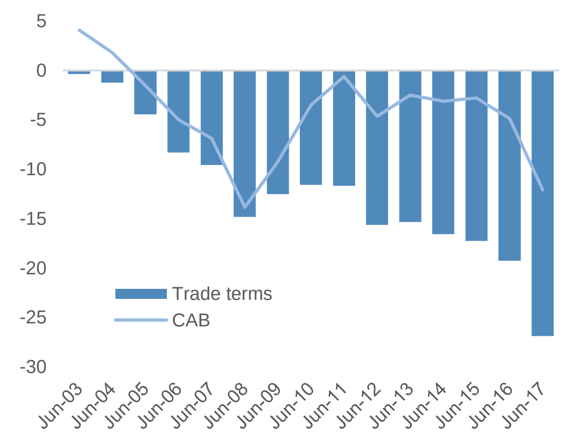


Exhibit: Remittances & FDI - funding source (USDbn)

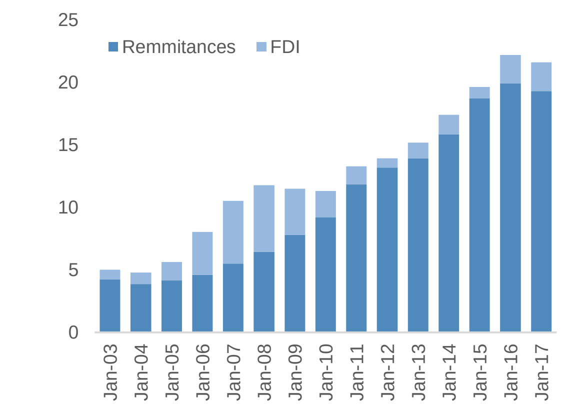


Exhibit: Historical trend in reserves (LHS) & PKR

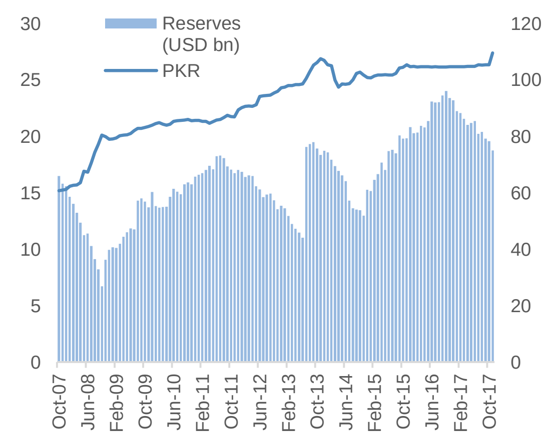
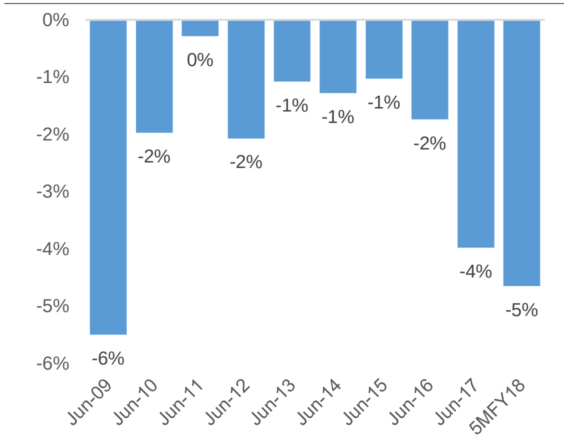


Exhibit: CAB as a percent of GDP on the rise again



IGI Securities
SERVING YOU SINCE 1994

Economy

PKR depreciation partially incorporated; more likely to come?

- Surrendering to the concerns on external accounts, PKR depreciated nearly 3.2% in Jul-17 to touch a low of 108.3 against USD. Later, official statements by SBP blamed brief market demand and supply anomaly as a cause of devaluation and with a silent intervention, helped PKR to regain its lost ground. However, PKR experienced a similar episode in Dec-17, wherein, PKR dropped by almost 4.7% or PKR ~5 against USD and failed to regain grounds. Nevertheless, this brings one the sharpest end-to-end depreciation of ~5.5% of PKR against USD in the past 4Yrs.
- Furthermore, the much quoted REER measure of exchange rate, overvalued by nearly ~21%, is just one of the numerous indicators of currency value and is not empirically sound. Furthermore, the changing composition of Pakistan's trade basket, wherein, Pakistan has been increasingly carrying out trade with china, might also skew the said measure. Moreover, comparing with regional countries, India's and Bangladesh's currency is also overvalued against their respective REER, similar to Pakistan. Thus, it should not be the only indicator to gauge the macro-economically stable PKR value. At the same time, it must be highlighted that Pakistan has experienced PKR depreciation against USD post elections in recent past.
- Nevertheless, dampening affect of PKR depreciation on economy can be wide reaching, starting from higher core inflation, rise in government borrowing requirement and subsequently lower manufacturing gross margins.

Economy

Rising core inflation to lead higher interest rates in 2018

- **Monetary tightening ahead (+100bps min):** Amidst macro (external) concerns, we expect higher interest rates prevailing in 2018, where we foresee a minimum of +100bps rate hike, brining discount rate to 7.25% from the current 6.25% mark.
- **Headline inflation may not be that pronounced:** Inflation has remained subdued in 5MFY18, clocking in at +3.6%YoY, with food inflation up by +2.4%YoY and non-food inflation up by +5.1%YoY. Food inflation has remained low due to sluggish commodity prices worldwide, while rebounding oil price and increases in HRI has pulled up non-food index. Although PKR depreciation will lead to rise in headline inflation, yet we believe it will remain within the bounds of SBP target, at least until elections, as a large part of prices in CPI basket (~55%) are administered. However, major impetus for the anticipated rate hike comes from the need to arrest aggregate demand, which is driving trade deficit higher.
- Core inflation, a key lagging indicator of rising aggregate demand, is up by 5.5%YoY in 5MFY18 compared to last 2Yrs average of 4.7%, showing a growing degree of demand pull inflation. Growth in aggregate demand can also be estimated using the ratio of CIC (Cash in Circulation) to deposits as a proxy. The said ratio has risen to 38% compared to 22% in Jun-14 underlining the aforementioned rising aggregate demand.

Economy

PKR depreciation partially incorporated; more likely to come?

Exhibit: Historical trend in Core & Headline inflation

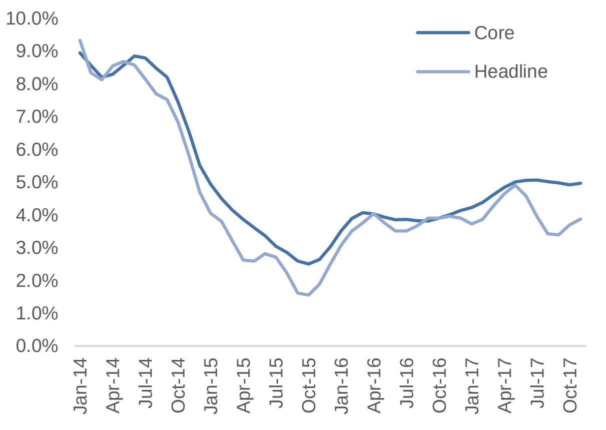


Exhibit: Percentage point impact on inflation

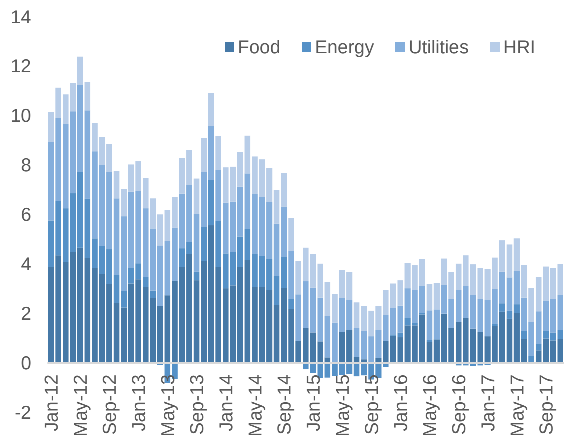


Exhibit: Rising CIC/Deposit - rising aggregate demand

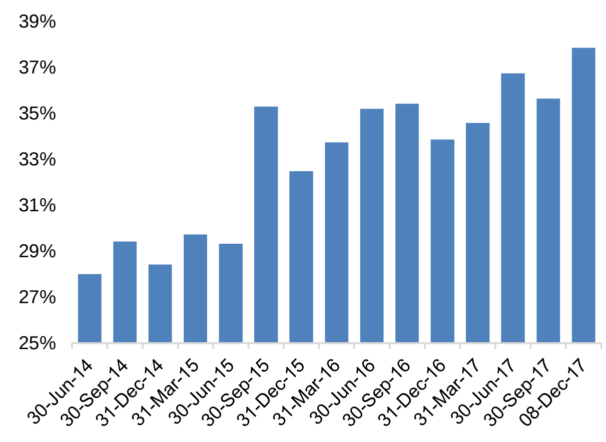
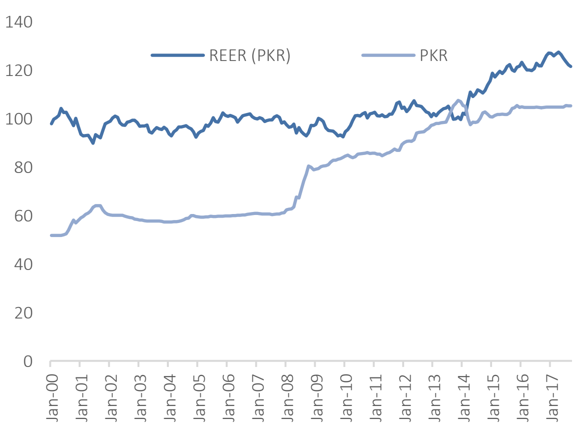


Exhibit: Differential between REER and PKR



IGI Securities
SERVING YOU SINCE 1994

Economy

Key Macro projections

Pakistan Economics

FY= (Jun)	Unit	FY09A	FY10A	FY11A	FY12A	FY13A	FY14A	FY15A	FY16A	FY17A	FY18F	FY19F	FY20F
Real													
GDP Growth	%	0.4	2.6	3.6	3.8	3.7	4.1	4.1	4.5	5.3	5.5	5.8	5.9
Service Sector	%	1.3	3.2	3.9	4.4	5.1	4.5	4.4	5.5	6.0	5.8	6.0	6.4
Industrial Sector	%	(5.2)	3.4	4.5	2.5	0.8	4.5	5.2	5.8	5.0	7.4	8.5	7.7
Agricultural Sector	%	3.5	0.2	2.0	3.6	2.7	2.5	2.1	0.3	3.5	2.3	2.2	2.1
Investment to GDP	%	19.0	17.3	15.6	15.4	15.2	15.0	16.6	16.9	17.3	18.2	18.6	19.0
GDP	(PKRtrn)	13.2	14.9	18.3	20.0	22.4	25.2	27.4	29.1	31.9	35.1	39.1	43.5
GDP	(USDbn)	168.2	177.4	213.8	224.6	231.4	244.7	270.9	279.4	304.3	322.4	337.3	361.5
GDP per capita	(USD)	1,000	1,033	1,219	1,256	1,268	1,314	1,427	1,443	1,529	1,588	1,630	1,714
Monetary													
CPI	%	-	10.1	13.7	11.0	7.4	8.6	4.6	2.8	4.2	5.5	6.6	6.4
Discount Rate - Per. end	%	14.00	12.50	14.00	12.00	9.35	10.00	7.00	6.25	6.25	6.25	6.75	6.75
Broad Money (M2)	%	12.5	13.7	16.3	12.7	17.1	12.2	12.7	13.2	12.5	13.2	14.3	14.2
External Sector													
Exports	(USDbn)	19.1	20.3	26.3	24.7	24.8	25.1	24.1	22.0	21.7	22.3	22.2	22.4
Imports	(USDbn)	31.7	31.9	37.9	40.4	40.2	41.7	41.4	41.3	48.6	45.3	48.3	51.3
Trade Terms	(USDbn)	(12.5)	(11.6)	(11.7)	(15.7)	(15.4)	(16.6)	(17.3)	(19.3)	(26.9)	(23.0)	(26.0)	(29.0)
Remittances	(USDbn)	7.8	9.2	11.9	13.2	13.9	15.8	18.7	19.9	19.3	19.3	28.9	31.9
CAB	(USDbn)	(9.3)	(3.5)	(0.6)	(4.7)	(2.5)	(3.1)	(2.8)	(4.9)	(12.1)	(15.0)	(12.5)	(10.0)
CAB (% of GDP)		- 5.5	- 2.0	- 0.3	- 2.1	- 1.1	- 1.3	- 1.0	- 1.7	- 4.0	- 4.7	- 3.7	- 2.8
Exchange rate													
USD		78.5	83.8	85.5	89.2	96.7	102.9	101.3	104.2	104.7	108.8	115.8	120.4
FX Reserves	(USDbn)	11.8	15.3	18.2	15.3	11.0	16.0	18.7	23.1	20.6	16.2	15.8	17.9
Fiscal (%age of GDP)													
Tax Revenue	%	9.1	9.9	9.3	10.2	9.8	10.2	11.0	12.6	12.5	12.6	12.8	12.9
Current Expenditure	%	15.5	16.0	15.9	15.6	16.4	15.9	16.1	16.1	16.3	16.3	16.3	16.3
Development Expenditure	%	3.5	4.4	2.8	3.7	5.1	4.9	4.2	4.5	5.3	5.4	5.6	5.7
Fiscal Balance	%	5.2	7.2	6.5	6.8	8.2	5.5	5.3	4.6	5.8	5.7	5.5	5.4
Debt (%age of GDP)													
Gross Public Debt	%	58.6	60.6	58.9	63.3	63.8	63.5	63.2	66.5	66.1	65.0	63.9	62.8

IGI Securities
SERVING YOU SINCE 1994

Market

Macro and Political concerns dominated market during 2017

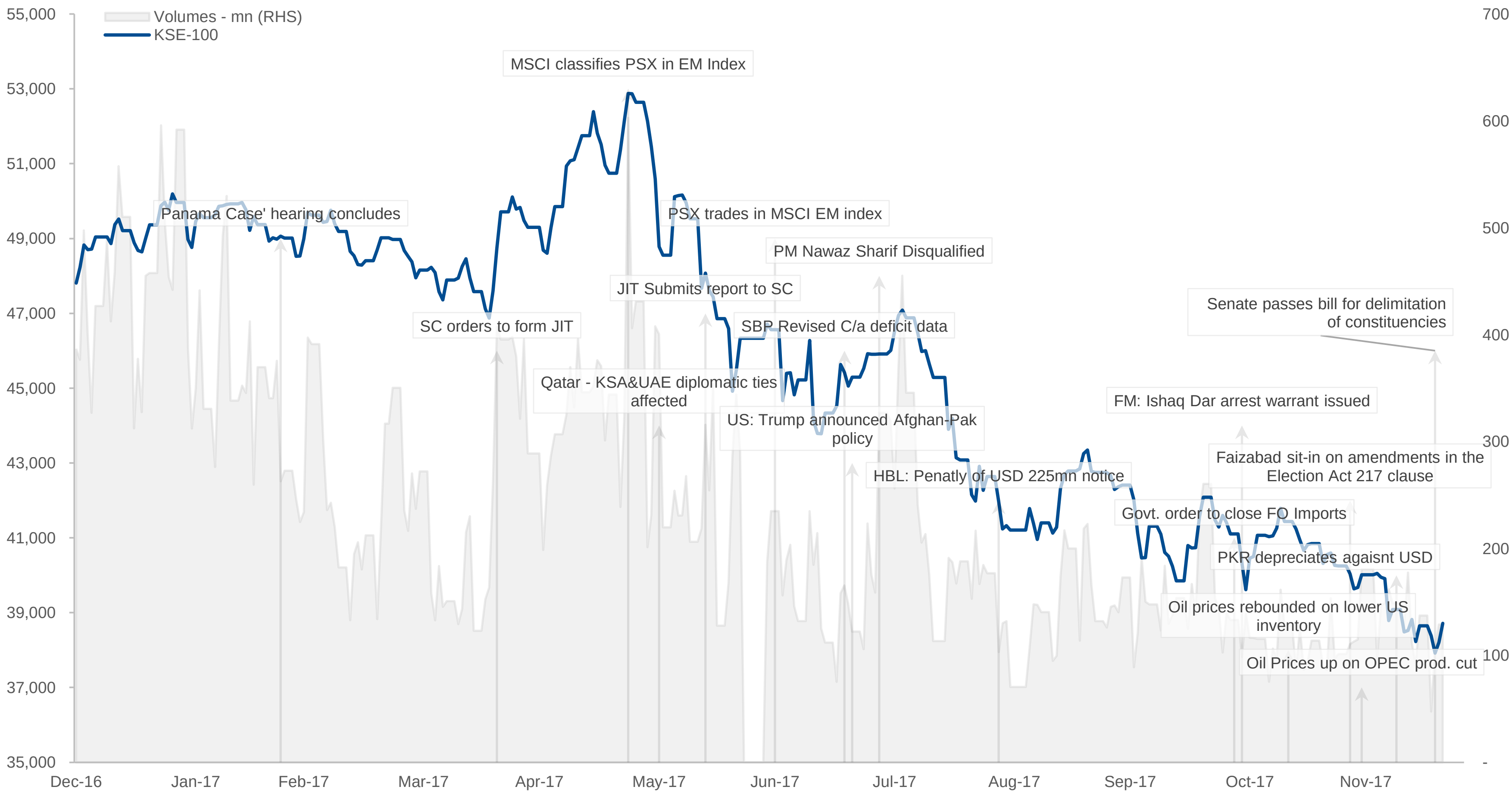
- **After posting positive returns for the past 5 years, the return cycle finally winded up in CY17:** KSE 100 index dropped by nearly 17% in 2017td making it one of the most underperforming market in the region. The year started off with increased optimism over inclusion of PSX in MSCI Emerging Market Index, whereby market touched an all-time high of ~53k and so did valuation multiples, which across the sectors stretched to a new high (P/E reached 12x, by May-17). However, the optimism was rather short lived as expected inflows from EM funds failed to impress investors, taking the market with it down to 44k level down by 7,962 (points) by Jun-17 end.
- The second half of the year turned out to be even hastier for the market. Revision in central bank external accounts data depicted sizeable difference in country's current account deficit and subsequently anticipated pressure on country's exchange rate which combined with global commodity price recovery started to weigh on corporate earnings outlook. Moreover, amidst this, investors 'confidence was rattled when country's political environment, took a rather unpleasant turn with incumbent party (PML-N) Prime Minister Nawaz Sharif was disqualified from holding public office by country's apex court on the Panama Papers case.
- **Market volumes dried as year concluded:** Market volumes averaged 237mn during the year, down by nearly ~16% from last year. However, much of the volumes attrition came in 4QCY17 wherein volumes averaged nearly ~140mn compared to ~350mn in the first three quarters of the year.
- This brings 2017 as the third consecutive year in a row in which foreigners remained net sellers in Pakistan equity market. CY17 saw the portfolio investment outflow of USD 497mn compared to USD 315mn and USD 339mn respectively in 2015 and 2016. However, local institutions in particular the Mutual funds and Insurance sector were quick to fill the in the gap, by pouring in roughly USD 382.7mn, while local individual remain net seller of USD 67.7mn.

QoQ Market Return Profile

	1Q	2Q	3Q	4Qtd
Autos	9%	14%	-20%	-4%
Banks	-5%	-2%	-13%	-6%
E&Ps	-11%	-3%	8%	8%
OMCs	11%	-3%	-4%	-31%
Fertiliser	3%	-12%	-3%	-9%
Cements	-1%	-8%	-29%	-24%
Engineering/Steel	39%	-2%	-12%	-24%
Textile	-10%	-10%	-16%	-14%
Tech./Comm.	-3%	-8%	-7%	-20%
Power	-6%	-12%	0%	-18%
Pharma./Food	-5%	-3%	9%	-14%
Market	**-2%**	**-4%**	**-7%**	**-7%**

Market

A look back at key events that impacted the market during 2017



Market

Market performance

Exhibit: KSE historical performance

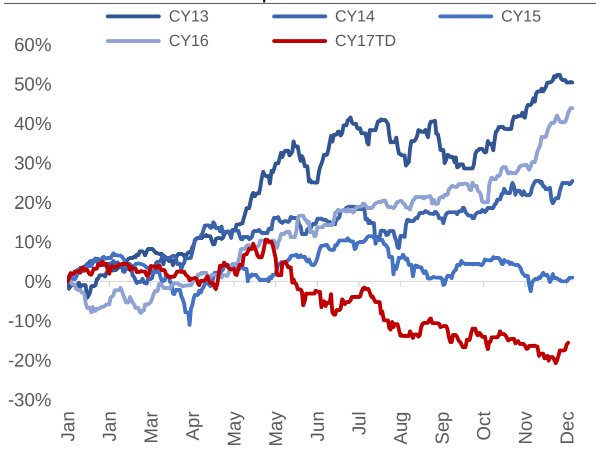


Exhibit: KSE 100 compared to regional performance

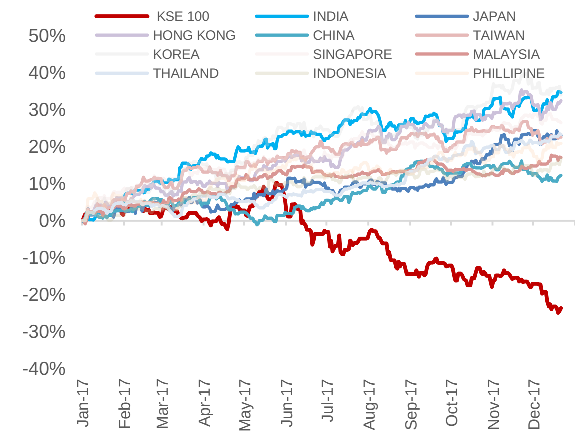


Exhibit: KSE 100 widening P/E discount to region

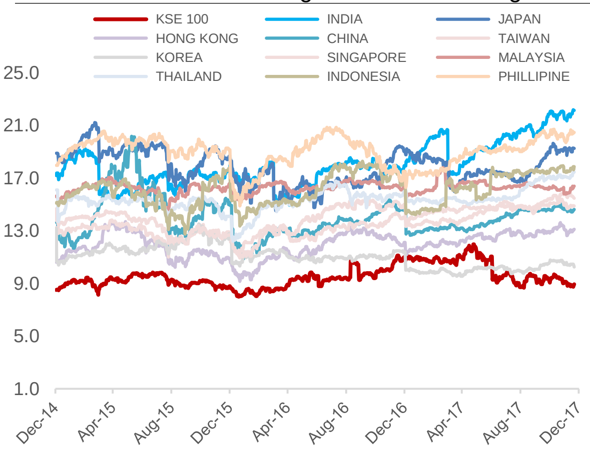


Exhibit: Banks attracted the highest volumes

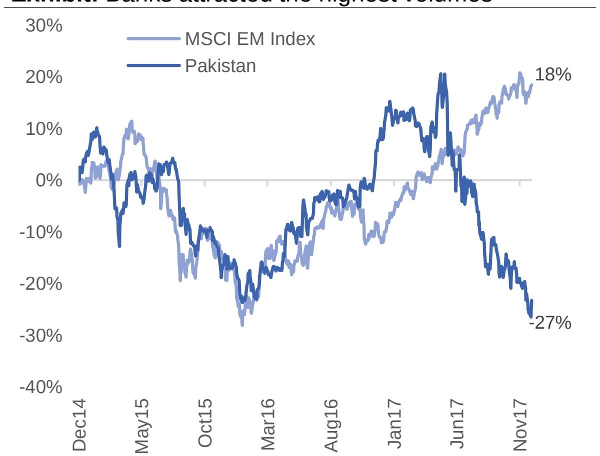


Exhibit: Bluechip comp. diverging trend (KSE100)

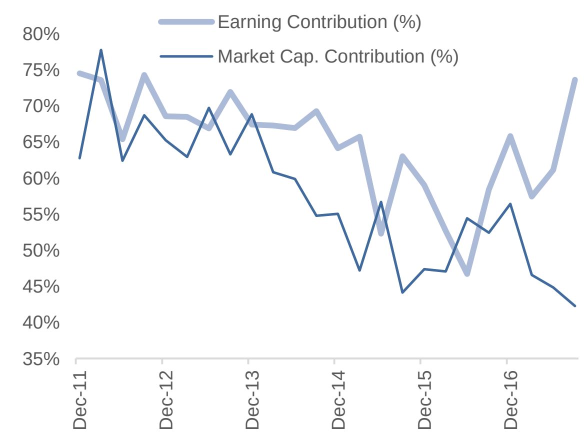
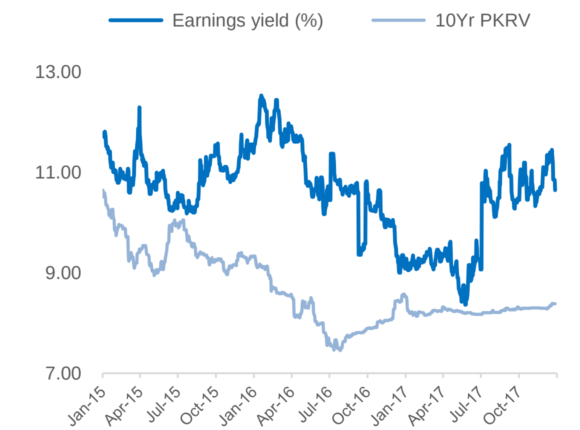


Exhibit: Market earning yield to 10yr PKRV rate



Market

Market liquidity remained dull during 2017

Exhibit: Highest ever foreign portfolio amount in 2017

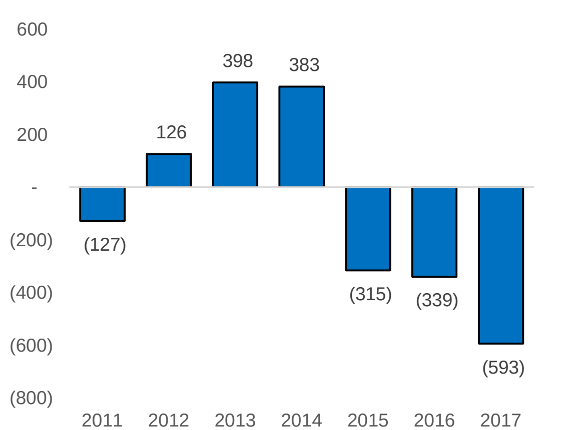


Exhibit: Cement sector witnessed highest sell

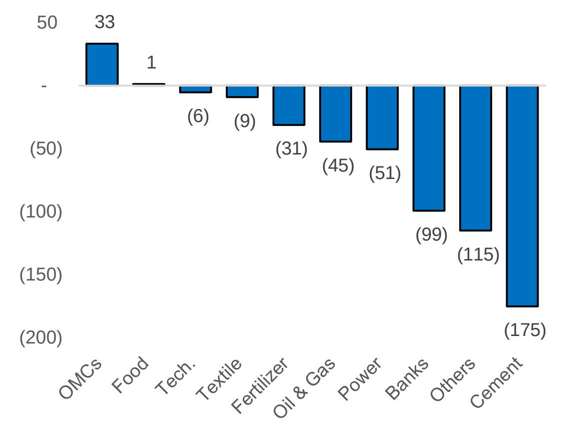


Exhibit: Market volumes dropped to the end of year

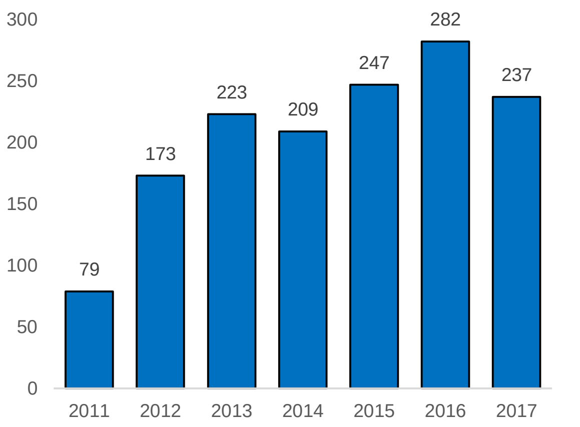


Exhibit: Banks attracted the highest volumes

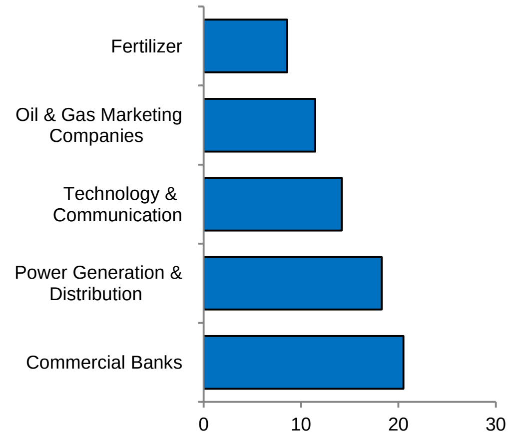


Exhibit: KEL leaded the volume chart

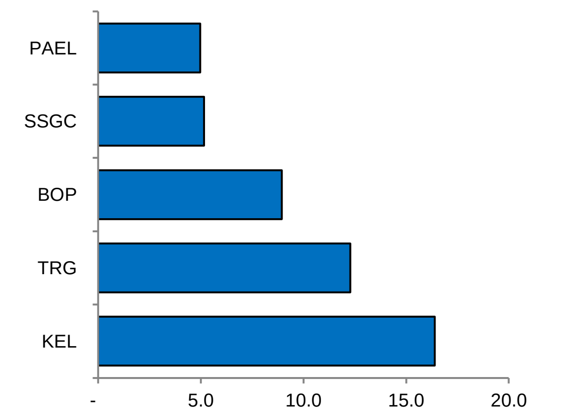
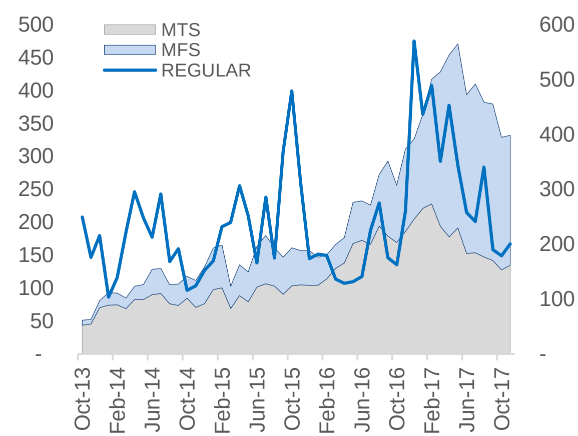


Exhibit: Financial products to increase market liquidity



Market

This Time Around It's Different!

