Pakistan Equity Outlook 2021

Monday, 18 January 2021

Market Outlook

2020: Market had one of its best year

The KSE100, benchmark index has reached new all-time highs in the past few weeks, driven by an impressive series of positive economic and corporate earnings surprises. Following a drawdown of nearly 33% in the first qtr and a sharp +61% (+55% in USD terms) recovery in the second and subsequent qtrs, the KSE100 index ended at 43.7k levels all the way back (101%) to its pre-Covid19 peak.

Exhibit: KSE100 historic annual returns

Despite the pandemic market posted decent return of 7% ann.

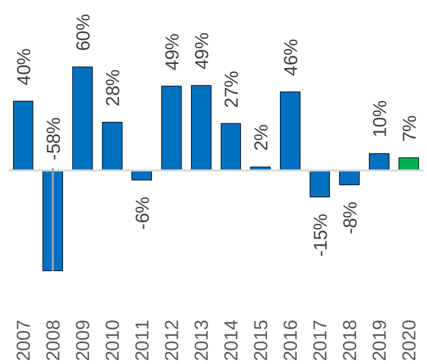


Exhibit: 2020 USD & PKR based returns

In 2020 market had one of the best years with return from Mar-20 up by +61% in PKR & +55% in USD

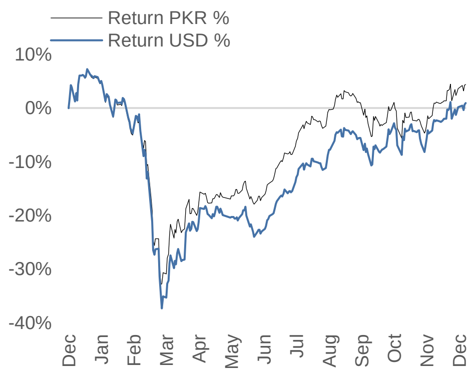
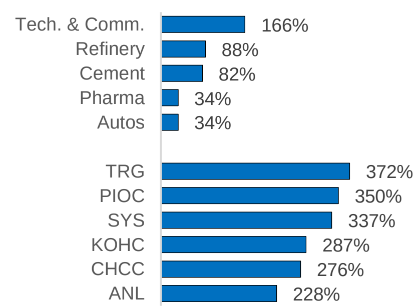


Exhibit: Top performing companies and sectors

Stocks that more than doubled their value in 2020, and top performing sectors in 2020



Source: Bloomberg, IGI Research

The accommodative monetary policy adopted by the State Bank of Pakistan (SBP) and the relief package by the government has delivered a much faster than expected recovery in manufacturing, construction and textile sector. Now expected rollout of vaccines in major global economies and later in Pakistan, has investors looking past the worrisome numbers of Covid19 cases. While the effects of Covid19 pandemic will continue to show-up in 2021, we remain positive overall on market and still expect 'V'-shaped economic recovery.

2021 earnings all set to recover from Covid19 impact; depicting a healthy growth of +13%y/y

From market standpoint we estimate 2021 earnings growth of our coverage companies (~51% of the KSE 100 market capitalization) to post a +13% y/y growth to EPS of PKR 15.6 compared to PKR 13.8 & 14.0 in 2020 and 2019, respectively. In terms of 3yr forward outlook, we expect a ~9.7% cagr which is higher than trailing 3yr cagr of ~5.8%.

Market looks to trade at a discount on nearly all broad valuation matrices

Moreover, although market P/E multiple has already re-rated nearly ~+61% from its bottom in Mar-20 and trades at a fwd 2021 multiple of 7.3x which is below its LT average of 8.6x and fwd dy of 6.2% (long-term average of 6.5%). Similarly, current market capitalization to GDP is at 17% compared to its historic average of ~22% and similarly on market capitalization to broad money (M2) basis at ~33% versus historic average of ~50%. More importantly on nearly every valuation account Pakistan market valuation trades at a discount to region and lately these discounts have widened up significantly.

Having said that, we believe that positive market catalysts may have run their course.

1 #. Fiscal and monetary policy: Incentive seems to have maxed out