- **This time around it's different!** For 2018, although political and macro headwinds do exist on the horizon, but these are somewhat momentary and in that respect attractive market valuation should be taken as an opportunity. We are comfortable with the distinction 'This time around it's different' as the upside to us looks fairly straightforward – market correction, recovering economic growth and steady corporate earnings outlook. At the same time, we believe much of the economic and political concerns have more or less been factored in by the market, thus the downside risks appear very limited.

  #1**: Market earnings growth of ~17% in 2018**

  #2**: Attractive market multiple**

- For 2018, we eye index target of 44,600 implying a return of 10% from its last closing of 40,371 level. We have taken earning growth as our basis for index estimation, which brings 2018F P/E to 8.6x and dividend yield of 5.9%.
- While we believe earnings growth, cheaper market multiples and long-term investment for case under CPEC USD 62bn project does make current market compelling, but we see near-term political clarity to be decisive for market sentiments to improve and thus potential of re-rating P/E multiples cannot be ruled out. Simply put, if market multiple re-rates to 10.0x this could easily take index above 50,000 level.
- **On liquidity:** With a focus of increasing the depth of market leverage products such as Margin Trading System (MTS) and increase in securities in Deliverable Future Contracts (DFC) counters, while introduction of Exchange Traded Funds (ETFs) in process will not only increase market depth but also improve market liquidity. To recall, the advent of these products as seen historically has greatly improved market liquidity historically. We see similar factors in play for 2018 and beyond to improve overall market liquidity.

Market

This Time Around It's Different!

- **Strategy:** From a market strategy standpoint, we have a strong preference for blue chip stocks. Moreover, as for market volatility concerns, we encourage a defensive play with companies offering higher dividend yields.
- **Companies with quality earnings and attractive forward multiples:** Generally, our valuation horizon extends over a 5 year period where expensive P/E multiples during early stages of investment are offset by substantial earnings growth which forms core return driver post expansionary phase when benefits from investment materializes. Thus companies incurring capex in high ROE projects tend to unlock quality earnings in the later part of their valuation horizon. Henceforth some stocks making our top picks may not seem attractive on current P/E multiple, but may attract investors on 3-5 years PEG ratio. Moreover, our selection criteria is based on companies having quality earnings (meaning low dispersion or having higher degree of predictability to them). With quality and attractive forward P/E, the potential for rebounding valuations in most of the blue chip companies remain compelling in our view.

Top Picks based on earning growth

	P/E				
SYM	CY/FY - 16	CY/FY - 17	CY/FY - 18	CY/FY - 19	CY/FY - 20
KOHC	4.9	6.1	6.1	6.3	5.9
PSO	9.5	5.4	6.3	7.2	6.4
ACPL	7.3	7.0	6.5	5.5	6.8
HBL	7.3	33.1	7.0	6.4	5.7
PIOC	5.7	5.0	7.3	5.5	3.4
BAHL	7.9	8.1	8.7	7.3	6.4
PPL	22.9	11.1	8.8	8.2	8.3
MARI	26.2	17.4	9.5	7.5	6.1
Market	**10.1**	**10.0**	**8.6**	**7.7**	**7.4**

Top Picks based on Dividend yield

	D/Y %				
SYM	CY/FY - 16	CY/FY - 17	CY/FY - 18	CY/FY - 19	CY/FY - 20
KAPCO	16.4	17.3	18.2	20.0	22.8
FFC	10.2	8.0	9.0	10.9	8.4
HMB	8.9	5.9	8.9	8.9	11.8
HUBC	12.0	8.2	8.7	9.8	14.2
EFERT	10.5	7.5	7.5	9.0	7.5
INDU	5.9	6.8	7.4	6.9	6.5
Market	**5.6**	**5.5**	**5.9**	**6.6**	**7.0**

IGI Securities
SERVING YOU SINCE 1994

Market

Earnings growth drives stocks!

- **We see a corporate earnings growth of 16.6% in 2018** (compared to 4% CAGR in past 3Yrs), normalising earnings for HBL penalty earnings growth trims down to ~7%.
- **Banks and E&Ps to lead the earnings recovery in 2018:** Since 2014 onwards, Banks and E&Ps stock have been stuck in sideways range owing to drop in international oil prices and subsequent monetary easing that came along with it. For E&Ps, elevated oil prices, increasing production and PKR depreciation, we estimate sector profitability to stay upbeat. For banks, low interest rates, high taxation, structural changes and one-off penalty of PKR ~24bn in HBL has albeit led to depressed earning period in 2017. In 2018, improved asset quality and expansion in banks loan sheet has ideally positioned the sector to benefit from monetary tightening ahead. We estimate for our coverage banks, a +100bps increase in discount rate could stretch 3Yr forward earnings by ~+21%.
- **Earnings to unlock on conclusion of expansionary cycle:** For construction, cements/steel recent expansions has positioned the sector favourably to capitalise on upcoming infrastructure growth helped by CPEC projects and expansionary fiscal policies. However, heavy capex along with rise in input prices is expected to underpin sector EBIT margins. Companies currently low on utlisation and undergoing expansion will be fast to catch upon growing demand. Moreover, companies taking tax credits on expansion along with and non-continuation of super tax would certainly benefit bottom line.
- **Higher earnings dispersion to fuel uncertainty:** We are under weight on Automobile assemblers, as we believe rising competition, high correlation of margins to exchange volatility and rising interest rate environment, the sector players will be left with limited pricing power. Possible introduction new models will albeit lead to higher capex cost further underpinning sector valuation. Our auto sector growth stand at ~12% in 2018, compared to ~55% CAGR in past 3Yr.

Market

Market liquidity remained dull during 2017

Exhibit: Market profitability outlook

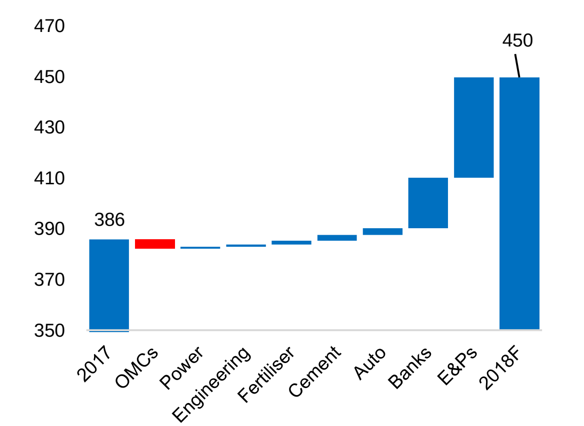


Exhibit: Profitability strongest in bluechip (base=2001)

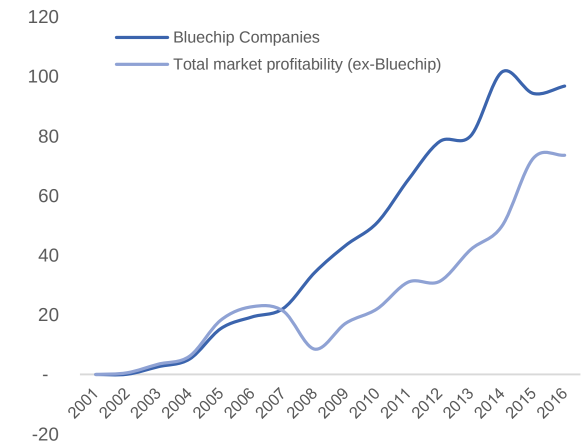


Exhibit: Earnings dispersion high for textile and autos

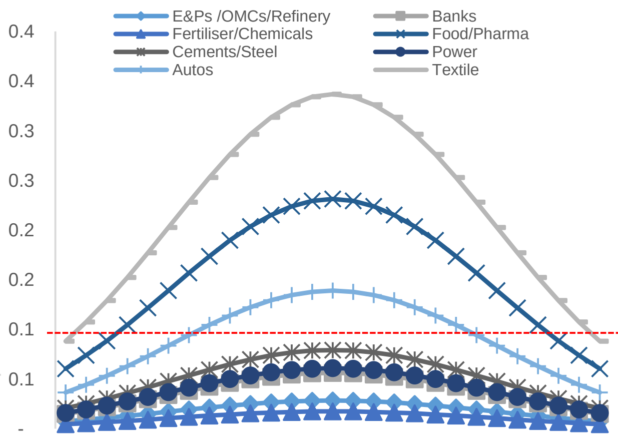


Exhibit: Sector earnings contribution to market

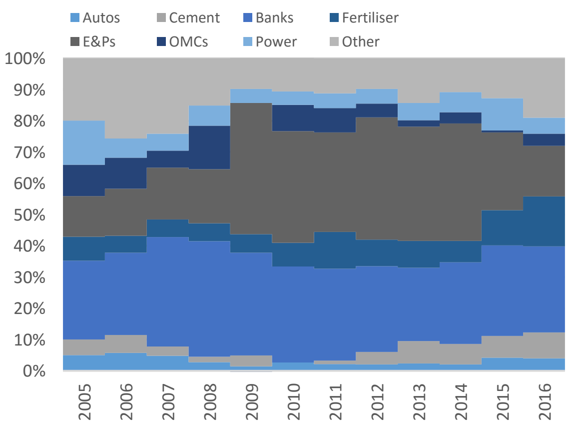


Exhibit: GDP, ROE and Market returns

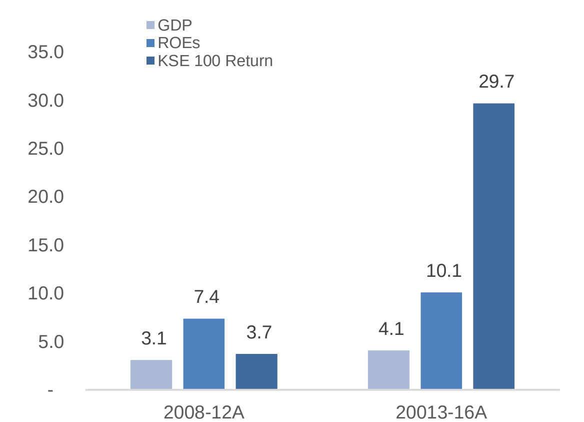
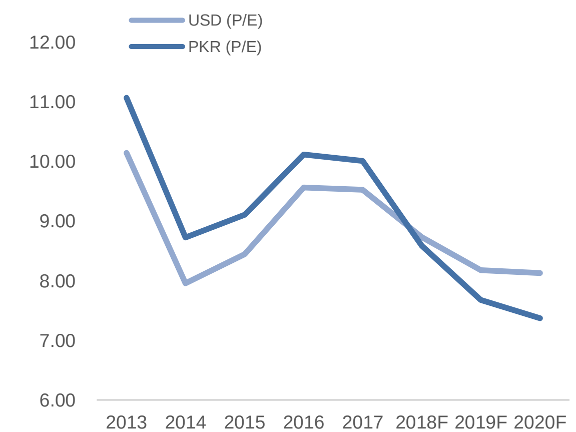


Exhibit: PKR depreciation to underpin USD based P/E



IGI Securities
SERVING YOU SINCE 1994

Market

Current market P/E near to a ~4 year historic low level

Historical	Going forward
Low GDP Growth rates	GDP growth expected over >5%
Lack of political and security stability	Political and security concerns lowered
Less reform based government agendas	High focus on reform
High power outages impeding industrial performance	Excess supply by 2018 onwards
High inflation	Steady inflation outlook
High interest rate environment	Low interest rates
High cost of doing business	Improving cost of business
Low investments	High investment outlook - incl. CPEC

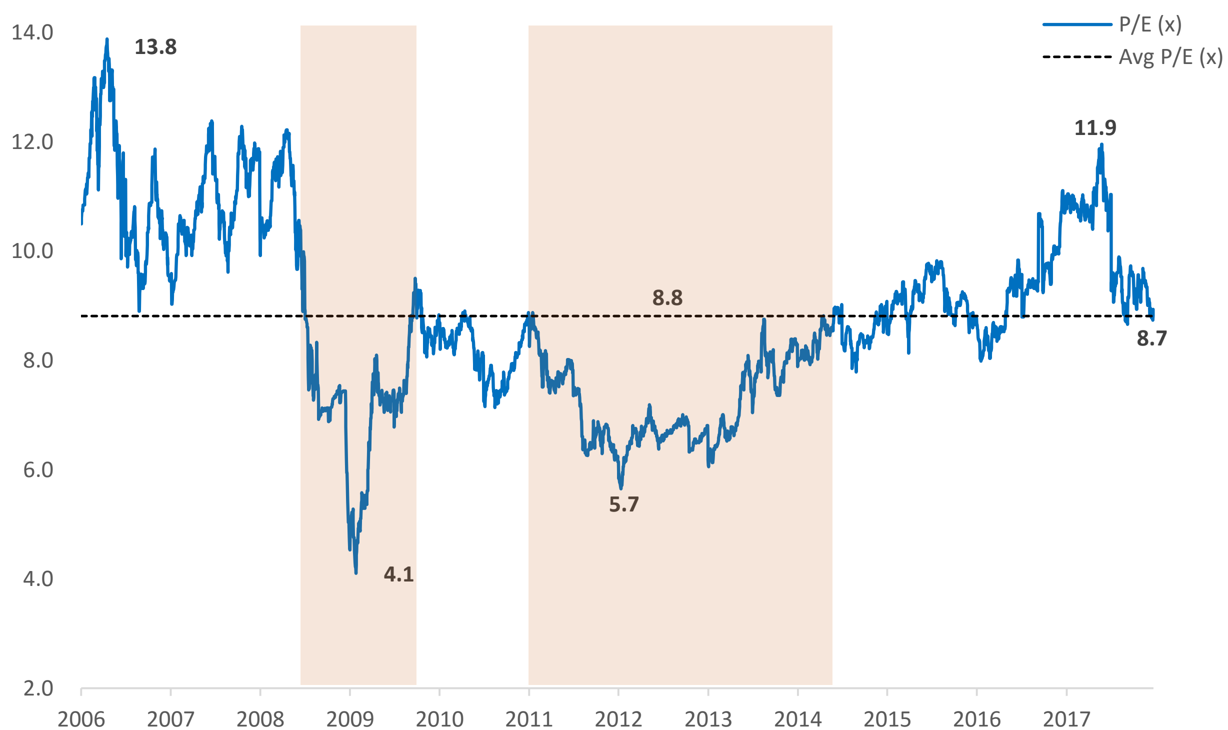
- Although market multiple remained high averaging 10.1x during the 11mCY17 period, but by Dec-17 market multiple dropped to 8.7x. Based on our earning estimates, market P/E (x) for 2018F comes at 8.6x, which takes it near to a ~4 year low level and close to its 12Yrs historic average of 8.8x. Periods of sustained low P/E under 8.8x are very rare historically. The lowest in 10yrs history market P/E averaged 6.4x starting by the end of 2008 and carried out till the 1Q of 2009. Later again in 2012/13 market multiple dropped to average 6.6x. Both the periods of low P/E were marked by weak global/domestic macro fundamentals and heightened domestic security/political risks, while exclusively for 2008/09 endured additional market risk owing to introduction of index floor to arrest market fall.
- **On a sector-wise basis:** For 2017 major market correction was witnessed in blue chip stocks (HBL, UBL, POL, OGDC, FFC, LUCK, etc) which despite posting a healthy earnings (adjusted for one-off) depicted a declining market capitalisation. To put things in perspective historical blue chip companies have somewhat maintained their overall earnings contribution of ~65% in market, but represented only ~60% of the total market capitalisation. Post Dec-16, there is some divergence seen in this historic trend. While these companies still represent ~65% of the total market earnings but their market capitalisation representation has dropped down to nearly ~45%. For companies other than blue chip have seen their valuation stretched out significantly starting 2017. Only recently and pronouncedly in 4QCY17, these companies have seen some downward correction in their market capitalisation.
- **Market P/E to low to be true:** For 2018, we highlight none of the aforementioned risks are high on the outlook. Countries economic growth is estimated to average in excess of 5.5%, while inflation is expected to stay comfortably under 8%. Moreover, development has been high on government agenda compounded by CPEC led projects.
- **Regional attractiveness still hold:** Based on the current market PE multiple of 8.5x, PSX is trading at significant discount to MSCI EM index P/E of 15.3x. Based on Nov-17 MSCI index data, MSCI Pakistan Index (representing 85% of Pakistan equity market) P/E of 8.11 is trading at almost half of the MSCI emerging market index P/E of 15.4. To recall, historically PSX discount to MSCI EM index has averaged around ~15%, while only once the PSX PER traded over and above MSCI EM index multiple back in 2008.

Market

Market Snapshot

KSE 100	2008	2009	2010	2011	2012	2013	2014	2015	2016	11MCY17	Dec-17	2018F	2019F	2020F
P/E (x)	9.1	7.3	8.1	7.3	6.6	7.4	8.4	9.1	9.3	10.2	8.9	8.5	7.6	7.3
D/Y (%)	4.6	7.1	6.0	6.3	6.8	6.5	5.7	5.8	5.8	5.2	6.4	6.0	6.7	7.1

Source: PSX, Bloomberg, IGI Research



2008/09

Global Recession
Outgoing coalition govt.
Heightened security risks
Large twin deficits
High inflation
High Power outages
PK Sovereign downgraded
Market floor Introduced

2011/13

Reformed capital gains tax
Flash floods
'Arab Spring' Middle eastern politics
Oil Prices rises
High interest rates
OBL led diplomatic tensions with US
Election year

Market

Sector Key Valuation

Sectors	Recom.	Mkt. Cap. PKR bn	Mkt. Cap. USD bn	WT %	P/E CY/FY - 17	P/E CY/FY - 18	P/E CY/FY - 19	D/Y % CY/FY - 17	D/Y % CY/FY - 18	D/Y % CY/FY - 19	P/B CY/FY - 17	P/B CY/FY - 18	P/B CY/FY - 19	ROE CY/FY - 17	ROE CY/FY - 18	ROE CY/FY - 19	EARNINGS %YoY CY/FY - 17	EARNINGS %YoY CY/FY - 18	EARNINGS %YoY CY/FY - 19	RETURN 3M	RETURN 6M	RETURN 12M
E&Ps	OW	1,394	12.6	19%	11.8	8.8	7.5	3.8	4.5	5.2	1.8	1.6	1.4	15.4	18.1	18.8	30.7	33.4	17.5	9%	18%	3%
Banks	OW	1,307	11.8	18%	9.2	7.9	7.0	6.7	7.0	8.0	1.1	1.1	1.0	12.2	13.6	14.5	(19.8)	16.3	13.1	-3%	-16%	-23%
Fertiliser	OW	483	4.4	7%	9.8	9.3	7.9	7.6	8.0	9.5	2.1	2.0	1.8	21.1	21.0	23.3	(9.2)	5.4	17.4	-6%	-8%	-17%
Cements	OW	458	4.1	6%	9.3	8.8	8.9	4.3	4.7	4.7	1.5	1.4	1.2	16.3	15.4	14.0	(6.2)	5.5	(1.1)	-12%	-38%	-44%
Power	MW	361	3.3	5%	7.7	7.4	6.8	11.0	11.7	13.0	2.4	2.3	2.3	30.9	31.4	33.3	(4.0)	3.7	9.0	-17%	-17%	-30%
Auto Assembler	UW	355	3.2	5%	10.6	9.5	10.0	4.9	5.5	5.3	3.3	2.9	2.5	31.5	30.1	25.1	30.8	11.5	(5.2)	-2%	-22%	-5%
OMC	OW	297	2.7	4%	7.5	8.6	8.8	7.0	5.7	5.8	1.5	1.4	1.3	19.8	15.8	14.2	27.1	(12.7)	(3.3)	-25%	-28%	-23%
Engineering	OW	113	1.0	2%	18.1	15.1	10.3	2.8	3.1	4.9	3.8	3.3	2.9	20.9	22.1	28.0	67.6	19.7	47.5	-13%	-27%	15%
KSE 100		**7,264**	**65.6**	**100%**	**10.0**	**8.6**	**7.7**	**5.5**	**5.9**	**6.6**	**1.6**	**1.4**	**1.3**	**15.7**	**16.8**	**17.3**	**1.1**	**16.6**	**11.8**	**-3%**	**-10%**	**-14%**

Top Picks

SYM	Target Price (Dec-18)	Recom.	Mkt. Cap. PKR bn	Mkt. Cap. USD bn	WT %	P/E CY/FY - 17	P/E CY/FY - 18	P/E CY/FY - 19	D/Y % CY/FY - 17	D/Y % CY/FY - 18	D/Y % CY/FY - 19	P/B CY/FY - 17	P/B CY/FY - 18	P/B CY/FY - 19	ROE CY/FY - 17	ROE CY/FY - 18	ROE CY/FY - 19	EARNINGS %YoY CY/FY - 17	EARNINGS %YoY CY/FY - 18	EARNINGS %YoY CY/FY - 19	RETURN 3M	RETURN 6M	RETURN 12M
PPL	237	BUY	396	3.6	5%	11.1	8.8	8.2	4.5	5.0	5.2	1.9	1.6	1.5	17.2	18.5	18.1	106.9	25.3	8.4	15%	35%	7%
MARI	2,382	BUY	159	1.4	2%	17.4	9.5	7.5	0.4	0.4	0.4	10.1	5.2	3.1	58.2	54.9	41.5	51.0	82.0	26.6	-4%	-9%	5%
HBL	206	BUY	249	2.2	3%	33.1	7.0	6.4	4.1	7.1	9.4	1.3	1.2	1.1	4.0	17.2	17.6	(78.0)	370.1	9.3	-6%	-37%	-38%
BAHL	73	BUY	64	0.6	1%	8.1	8.7	7.3	6.3	5.7	6.8	1.5	1.4	1.3	18.0	15.9	17.4	(2.4)	(7.0)	18.4	0%	1%	-3%
HMB	48	BUY	35	0.3	0%	8.0	6.5	5.3	5.9	8.9	8.9	0.9	0.8	0.7	10.9	12.4	14.2	(27.4)	23.1	23.2	1%	2%	-9%
EFERT	84	BUY	89	0.8	1%	9.2	8.7	7.6	7.5	7.5	9.0	2.0	1.8	1.7	21.8	21.1	22.5	7.9	4.7	14.5	6%	21%	-2%
FFC	89	BUY	98	0.9	1%	11.2	10.0	8.3	8.0	9.0	10.9	3.4	3.3	3.1	30.2	32.8	38.1	(25.5)	12.4	20.6	-7%	-6%	-26%
LUCK	666	BUY	167	1.5	2%	12.2	12.0	13.1	2.3	3.4	3.1	2.1	1.9	1.7	17.2	15.9	13.3	5.8	2.0	(8.9)	-8%	-38%	-40%
KOHC	270	BUY	22	0.2	0%	6.1	6.1	6.3	10.0	7.2	6.5	1.4	1.2	1.1	23.2	20.4	17.7	(19.6)	(0.4)	(2.9)	-7%	-39%	-52%
PIOC	134	BUY	14	0.1	0%	5.0	7.3	5.5	8.7	5.5	7.5	1.2	1.1	1.0	23.8	14.7	17.7	15.8	(32.5)	34.5	-29%	-51%	-55%
ACPL	358	BUY	21	0.2	0%	7.0	6.5	5.5	7.3	7.8	8.9	1.8	1.6	1.4	25.4	24.1	24.7	5.0	7.7	17.0	-8%	-39%	-45%
HUBC	133	BUY	106	1.0	1%	9.9	9.5	8.9	8.2	8.7	9.8	3.3	3.2	3.1	32.8	33.8	35.2	(10.2)	5.0	6.6	-18%	-22%	-26%
KAPCO	72	BUY	48	0.4	1%	5.1	5.0	4.5	17.3	18.2	20.0	1.5	1.4	1.4	29.1	29.0	31.3	4.1	2.3	11.8	-28%	-24%	-30%
INDU	2,202	BUY	133	1.2	2%	10.2	9.5	10.2	6.8	7.4	6.9	4.2	3.7	3.4	41.7	39.5	33.1	13.5	7.7	(6.9)	-2%	-6%	4%
PSO	385	BUY	98	0.9	1%	5.4	6.3	7.2	8.3	5.7	5.0	1.0	0.9	0.8	17.7	13.6	11.1	77.4	(15.3)	(12.0)	-32%	-22%	-31%
ASTL	130	BUY	28	0.3	0%	26.1	19.3	17.2	2.1	2.2	2.9	2.5	2.3	2.2	9.6	12.1	12.7	(16.0)	35.4	12.3	-7%	-23%	42%
ISL	131	BUY	47	0.4	1%	15.3	13.4	8.3	3.3	3.7	6.1	5.4	4.5	3.5	35.6	33.8	43.0	158.2	14.1	62.2	-12%	-16%	9%

Sectors

Overweight | **Oil & Gas Exploration Companies**

E&P sector outperforms KSE-100 on rising oil prices and production

Exhibit: E&P Sector profitability up by 61% in CY17TD

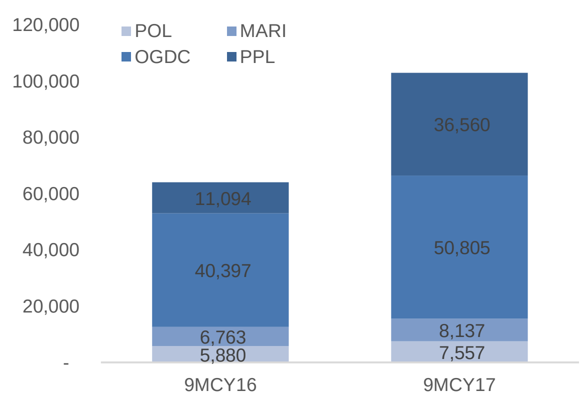


Exhibit: Oil & Gas production

	9MCY16		9MCY17	
	Oil (bopd)	Gas (mmcfd)	Oil (bopd)	Gas (mmcfd)
POL	6,363	74	6,992	81
MARI	1,439	652	1,527	685
OGDC	41,166	1,022	44,628	1,039
PPL	15,088	777	16,840	796

- **FY17: Sector profitability corroborated by higher oil prices and improved fundamentals:** Pakistan E&P sector under-performed KSE-100 by 14% posting a return of 9% in FY17 as compared to 23% for benchmark index. Overall sector profitability increased substantially by +30.7%YoY in FY17, led by a +19%YoY rise in oil prices and +8.5%/+2.6%YoY increase in oil/gas production. OGDC /PPL /POL/MARI earnings augmented by +6.4%/+106.9%/+33.8%/+51.0%YoY in FY17.
- **IGI E&P Universe's oil/gas production grew by +8.5% / +2.6%YoY in FY17:** Total oil and gas production of IGI E&P universe grew by +8.5%YoY and +2.6%YoY to 68,443bopd and 2,654mmcfd, respectively in FY17. For OGDC, oil production augmented by +8.5%YoY to 44,041bopd while gas production witnessed a decline of 0.5%YoY to 1,051mmcfd in FY17, PPL reported an uptick in oil and gas production of +8.1%YoY and +4.4%YoY to 16,066bopd and 857mmcfd respectively in FY17, while POL posted a growth of +8.0%YoY and +3.6%YoY in oil and gas production to 6,818bopd and 78mmcfd respectively in FY17. MARI remained the leader posting +17.3%YoY and +5.0%YoY rise in oil and gas production to 1,518bopd and 668mmcfd, respectively in FY17.
- **In CY17TD, Pakistan E&P sector out-performed KSE-100 by +20.2%** posting a return of +0.3% in CY17TD as compared to negative return of 19.9% for benchmark index. Overall sector profitability increased substantially by +55%YoY in CY17TD, led by a +14%YoY rise in oil prices and +9%/+3%YoY increase in oil/gas production. PPL / POL / OGDC / MARI earnings augmented by +3.3x/+29%/+26%/+20%YoY in CT17TD.
- **For OGDC, oil production augmented by +8.5%YoY to 44,041bopd** while gas production witnessed a decline of 0.5%YoY to 1,051mmcfd in CY17TD, PPL reported an uptick in oil and gas production of +8.1%YoY and +4.4%YoY to 16,066bopd and 857mmcfd respectively in CY17TD, while POL posted a growth of +8.0%YoY and +3.6%YoY in oil and gas production to 6,818bopd and 78mmcfd respectively in CY17TD. MARI remained the leader posting +17.3%YoY and +5.0%YoY rise in oil and gas production to 1,518bopd and 668mmcfd, respectively in CY17TD.

Overweight | **Oil & Gas Exploration Companies**

Exhibit: E&P Sector profitability up by 31% in FY17

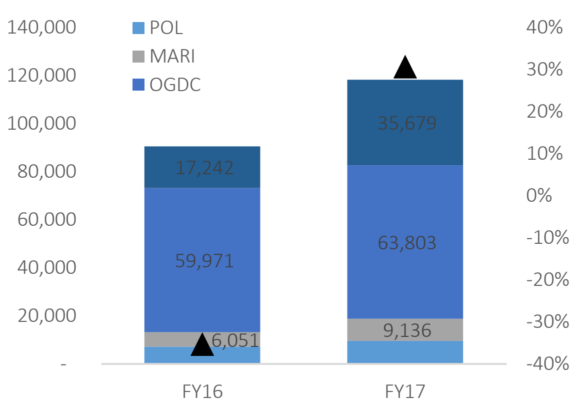


Exhibit: E&P sector Outperformed KSE-100 in CY17TD

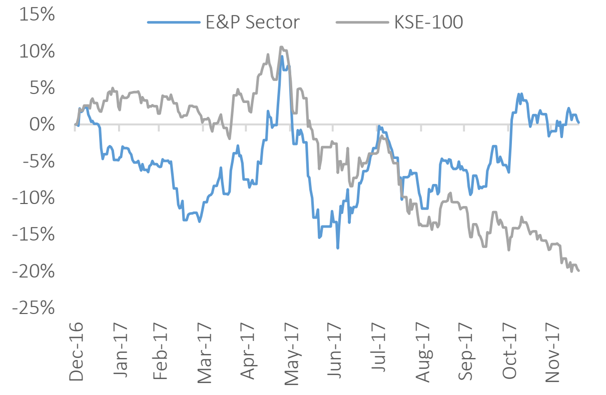


Exhibit: Gas production bopd (company-wise)

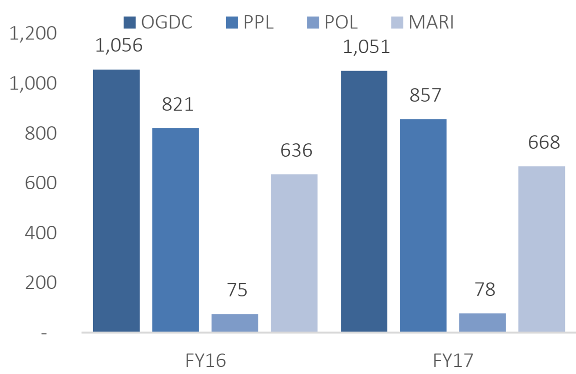
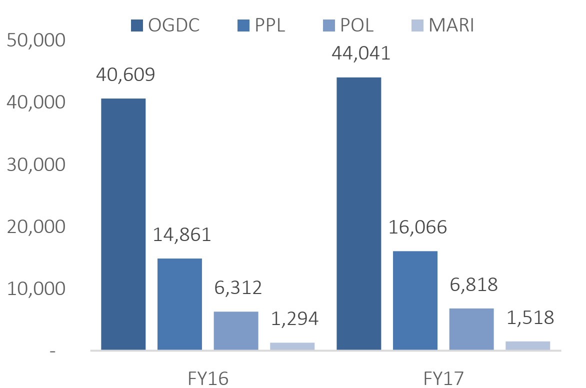


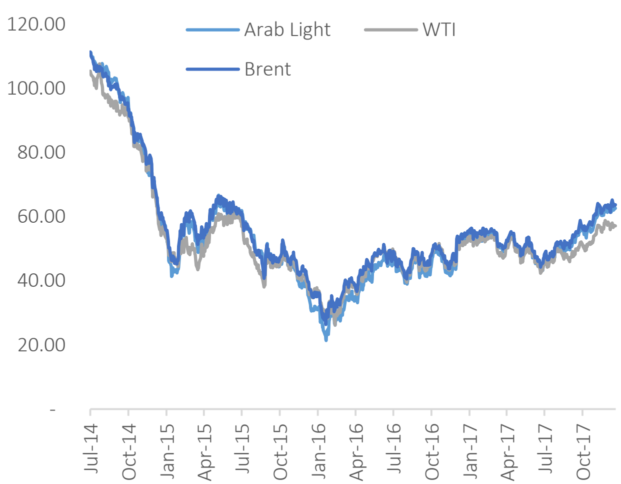
Exhibit: Oil production bopd (company-wise)



Overweight | **Oil & Gas Exploration Companies**

Oil prices surge on hopes of rebalancing but remain in backwardation

Exhibit: Oil prices up by 14% CY17TD – USD/bbl



- **Oil prices strengthened during CY17TD on OPECs efforts, supply disruptions and geopolitical tensions…** Arab Light price (benchmark crude), has surged by nearly +14% in CY17TD, as geopolitical tension in Middle East rises along with US oil inventory and rig count witnessing a steady decline (down to 763 rigs in Jul-17 from 747 currently). Further rise in oil prices emanated from OPEC and Non-OPEC mutually agreeing on extension of production cuts by a further 9 months beyond Mar-18. Supply disruptions also emerged from Key members of Saudi Arabia ministry were arrested on corruption charges leading to country wide anti-corruption movement. On the demand side, China world largest oil consumer has shown improving growth trend leading to higher oil consumption.
- **…however US production looms over rebalancing of oil supply glut:** Although OPEC and Non-OPECs efforts, supply disruptions and geopolitical tension have helped in rebalancing the oil supply glut thus providing an uplift in oil prices during CY17TD. However, rising US production led by increasing shale output has kept a lid on the oil prices. US rig count has been on a decline in recent months, however still remain well above Jan-17 level of 525 rigs. As a result oil price (Arab light) has remained shy of USD 65/bbl to currently stand at USD 63/bbl while WTI has settled below USD 60/bbl (currently at USD 57/bbl).
- **Expected exit of Russia from agreement and global shift away from oil may call for a correction in oil prices:** Russia has signaled towards early exit from the production cut to keep a lid on rise in oil prices as higher oil prices will encourage US shale producers to boost production. Russia is also comfortable with lower oil prices to balance its budget. Furthermore, most of the countries have planned and announced to part ways with oil consumption completely by 2025 and switch to renewable sources and electric cars which are also environmental friendly. This would in turn reduce oil demand substantially going forward and higher oil price regime may revert back.
- **Raising our oil price assumption for FY18 to USD 57/bbl but keeping long term assumption at USD 50/bbl:** As a result of recent incline in oil prices we have increased our oil price assumption for FY18 to USD 57/bbl, while keeping our long term price assumption of USD 50/bbl intact based on aforementioned reasons. As a result, IGI E&P universe earnings have been revised upwards by nearly 7%-11%.

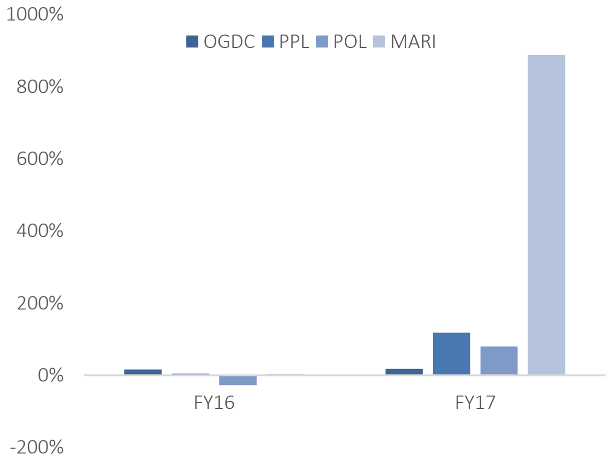
Overweight | **Oil & Gas Exploration Companies**

Depletion in reserves witnessed a slowdown in FY17

Oil & Gas Reserves

mnBoE	FY17	FY16	YoY
OGDC	1,160	1,237	-6%
PPL	661	649	2%
POL	61	62	-2%
MARI	909	570	60%

Exhibit: Total-Reserve Replacement Ratio (BoE)



- **Pakistan's oil and gas reserves stand at 332mnbbl and 20.8tcf as at FY17:** According to the data published by PPIS, Pakistan's total oil and gas 2P reserves stands at 332mnbbl and 20.8tcf as at Jun-17. During FY17 Pakistan's oil reserves declined by 5%YoY to 332mnbbl compared to 351mnbbl at Jun-16, whereas gas reserves increased by +9%YoY to 20.8tcf from 19.2tcf. Depletion witnessed a slowdown compared to last year where oil reserves declined by 9%, whereas gas reserves increased by +5%.
- **OGDC**'s total oil and gas 2P reserves declined by 9%YoY and 6%YoY respectively to stand at 163mnbbls and 5.7tcf, translating to cumulative reserves of 1.2bnBoE.
- **MARI**'s total 2P oil reserves declined by 27%YoY in FY17 to stand at 1.3mnbbls compared to a drop of 14%YoY in FY16, whereas total 2P gas reserves leaped up substantially by +60%YoY to 5.2tcf as of Jun-17 compared to a drop of 6% in FY16.
- **PPL**'s total 2P oil reserves declined by 3%YoY to stand at 64mnbbls in FY17 compared to a drop of 7%YoY in FY16, whereas total 2P gas reserves increased by +2%YoY to 3.4tcf compared to 8%YoY decline in FY16. This translates to a cumulative reserve of 0.66bnBoE.
- **POL**'s total 2P oil reserves declined by 1%YoY to stand at 20mnbbls compared to 3% decline in FY16, while total 2P gas reserves dropped by 3%YoY to 0.2bcf compared to 13%YoY decrease in FY16. This translates in to a cumulative reserve of 0.06bnBoE.
- **MARI leads with highest Reserve Replacement Ratio (RRR):** During FY17, IGI E&P universe companies witnessed a positive Reserve Replacement Ratio (RRR). MARI led the way with highest RRR of 899% for gas owing to 64% increase in Mari field reserves during the year. POL witnessed a highest RRR for oil owing to addition of Mardankhel reserves. PPL reported second highest RRR of 123% for gas owing to addition of Mardankhel and upward revision in Kandhkot reserves. OGDC remained the laggard with regards to RRR for oil and gas with RRR ratio of 2% and 21% respectively despite addition of Mardankhel owing to high base of reserves.

Overweight **Oil & Gas Exploration Companies**

Exhibit: OGDC Oil & Gas Reserves (Historical)

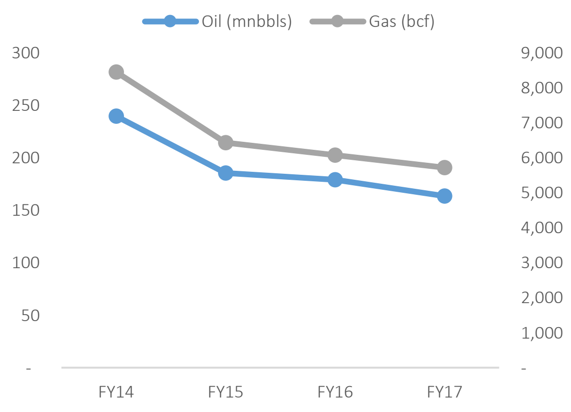


Exhibit :MARI Oil & Gas Reserves (Historical)

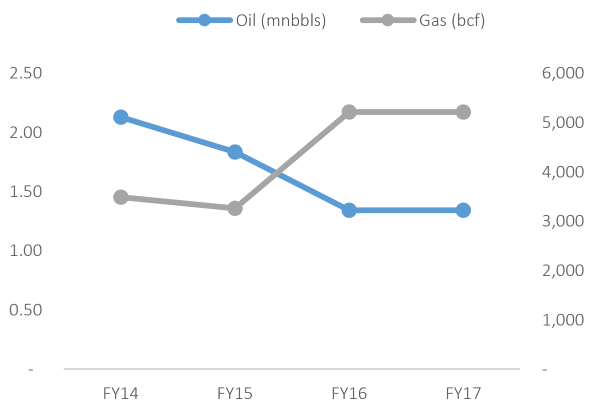


Exhibit: PPL Oil & Gas Reserves (Historical**)**

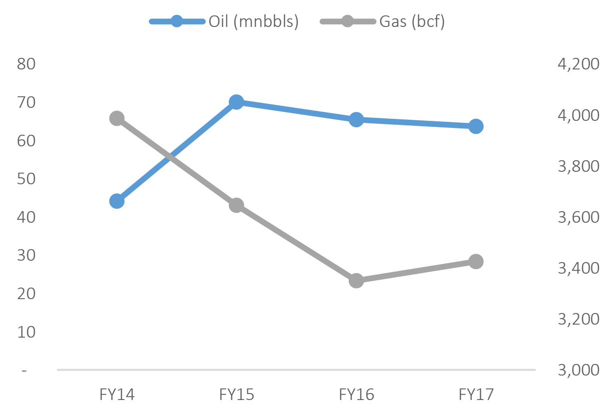
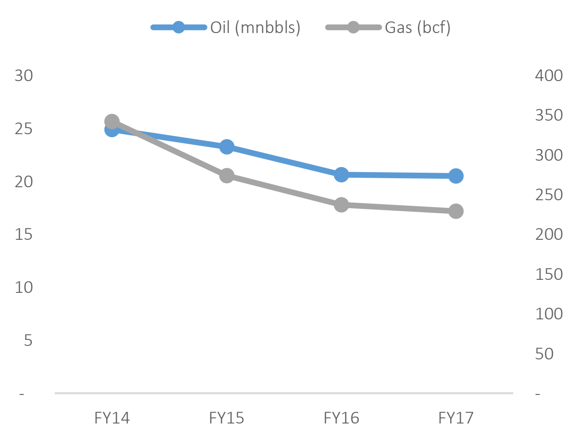


Exhibit: POL Oil & Gas Reserves (Historical**)**

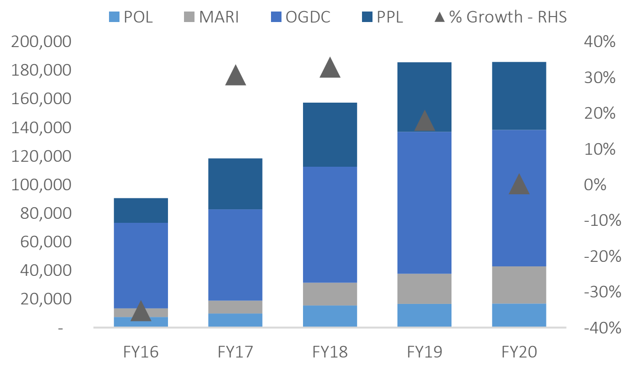


Overweight | **Oil & Gas Exploration Companies**

E&P sector to post +33%YoY growth in FY18; MARI and PPL top picks

- **Profitability to grow by +33%YoY in FY18F:** We estimate IGI E&P Universe profitability to grow by a +33% in FY18 to PKR 157bn and thereby posting a 3Yr CAGR of +16%. Primarily we say this owing to improved profitability led by stability in oil prices, slightly higher than FY17 level and additional production through new discoveries coming online. E&P industry is currently trading at FY18/FY19F forward P/E multiple of 8.8x/7.4x. On individual basis, MARI is expected to post highest growth of +75%YoY in FY18, followed by POL with earnings growth of +58%YoY. PPL's earnings growth excluding one off event of retrospective amount pertaining to Sui re-pricing would stand at 78%YoY in FY18.
- **One off impact of Tal block to corroborate earnings growth in FY18:** One off impact such as retrospective amount in respect of revision in wellhead gas price for Tal block is further expected to provide earnings growth in FY18 amounting to PKR 2.9bn (after tax PKR 6.8/share) for POL and PKR 3.6bn for OGDC and PPL (PKR 0.4/share and PKR 1.3/share).
- **IGI E&P Universe's oil/gas production to increase by 11%YoY and 15%YoY in FY18:** We expect IGI E&P universe oil and gas production to increase by 11%YoY and 15%YoY in FY18 to 75,948bopd and 2,978mmcfd, respectively. Growth in oil production is primarily led by higher production from POL which is likely to register +27%YoY rise to 8,590bopd, while incline in gas production is primarily attributable to MARI which is expected to register +5%YoY increase in gas production to 660mmcfd in FY18.

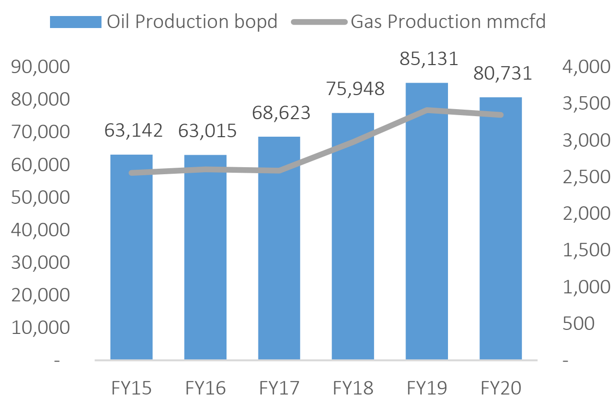
Exhibit: IGI E&P Universe profitability to post 3yr CAGR of 16% during FY18-20F



Overweight | **Oil & Gas Exploration Companies**

E&P sector to post +33%YoY growth in FY18; MARI and PPL top picks

Exhibit: IGI E&P Universe Oil & Gas production forecast



- **PKR devaluation:** Pakistan E&P sector is expected to benefit most from PKR depreciation where we expect every 1% depreciation to augment IGI E&P universe's earning by 1% or PKR 0.7/share, PKR 1.8/share, PKR 0.2/share and PKR 0.3/share for POL, MARI, OGDC and PPL, respectively.
- **PPL and MARI as our top pick, fundamentals already priced in for POL:** We highlight MARI and PPL as our top picks with our Dec-18 Target Price of PKR 2,382/share and PKR 237/share providing 65% and 18% upside from its last close. MARI and PPL are currently trading at FY18F P/E of 9.5x and 8.8x, respectively. MARI and PPL remain the cheapest on EV/BoE multiples of USD 2.5/BoE and USD 4.8/BoE, respectively.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
PPL	BUY	200.6	237.2	18.3	3,589	22.7	10.0	8.8	5.0	10%
POL	BUY	590.8	689.4	16.7	1,268	64.5	60.0	9.2	10.2	20%
MARI	BUY	1,440.0	2,382.2	65.4	1,441	150.8	5.6	9.5	0.4	42%
OGDC	BUY	162.8	194.7	19.6	6,355	18.9	6.5	8.6	4.0	14%
SECTOR					**12,653**			**8.8**	**4.5**	**16%**

Source: IGI Research, PSX

IGI Securities
SERVING YOU SINCE 1994

Overweight | **Pakistan Petroleum Limited (PPL)**

Sui re-pricing and production enhancement from Kandhkot / Gambat South to drive profitability

- **Sui re-pricing:** PPL largest gas producing field is Sui which contributes nearly 49% of the total gas produced and PKR 9.2/share or 41% in total earnings. Upon expiration of Gas Price Agreement (GPA) in FY15, the revised GPA offers nearly 64% higher wellhead gas price for Sui field which is linked with Petroleum Policy 2012 (PP12). We expect revised wellhead price to contribute nearly PKR 3.65/share or 16% of total earnings in FY18.
- **New discoveries and production enhancement:** We expect new discoveries coming online and production enhancement from Kandhkot to lift oil and gas production by +9%YoY and +4%YoY to 18,002bopd and 822mmcfd in FY18. New discoveries are expected to add nearly 301bopd and 9mmcfd of oil and gas production contributing nearly PKR 0.8/share to FY18 earnings. Production enhancement of nearly 8%YoY from Kandhkot is expected to augment earnings by PKR 0.2/share in FY18.
- **Completion of Gas Processing Facility (GPF) at Gambat South:** Discoveries in the past 2-3years in Gambat South have faced delays due to capacity constraints. As a result the company has commissioned GPF I-II which has led to production commencement from Kabir field while construction on GPF III-IV are underway. This would allow PPL to commence production from new discoveries made in the block in the past 2 years which cumulatively is expected to add 109mmcfd of gas and 452bopd of oil out of which production of 23.9mmcfd of gas and 452bopd of oil has commenced.
- **Development in Adhi field to further boost production:** PPL has focused on drilling in Adhi block and Kandhkot which has enabled the company to enhance production from these fields.
- **Recommendation:** As a result we estimate PPL's earnings to augment by +25%YoY in FY18 and post 3yr CAGR of 10% (25% on recurring EPS) over FY18-20F. We maintain our **'BUY'** stance on PPL with our Dec-18 Target Price of PKR 237/share offering 18% upside from its last close. The company is currently trading at FY18F P/E of 8.8x.

Pakistan Petroleum Limited
Oil & Gas Exploration Companies

Recommendation		**BUY**
Target Price:		237.2
Last Closing:	28-Dec-17	200.6
Upside:		18.3
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

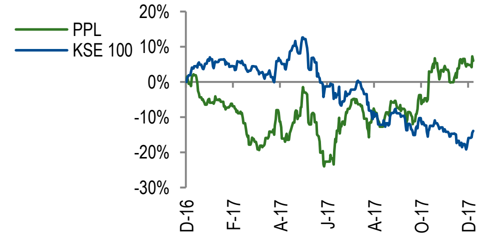
Bloomberg Tkr.		PPL PA
Shares (mn)		1,971.7
Free Float Shares (mn)		481.3
Free Float Shares (%)		24.4%
Market Cap (PKRbn | USDmn)	395.5	3,573.1
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	14.8	35.4	4.5
Lo	166.6	144.7	143.7
Hi	203.0	203.0	203.0

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	87.3	131.5	148.0	148.7
Net Income	35.7	44.7	48.5	47.6
EPS (PKR)	18.1	22.7	24.6	24.2
DPS (PKR)	9.0	10.0	10.5	10.5
Total Assets	282.7	350.1	375.1	396.3
Total Equity	207.3	241.1	268.2	294.9
Key Financial Ratios				
ROE (%)	17.2	18.5	18.1	16.1
P/E (x)	11.1	8.8	8.2	8.3
P/B (x)	1.9	1.6	1.5	1.3
DY (%)	4.5	5.0	5.2	5.2

Relative Price Performance



December 29, 2017

IGI Securities
SERVING YOU SINCE 1994

Overweight | **Mari Petroleum Company Limited (MARI)**

Divestment of GoP stake overshadowing high earnings growth

- **Higher gas contribution keeps MARI immune to recent FO ban which has led to lower demand from refineries:** Gas production contributes nearly 80% of the total revenues which provides company immunity against the recent decision by GoP to immediately stop 4000MW of FO based power plants and remaining to utilize imported FO. This has led to drop in demand of local oil from refineries and lower production from Tal block and Nashpa however MARI due to high contribution of gas stands out as least effected E&P in IGI E&P Universe.
- **Mari field new GPA offering higher price:** Under the revised GPA, Mari gas field's cost plus pricing formula has been replaced with international crude price linked formula, at a stated discount to price under Petroleum Policy 2001 (PP01). The revised price (which at current discount of 20.1% is 46% higher than price under old GPA) is estimated to contribute PKR 30.6/share in total earnings in FY18. The discount would gradually decrease every six months to offer higher wellhead gas price. Based on our estimates, this alone will result in incremental earnings of PKR 21.0/share.
- **PP12 price incentive on production enhancement from Mari field:** Under the agreement, production exceeding by 10% from benchmark of 525mmcfd (including 10%) is entitled for higher gas price under PP12. MARI has been further provided with incentive of lowered benchmark of 478mmcfd during annual turnaround of customers plant when demand is low to fully avail PP12 price incentive. Mari fields current production stands at 677mmcfd, while the company (post increase in field's reserve by 64% in Dec-16) expects to raise production to nearly 800mmcfd by FY20. Every 50mmcfd increase in production from Mari field above benchmark level of 525mmcfd would contribute PKR 29.1/share in total earnings.
- **Installation of compressors at Guddu Plant:** MARI concluded the installation of compressors at Guddu plant during FY17 which allowed the company to increase its offtake to Guddu by a further 62mmcfd. This had led to nearly 4% increase in production from Mari field during 1QFY18.
- **Recommendation:** MARI is expected to post earnings growth of +75%YoY in FY18 and post 3Yr CAGR of 42% over FY18-20F. We maintain our **'BUY'** stance on MARI with our Dec-18 Target Price of PKR 2,382/share offering 65.4% upside from its last close. The company is currently trading at FY18F P/E of 9.5x.

Mari Petroleum Company Limited
Oil & Gas Exploration Companies

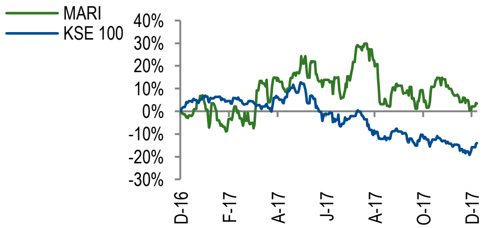
Recommendation		**BUY**
Target Price:		2,382.2
Last Closing:	28-Dec-17	1,440.0
Upside:		65.4
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data			
Bloomberg Tkr.			MARI PA
Shares (mn)			110.3
Free Float Shares (mn)			22.1
Free Float Shares (%)			20.0%
Market Cap (PKRbn | USDmn)		158.8	1,434.1
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	(4.3)	(8.6)	4.0
Lo	1,398.4	1,398.4	1,270.4
Hi	1,600.8	1,809.4	1,809.4

Key Company Financials
Period End: Jun

PKRbn	FY17A	FY18E	FY19F	FY20F
Total Revenue	33.4	39.7	51.6	62.0
Net Income	9.1	16.6	21.1	26.0
EPS (PKR)	82.9	150.8	191.0	235.7
DPS (PKR)	5.6	5.6	6.0	6.3
Total Assets	80.9	118.7	156.9	200.2
Total Equity	15.7	30.3	50.7	76.0
Key Financial Ratios				
ROE (%)	58.2	54.9	41.5	34.2
P/E (x)	17.4	9.5	7.5	6.1
P/B (x)	10.1	5.2	3.1	2.1
DY (%)	0.4	0.4	0.4	0.4

Relative Price Performance



Overweight | **Commercial Banks**

The 3 Habibs; our preferred picks!

- Strategy: With the onset of monetary easing since 2014, banks have been stuck in sideways range. Low interest rates, high taxation, structural changes and one-off penalty amounting PKR 23.7bn on HBL has transformed 2017 into a depressed earning period. Moving into 2018, improved asset quality and expansion in bank's loan sheet during CY17 has placed banking sector ideally to benefit from monetary tightening ahead. As per our estimates, a +100bps rise in discount rate could stretch our IGI banking universe 3Yr forward earnings by ~21%. Moreover, exclusion of super-tax and structural changes in operating costs for few banks will prove as a valuable earning driver.

- Although the banking sector as a whole, stands to benefit from rising interest rates, but we assert our liking for HBL, BAHL and HMB. We prefer HBL for its deposit size and stable capital, which ideally places the bank to benefit from infra/power development under CPEC umbrella while BAHL possesses all the markers of strong fundamentals - highest asset quality with ample of provision reserve, ideally placed investment portfolio to benefit from rising interest rate environment and highest 5Yr average ROE in IGI universe. Moreover, in small banks, we have a liking for HMB for its highest dividend yield amongst our coverage companies (excluding NBP), high capital buffer, high proportion of fee income and low cost to asset ratio.

Overweight | **Commercial Banks**

- For 2017, banking sector has had a love and hate relationship with investors. Sector performed exceptionally well in the first half of the year, owing to anticipated inclusion of HBL, UBL, and MCB in reclassified Emerging Market status of Pakistan. However, post reclassification, banking sector started to experience a series of negative news; maturing high yield investment bonds, lower T-bill returns, loan suppression due to excess liquidity, continuation of super tax, with penalty on HBL and lost pension case by NBP being the final nail on the head. The sector market cap reduced by USD 4.4bn, dropping by 29% from its high in May-17. Simultaneously, profitability of the sector displayed a flattish trend, falling by a meagre 1.9% (HBL normalized). However, BAHL, BAFL and NBP surprised with a significant earnings growth while HMB and ABL performed the worst.

- Despite all the hiccups, our liking for banks stems from favorable macro environment and historically low valuations. On the macro front, foreseeable rate hike provides massive upside to banks while burgeoning government borrowing requirement brings forth another catalyst for earnings growth. Furthermore, neutrality to PKR depreciation, in the current external environment, serves as another plus for the sector. At the same time, historically low multiples wherein, the banks are currently trading at P/B of 1.1x compared to average of 1.50x in last 3 years, provides attractive entry point for investors. Moreover, with an average dividend yield of 6.6% (ex-NBP) and a 3Yr earnings CAGR of 14.1% (from CY17E to CY20F), banks automatically qualify as our preferred scrips.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
HBL	BUY	169.7	206.0	21.4	2,259	24.1	12.0	7.0	7.1	4%
UBL	BUY	185.5	227.0	22.4	2,061	20.5	11.0	9.1	5.9	2%
MCB	HOLD	210.1	191.0	(9.1)	2,122	18.7	14.0	11.2	6.7	3%
NBP	BUY	46.9	54.0	15.1	906	8.4	6.0	5.6	12.8	-5%
ABL	BUY	83.5	94.0	12.6	868	11.2	6.0	7.4	7.2	1%
BAHL	BUY	57.5	73.0	27.0	580	6.6	3.3	8.7	5.7	2%
FABL	BUY	21.5	27.0	25.7	234	3.9	1.1	5.4	5.1	9%
BAFL	BUY	42.0	50.0	19.0	608	5.3	1.6	8.0	3.7	5%
AKBL	BUY	19.1	23.0	20.4	219	3.5	1.1	5.5	5.8	-1%
HMB	BUY	33.9	48.1	42.1	322	5.2	3.0	6.5	8.9	3%
SECTOR					**10,178**			**7.9**	**7.0**	**2%**

2018
Pakistan Equity Market Outlook

IGI Securities
SERVING YOU SINCE 1994

Overweight | **Commercial Banks**

Exhibit: 1 year price performance

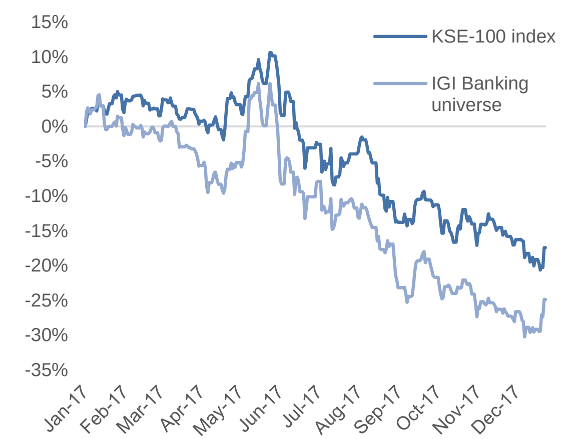


Exhibit: Historical P/B (LHS) & historical P/E (RHS)

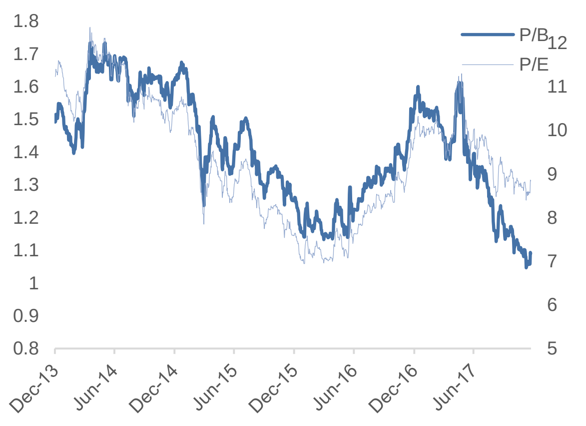


Exhibit: 3Yr fwd ROE to current P/B

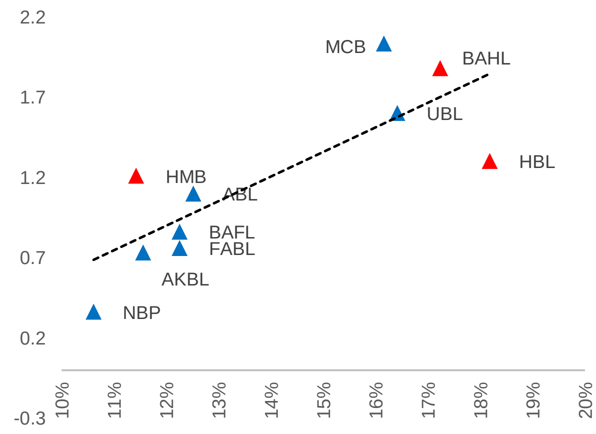


Exhibit: Historical investment proportions

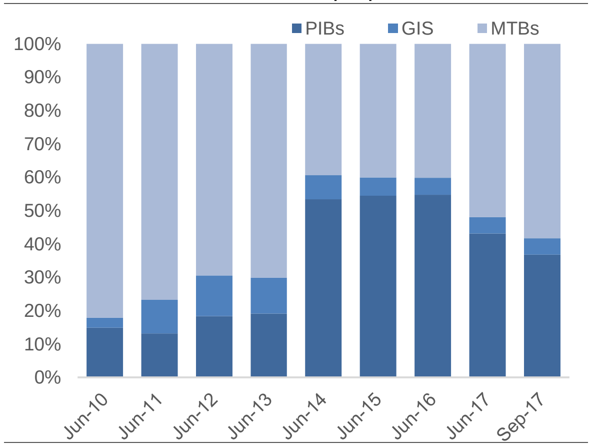


Exhibit: Advances growth for IGI Banking Universe

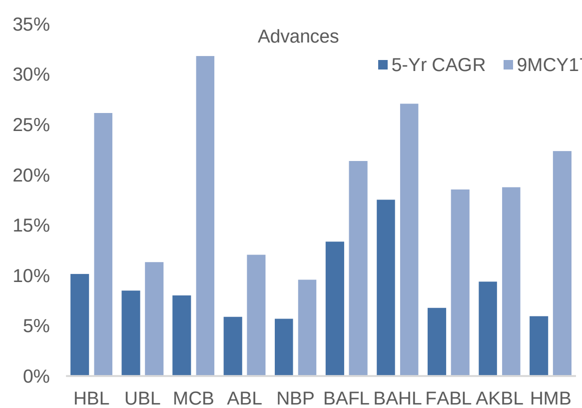
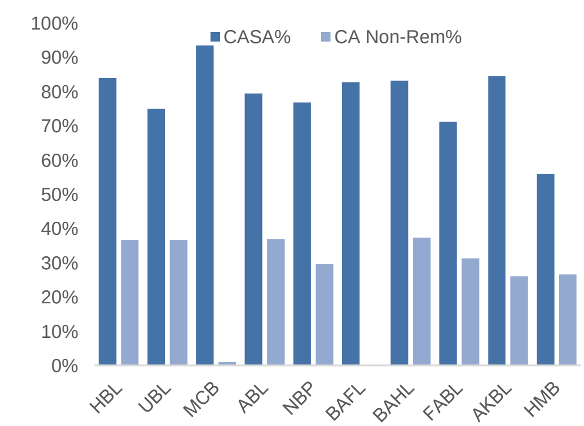


Exhibit: Deposit composition in IGI Banking universe



December 29, 2017

Overweight | **Habib Bank Limited (HBL)**

Infra financing: Clouds of uncertainty dispersing

- Habib Bank Limited (HBL), the largest deposit franchise in Pakistan, is optimally placed to benefit from Pakistan's growth story. Following the news of NYSDFS penalty, the scrip plunged ~30% compared to sector decline of 3.3% (ex-HBL), trading at a P/B of 1.17x. However, despite the dent from penalty, the underlying fundamentals of the company are still intact. We believe, HBL will keep its focus on advances growth (3Yr CAGR of +10.7% from CY17E to CY20F) albeit venturing into less risky credit (lower yields) to rebuild its CAR to ~15% level. 5Yr average ROE is expected to come in at +19.5% with ROA at +1.2% from CY17E to CY22F. Moreover, although the bank did not pay a dividend in 3QCY17 to restore capital, we see payout to normalize CY18 onwards with dividend yield of 7.1%. HBL's virtue relies on its cheap valuation, due to overreaction to penalty, as well as its attractive dividend yield.
- Furthermore, the bank is well placed to take advantage of an imminent rate hike due to a decent proportion of T-bills (40%) and high CASA (84%) with focus on non-remunerative CA growth (9MFCY18: 9.3%). The bank's operating expense is also expected to normalize post CY17 as FMFB (First Micro Finance Bank) consolidation costs and penalty remediation costs subside, whereby, we expect its cost to asset ratio to drop to 1.6% in CY22F compared to 2.2% in CY16. Additionally, the bank also expects to get tax benefit from the recently booked penalty which will have a per share impact of PKR 5.7.
- Potential risk to the bank stems from continuing investigation by NYSDFS, but the chance for a further charge is limited. The bank's CAR also took a hit from penalty, dropping to 13.6% as per the management, yet with curtailed dividend in 3QCY17 and expected holdout in 4QCY17, combined with deleveraging, we expect the CAR to restore soon enough.
- We recommend a **'BUY'** call on HBL due to its attractive valuation with Dec-18 target price of PKR 206/share and CY18F fwd P/B of 1.2x,offering a +21.4% upside with 7.1% dividend yield.

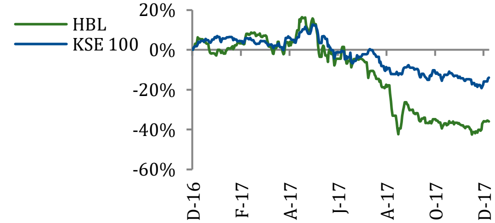
Habib Bank Limited
Commercial Banks

Recommendation				**BUY**
Target Price:				206.0
Last Closing:	28-Dec-17			169.7
Upside:				21.4
Valuation Methodology:				Asset based Valuation / Dividend Discount Model (DDM)
Time Horizon:				Dec-18
Market Data				
Bloomberg Tkr.				HBL PA
Shares (mn)				1,466.9
Free Float Shares (mn)				660.1
Free Float Shares (%)				45.0%
Market Cap (PKRbn | USDmn)			249.0	2,249.0
Exchange				KSE 100
Price Info.		90D	180D	365D
Abs. Return		(6.1)	(36.9)	(36.7)
Lo		152.4	152.4	152.4
Hi		180.8	269.1	308.6

Key Company Financials
Period End: Dec

PKRbn	**CY16A**	**CY17E**	**CY18F**	**CY19F**
Total Revenue	113.0	113.3	117.7	129.3
Net Income	34.2	7.5	35.4	38.6
EPS (PKR)	23.3	5.1	24.1	26.3
DPS (PKR)	14.0	7.0	12.0	16.0
Total Assets	2,507.2	2,758.0	3,147.3	3,568.3
Total Equity	196.3	188.7	204.9	218.6
Key Financial Ratios				
ROE (%)	17.4	4.0	17.3	17.7
P/E (x)	7.3	33.1	7.0	6.4
P/B (x)	1.3	1.3	1.2	1.1
DY (%)	8.2	4.1	7.1	9.4

Relative Price Performance



Overweight | **Bank Al-Habib Limited (BAHL)**

Suitably Poised for Growth

- Rapid advances growth (~+27%YoY), superior asset quality (infection ratio: 1.9%), robust deposit growth (+17%YoY), highest 5Yr average ROE (~22%) in IGI Universe and optimal positioning to take advantage of a rate hike – Bank Al-Habib Limited (BAHL) justifies the P/B (above mid-tier banks) it trades at. During 9MFY17, the bank's profitability (up +20%YoY) grew the most in IGI Universe, on the back of high advances growth (interest income from advances up +25%YoY), albeit with meagre spreads, higher fee income (+28%YoY) and higher capital gains (PKR 2.9bn). The bank also commands a high deposit growth, translating into costlier deposits, yet it was able to mitigate that cost by focusing on current account mix.
- The bank has a decent CASA (83.2%), with highest proportion of CA (34.4%), while its investment portfolio has the greatest concentration of T-bills (68.2%) whereby, the bank has positioned itself well to take advantage of a rate hike. BAHL holds the highest percentage of RSA (Risk Sensitive Assets) compared to RSL (Risk Sensitive Liabilities) in IGI Universe, to capture upside of interest rate rise, while its remaining high yield PIBs give a way to stabilize NIMs in the meantime. Moreover, the bank is also expected to keep its operating expenses low, wherein, we expect its cost-to-asset ratio to drop to 2.1% in CY19F compared to 2.4% in CY16.
- On the flip side, the bank holds a limited CAR ratio which could be a hindrance to growth. Furthermore, the bank's fee income to core income proportion is also low, which is a draw back in low interest rate environment.
- We recommend a **'BUY'** call on BAHL due to its attractive valuation and sound fundamentals, with Dec-18 target price of PKR 73/share and CY18F fwd P/B of 1.4x, offering a +27.0% upside along with 5.7% dividend yield.

Bank Al Habib Limited
Commercial Banks

Recommendation	**BUY**
Target Price:	73.0
Last Closing: 28-Dec-17	57.5
Upside:	27.0
Valuation Methodology:	Asset based Valuation / Dividend Discount Model (DDM)
Time Horizon:	Dec-18

Market Data

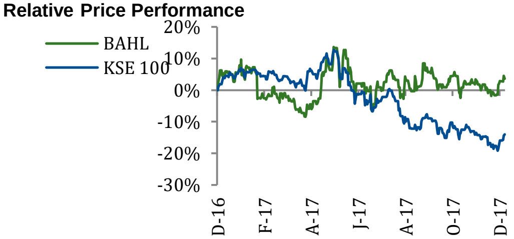
Bloomberg Tkr.		BAHL PA
Shares (mn)		1,111.4
Free Float Shares (mn)		722.4
Free Float Shares (%)		65.0%
Market Cap (PKRbn | USDmn)	63.9	577.3
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(0.2)	1.3	0.9
Lo	54.1	52.0	50.8
Hi	58.7	60.2	63.1

Key Company Financials
Period End: Dec

PKRbn	**CY16A**	**CY17E**	**CY18F**	**CY19F**
Total Revenue	29.7	32.6	33.4	37.5
Net Income	8.1	7.9	7.4	8.7
EPS (PKR)	7.3	7.1	6.6	7.9
DPS (PKR)	3.5	3.6	3.3	3.9
Total Assets	751.4	864.3	980.0	1,101.0
Total Equity	42.5	44.0	46.3	49.7
Key Financial Ratios				
ROE (%)	19.1	18.0	15.9	17.6
P/E (x)	7.9	8.1	8.7	7.3
P/B (x)	1.5	1.5	1.4	1.3
DY (%)	6.1	6.3	5.7	6.8

Relative Price Performance



Overweight

Habib Metropolitan Bank Limited (HMB)

A multi-asset growth play

- Adequate capital buffer as well as high dividend yield places Habib Metro Bank (HMB) as a top pick in defensive strategy. Within the IGI Universe, Habib Metro Bank offers the most dividend yield at 11.8% (ex-NBP). Simultaneously, the bank has grown its loan sheet by +17% over the 9MCY17 period compared to 3Yr CAGR of 3.5%, while at the same time, the bank has pulled down its interest expenses (down 14%YoY) by reconfiguring its deposit composition and reducing borrowings. Moreover, the bank was also able to supplement its core income (up +16.2% during 9MCY17) due to its high fee income proportion. Additionally, although the bank's asset quality is a cause of concern, yet given the rapid improvement it has made, the future trend seems supportive, in our view.
- HMB's heavy presence in trade and commerce segment gives it an edge over other banks in the concurrent low interest rate environment, wherein, the bank commands high fee income to core income ratio, diversifying its revenue stream. The bank has a 3Yr fee income CAGR of 10.7%. Moreover, the bank has one of the lowest cost to asset ratios in IGI Universe, underlining another valued growth driver in tough revenue conditions. As of 9MCY17, the bank's cost to asset ratio stands at 1.9%. Furthermore, although the bank lacks high CASA deposits but it has accumulated a high proportion of T-bills which should boost profitability once the interest rate cycle reverses.
- However, asset quality of the bank remains a weak spot, with infection ratio at 10% and coverage ratio at 88%. Combined with expected advances growth of ~11.6% (3Yr CAGR from CY17E to CY20F), NPL accretion could be one of the foremost concerns. Yet, it must be emphasized, that the bank has pulled down its infection ratio the most in IGI Universe during 9MCY17 (243bps) which points to a positive trend on asset quality front.
- We recommend a 'BUY' call on HMB due to its attractive dividend yield (11.8%) as well as its revenue diversification with Dec-18 target price of PKR 48.1/share and CY18F fwd P/B of 0.8x, offering a +42.1% upside.

Habib Metropolitan Bank Limited
Commercial Banks

Recommendation	**BUY**
Target Price:	48.1
Last Closing: 28-Dec-17	33.9
Upside:	42.1
Valuation Methodology:	Asset based Valuation / Dividend Discount Model (DDM)
Time Horizon:	Dec-18

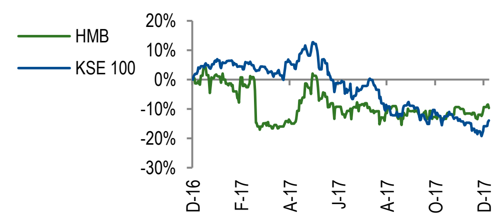
Market Data

Bloomberg Tkr.			HMB PA
Shares (mn)			1,047.8
Free Float Shares (mn)			471.5
Free Float Shares (%)			45.0%
Market Cap (PKRbn | USDmn)		35.5	320.4
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	1.2	2.4	(10.2)
Lo	32.4	31.7	31.1
Hi	34.3	34.6	39.0

Key Company Financials
Period End: Dec

PKRbn	**CY16A**	**CY17E**	**CY18F**	**CY19F**
Total Revenue	20.6	18.2	21.2	23.7
Net Income	6.1	4.4	5.5	6.7
EPS (PKR)	5.8	4.2	5.2	6.4
DPS (PKR)	3.0	3.0	4.0	4.0
Total Assets	526.6	597.0	696.6	786.2
Total Equity	39.7	40.0	42.1	44.2
Key Financial Ratios				
ROE (%)	15.4	11.1	13.0	15.3
P/E (x)	5.8	8.0	6.5	5.3
P/B (x)	0.9	0.9	0.8	0.8
DY (%)	8.9	8.9	11.8	11.8

Relative Price Performance



Overweight **Cements**

Wounded… Not dead! Earnings to unlock after 2021

- **Performance:** Enjoying a market capitalization CAGR of ~+42%YoY for the last 3 years, the cement sector eventually fell from investors grace in CY17, marking a massive 50%YoY correction. Even though our coverage companies' earnings registered a mere 6%YoY attrition in FY17 as compared to FY16, major draw down in valuation stemmed from poor market sentiment overshadowing the sector as a whole. Concerns of a possible supply glut and apprehensions of price wars emerging from an industry wide expansionary cycle kept on bothering investor confidence. Further bad news surfaced in the shape of a) imposition of enhanced FED through Finance Act 2017-18, b) trimmed cement sales prices in the northern region due to rising competition by regional players in an effort to dominate market share; and c) elevated international coal prices.

Future Outlook:

- **Excess demand to emanate from under developed regions of Southern Punjab and Baluchistan:** With CPEC entering into its long term phase and Gwadar being the prime focus, we foresee gradual urbanization to trigger in the currently under-developed province of Baluchistan. Moreover, with Northern Punjab remaining the center of development for the last several decades, we expect a break out in this trend in the years to come with excess demand to emanate from Southern Punjab as well which has long been neglected and remains backward as compared to other regions of the country. With a record high budget allocated for Southern Punjab in the Provincial Budget 2017-18 and several infrastructure projects currently progressing in the region, we foresee ample demand to come along moving ahead. Additionally, upcoming hydel projects having combined capacities of ~6,000 MW will also add further impetus in demand.
- **Favorable interest rate environment and generous tax measures attracting capital investment:** Making optimal use of investor friendly interest rate environment and pro-business tax policies, the cement industry entered its third expansionary cycle. Accordingly, about 20mn fresh capacities are bound to enter the market in the next 4 years, with South taking 7.7mn tons and North taking 12.3mn tons share.

IGI Securities
SERVING YOU SINCE 1994

Overweight | **Cements**

- **Competition to keep prices in check… Incidental depreciation and finance cost to hamper earnings… Players with lower depreciation and finance cost per bag to fare high…** Although excess capacities and rising demand will enhance volumetric sales of industry players, however, their ability to dictate cement sales prices will be considerably marred thereby providing an ambient environment for the construction sector to boom. Additionally, major dent on earnings will stem from incidental depreciation and borrowing costs derived from expansion in which we foresee our coverage companies to increase their depreciation and borrowing costs by a 3Yr CAGR of 20% and 40% respectively. However, having said that, companies like LUCK, KOHC & ACPL having low depreciation and borrowing cost per bag due to negligible or lesser utilization of leverage and incurring rather economical capital expenditure with respect to expansions will emerge as cost leaders in this period.
- **Reduced taxes to support earnings while investment in power capacities to enhance efficiencies…** Currently, two attractive tax benefits are incidental to expansions which are a) 10% flat tax credit on cost of plant and machinery procured for expansion and; b) 5 years tax holiday on profits reaped on expansionary plants commissioned in the provinces of Baluchistan and KPK. Even though we assume both these tax benefits to be mutually exclusive, still we foresee considerable tax savings in the years from expansion with average 5Yrs effective tax rate clocking in at 21% as against otherwise applicable corporate tax rate of 30%. However, based on some non-clarity in tax laws, players like DGKC appear confident to avail both the above mentioned benefits jointly. We have not held this contingency in our projections on a safe side, however, does this hold true, this will generate further hefty tax savings. Additionally, investments made by players in power efficiencies is also expected to support margins going forward.
- **Coal prices to bottom out in the years to come… However will remain on higher side in the near term…** The Chinese government's intent to shift away from dirtier fuels like coal and petroleum in an effort to clean the air in its smog-choked cities is considered to draw down coal prices internationally. However, short supply of natural gas as an immediate alternate coupled with National Development & Reform Commission's decision to reduce number of coal mining days are to keep coal prices on the high side in the very near term.

Overweight | Cements

- **South players to have added advantage:** With demand to spring from Southern Punjab and Baluchistan and given incremental depreciation and finance cost to add burden to the existing cost structure for the next 3Yrs, we believe players expanding their capacity bases in South to be in a more favorable position due to a) close proximity towards port to reduce inward freight & transit insurance cost of coal, thereby providing excess cushion to extend their supply to far-fetched areas, b) ensuring higher market share in South market where all season sales are made as against North where poor weather in winter hinders sales for approximately two months, c) comparatively better retentions in South than North region, d) advantage of 5yrs tax holiday available through section 126L of the Income Tax Ordinance (ITO) for establishment of industrial undertaking in Baluchistan (Khyber Pakhtunkhwa as well) , e) geographically and economically better suited to cater demand in Southern Punjab and Baluchistan where highest demand is expected, and; f) providing additional option of exports via sea given political strained relations with Afghanistan & India.
- **Earnings to unlock after 2021… LUCK, ACPL, KOHC and PIOC being preferred picks…** With incidental depreciation and finance costs to keep sector earnings on check for the next 3 years, we believe sector earnings to resurface after 2021, when these costs are to subside eventually. Albeit, players like LUCK, ACPL and KOHC, having lowest depreciation and finance cost per bag, remain our preferred picks for CY18. We also have a liking on PIOC based on its attractive valuation and robust earning growth potential moving forward.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
CHCC	BUY	110.4	150.6	36.4	177	12.6	5.3	8.7	4.8	14%
LUCK	BUY	517.5	666.1	28.7	1,519	43.2	17.5	12.0	3.4	-8%
ACPL	BUY	185.0	358.2	93.6	192	28.5	14.5	6.5	7.8	1%
KOHC	BUY	139.4	270.1	93.8	195	22.9	10.0	6.1	7.2	1%
DGKC	BUY	133.2	189.3	42.1	529	21.9	9.0	6.1	6.8	-6%
MLCF	HOLD	70.8	77.7	9.8	339	9.2	3.5	7.7	4.9	3%
PIOC	BUY	63.6	134.2	111.1	131	8.7	3.5	7.3	5.5	14%
FCCL	BUY	25.9	29.0	12.1	324	2.4	1.0	10.8	3.9	10%
SECTOR					**3,406**			**8.8**	**4.7**	**-1%**

Overweight | Cements

Exhibit: Relative price performance of cement Sector against KSE-100 index

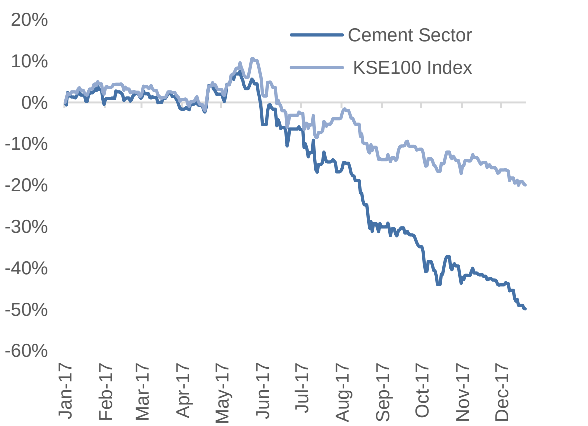


Exhibit: Month wise total dispatches

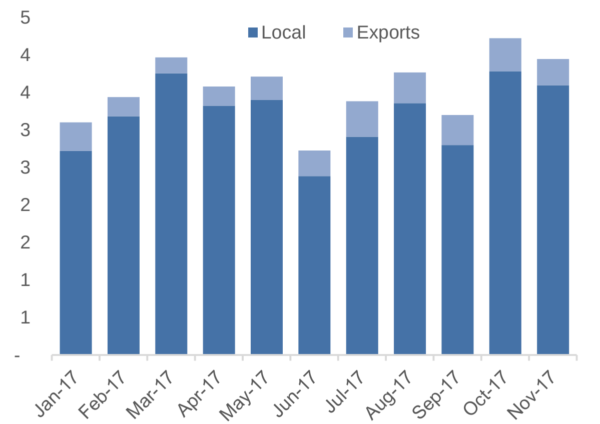


Exhibit: Coal and cement price growth since Jan-15

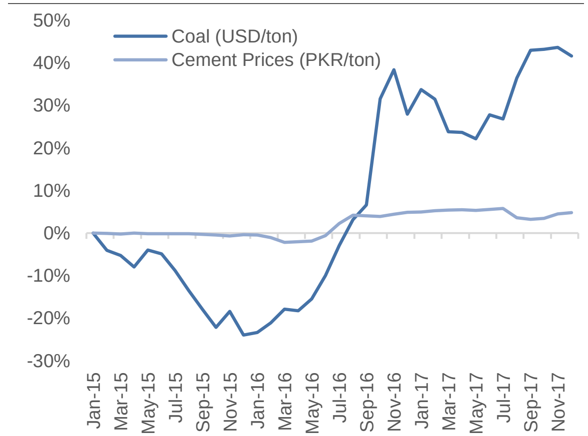
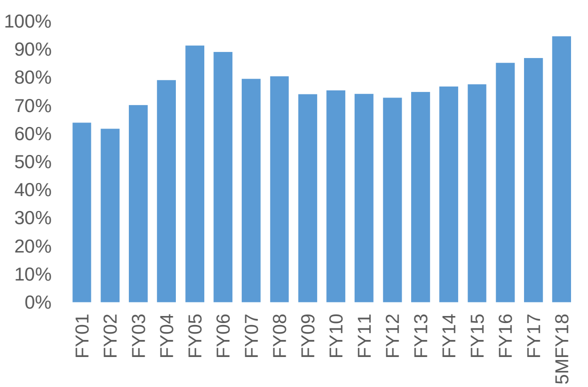


Exhibit: Historical Capacity Utilization



IGI Securities
SERVING YOU SINCE 1994

Overweight | **Attock Cement Pakistan Limited (ACPL)**

Geographical advantage and tax benefits to generate earnings growth

- **Economical plant and low debt to capital ratio to favor ACPL**: With an estimated cost of new plant of around PKR 13.5bn as against other players cost of PKR 25bn to PKR 35bn, ACPL's economic plant deployment will enable the company to be one of the lowest expansion cost allocators to its products. With depreciation and borrowing cost of PKR 23/bag, the company bags third position in the list of low cost producers of our coverage companies.
- **Brand loyalty and premium price of Falcon brand an added advantage**: Marketed under its flagship Falcon brand, ACPL has long enjoyed premium price of approximately 10% from other players in the market due to its high quality cement and high brand loyalty of its customers. Although standing third in the list of lowest cost producers, however, its ability to charge premium price on its sales products technically makes it the most advantageous company in the entire industry.
- **5 years tax holiday on new plants:** Expanding its capacity base in its province of origin, Baluchistan, the Company becomes eligible to claim 5 years tax holiday on profits reaped from its new plant as per section 126L of the Income Tax Ordinance. Accordingly, we foresee ACPL's effective tax rate to significantly reduce to 21% and ~15% for FY18 and FY19-22 respectively as against otherwise applicable corporate tax rate of 30%. Further, joint application of Section 65B of ITO providing 10% tax credit on plant and machinery commissioned in expansion plant remains a contingency, and does it hold true will present further tax efficiencies.
- **Going beyond borders to enhance earnings**: With the company engaged in commissioning a cement grinding mill in Iraq in order to cater the rising demands of the booming construction industry of the once war trodden country, ACPL appears fully equipped to enhance its shareholders wealth. The grinding mill expected to come online by Jun-18 will enable the company to capture higher margins available in Iraq along with a rising advantage of positive currency translation benefit.
- **Recommendation:** We recommend a **'BUY'** call on ACPL due to its attractive valuation with a Dec-18 target price of PKR 358/share, offering 93.6% upside.

Attock Cement Pakistan Limited
Cement

Recommendation		**BUY**
Target Price:		358.2
Last Closing:	28-Dec-17	185.0
Upside:		93.6
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

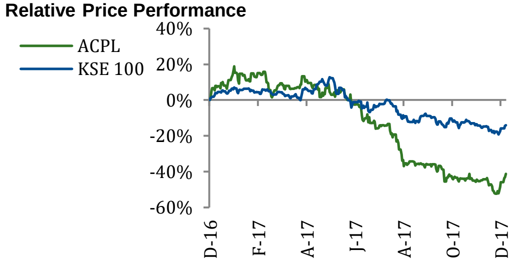
Bloomberg Tkr.		ACPL PA
Shares (mn)		114.5
Free Float Shares (mn)		22.9
Free Float Shares (%)		20.0%
Market Cap (PKRbn | USDmn)	21.2	191.4
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(8.4)	(38.9)	(42.0)
Lo	150.1	150.1	150.1
Hi	202.0	302.7	374.5

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	14.7	18.1	21.4	19.3
Net Income	3.0	3.3	3.8	3.1
EPS (PKR)	26.5	28.5	33.4	27.2
DPS (PKR)	13.5	14.5	16.5	16.5
Total Assets	20.7	24.1	23.5	22.7
Total Equity	11.9	13.6	15.5	16.7
Key Financial Ratios				
ROE (%)	25.4	24.1	24.7	18.7
P/E (x)	7.0	6.5	5.5	6.8
P/B (x)	1.8	1.6	1.4	1.3
DY (%)	7.3	7.8	8.9	8.9

Relative Price Performance



IGI Securities
SERVING YOU SINCE 1994

Overweight

Kohat Cement Company Limited (KOHC)

Operational efficiencies paving way towards success

- **Grinding mill to enhance volumetric sales**: KOHC has long been a victim of capacity underutilization largely accredited to its cement grinding mill bottle necks. With this issue expected to be resolved by 3QFY18 through commissioning of 0.8mn ton capacity grinding mill, we expect KOHC to enhance its volumetric sales. The existing ~70% capacity utilization provides ample space to do so. Additionally, we expect KOHC's exports towards Afghanistan to also rise marginally.
- **Credit lines established for new plant… Plant expected to come online by Dec-19:** Having already obtained necessary approvals from the concerned authorities, KOHC has finally established credit lines for its 2.34mn tons brownfield cement production plant. Accompanied by an 18MW Waste Heat Recovery (WHR) power plant, we expect the plant to come online by 2QFY20. Accordingly, we expect KOHC's market share to eventually surface at ~8% as against current share of ~5% once all the industry wide expansions have settled down. This will add around PKR 12/share/yr to the bottom line of the company after successful commissioning of plant.
- **Cash & cash equivalents piled up for upcoming expansion makes way for bare minimum debt financing**: Although the management has prudently stated that a maximum debt to capital ratio employed would be 40:60, however, given cement sectors strong cash flow generation strength and KOHC's already piled up cash and cash equivalents balance of more than PKR 6bn as of Sep-17 financial accounts, in excess of investment property worth more than PKR 4bn (estimated market value), KOHC appears all set to come up with its new plant with almost no additional debt.
- **Economical plant and low debt to capital ratio to favor KOHC:** With an estimated cost of new plant of around PKR 14bn as against other players cost of PKR 25bn to PKR 35bn, KOHC's economic plant deployment will enable the company to be one of the lowest expansion cost allocators to its products.
- **5 years tax holiday on new plants:** Since ITO 2017 has provided a timeline of Jun-19 to avail tax benefit as per section 126L we have cautiously not yet included this benefit for KOHC, given its expansion plant is to come online by Dec-19. However, as per historic precedence such benefits tend to extend beyond their original time line prescribed. Accordingly, does that become available in Dec0-19, KOHC will add further PKR 6.5/share /yr for the next five years to follow. Presently, we have only incorporated tax benefit of section 65B of ITO.
- **Recommendation:** Currently trading at a relatively modest trailing P/Ex of 6.2 and given a Dec-18 target price of PKR 270/share offering a 93.8% upside from its last close, we recommend a strong **'BUY'** over the scrip.

Kohat Cement Company Limited
Cement

Recommendation		**BUY**
Target Price:		270.1
Last Closing:	28-Dec-17	139.4
Upside:		93.8
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

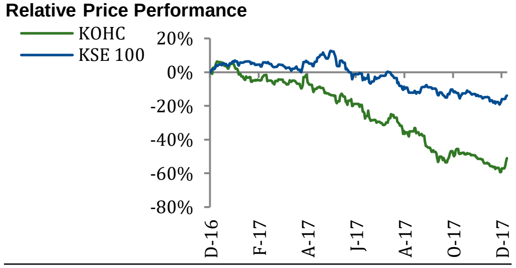
Bloomberg Tkr.		KOHC PA
Shares (mn)		154.5
Free Float Shares (mn)		46.4
Free Float Shares (%)		30.0%
Market Cap (PKRbn | USDmn)	21.5	194.6
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(7.0)	(39.2)	(50.7)
Lo	115.5	115.5	115.5
Hi	154.8	229.3	302.2

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	13.5	14.0	15.1	18.3
Net Income	3.5	3.5	3.4	3.6
EPS (PKR)	22.9	22.9	22.2	23.6
DPS (PKR)	14.0	10.0	9.0	12.0
Total Assets	20.2	22.2	25.9	28.9
Total Equity	15.3	17.3	19.3	21.1
Key Financial Ratios				
ROE (%)	23.2	20.4	17.7	17.2
P/E (x)	6.1	6.1	6.3	5.9
P/B (x)	1.4	1.2	1.1	1.0
DY (%)	10.0	7.2	6.5	8.6

Relative Price Performance



IGI Securities
SERVING YOU SINCE 1994

Overweight

Pioneer Cement Limited (PIOC)

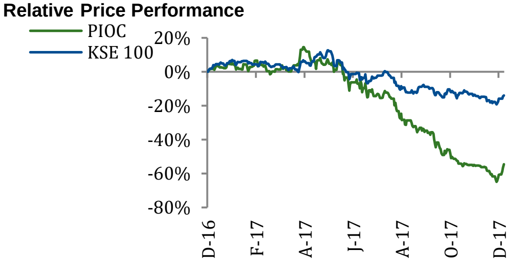
Wrongly hammered out!!!

- **Grinding mill to enhance volumetric sales**: Similar to KOHC, PIOC has also been facing severe capacity underutilization issues stemming from its cement grinding mill bottle necks. With this issue expected to be resolved by 3QFY18 through commissioning of new capacity grinding mill, PIOC appears all set to enhance its total dispatches. Moreover, the present unutilized capacity of around ~25% provides ample room for capturing rising domestic demand.
- **2.5mn tons per annum expansion plant to come online by Dec-19… To provide earnings accretion of PKR ~14/share:** With letters of credits established, PIOC's 2.5mn tons per annum expansion plant is scheduled to come online by Jun-19. Accordingly, we expect PIOC's market share to rise from its present ~4% mark to enhanced levels of ~7% once all the industry wide expansions have settled down. This will add on average PKR ~14/share/yr to the bottom line of the company after successful commissioning of plant.
- **Investment in 24MW coal captive power plant to generate earnings upside of PKR ~4/share**: Along with its expansionary cement plant, PIOC is also engaged in commissioning a 24MW coal based captive power plant (CPP). With coal being the cheapest non-renewable fuel in sourcing power, we expect significant power efficiencies to play in favor of the Company. Accordingly, we expect the CPP to draw incremental earnings of PKR ~4/share/yr after successful commissioning.
- **Possible entry in South region:** Only recently, PIOC entered into a non-binding memorandum of understanding with the sponsors of Galadari Cement (Gulf) Limited for possible acquisition. Since no contractual agreement has been entered into by now, we have not yet incorporated this factor in our forecasts. However, does it materialize, PIOC will establish a significant footprint in the South market enabling it to further reduce its costs and enhance geographical market share.
- **Short term investment in equity mutual funds to subdue FY18 earnings… However, recovery will generate excess returns in FY19…** Having exposure of PKR ~2.5bn in equity mutual funds, the Company has already reported loss of PKR~100mn as of Sep-17. With this loss as of now accumulated to PKR~200mn due to weak capital market performance, we expect PIOC to end up with a total loss of PKR 400mn by end of FY18. This will reduce FY18 expected earnings to PKR 8.67/share. However, with our belief of strong comeback of the capital market, we expect healthy gains to accrue in FY19 coupled with reduced capital gains tax liability due to compliance of minimum holding period.
- **Recommendation:** Currently trading at a very inexpensive trailing P/E of 5.5x and given a Dec-18 target price of PKR 134/share offering a 111.1% upside from its last close, we recommend a strong **'BUY'** over the scrip.

Pioneer Cement Limited
Cement

Recommendation				**BUY**
Target Price:				134.2
Last Closing:	28-Dec-17			63.6
Upside:				111.1
Valuation Methodology:				Discounted Cash Flow (DCF)
Time Horizon:				Dec-18
Market Data				
Bloomberg Tkr.				PIOC PA
Shares (mn)				227.1
Free Float Shares (mn)				124.9
Free Float Shares (%)				55.0%
Market Cap (PKRbn | USDmn)			14.4	130.5
Exchange				KSE 100
Price Info.		90D	180D	365D
Abs. Return		(29.3)	(51.1)	(54.7)
Lo		48.9	48.9	48.9
Hi		89.9	132.3	160.0
Key Company Financials				
Period End: Jun				
PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	10.6	10.6	11.8	13.1
Net Income	2.9	2.0	2.6	4.3
EPS (PKR)	12.8	8.7	11.7	19.0
DPS (PKR)	5.5	3.5	4.8	7.8
Total Assets	17.8	24.1	35.6	40.0
Total Equity	12.2	13.4	15.0	17.5
Key Financial Ratios				
ROE (%)	23.8	14.7	17.7	24.5
P/E (x)	5.0	7.3	5.5	3.4
P/B (x)	1.2	1.1	1.0	0.8
DY (%)	8.7	5.5	7.5	12.2

Relative Price Performance



Overweight | **Lucky Cement Limited (LUCK)**

Lowest cost producer to be the LUCKiest in tough times ahead

- **Cheapest plant and No debt policy will keep LUCK at the most advantageous position:** With an estimated cost of new plant of around PKR 3.5bn which is the most economical in the entire industry and given the company's no debt policy, LUCK stands out as the most advantageous company from the lot. With a depreciation and finance cost per bag of PKR ~17/ bag, LUCK is expected to maintain its cost leader position in the years to come which will help the company in possible price wars enabling it to supply in far-fetched areas.
- **Portfolio of all sorts available in the price of cements:** Over the years Lucky Cement Limited has diversified itself into many other different business avenues as well, namely chemicals, polyester, soda ash, life sciences, power and most recently automobile assembly. Keeping KIA Lucky Motors Limited (KIA) a direct subsidiary of the Company as against other companies in the past which have been technically kept as indirect subsidiaries, dividend income from KIA will also add to the healthy bottom line of the standalone P&L of the company. With the current market underweight position of cements, the entire portfolio appears mispriced and has become available on the P/E of cement sector providing investors opportunity to take long positions in order to earn alpha returns.
- **Dominant South player**: As previously mentioned, companies located in south would remain in further advantageous position as against players in North due to their ability to save transportation cost in obtaining coal as well as in supply of cement in different regions of the country, LUCK's decision to enhance its capacity base in South will fare well for its earnings.
- **Recommendation:** We recommend a **'BUY'** call on LUCK due to its attractive valuation with a Dec-18 target price of PKR 666/share, offering 28.7% upside.

Lucky Cement Limited
Cement

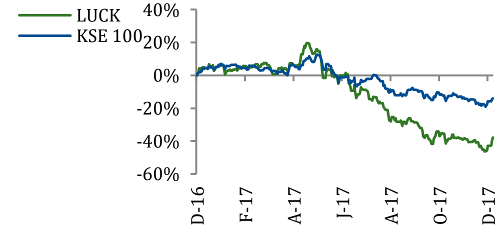
Recommendation		**BUY**
Target Price:		666.1
Last Closing:	28-Dec-17	517.5
Upside:		28.7
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data			
Bloomberg Tkr.			LUCK PA
Shares (mn)			323.4
Free Float Shares (mn)			129.4
Free Float Shares (%)			40.0%
Market Cap (PKRbn | USDmn)		167.3	1,511.7
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	(8.4)	(38.1)	(38.4)
Lo	445.8	445.8	445.8
Hi	565.2	836.3	994.7

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	45.7	51.8	53.4	48.8
Net Income	13.7	14.0	12.7	10.5
EPS (PKR)	42.3	43.2	39.4	32.5
DPS (PKR)	12.0	17.5	16.0	13.5
Total Assets	97.3	108.2	115.5	120.0
Total Equity	79.8	88.1	95.7	101.8
Key Financial Ratios				
ROE (%)	17.2	15.9	13.3	10.3
P/E (x)	12.2	12.0	13.1	15.9
P/B (x)	2.1	1.9	1.7	1.6
DY (%)	2.3	3.4	3.1	2.6

Relative Price Performance



Overweight | **Oil & Gas Marketing Companies**

Down but not out! Retail segment to overshadow depressed FO sales

Exhibit: OMC Sector Profitability up by +29%YoY in CY17TD

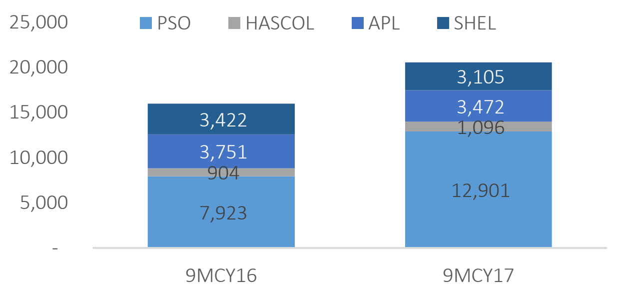


Exhibit: Total Sales Volumes

mn Mtons	CY16TD	CY17TD	FY17TD	FY18TD
PSO	13.13	13.09	6.20	6.32
APL	1.69	1.99	0.83	0.90
HASCOL	1.66	2.44	0.80	1.21
SHEL	2.20	1.81	1.00	0.66
Total	**18.68**	**19.33**	**8.83**	**9.08**

- **CY17TD Sector profitability grew by +29%YoY while market cap declined by 30%:** IGI OMC sector under-performed KSE-100 by 10% posting a negative return of 30% in CY17TD as compared to 20% for benchmark index. Overall sector profitability increased substantially by +29%YoY in CY17TD, led by a 3%YoY increase in total volumes and +8.0% increase in FO prices. PSO/HASCOL earnings augmented by +63%/+21%YoY in CY17TD, while APL/SHEL profitability dropped by 7%/9%YoY.
- **IGI OMC Universe's total sales grew by +3.5%YoY in CY17TD:** IGI OMC universe total sales grew by +3.5%YoY in CY17TD to 19.3mn Mton as compared to 18.7mn Mton in the same period last year. Volumes growth was primarily led by +47%/+18%YoY increase in sales to 2.4mn/2.0mn Mton for HASCOL/APL. However, SHEL posted highest decline of 18%YoY to 1.8mn Mtons. Similarly, in FY18TD HASCOL/APL/PSO posted a growth of +52%/+8%/+2%YoY growth while SHEL's sales declined by 35%YoY.
- **MS and HSD posted highest growth in CY17TD:** MS and HSD contribute nearly 59% of the total OMC sales in Pakistan. In CY17TD, MS posted +13%YoY rise in volumes led by +68%/15%/+12%YoY increase in HASCOL/APL/PSO. HSD sales increased by +4%YoY led by +65%/+24%YoY incline in HASCOL/APL sales, while PSO/SHEL posted a decline in HSD sales of 4%/22%YoY in CY17TD.
- **FO sales plummet on closure of FO based power plants:** FO sales are down by 3%YoY in CY17TD to 7.4mn Mtons primarily owing to lower generation by FO based power plants. APL/HASCOL posted a +4%/+13%YoY increase in sales while SHEL/PSO registered a decline of 62%/5%YoY in CY17TD. In Nov-17 alone, FO sales are down by 56%MoM to 0.4mn Mtons.

Exhibit: IGI Universe MS Sales

mn Mtons	CY16TD	CY17TD	FY17TD	FY18TD
PSO	2.34	2.61	1.13	1.32
APL	0.47	0.54	0.24	0.25
HASCOL	0.48	0.81	0.23	0.40
SHEL	1.02	0.90	0.47	0.37
Total	**4.31**	**4.86**	**2.06**	**2.35**

Exhibit: IGI Universe HSD Sales

mn Mtons	CY16TD	CY17TD	FY17TD	FY18TD
PSO	3.71	3.55	1.68	1.78
APL	0.64	0.80	0.31	0.35
HASCOL	0.66	1.09	0.31	0.56
SHEL	0.97	0.75	0.42	0.25
Total	**5.97**	**6.18**	**2.73**	**2.93**

Exhibit: IGI Universe FO Sales

mn Mtons	CY16TD	CY17TD	FY17TD	FY18TD
PSO	6.47	6.17	3.10	2.85
APL	0.54	0.61	0.27	0.27
HASCOL	0.52	0.54	0.25	0.25
SHEL	0.07	0.02	0.04	0.00
Total	**7.60**	**7.35**	**3.65**	**3.37**

Overweight | **Oil & Gas Marketing Companies**

Impact of closure on FO based power plants

Exhibit: FO Sales-(local and imported)

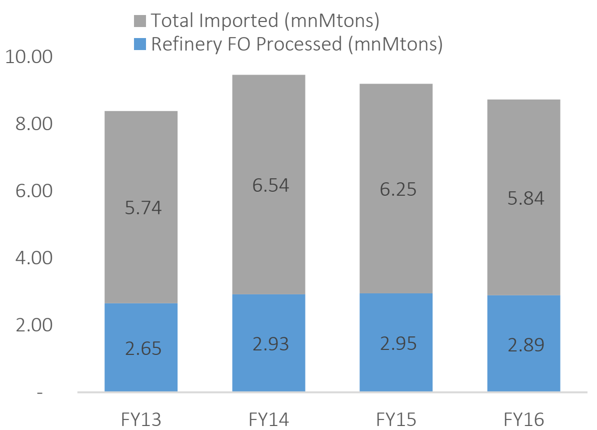
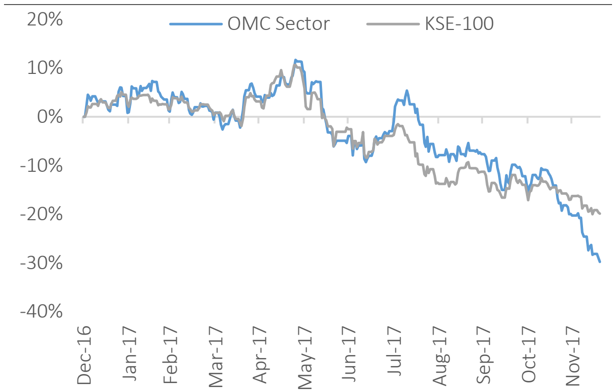


Exhibit: OMC sector relative price performance in CY17TD



- **Brief background on FO in Pakistan:** Pakistan consumes nearly 9.0-9.4mn Mtons of FO yearly wherein power sector utilized nearly ~85% in power sector (83% in FY16). The rest is utilized by industries and in transport. Out of 9.0-9.4mn Mtons consumed, refineries produce nearly 30%-33% while the remaining is imported by PSO.
- **Decision to close FO based power plants:** The recent decision by government to close down Furnace Oil (FO) based Independent Power Producers (IPPs) as a way to improve country's widening external account imbalances and lower the cost of power. The decision led to closure of 4,000MW of FO based power plant out of 6,129MW while efficient IPPs are still operating at low load factor but utilizing imported FO rather than produced by refineries.
- **FO sales plummet on closure of FO based power plants:** FO sales are down by 3%YoY in CY17TD to 7.4mn Mtons primarily owing to lower generation by FO based power plants. APL/HASCOL posted a +4%/+13%YoY increase in sales while SHEL/PSO registered a decline of 62%/5%YoY in CY17TD. In Nov-17 alone, FO sales are down by 56%MoM to 0.4mn Mtons.
- **OMCs likely to retain 3.1-3.5mn Mtons of FO sale: :** Local refineries process nearly 3.1mn Mtons of FO which in our view will be utilized locally by running 1,000-1,600MW of efficient FO power plants. As a result, total FO consumption is expected to come down from current 9.4mn Mtons in FY17 to 3.1-3.5mn Mtons annually. As a result, we expect OMCs to retain nearly 3.1-3.5mn Mtons of FO which is expected to be utilized by 1,000-1,600MW of efficient FO power plants.

Exhibit: PSO held lion's share in FO sales

mn Mtons	FY14	FY15	FY16	FY17
PSO	6.90	6.11	6.29	6.96
APL	0.90	1.00	0.61	0.65
HASCOL	0.32	0.53	0.49	0.60
SHEL	0.06	0.07	0.06	0.07
Others	1.26	1.38	1.29	1.12
Total FO sales	**9.43**	**9.10**	**8.73**	**9.40**

Overweight | **Oil & Gas Marketing Companies**

Focus shifted towards retail segment in recent years

Exhibit: MS/HSD contribution in total sales mix increased in last few years - mnMtons

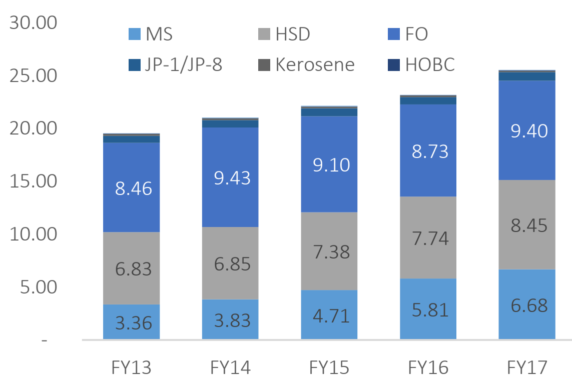


Exhibit: PSO gaining traction while APL/HASCOL maintain strong retail presence - mnMtons

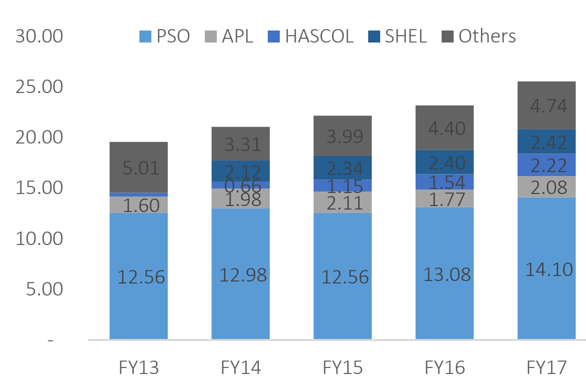


Exhibit: MS Market share

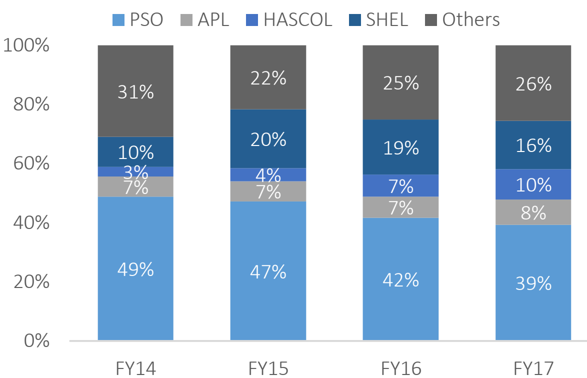


Exhibit: HSD market share company wise

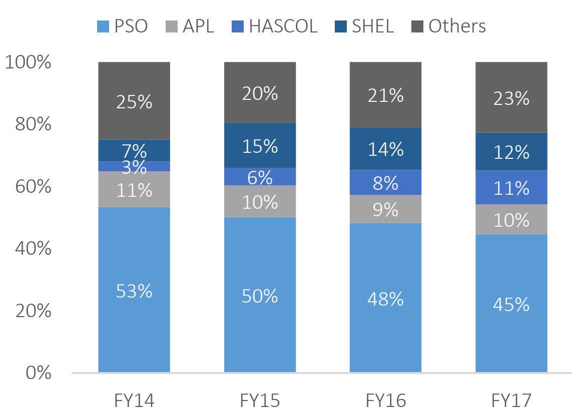
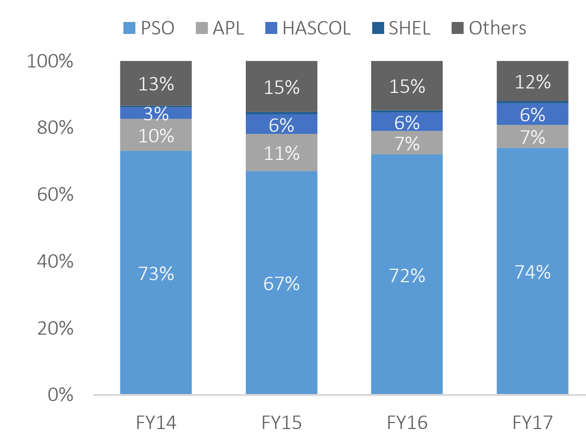


Exhibit: PSO held lion's share in FO sales



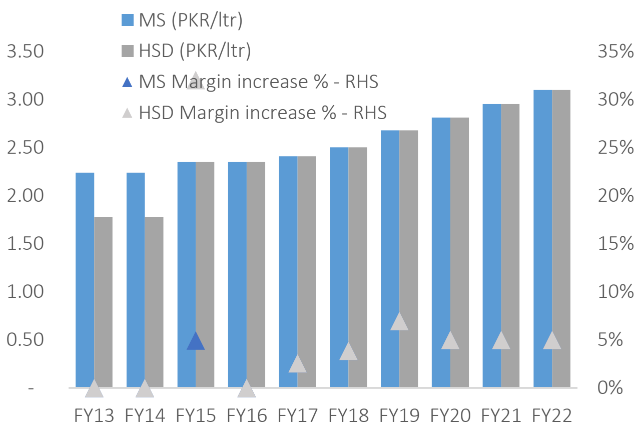
IGI Securities
SERVING YOU SINCE 1994

Overweight | **Oil & Gas Marketing Companies**

Annual margin revision and retail segment backbone to earnings growth; PSO top pick

- **Annual margin revision linked with CPI:** For OMCs annual margin increase on MS is linked with CPI while for HSD OMCs will now set their margins due to recent deregulation of OMC/dealer margin. However, we expect due to high competition, HSD margins will remain parallel to MS margin. Previously OMC margins were revised on when needed basis, whereas now margins will be revised annually in line with CPI inflation. For every 1% increase in MS/HSD margins, PSO/APL/HASCOL/SHEL's earning would augment by 1.2%/0.6%/2.9%/3.9% in CY18/FY19.
- **Industry volumes growth to remain stagnant amid decline in FO sales:** We estimate total industry volumes to grow at 5yr CAGR of +0.3% amid decline in FO sales. We expect MS/HSD sales to remain robust going forward on the back of increasing automobile sales posting a 5yr CAGR of +10%/+5% over FY18-22F. For MS, HASCOL is expected to post above industry growth of 13% on average while PSO/APL and SHEL to post industry growth. For HSD PSO is expected to lead with 5yr CAGR of 7% in sales while HASCOL/APL/SHEL to remain in line with industry growth of +5%.
- **FO sales to drop to 3.1-3.5mn Mtons:** We expect FO sales to drop to 3.1-3.5mn Mtons in order to utilize refineries offtake. We expect PSO to retain 2.2-2.5mn Mtons of FO sales owing to supply to Hub plant and other efficient FO based IPPs. Whereas for APL we expect FO sales to remain between 0.4-0.5mn Mtons owing to supply to Attock Gen power plant. However, HASCOL FO sales may drop as captive power plant would likely switch to grid for cheaper power cost.

Exhibit: MS and HSD historical margins PKR/ltr



Overweight | **Oil & Gas Marketing Companies**

Annual margin revision and retail segment backbone to earnings growth; PSO top pick

Exhibit: IGI OMC Universe FY/CY18F P/E and Dividend Yield

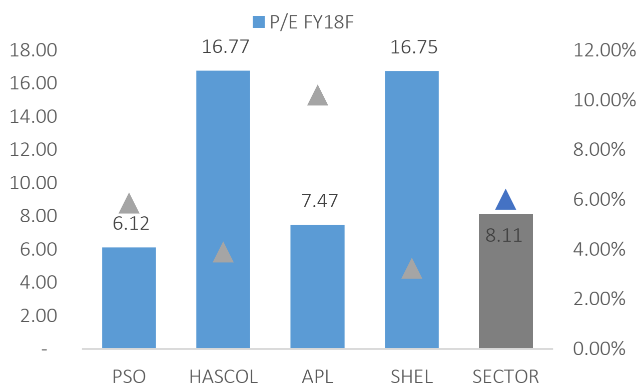
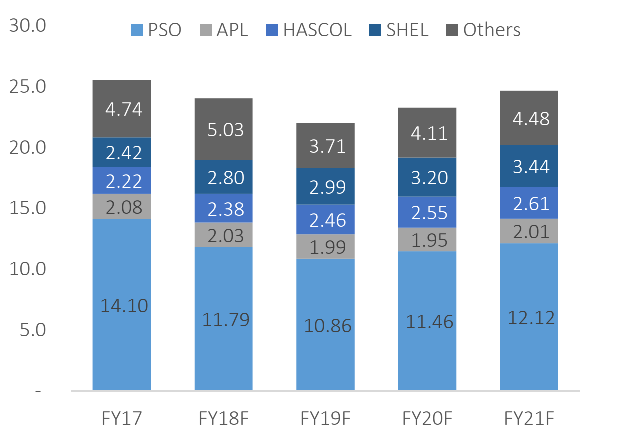


Exhibit: Forecasted industry sales company wise - mn Mtons



- **PKR devaluation:** Although PKR devaluation is expected to erode earnings for OMCs, we opine the impact to remain restricted to 4QCY17. However, any further depreciation if witnessed gradually over the next 6 months would have a minimal impact.
- **PSO and APL as our top pick:** We highlight PSO as our top picks with our Dec-18 Target Price of PKR 385/share providing 28% upside from its last close. PSO is currently trading at FY18F P/E of 6.3x. We also have a 'BUY' call on APL with our Dec-18 Target Price of PKR 677/share offering 30% upside from its last close. The company is currently trading at FY18E P/E of 8.5x. Although loss of FO income looms over APL upon permanent closure of Attock Gen, however APL offers a healthy dividend yield of 9.6%.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
PSO	BUY	300.3	385.2	28.3	888	47.4	17.0	6.3	5.7	-6%
HASCOL	BUY	245.5	304.6	24.1	323	13.7	9.0	17.9	3.7	26%
APL	BUY	521.4	677.1	29.9	392	61.5	48.0	8.5	9.2	2%
SHEL	BUY	307.9	429.9	39.6	299	18.4	10.0	16.8	3.2	-1%
SECTOR					**1,902**			**8.6**	**5.7**	**-1%**

Source: IGI Research, PSX

Overweight

Pakistan State Oil Company Limited (PSO)

Lower FO sales may churn out improved cash cycle; Unlocking valuations!

- **PSO likely to retain 2.2-2.5mn Mtons of FO sales:** PSO sold nearly 6.9mn Mtons of FO compared to total of 9.4mn Mtons in Pakistan. This comes to a market share of 74% while FO sales contributed nearly PKR 20-22/share in company's profitability. We expect PSO to retain 2.2-2.5mn Mtons of FO sales contributing PKR 7.3/share in PSO's earnings.
- **Improving cash cycle to ease cash constraints:** As circular debt has crossed PKR 450bn and PSO's receivables exceeding PKR 300bn, FO sales remained prime source behind accumulating receivables (FO sales contributes 87% of total receivables). Once FO sales are reduced (49% of total PSO's sales in FY17) to 22% of total sales by FY19, we expect cash cycle to improve as MS and HSD (45% of total sales) are solely sold on cash based transactions. As a result PSO's is expected to reduce reliance on short term borrowings and post positive CFOs (negative PKR 21bn CFO is FY17). Payments of outstanding dues of PKR 181bn would further improve cash position for future expansions in retail segment. Upon payment of outstanding dues, we expect PSO's P/E multiple to re-rate which due to circular debt has traded at a discount of 28% to market P/E over last 5 years. However, in FY14 when incumbent Government settled PSO's receivables, the company's P/E increased to 16x in FY15 (at a premium of 35% to market P/E). Accumulation of circular debt on LNG remains negligible owing to transaction backed by Letter of Credit (LC).
- **MS, HSD and JP-1/JP-8 to drive volumes:** PSO total volumes are expected to decline by nearly 16%YoY in FY18 owing to 42%YoY decline in FO volumes to settle at 2.5mn Mtons from FY18 onwards, however decline in volumes is estimated to be mitigated by +13%/+5%/+9%YoY increase in MS/HSD/JP 1-8 sales. During FY18-22 MS and HSD sales are expected to increase at 5yr CAGR of +9% and +5%, respectively.
- **LNG contract may likely remain with PSO:** PSO is currently importing 450-500mmcfd of LNG which contributes nearly PKR 7.3/share in company's earning. Although LNG import contract will eventually shift from PSO to Pakistan PNG Terminals, but due to delay of more than 1 year and GoP encouraging local industries to enter in to LNG import business, we believe PSO may likely retain LNG import contract.
- **Recommendation:** We maintain a **'BUY'** call on PSO with our Dec-18 Target Price of PKR 385/share offering 28.3% upside from its last close. The company is currently trading at FY18F P/E of 6.3x.

Pakistan State Oil Company Limited
Oil & Gas Marketing Companies

Recommendation		**BUY**
Target Price:		385.2
Last Closing:	28-Dec-17	300.3
Upside:		28.3
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

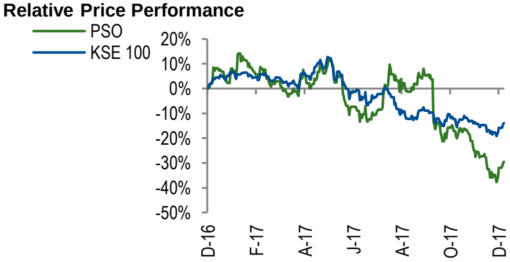
Market Data		
Bloomberg Tkr.		PSO PA
Shares (mn)		326.0
Free Float Shares (mn)		146.7
Free Float Shares (%)		45.0%
Market Cap (PKRbn | USDmn)	97.9	884.4
Exchange		KSE 100

Price Info.	**90D**	**180D**	**365D**
Abs. Return	(32.0)	(22.5)	(30.1)
Lo	265.2	265.2	265.2
Hi	441.8	466.6	486.1

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	878.1	779.7	807.7	892.3
Net Income	18.2	15.4	13.6	15.4
EPS (PKR)	55.9	47.4	41.7	47.2
DPS (PKR)	25.0	17.0	15.0	17.0
Total Assets	392.4	336.3	324.6	307.3
Total Equity	102.8	113.3	122.0	131.8
Key Financial Ratios				
ROE (%)	17.7	13.6	11.1	11.7
P/E (x)	5.4	6.3	7.2	6.4
P/B (x)	1.0	0.9	0.8	0.7
DY (%)	8.3	5.7	5.0	5.7

Relative Price Performance



December 29, 2017

Overweight | **Pakistan State Oil Company Limited (PSO)**

Lower FO sales may churn out improved cash cycle; Unlocking valuations!

Exhibit:

PSO Sensitivity to FO sales

PKR	FY18F	FY19F	FY20F	FY21F
Base case assumption				
FO Sales (mn Mtons)	4.00	2.50	2.50	2.50
Cash flow from operations (PKRbn)	38.72	36.05	38.46	39.08
EPS	47.37	41.67	47.17	52.93
Target Price (PKR/share)	**385.18**			
Case-1: FO sales of 2.0mn Mtons				
FO Sales (mn Mtons)	3.50	2.00	2.00	2.00
Cash flow from operations (PKRbn)	40.44	35.56	37.22	37.89
EPS	45.91	40.13	45.57	51.26
Change in EPS (%)	*-3%*	*-4%*	*-3%*	*-3%*
Case-2: FO sales of 3.0mn Mtons				
FO Sales (mn Mtons)	4.50	3.00	3.00	3.00
Cash flow from operations (PKRbn)	30.56	32.04	27.28	25.20
EPS	49.07	43.66	49.76	56.43
Change in EPS (%)	*4%*	*5%*	*5%*	*7%*

Exhibit: Cash flows cash cycle improved every time receivables decline

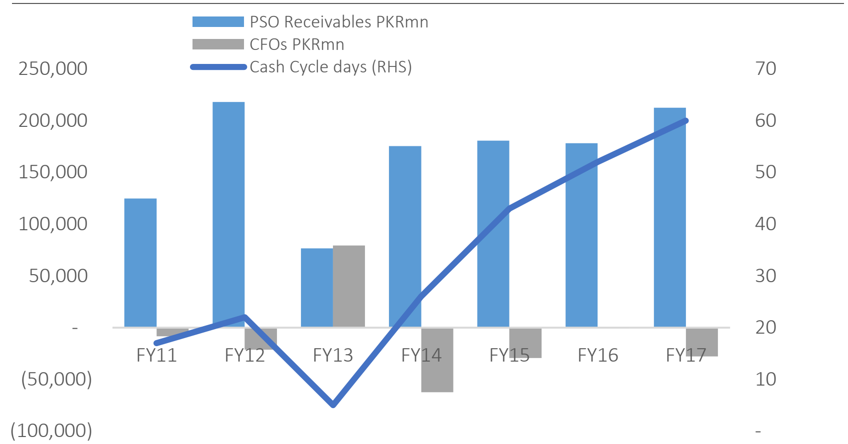
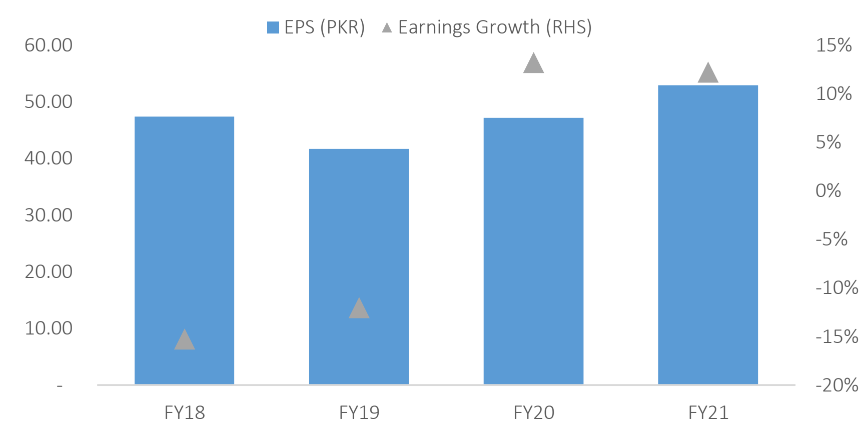


Exhibit: PSO earnings to pick up post FY19F



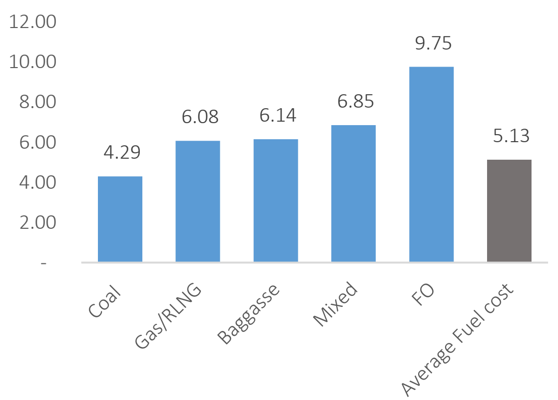
Marketweight | **Independent Power Producers**

Out with the old & in with the new – LNG/Coal generation takes center stage

Exhibit: New power projects

	Gross Capacity (MW)
2017	6,858
2018	2,503
2019	2,505
2020	1,980
2021	3,330
2022	870
2023	-
2024	2,312
2025	998
Total	21,356
Under Assessment	1,281
Total	**22,637**
2016 Capacity	**23,270**

Exhibit: Source wise fuel cost – PKR/KWH



- **FY17: Sector turnaround underway; FO based generation declines:** Pakistan's power sector is on the cusp of a turnaround as furnace oil (FO) based generation is phased out on war footing to curb reliance on expensive fuels. We perceive the recent shut down of 8 Residual Furnace Oil (RFO) based IPPs (during seasonally lower demand) is not an isolated event as new, less costly, LNG/coal based plants come online. Although materialization hinges on reforms within the transmission network, this is a dedicated effort by the Government to reduce import bill which has ballooned to PKR 21.9bn in 5MFY18. While this may not alleviate circular debt buildup (currently PKR 480bn), as reliance on imports is an unavoidable eventuality, it may allow for higher liquidity for certain IPPs with viscous working capital lines (namely: NCPL & NPL).
- **Surplus electricity here to stay?** Pakistan is expected to add 9,100MW of new coal and RLNG power plants by CY19 taking overall nameplate capacity to 38,500MW (Oct'17: 29,400MW). Annual power consumption by CY19 should reach ~17,000MW (~20,000MW in peak hours) resulting in 17,573MW surplus generation, last seen in 2003. Against this backdrop, NTDC's Merit Order Dispatch list will favor efficient and cheaper energy (LNG/coal and hydel when seasonally).
- **Cost of generation to come off as reliance on FO drops…** Pakistan's current weighted average consumer tariff stands at PKR 10/Kwh (after accounting for certain new additions in CY17). This is likely to go down as low as PKR 8.0/Kwh by CY19 as reliance on coal/LNG generation rises. We take cue from fuel cost/Kwh for coal which stands at PKR 4.29/Kwh and PKR 6.0/Kwh for LNG compared to PKR 9.8/Kwh for FO.
- **…however, 1,000MW FO generation essential for smooth refining operations:** Pakistan's refineries produce 3.1mn Mtons of FO which produces ~1,000-1,300MW of electricity based on ~38-40% efficiency. It is essential for this FO production to be utilized in order to produce ancillary by-products of POL. Otherwise the gap would be required to be bridged through imports which may not be viable as it would defeat the purpose of reducing import burden.

Marketweight | **Independent Power Producers**

Power sector underperforms KSE-100 on dividend cuts

Exhibit: Pakistan's total consumption and generation historically (MW)

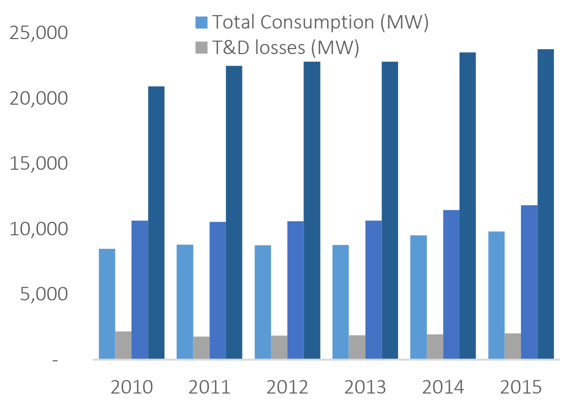


Exhibit: IPP sector relative price performance in CY17TD

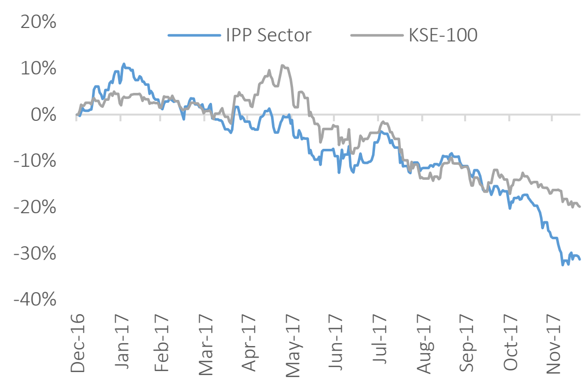


Exhibit: Contribution in composition of Pakistan total generation capacity fuel wise

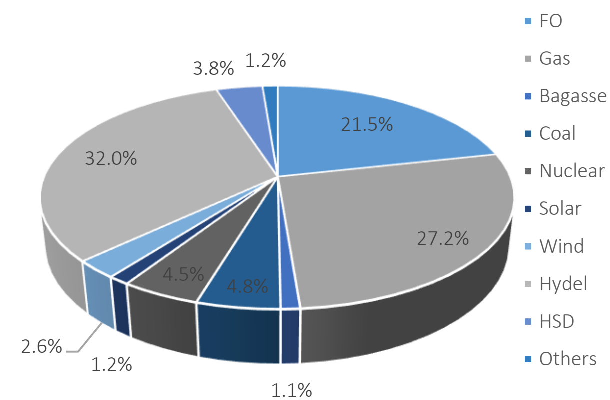
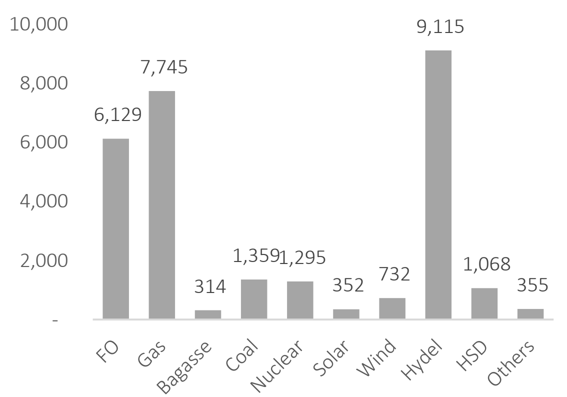


Exhibit: Pakistan generation capacity (MW)

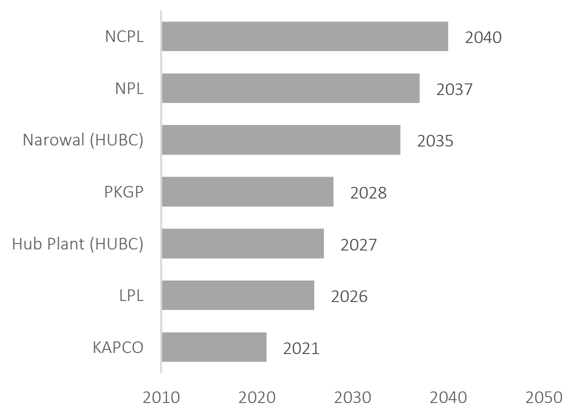


Marketweight | **Independent Power Producers**

FO based IPPs to feel the pinch as offtake squeezes

- **Power Purchase Agreement (PPA) extension for certain FO players now seems unlikely…** Among the listed space, KAPCO is facing the earliest PPA expiry (by FY21) which was expected to receive a 10-year extension. However, under the current climate, chances of materialization seem slim.
- **… however capacity payments may keep the boat from tipping:** The matter may not be as intense for certain FO players as Capacity Purchase (CPP) payments (ROE+Fixed Costs) to IPPs are paid irrespective of dispatch. IPPs with significant reliance on CPP would emerge victorious while those with reliance on fuel/O&M savings would take a hit and resort to reduction in payout. Consequently, among the listed players, we see limited impact on HUBC's earnings, notwithstanding drop in generation bonus (EPS impact: PKR 0.1/share) paid above 65% load factor. NCPL/NPL therefore would lose due to historically high efficiency gains while inefficient plants like LPL and PKGP will begin looking attractive on yield.
- **Listed IPPs will feel the pinch as offtake squeezes:** Inefficient IPPs (PKGP, LPL) will likely be shut down after FY18, which given fuel loss issues, is positive for earnings in the event they receive timely capacity payments. HUBC's base plant and KAPCO's FO based units will see declining offtake while its LNG turbines may yet still be utilized. As offtake drops, NPL & NCPL will likely witness drop in fuel and O&M savings which contributes a major chunk of their dividends (PKR 2.0/share sustainable in worst case).

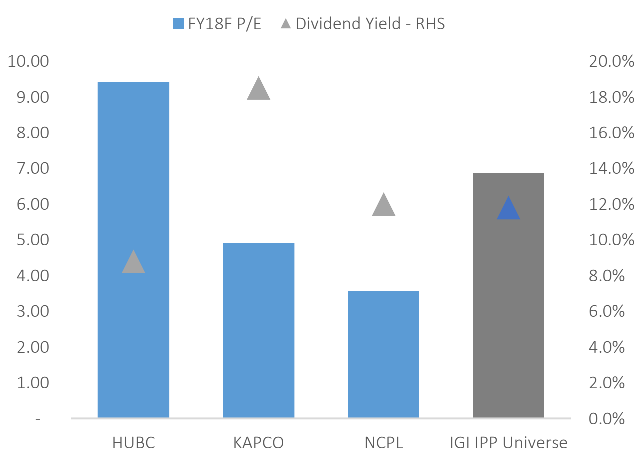
Exhibit: PPA Expiration of RFO based listed IPPs



Marketweight | **Independent Power Producers**

FO based IPPs to feel the pinch as offtake squeezes

Exhibit: IGI IPP Universe FY18F p/E and DY



- **Rupee devaluation is a silver lining:** Recent 4.5%CYTD rupee depreciation vs. the USD is net positive for Pakistan IPPs which have a dollar denominated return structure. Moreover with SBP Governor not ruling out further slippage, uptick in absolute ROE stands as key upside risk.
- **Yields at risk as payout drops:** IPPs in the IGI Universe trade at a FY18 P/E of 7.0x and offer a D/Y of 11.7 %. While HUBC does not face any immediate risks to dividends, (having guaranteed quarterly DPS: PKR 1.5/share), the same cannot be said for Nishat IPPs which have curtailed dividends since 2QFY17. IGI IPPs universe in CY17TD has shed 31.3% against negative return of 19.9% for benchmark index underperforming by 11.4%. We prefer HUBC with a Target Price of PKR133/share, BUY.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
HUBC	BUY	91.8	133.3	45.3	963	9.7	8.0	9.5	8.7	17%
KAPCO	BUY	54.9	72.5	32.1	438	11.0	10.0	5.0	18.2	7%
NCPL	HOLD	31.4	32.0	1.8	105	8.1	3.5	3.9	11.1	4%
SECTOR					**1,507**			**7.0**	**11.7**	**11%**

Source: IGI Research, PSX

IGI Securities
SERVING YOU SINCE 1994

Overweight | **The Hub Power Company Limited (HUBC)**

Risks are priced in- Still the best hedge to Pakistan's energy upcycle

- **HUBC- Still the safest bet :** HUBC, the second largest power producer in Pakistan has historically contributed +7% to total generation of the country. Recent decision to phase out FO based power plants is not likely to pose a major risk to cash flows given significant reliance on CPP payments for the base plant (1200MW) which are received irrespective of dispatch. That said, we have trimmed our FY18 dispatch levels from HUBC's base plant to 45%, sustainable over the life of the plant, while expecting Narowal to remain shut FY18 onwards. HUBC will likely forgo a) generation bonus (PKR 0.1/share) from base plant and b) suffer lower earnings contribution from Narowal.
- **Dividend lifecycle to be unhindered by industry noise:** With marginal downside risk, despite headwinds from Narowal, HUBC is an ideal defensive play with dividend lifecycle to stretch to FY50. The name provides an ideal hedge within the energy space given exposure to both hydel and coal while being relatively immune to the ongoing industry noise. HUBC's 49% owned subsidiary; CPHGCL is expected to achieve commercial operations by FY21, while its 330MW mine mouth coal project TEL by mid 2020. Dividends from these projects will help sustain dividend payout in the long run.
- **China Power Hub Generation Company Limited (CPHGCL) and Thar Energy Limited (TEL) to ensure LT sustainability:** Based on HUBC's 49% stake in CPHGCL (CPIH 51% stake), the project is expected to add PKR 37/share to HUBC's valuation and will lift dividends by PKR 3.0- 4.0/share from FY20 onwards. The project offers a US$ denominated IRR of 17% (HUBC's IRR: 12%). Being part of CPEC's priority projects, it will likely witness smooth construction and operations. The project will lend a longer life to the company (until 2050), especially as the base plant's PPA expires in 2021 and Laraib (though small) will run till 2035. Additionally HUBC's 60% exposure in 330MW coal mine-mouth power plant TEL also contributes PKR 5.2/share to HUBC's existing valuation.
- **Recommendation:** Despite downward revision in earnings, HUBC still trades at an FY18F P/E of 9.5x and offers a dividend yield of 8.7%. Our Dec-18 Target Price of PKR 133/share offers a +45.3% upside to its last close, **'BUY'**.

The Hub Power Company Limited
Power Generation & Distribution

Recommendation	**BUY**
Target Price:	133.3
Last Closing: 28-Dec-17	91.8
Upside:	45.3
Valuation Methodology:	Dividend Discount Model (DDM)
Time Horizon:	Dec-18

Market Data

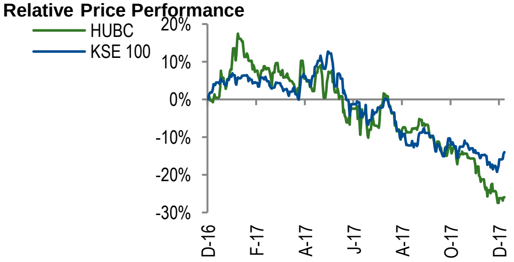
Bloomberg Tkr.		HUBC PA
Shares (mn)		1,157.2
Free Float Shares (mn)		752.2
Free Float Shares (%)		65.0%
Market Cap (PKRbn | USDmn)	106.2	959.1
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(17.9)	(21.9)	(26.7)
Lo	89.9	89.9	89.9
Hi	111.8	125.9	145.4

Key Company Financials
Period End: Jun

PKRbn	FY17A	FY18E	FY19F	FY20F
Total Revenue	101.2	131.9	129.3	134.6
Net Income	10.7	11.2	12.0	17.0
EPS (PKR)	9.2	9.7	10.3	14.7
DPS (PKR)	7.5	8.0	9.0	13.0
Total Assets	159.6	171.1	153.5	124.2
Total Equity	32.6	33.3	34.0	34.9
Key Financial Ratios				
ROE (%)	32.8	33.8	35.2	48.6
P/E (x)	9.9	9.5	8.9	6.2
P/B (x)	3.3	3.2	3.1	3.0
DY (%)	8.2	8.7	9.8	14.2

Relative Price Performance



Overweight | **The Hub Power Company Limited (HUBC)**

Exhibit: HUBC Project Company Equity

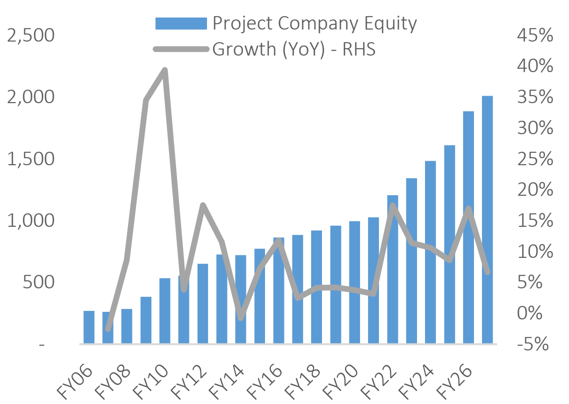


Exhibit: Key project timeline

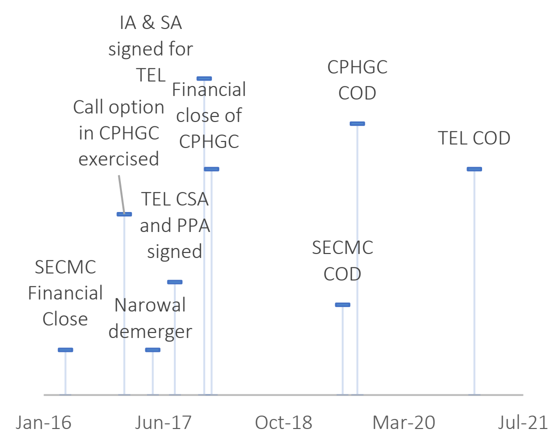


Exhibit: Value addition of project in HUBC

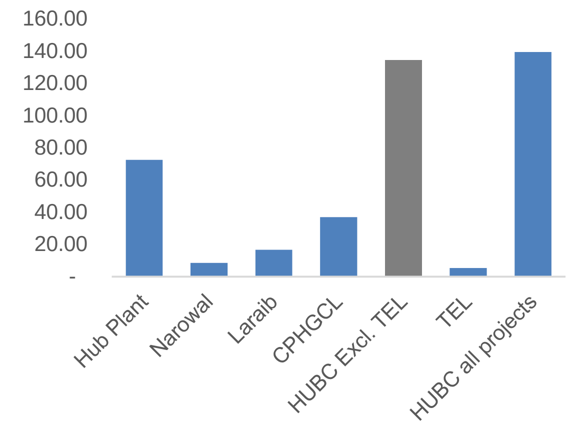
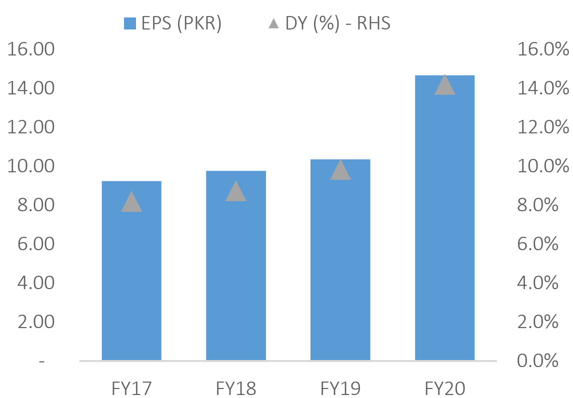


Exhibit: HUBC EPS and dividend yield



Overweight

Kot Addu Power Company Limited (KAPCO)

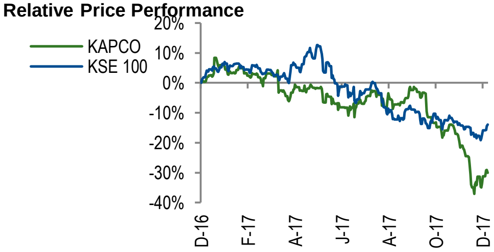
A short term yield play!

- **Recurring windfall earnings as PPA draws closer to expiry…** With dividend yield being the touchstone by which IPPs are compared, KAPCO continues to offer a superior FY18F 18% yield as its PPA draws closer to expiry at which point ROE is highest. This despite ongoing sector dynamics seeing as KAPCO's duel fuel turbines will likely run on LNG against historically high FO reliance (+75%) which is not only cheaper but also allows for higher efficiency. Although overall dispatch may come off, we see this as a non-event for distributable cash flows which are dependent solely on capacity payments.
- **PPA extension however, is nowhere in sight:** While KAPCO was hopeful to receive Letter of Comfort for PPA extension, chances of materialization have slimmed ahead of incoming excess generation capacity by 2021. Consequently, options for KAPCO remain slim at best, with the plant likely to be sold for parts post PPA expiry.
- **This has soured privatization deal:** Uncertainty of future cash flows has thrown a damper on KAPCO's privatization deal which was to materialize in CY16. To recall, WAPDA has a 40.25% equity stake in KAPCO which it was looking to offload via a strategic sale. Unless KAPCO manages to receive an extension, privatization may remain a slow burner.
- **All bridges burnt- GoP fails to approve acquisition of 17.4% stake in HUBC:** In Nov'17, KAPCO announced interest to acquire 17.4% stake (14.9% stake of DAWH and 2.5% stake of other parties) in HUBC. This would have extended KAPCO's life to FY50 from current FY21, given HUBC's CPHGCL/TEL project expire in FY50. However, given the regulatory requirements were not fulfilled within the stipulated time the transaction was mutually terminated. This would however have had a net negative impact initially in order to finance the transaction.
- **Recommendation:** We view KAPCO as a short term dividend yield play amid ongoing sector headwinds**.** We maintain our **'BUY'** stance on KAPCO with our FY18F Target Price of PKR 73/share offering 32.1% upside from its last close. The company is currently trading at FY18F P/E of 5.0x.

Kot Addu Power Company Limited
Power Generation & Distribution

Recommendation				**BUY**
Target Price:				72.5
Last Closing: 28-Dec-17				54.9
Upside:				32.1
Valuation Methodology:				Dividend Discount Model (DDM)
Time Horizon:				Dec-18
Market Data				
Bloomberg Tkr.				KAPCO PA
Shares (mn)				880.3
Free Float Shares (mn)				455.0
Free Float Shares (%)				51.7%
Market Cap (PKRbn | USDmn)			48.3	436.4
Exchange				KSE 100
Price Info.		90D	180D	365D
Abs. Return		(27.8)	(23.8)	(30.6)
Lo		49.4	49.4	49.4
Hi		76.0	77.4	85.0
Key Company Financials				
Period End: Jun				
PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	81.8	59.0	50.9	52.9
Net Income	9.4	9.7	10.8	11.6
EPS (PKR)	10.7	11.0	12.3	13.2
DPS (PKR)	9.5	10.0	11.0	12.5
Total Assets	116.0	77.3	71.7	72.2
Total Equity	32.5	33.4	34.5	35.1
Key Financial Ratios				
ROE (%)	29.1	29.0	31.3	33.1
P/E (x)	5.1	5.0	4.5	4.2
P/B (x)	1.5	1.4	1.4	1.4
DY (%)	17.3	18.2	20.0	22.8

Relative Price Performance



Neutral -Overweight | **Refineries**

Dent in cracking spreads but cracking may not be dented!

Exhibit: Total refining capacity of Pakistan

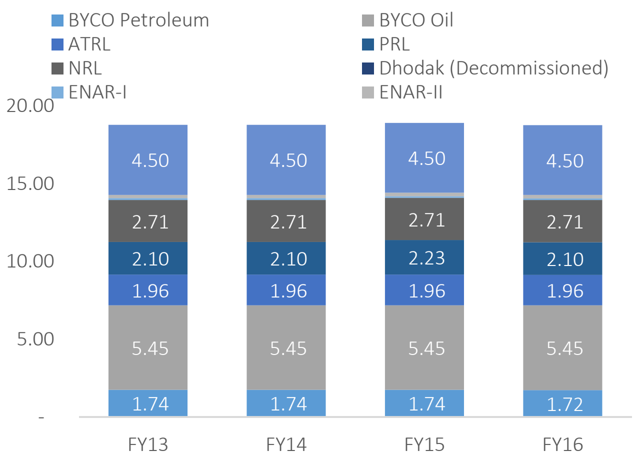
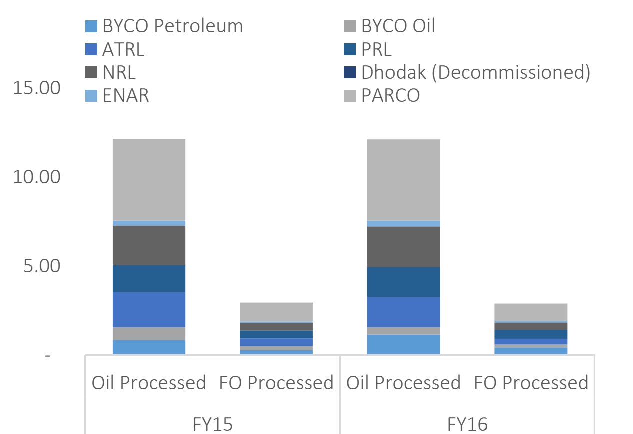


Exhibit: Total POL product and FO processed



- **Background on FO:** Pakistan consumes nearly 9.4mn Mtons of FO yearly wherein power sector utilizes nearly ~85% in (83% in FY16). FO sales of 1.5-1.7mn Mtons is utilized by industries. Pakistan imports nearly 6.0-6.5mn Mtons of FO while rest is processed locally. Refining capacity in Pakistan as of FY16 stood at 18.8mn Mtons. Total POL products processed stood at 12.1mn Mtons out of which FO produced was 24%. For refineries (ATRL, NRL, BYCO and PRL) produce nearly 62% of the total processed FO.
- **Closure of FO based power plants; Uncertainty prevails on future of refineries:** Pakistan refineries faced headwinds on closure of FO based power plants to reduce generation cost and provide relief on import bill. Refineries can not curb FO production because other POL products processed will have to be reduced. As refineries utilize local crude production and contribute nearly 30% of total POL products consumed in Pakistan, closure of refineries may not be a viable and sustainable option.
- **PKR depreciation adding fuel to fire amid FO plants closure**: With refineries stuck with inventories amid uncertainty and closure of FO plants, their utilization levels have dropped significantly. PKR depreciation is likely to erode Gross Refining Margins (GRM) by nearly 4.5%. Average GRMs to drop down to USD 6.1/bbl in Dec-17 and average USD 7.4/bbl in FY18E amid PKR depreciation and rising oil prices compared to nearly USD 8.4/bbl in FY17.
- **Globally FO utilization is 30% in power generation:** Globally when countries phased out power generation on FO, local refineries output was not curtailed as refineries consumed RFO as feedstock and processing of bunker fuel. Globally FO is utilized 23% as refinery feedstock, 47% in bunker fuel and only 30% for power generation. Although international demand for FO does exist, but due to competitive international prices and much efficient refineries than Pakistan export option may not be feasible. So, for Pakistan refineries to incur capex and utilize RFO as feedstock seems more economically viable.

Neutral -Overweight **Refineries**

Dent in cracking spreads but cracking may not be dented!

Exhibit: Refinery sector relative price performance in CY17TD

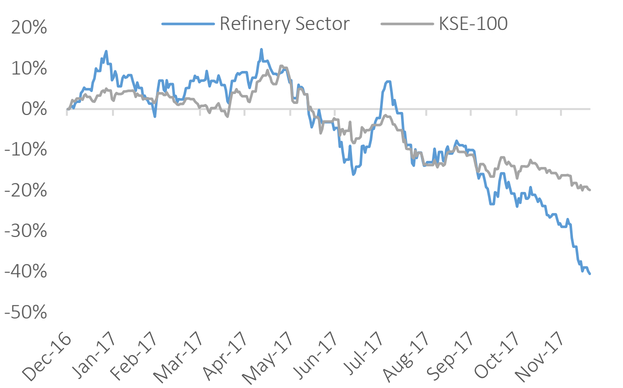
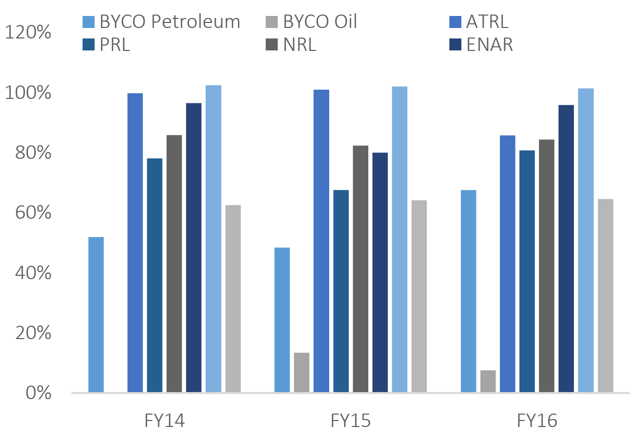


Exhibit: Historical utilization levels of refineries



- **Additional Capex requirement for refineries:** As refineries remain inefficient utilization of FO as feedstock requires additional Capex (except for NRL which already has facility to use FO in processing base oil and other non-energy products). Due to additional capex requirement, refineries are considering export option which owing to competitive international markets may not be feasible. As a result refinery sector has under performed benchmark index by 21% in CY17TD.
- **Only viable option is to utilize refineries' FO to run efficient FO based plant:** We believe only viable option is to utilize refineries' FO production to run efficient FO based power plants in order to avoid country wide energy crisis (1,000 -1,600MW plants would utilize 3.1mn Mtons of refinery production). For the time being refineries may be allowed to sell FO to power plants and incur capex to utilize FO as feedstock to process Asphalt, base oil for lubricants and other non-energy products. Once refineries are upgraded, FO plants could be permanently closed thereafter.
- **NRL the safest bet:** We expect refineries will eventually end up operating at level of pre-closure of FO power plants. Closure of ATRL will lead to closure of major oil fields in Pakistan i.e Nashpa and Tal block (production down by nearly 10,000bopd in Dec-17 due to lower demand from refineries). However, we highlight NRL will be least effected even if 6,129MW of FO plants are closed down owing to utilization of FO to process middle distillates such as Asphalt and base oil. Expansion of production capacity, tax benefit on BMR, Naphtha isomerization and WHR boiler to provide cost savings and increased production of MS which is a high margin product for refineries (average GRM of USD 10-12/bbl).

Neutral-Overweight **Refineries**

Exhibit: Company wise contribution in total refining capacity of Pakistan in FY16

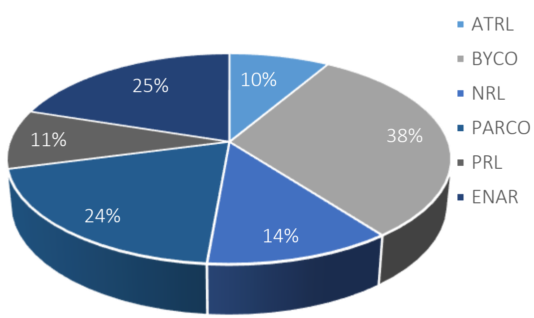


Exhibit: % of FO in product mix of refineries

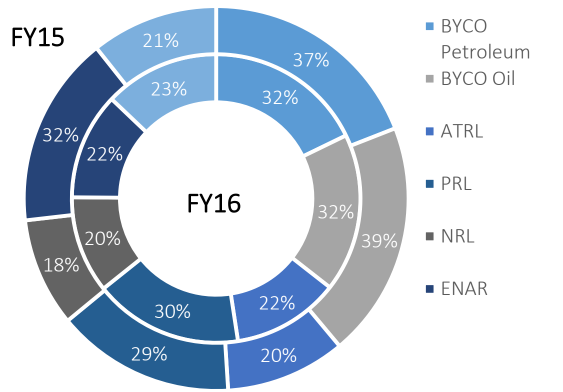


Exhibit: Pakistan refineries market share FO

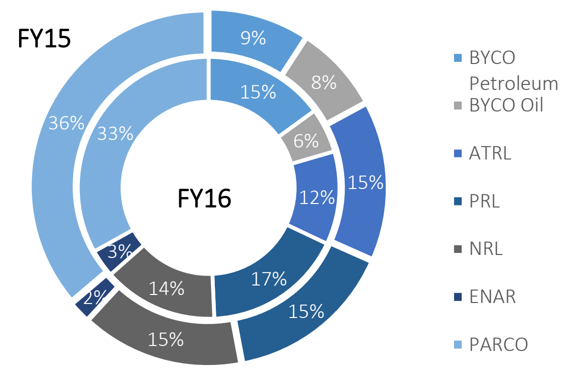


Exhibit: Utilization of FO in Pakistan

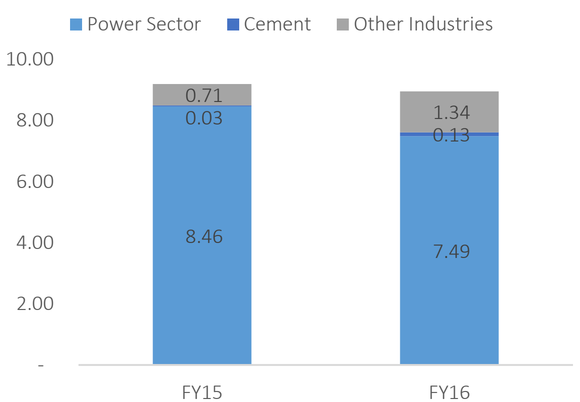
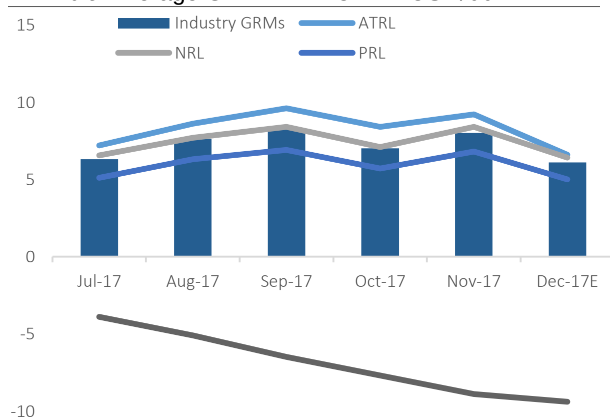


Exhibit: Average GRM in FY18TD – USD/bbl



Overweight

National Refinery Limited (NRL)

Reaping benefits of expansion; least affected by FO based plant closure

- **Lower production of FO despite higher refining capacity than ATRL and PRL:** NRL being 3rd largest refinery of Pakistan in term of capacity processes lowest quantity of FO (19% of total oil processed) compared to industry range of 22%-33%. Further due to utilization of light crude, quantity of RFO processed is lower compared to heavy crude thus benefiting NRL over its peers given reduced possible demand of FO in Pakistan going forward.
- **Competitive advantage over its peers:** Further NRL has the facility to utilizes RFO as feedstock in processing of base oil for lubricants, asphalt and other non-energy products. Incase of non-feasibility of exports and complete closure of FO based plants, NRL can utilize FO internally and not curb production of other POL products. Globally in developed countries where FO power generation was phased out, refineries output was not curtailed and instead RFO was consumed as feedstock or in processing bunker fuel for ships. Currently, FO is utilized 23% as refinery feedstock, 47% in bunker fuel and only 30% for power generation globally.
- **Completed and future projects to enhance production and margins:** During Jun-17, NRL completed its Diesel Hydro-Sulphurization project to achieve Euro-II standards. Completion of project is expected to improve margins on HSD in the absence of price differential. Further the company enhanced its crude processing capacity during FY17 by 3,000bopd to 65,000bopd. The company has also completed Naphtha Isomerization plant which will utilize Naphtha as feedstock to process MS which is a high margin product with increasing demand in Pakistan.
- **Cost per unit to come down post installation of WHR boiler and turbo generators:** NRL has completed installation of Waste Heat Recovery (WHR) boiler, up gradation of turbo generators and commissioning of used diesel generators of 8.2MW during FY17 and 1QFY18, which is expected to reflect in cost savings. As the WHR boiler was completed during 1QFY18, we expect cost saving benefits to fully reflect in 2Q-3QFY18.

National Refinery Limited
Refinery

Recommendation	**NR**
Target Price:	-
Last Closing: 28-Dec-17	450.8
Upside:	NR
Valuation Methodology:	-
Time Horizon:	Dec-18

Market Data

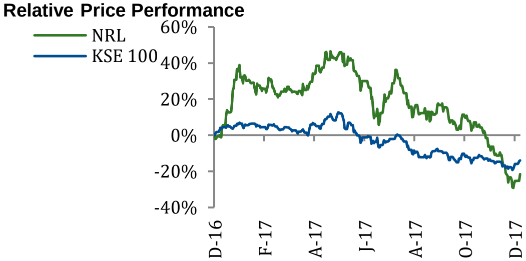
Bloomberg Tkr.	NRL PA
Shares (mn)	80.0
Free Float Shares (mn)	25.8
Free Float Shares (%)	32.3%
Market Cap (PKRbn | USDmn)	36.0 | 325.7
Exchange	KSE 100

Price Info.	90D	180D	365D
Abs. Return	(32.1)	(37.9)	(19.8)
Lo	406.7	406.7	406.7
Hi	663.9	782.7	841.5

Key Company Financials
Period End: Jun

PKRbn	**FY14A**	**FY15A**	**FY16A**	**FY17A**
Total Revenue	207.4	148.5	93.8	107.4
Net Income	1.0	3.7	7.7	8.0
EPS (PKR)	12.0	46.4	96.1	100.6
DPS (PKR)	-	10.0	20.0	22.5
Total Assets	52.5	48.0	53.6	61.3
Total Equity	26.6	30.1	36.8	43.3
Key Financial Ratios				
ROE (%)	3.6	12.3	20.9	18.6
P/E (x)	37.5	9.7	4.7	4.5
P/B (x)	1.4	1.2	1.0	0.8
DY (%)	-	2.2	4.4	5.0

Relative Price Performance



Overweight | **National Refinery Limited (NRL)**

Completed Projects

Project	Status
Diesel Hydro De-Sulphurization	Completed Jun-17
CDU Revamp Project	Completed FY17
Installation and Commissioning of used Diesel Generator of 8.2 MW	Completed FY17
Waste heat recovery boiler	Completed FY18
Up gradation of existing Turbo Generator	Completed FY18
Water Demineralization plant	Expected Dec-17
Isomerization - Naphtha	Completed FY18
Implementation of DCS at Lube-I Refinery	Completed FY18
Two stage unit at Lube-I Refinery	Completed FY18
Topping Unit and Reformer Unit	Expected FY18

Ongoing Projects

Project	Status
Isomerization - Naphtha	Expected FY18
Implementation of DCS at Lube-I Refinery	Expected FY18

Future Projects

Project	Status
Replacement of Fuel and Lube refineries and Utilizes Control System with centralized Distributed Control Systems	Expected 3 Years
101-F-1 Air Pre-Heater Project.	Expected FY18
Turnaround of Lube – II Refinery	Expected FY18
New Sea Water Reverse Osmosis Plant	Planning Stage

Overweight | **Fertilizer**

Stable demand outlook to keep sector evergreen

- **Strategy:** Although sector core earnings are likely to depict stable growth in the next 3 years, but consistent dividend pay-outs and business diversification makes this sector as our preferred play for 2018. We expect sector earnings to remain stable over the next three yrs, compared to -8% CAGR in the last three years. Amongst our coverage companies (FFC, EFERT, FFBL and FATIMA), we highlight EFERT as our top pick for CY18 (dividend yield 7.8%, P/E 8.3x), followed by FFC (dividend yield 9.3%, P/E 9.7x).
- **Performance:** IGI Fertilizer sector underperformed the KSE-100 index by 23%, wherein FFC underperformed by 30%, EFERT by 8%, FATIMA by 16% and FFBL by 40%. Overall IGI sector earnings during 9MCY17 have steamed up by +6%YoY to PKR19bn led by robust growth of +20/32% YoY in urea and DAP segment. However, for the year end (CY17) we expect sector earnings to record at PKR 28bn, down by 9%YoY.
- **Production:** Overall fertilizer sector attained production of 5.2k tons in urea, down by 6% during 11MCY17. Consistent gas supply ensured smooth production activity during 1HCY17, but in the later half outflow remained minimal for some fertilizer plants especially in Punjab (Pak Arab, Fatima fert, Agri tech), due to supply glitches in the new LNG terminal and disagreement over the new LNG tariff rate. Going forward, as the LNG supply materializes and related talks end in positive note, we expect production levels to improve in the later half of CY18E. We expect production levels to hover close to ~5.5mn tons for CY18E.
- **Urea demand to remain stable; government schemes triggering offtake:** For 11MCY17, urea and DAP offtake increased by +12%/+9%YoY to 5.2/2.2k tons, owing to improved farmer economics supported by government scheme (Kissan Package). With urea witnessing stable demand in last two years (close to 6mn tons), we expect offtake for CY18E to accumulate at ~5.3ktons. Similarly for DAP we expect offtake to clock in at ~5.3k tons as continued government supportive measures (Khadam-e-Kissan package) will boost demand.

IGI Securities
SERVING YOU SINCE 1994

Overweight

Fertilizer

- **Inventory to witness minimal levels:** The start of the year witnessed piled up urea inventory (1.075mn tons) on account of aggressive production during last year (supply outpacing the demand), which was later eased down with government subsequently announcing exports (600k tons).For the same month, inventory now stands at around 505k tons, compared to 1.5mn tons last year. With that said, we expect year-end inventory to reach at ~375k tons, indicating that the supply glut situation may cease to exist in the beginning of CY18E. Even, though still if high inventory situation arises then export may seem feasible as such.
- **Urea retail prices to increase owing to gas price hike:** The retail price for the urea averaged around PKR1,340/bag (discounted prices), despite government allowing base price of PKR 1,400/bag. Going forward, we expect prices to increase owing to increase in gas prices, while sales tax (5%) and subsidy (PKR 100/bag) will remain stable. However, still any changes in subsidy will likely be translated in the form of reduced sales tax, thus keeping price levels moderate.
- **International DAP price to remain dull, but pricing levels to increase owing to PKR deprecation:** During the outgoing year, international DAP prices increased within the range USD 320/ton- USD 360/ton, owing to increase in raw material prices and limited supply from China. Going forward, on international front new supply additions, will keep DAP prices bearish, but on domestic front overall effect will be countered by USD/PKR depreciation. Similarly, for local phosphate manufacturers (FFBL and FATIMA), the exchange rate effect will be reflected in the imported cost (phosphate rock and phosphoric acid), which we expect to get passed-over.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
FFC	BUY	77.3	89.1	15.2	893	7.8	7.0	10.0	9.0	0%
EFERT	BUY	66.9	83.6	25.0	810	7.6	5.0	8.7	7.5	9%
FFBL	BUY	34.7	41.4	19.5	294	1.0	0.5	33.8	1.5	25%
FATIMA	BUY	30.5	48.5	59.1	581	4.5	3.2	6.7	10.4	0%
SECTOR					**2,578**			**9.3**	**8.0**	**4%**

Overweight | **Fertilizer**

Exhibit: Stable urea demand (ktons)-Low inventory level in the beginning of CY18E

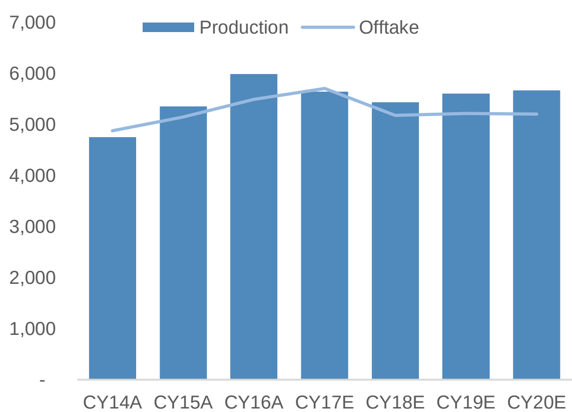


Exhibit: Exponential growth in DAP offtake

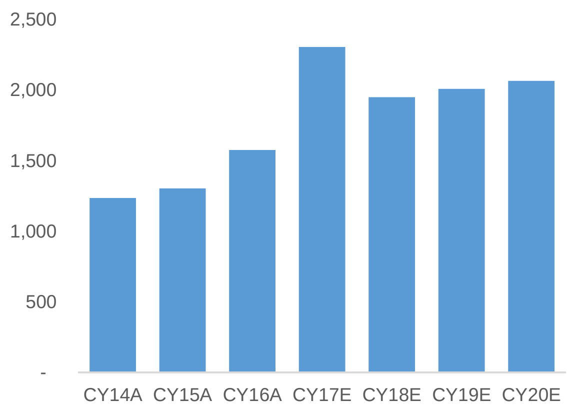


Exhibit: Sector Profitability and price levels (PKR/bag)

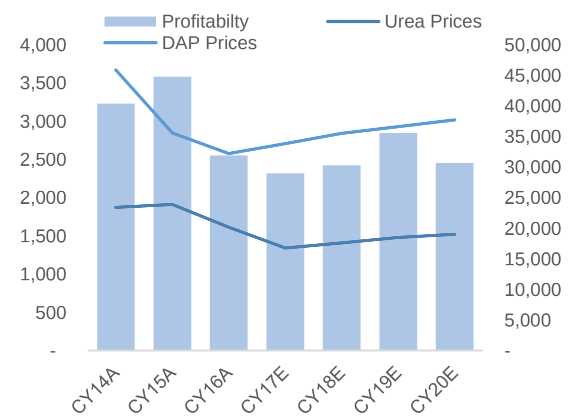


Exhibit: Fertilizer performance relative to KSE-100

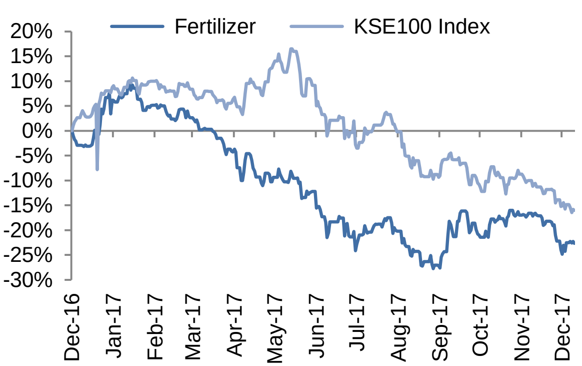


Exhibit: urea production(ktons) and utilization levels

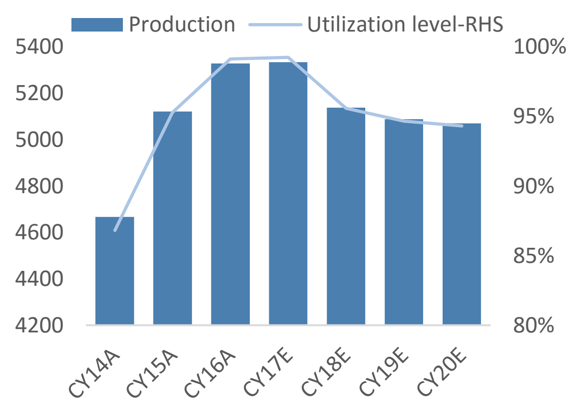
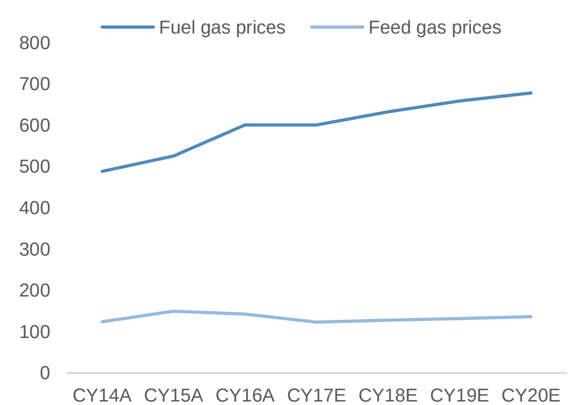


Exhibit: Fuel and feed gas prices (PKR/mmbtu)



IGI Securities
SERVING YOU SINCE 1994

Overweight | **Engro Fertiliser Company Limited (EFERT)**

Attractive valuation and strong fundamentals to cast a safe bet

- **Market share to remain steadfast in urea and DAP:** The company has attained favorable market share of 32% and 30% on average in urea and DAP, respectively. Given the capacity to offer at discounted prices the company will be able to sustain its offtake. However, LNG based fertilizer plant remains an imminent threat, as witnessed in the foregoing years (CY15). Despite this shortcoming, as well as taking conservative approach we expect company maintaining its market share along these level in the future while offering discounts.
- **Operational efficiency at maximum utilization levels (enVen being the support):** Given the sufficient capacity to produce (2.3Mn tons) and having the benefit of receiving feed gas at concessionary rate ($0.70/mmbtu) amongst its peers, the company bears low variable cost/ unit (PKR 480/bag on average), and as a result high margins (28% for CY17E). We expect the company to continue utilizing its enVen plant at maximum levels (97% on average) which receives the concessionary feed gas supply. However, the concessionary rate will last until CY23, post which we expect costs to increase (~9% increase), thereby compressing the margins slightly (106bps).
- **Offering attractive yield at a payout ratio of 70%, despite being leveraged:** Despite excessive debt (50% on average for the past three years), the company has continued to pay consistent dividends at a payout ratio of 70% with a dividend yield of 8.3%. With subsequent repayments to be made in the upcoming years we still expect company to pay dividend (~PKR 5/share) in CY18E at a payout ratio of 70% with dividend yield of 7.8%.
- **Recommendation:** We have a **'BUY'** call on EFERT, based on our Dec-18 target price of PKR 83.6/share, offering +25% upside from its last closing. The company is currently trading at CY18E P/E of 8.7x and offers a dividend yield of 7.5%.

Engro Fertilizer Limited
Fertilizer

Recommendation		**BUY**
Target Price:		83.6
Last Closing:	28-Dec-17	66.9
Upside:		25.0
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

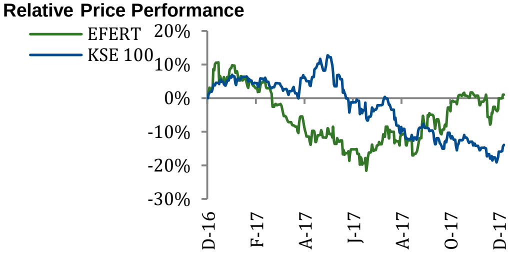
Bloomberg Tkr.		EFERT PA
Shares (mn)		1,335.3
Free Float Shares (mn)		598.9
Free Float Shares (%)		44.9%
Market Cap (PKRbn | USDmn)	89.3	806.6
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	6.3	21.1	(0.9)
Lo	59.1	51.9	51.9
Hi	67.3	67.3	73.3

Key Company Financials
Period End: Dec

PKRbn	CY16A	CY17E	CY18F	CY19F
Total Revenue	69.5	72.9	76.0	80.2
Net Income	9.0	9.7	10.2	11.7
EPS (PKR)	6.8	7.3	7.6	8.8
DPS (PKR)	7.0	5.0	5.0	6.0
Total Assets	102.4	98.7	94.9	96.8
Total Equity	41.3	44.8	48.3	52.0
Key Financial Ratios				
ROE (%)	21.9	21.8	21.1	22.5
P/E (x)	9.9	9.2	8.7	7.6
P/B (x)	2.2	2.0	1.8	1.7
DY (%)	10.5	7.5	7.5	9.0

Relative Price Performance



Overweight | **Fauji Fertiliser Company Limited (FFC)**

Diversification to uphold bottom-line

- **Diversification leading the way:** The company has diversified its income stream by investing in different areas pertaining to food, energy, banking and cement sectors. The combined income from the Associate businesses (FFBL, AKBL and FCCL) contributes 18% on average to pre-tax income while also providing cash flow. We expect stable dividend income stream to continue growing by +7% at a 4-Yr CAGR level from CY17E onwards.
- **Market share to remain intact; supportive of high capacity to produce:** The company enjoys a dominant market share in urea (43%) which it is has maintained over the period, selling it by the famous brand name (Sona urea). This was supported by having substantial capacity (2.5k tons) to produce amongst its peers along with high utilization levels. Hence, going forward for CY18E we expect company to maintain this share at an offtake level (~2.4k tons), while utilizing its capacity at maximum level (120% on average).
- **High dividend yield:** Continuing on with its trend to offer dividend at a payout ratio of 90%, we expect the company to maintain the same for the CY18E as well. Hence, we expect company to pay dividend (~6.83/share) at a yield of 9.3%.
- **Recommendation:** We have a **'BUY'** call on FFC, based on our Dec-18 target price of PKR 89/share, offering +15% upside from its last closing. The company is currently trading at CY18E P/E of 10.0x and offers a dividend yield of 9.0%.

Fauji Fertilizer Company Limited
Fertilizer

Recommendation		**BUY**
Target Price:		89.1
Last Closing:	28-Dec-17	77.3
Upside:		15.2
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

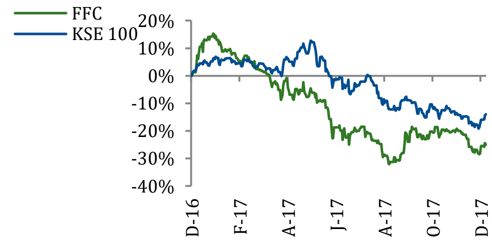
Bloomberg Tkr.		FFC PA
Shares (mn)		1,272.2
Free Float Shares (mn)		699.7
Free Float Shares (%)		55.0%
Market Cap (PKRbn | USDmn)	98.4	888.6
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(7.0)	(6.4)	(25.5)
Lo	73.7	70.1	70.1
Hi	84.0	84.1	119.0

Key Company Financials
Period End: Dec

PKRbn	**CY16A**	**CY17E**	**CY18F**	**CY19F**
Total Revenue	72.9	85.4	81.4	86.9
Net Income	11.8	8.8	9.9	11.9
EPS (PKR)	9.3	6.9	7.8	9.4
DPS (PKR)	7.9	6.2	7.0	8.4
Total Assets	90.7	82.2	75.7	74.5
Total Equity	28.2	29.1	30.1	31.3
Key Financial Ratios				
ROE (%)	41.8	30.2	32.8	38.1
P/E (x)	8.3	11.2	10.0	8.3
P/B (x)	3.5	3.4	3.3	3.1
DY (%)	10.2	8.0	9.0	10.9

Relative Price Performance



Overweight | **Steel**

Notable trends in the Pakistan steel Industry…

- **Steel production numbers led the LSM chart in FY17:** During FY-17 strong construction activities kept the steel industry on its peak utilization levels. According to Pakistan Bureau of Statistics (PBS), production of re-bars/billets grew at a robust growth of 58%YoY in Sep17, marking a 5Yr CAGR of +20.5%. The construction industry in Pakistan is mounting owing to increase in infrastructure activities, CPEC outlay and upcoming development in Baluchistan. Moreover, 6000-MW hydel power projects and favorable interest rate environment pull the re-bars demand in going forward.
- **In supply front:** with China steel manufacturers employing high quality expensive iron ore on their input material to bring pollution at lowest level resultantly the price of international steel has increased strikingly in the international arena, coupled with seasonal production cut. However international outlook, given china infrastructural development to concise in the short term. We see a decline in international steel prices moving ahead.
- **NTC protectionary measures to shield on Pakistan infant steel industry**: In Jun-17 National Tariff Commission imposed a 5-year definitive anti-dumping duty of 24.04% on import of CC-Billets. Moreover, the recent imposition of additional 5-year 19.5% anti-dumping duty on re-bars, in excess of existing 30% regulatory duty and 5% custom duty, provides further protection against imported re-bars. These measures will help in the protection of local industry and provide them better pricing power.
- **Steel sector earnings to grow by 19.7% in FY18E:** We expect Long steel and Flat steel production to grow by ~8% and ~12% by FY22 to ~6.7mn Mts and ~1.5mn Mts, respectively. We expect IGI steel sector earnings to grow at 5Yr CAGR of 15.2% led by ASTL and ISL with 5Yr earnings CAGR of 20.7% and 13.0%, respectively.
- **ASTL and ISL as our top picks:** We highlight ASTL and ISL as our top pick in IGI Steel Sector Universe with our Dec-18 target prices of PKR 130/share and PKR 131/share, respectively offering 38% and 23% upside from last close.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
ISL	BUY	107.0	131.3	22.8	422	8.0	4.0	13.4	3.7	21%
ASTL	BUY	94.5	130.0	37.5	255	4.9	2.1	19.3	2.2	20%
SECTOR					**677**			**15.1**	**3.1**	**20%**

Overweight | Steel

Exhibit: Billets/re-bars production numbers '000'

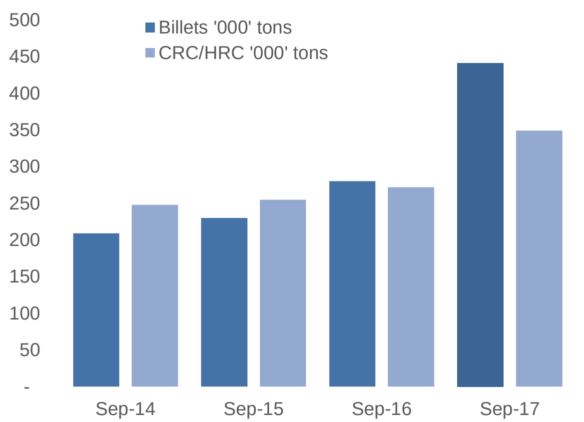


Exhibit: Per capita consumption

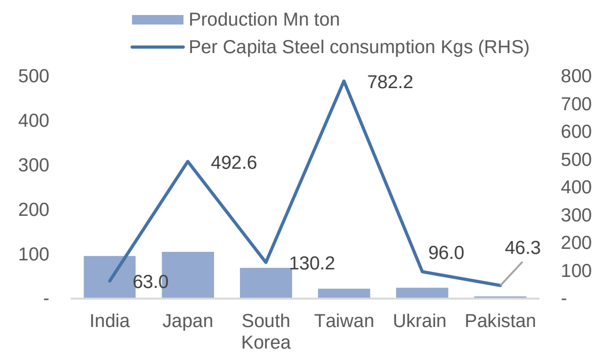


Exhibit: Automobile annual numbers '000'

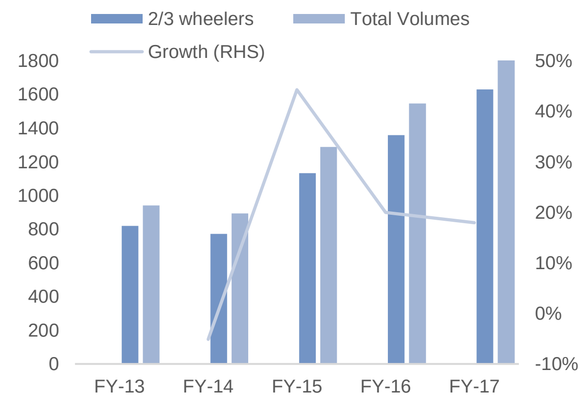


Exhibit: International CRC/HRC prices USD/ton

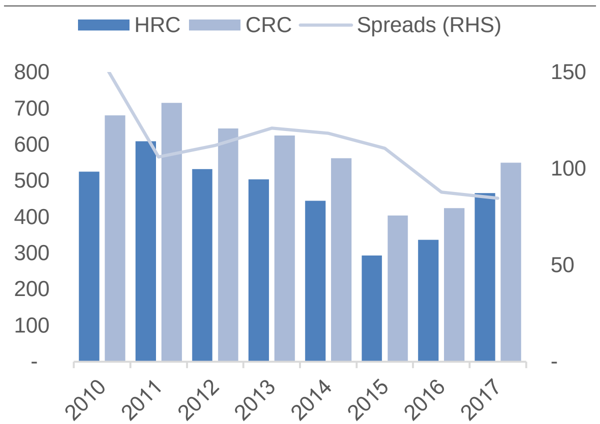


Exhibit: Re-bars USD/ton

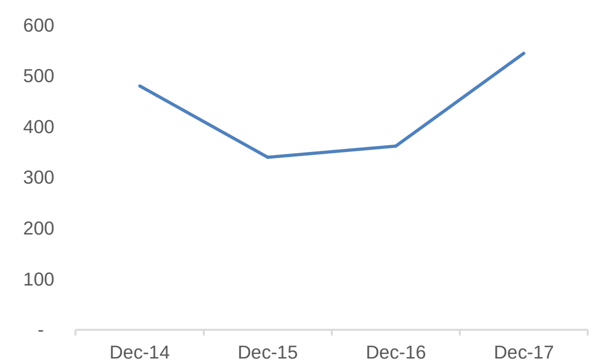
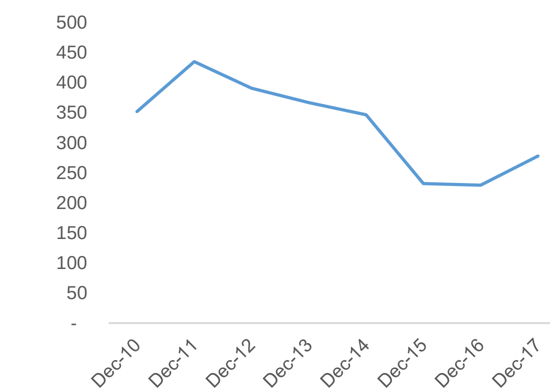


Exhibit: International scrap prices USD/ton



IGI Securities
SERVING YOU SINCE 1994

Overweight

Amreli Steel Limited (ASTL)

Timely expansion and protectionary measures beneficial for Amreli

- **Earnings to post 5Yr CAGR of 20.7% during FY18-FY22F:** We forecast ASTL's earnings to grow at a 5Yr CAGR of 20.7% during FY18-22F on the back of a) additional capacity expansion of re-bars and Billets, b) gross margins to remain between 17%-19% during FY18-22F on the back of better pricing power despite increase in international scrap prices and PKR depreciation, and c) volumes to increase by 19% by FY22 owing to robust growth in construction activities.
- **Long awaited Expansion near to operationalize:** In long steel category, ASTL is well positioned owing to expansion planned expansion is near to operationalize in the end of 3QFY18, Upcoming expansions will not only generated volumetric growth but also bring operational efficiencies, ASTL is also mulling to make its footprint in North, once its capacity become online, being a quality rebar brand name, we believe ASTL can increase its market share in North, coupled with NTC protection and new demand emanating from 6000-MW hydel power in near future.
- **Increase in Scrap prices:** Scrap is the main component in COGS contributing ~56% in cost breakup, volatility in scrap prices are major risk, however contemporary protection by NTC provided enough room to pass increase in scrap price factor on consumers.
- We recommend a **'BUY'** call on ASTL with our Dec-18 Target price of PKR 130/share offering 38% upside from its last close. The company is currently trading at FY18F P/E of 19x, however having a low PEG ratio of 0.6x making a stock attractive in current level.

Amreli Steels Limited
Engineering

Recommendation		**BUY**
Target Price:		130.0
Last Closing:	28-Dec-17	94.5
Upside:		37.5
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

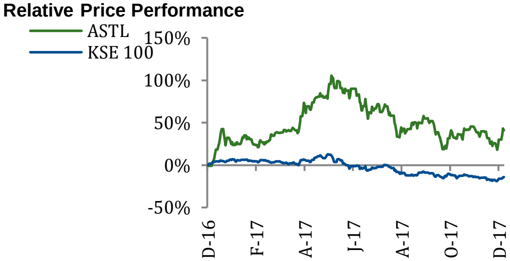
Bloomberg Tkr.		ASTL PA
Shares (mn)		297.0
Free Float Shares (mn)		74.3
Free Float Shares (%)		25.0%
Market Cap (PKRbn | USDmn)	28.1	253.7
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(7.3)	(23.1)	41.9
Lo	79.1	79.1	66.4
Hi	102.0	123.0	138.0

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	13.3	15.1	18.3	22.0
Net Income	1.1	1.5	1.6	1.8
EPS (PKR)	3.6	4.9	5.5	6.2
DPS (PKR)	2.0	2.1	2.7	4.3
Total Assets	18.2	20.2	21.2	22.3
Total Equity	11.1	12.0	12.8	13.4
Key Financial Ratios				
ROE (%)	9.6	12.1	12.7	13.7
P/E (x)	26.1	19.3	17.2	15.3
P/B (x)	2.5	2.3	2.2	2.1
DY (%)	2.1	2.2	2.9	4.6

Relative Price Performance



December 29, 2017

Overweight | **Amreli Steel Limited (ASTL)**

Exhibit: Utilization level

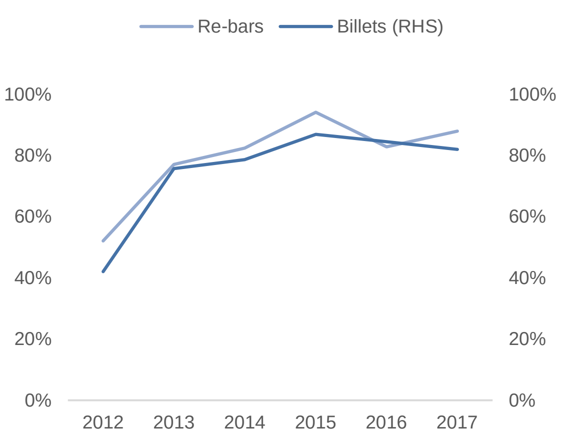


Exhibit: Volumes

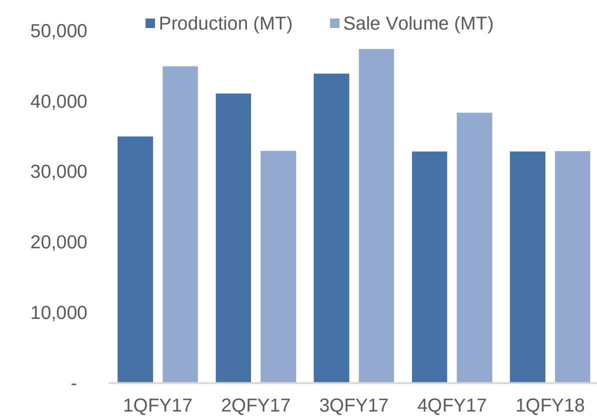


Exhibit: Capacity (pre and post expansion)

Capacity (Pre and Post expansion)

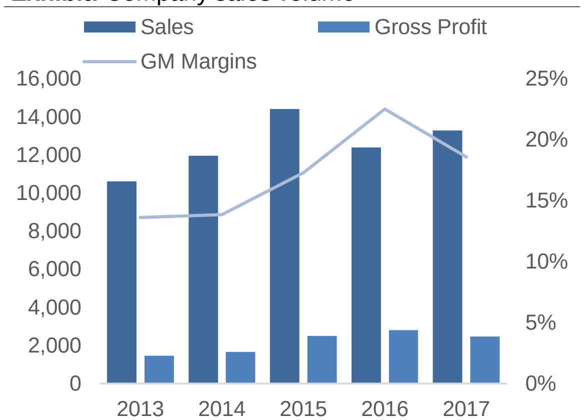
Site Plant

'000'MT		Expansion	
Plant	Existing	In progress	Total
Rolling	**180**	**-**	**180**
Melting	-	-	**-**

Dhabeji Plant

'000'MT		Expansion	
Plant	Existing	In progress	Total
Rolling	**-**	**425**	**425**
Melting	**400**	**200**	**600**

Exhibit: Company sales volume



IGI Securities
SERVING YOU SINCE 1994

Overweight | **International Steel Limited (ISL)**

Automobile/Appliances pulling up flat steel demand

- **Earnings to post 14.0% in FY18E:** We forecast ISL's earnings to grow at a 5Yr CAGR of 13.0% during FY18-20F on the back of a) double its capacity to post healthy volumes, b) gross margins to remain between 15%-16% during FY18-20F , (decline in margins on the back of contraction in spreads) and c) volumes to maintain 5yr CAGR of 8.4% by FY18-22, owing to robust growth in construction activities, and entrance of new players in Automobile sector.
- **Growth driven Factors:** Flat steel which is primarily used in home appliance, automobile assemblers and construction activities, in last couple of years Pakistan automobile sector witness a significant growth of 19%, while consumer appliances also in growth trajectory, we believe this growth will remain intact.
- **Volumetric Growth in locally produced steel:** Taking a PBS numbers import of HRC is touched its peak of 1.08mn Mts in 3QCY17, due to robust demand of flat steel in country, while in a supply side International steel limited (ISL) and Aisha steel Limited are the main producer flat steel, having a capacity of 550k / 220k Mts respectively, however ISL has always enjoy monopoly in hot dip galvanized (HDGC), color coated coils being the only local manufacturer of aforementioned product Color coated steel.
- **Capacity Expansion near to commissioning:** ISL capacity expansion which is expected to be completed in the end of FY-18 that translate total capacity of CRC up to 1.0mn Mts, moreover this will lead to debottlenecking of Galvanized coil production as well.
- **Protectionary measures by NTC form China dumped:** National Tariff commission (NTC) imposed with the range of 13.17% to 19.04% for CRC dumped, while 6.09% to 40.40% range for hot dip galvanized coil, this enabled local players to post volumetric growth by curtailing the influx of Chinese cheap steel.
- **Expected anti duping duty on color coated steels**: Recent preliminary investigation by NTC regarding dumping of color coated coils from china, causing injuries to local producer (ISL). We expect NTC to impose Anti dumping duty on color coated coils, though NTC did not imposed any provisional duty yet.
- We recommend a **'BUY'** call on ISL with our Dec-18 Target price of PKR 131/share offering 22.8% upside from its last close. The company is currently trading at FY18F P/E of 13.4x.

International Steels Limited
Engineering

Recommendation		**BUY**
Target Price:		131.3
Last Closing:	28-Dec-17	107.0
Upside:		22.8
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

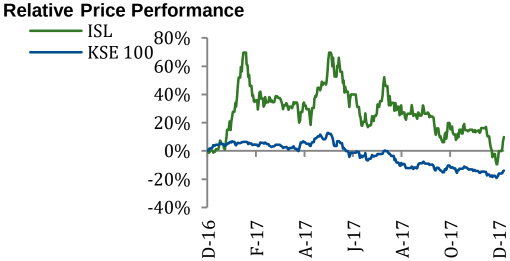
Bloomberg Tkr.		ISL PA
Shares (mn)		435.0
Free Float Shares (mn)		174.0
Free Float Shares (%)		40.0%
Market Cap (PKRbn | USDmn)	46.5	420.3
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(11.7)	(16.4)	11.1
Lo	88.3	88.3	88.3
Hi	121.1	148.3	165.4

Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	33.7	42.3	50.7	62.6
Net Income	3.0	3.5	5.6	5.4
EPS (PKR)	7.0	8.0	13.0	12.3
DPS (PKR)	3.5	4.0	6.5	4.9
Total Assets	26.4	28.8	32.3	36.7
Total Equity	8.6	10.3	13.1	16.3
Key Financial Ratios				
ROE (%)	35.6	33.8	43.0	32.8
P/E (x)	15.3	13.4	8.3	8.7
P/B (x)	5.4	4.5	3.5	2.9
DY (%)	3.3	3.7	6.1	4.6

Relative Price Performance



IGI Securities
SERVING YOU SINCE 1994

Underweight | **Automobile Assemblers**

Heightening competition and uncertainty on its way to shake oligopoly

- **Strategy**: We are under weight on automobile assemblers, as we believe rising competition, high correlation of margins to exchange rate volatility and rising interest rate environment, the sector players will be left with limited pricing power. Moreover, possible introduction of new models will also lead to higher Capex cost, further underpinning sector valuations. We estimate automobile assemblers' (HCAR, INDU and PSMC) earnings to register a +12% growth in 2018, compared to an impressive +55% CAGR during past three years. Amongst our coverage companies we highlight INDU as our top pick, owing to +8%YoY growth in earnings expected during FY18, attractive on the basis of high dividend yield (7.4%), and inexpensive P/E 9.4X.
- **Performance**: Overall IGI Auto Sector has underperformed by 3% with respect to benchmark KSE-100 index, wherein INDU out performed by +6% (launch of corolla face-lift model in the beginning of FY18), while HCAR and PSMC under performed by 13% and 8%, respectively.
- **Volumes:** Overall volumes growth have remained upbeat owing to multiple factors: strong consumer demand driven by low interest rate environment and introduction of new models, in particular by PSMC, HCAR and INDU. To recall, the auto sector witnessed robust growth of +20%YoY to 1.9mn units during 11MCY17, under which IGI Auto Sector attained growth levels of+30%YoY to 220k units. Going forward, we expect the volumes to reach at 280k units by the year end (CY17). Looking ahead, from 2020 onwards with competition (KIA, Renualt, Hyundai and United Motors) to kick- in, we see auto sector becoming largely fragmented. As such, we see IGI Auto Sector facing tough challenge in keeping volumetric growth intact, which we expect to restrain (market share to shrink slightly).

Underweight | **Automobile Assemblers**

- **Pricing power and gross margins:** International pricing dynamics in steel and volatile exchange rate movements have kept sector margins sensitive. CRC prices during CY17TD have averaged around USD 695/ton, increasing by 45% YoY owing to combined effect of China subsiding its exports and its steel manufacturers shifting to high quality ore. Exchange rate hovered around 112 USD/JPY during CY17TD, as compared to 108 USD/JPY during the same period last year. With respect to company wise margins, INDU witnessed +135bps growth in margins (18%), while HCAR attained 14% margins (a decline of 100bps). Similarly, PSMC on average attained 10% margins during 9MCY17 period (up by +100bps). Going forward, we expect USD/JPY to appreciate given interest rate hike by FED and Japan continuing with its expansionary policy. Although this may tend to keep margins soft, but the overall impact will be countered by PKR depreciation which recently has depreciated to 110 against USD. Under this scenario, price pass-over capacity of existing players will be the defining criteria in keeping margins less pressurized. We therefore expect PSMC to suffer given its limited capacity to pass on the price, while INDU and HCAR to capitalize on it.

	Recomm.	Current Price (PKR)	Target Price (PKR)	Upside (%)	Market Cap. (USDmn)	EPS 2018	DPS 2018	P/E 2018	DY 2018	3Yr Earnings Growth
INDU	BUY	1,686.7	2,201.8	30.5	1,203	178.1	124.0	9.5	7.4	-2%
HCAR	HOLD	507.8	536.4	5.6	658	56.7	22.7	9.0	4.5	4%
PSMC	HOLD	501.2	489.9	(2.2)	374	46.7	8.0	10.7	1.6	-10%
SECTOR					**2,235**			**9.5**	**5.5**	**-1%**

Underweight | **Automobile Assemblers**

Exhibit: IGI Auto Sector performance relative to KSE-100 index

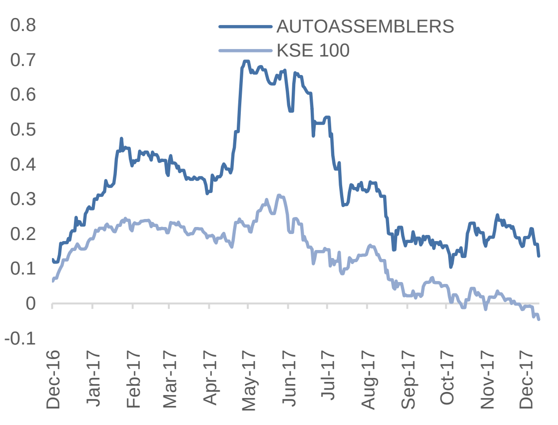


Exhibit: Exchange rate movements and CRC (USD/ton)

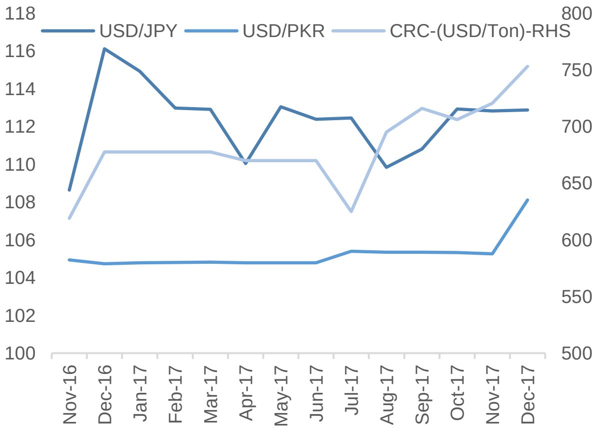


Exhibit: Sales composition-5MFY18

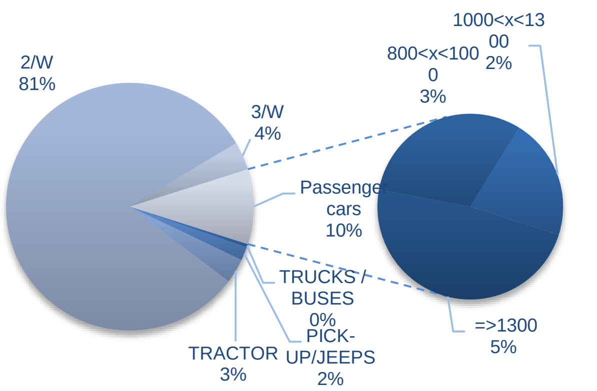
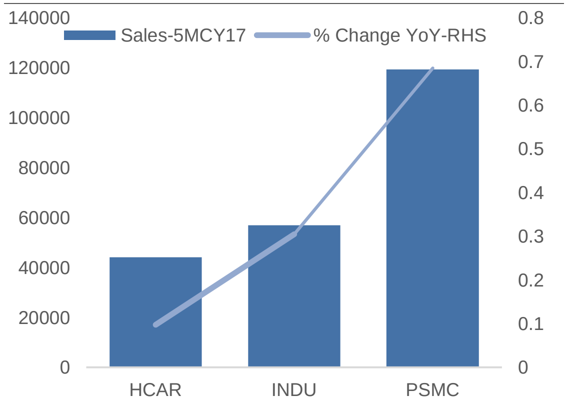


Exhibit: Growth in sales volumes



Overweight

Indus Motor Company Limited (INDU)

Gearing up to resist approaching headwinds

- **Volumes:** Over the period of last three years the company has achieved massive growth (+60%-3Yr CAGR) in its earning as sales volume advanced (+21% -3Yr CAGR) substantially with new model launches in various segments. For the 5MFY18 period, company attained growth level of +7% YoY to 26k units as the sales of Corolla face-lift model propelled, followed by Fortuner and Hilux sales. Moving forward with this trend we expect sales of 62k units (+4%YoY) to augment earnings by ~+8%YoY to PKR 178/share for FY18 as the demand surfaces during election period. Also, with launch of Fortuner 2GD variant (expected during 3QFY18) we expect volumetric growth in high margin segment to kick-in. With respect to competition, imported cars continue to pose a threat, which the company has able to manage given strong consumer base and volumetric growth attained. However, with foreign entrants approaching, this poses a challenge for the company in keeping its sales upbeat without significantly comprising the market share. As such, the company will be poised to deliver new offerings to cushion against any major setback in its volume.
- **Pricing power resisting margin compression to an extent**: With the recent PKR deprecation (4.7%) and the prevailing uncertainty, we expect company's margins to remain sensitive over the upcoming years. However, since INDU enjoys high pricing power coupled with strong brand value (Corolla being the flagship model), it may passover the impact to the customers. But with the price wars stemming from increased competition (2020 onwards) it would be tough for the company to keep its pricing power strong. Nevertheless, we expect gross margins to remain under pressure, squeezing slightly (+61bps on average). Similarly, we expect market volumetric growth to restrain and market share to shrink slightly.
- **Operational front**: It is expected that the company will be able to complete its debottlenecking activity by 3QFY18, hence having the capacity (66,000 units) to curb backlogs and meet unexpected rise in demand. The overall impact of capacity addition will become pronounced from FY19 onwards.
- **High dividend yield and payout**: Amongst its peers, INDU offers relatively high dividend yield (7% as of FY17) with a payout ratio of 70%. Therefore, our **'BUY'** call remains intact on the scrip with Dec-18 based target price of PKR 2,201/share, offering +30.5% upside. The company is currently trading at FY18E P/E of 9.4x.

Indus Motor Company Limited
Automobile Assembler

Recommendation		**BUY**
Target Price:		2,201.8
Last Closing:	28-Dec-17	1,686.7
Upside:		30.5
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Dec-18

Market Data

Bloomberg Tkr.		INDU PA
Shares (mn)		78.6
Free Float Shares (mn)		13.3
Free Float Shares (%)		16.9%
Market Cap (PKRbn | USDmn)	132.6	1,197.6
Exchange		KSE 100

Price Info.	90D	180D	365D
Abs. Return	(2.0)	(6.0)	6.4
Lo	1,603.4	1,603.4	1,580.2
Hi	1,822.9	1,822.9	2,044.3

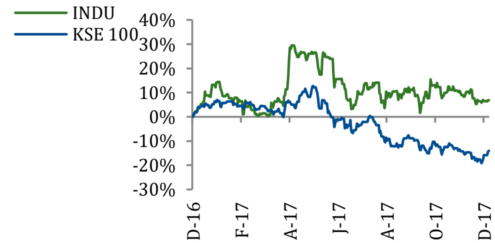
Key Company Financials
Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	112.3	122.6	126.9	128.2
Net Income	13.0	14.0	13.0	12.4
EPS (PKR)	165.4	178.1	165.8	157.7
DPS (PKR)	115.0	124.0	116.0	110.0
Total Assets	63.9	67.0	72.2	76.9
Total Equity	31.2	35.5	39.4	43.1

Key Financial Ratios

ROE (%)	41.7	39.5	33.1	28.8
P/E (x)	10.2	9.5	10.2	10.7
P/B (x)	4.2	3.7	3.4	3.1
DY (%)	6.8	7.4	6.9	6.5

Relative Price Performance



Important Disclaimer and Disclosures

Research Analyst(s) Certification: The Research Analyst(s) hereby certify that the views about the company/companies and the security/securities discussed in this report accurately reflect his or her or their personal views and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst(s) is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

Disclaimer: The information and opinions contained herein are prepared by IGI Finex Securities Limited and is for information purposes only. Whilst every effort has been made to ensure that all the information (including any recommendations or opinions expressed) contained in this document (the information) is not misleading or unreliable, IGI Finex Securities Limited makes no representation as to the accuracy or completeness of the information. Neither, IGI Finex Securities Limited nor any director, officer or employee of IGI Finex Securities Limited shall in any manner be liable or responsible for any loss that may be occasioned as consequence of a party relying on the information. This document takes no account of the investment objectives, financial situation and particular needs of investors, who shall seek further professional advice before making any investment decision. This document and the information may not be reproduced, distributed or published by any recipient for any purpose. This report is not directed or intended for distribution to, or use by any person or entity not a client of IGI Finex Securities Limited, else directed for distribution.

Rating system: IGI Finex Securities employs three tier ratings system, depending upon expected total return (return is defined as capital gain exclusive of tax) of the security in stated time period, as follows:

Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security(ies)/company(ies) in the report will be achieved.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment. **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E:** Price to Earnings ratio of a company's share price to its per-share earnings. **P/B:** Price to Book ratio used to compare a stock's market value to its book value. **DY:** The dividend yield is dividend per share, divided by the price per share.

Research Entity Number: **BRP - 009**

http://www.jammapunji.pk

2018
Pakistan Equity Market Outlook

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780

Website: www.igisecurities.com.pk
Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542
Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815
Multan Office

Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44
Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861
Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651
Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Radio
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44
Sialkot Office
Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762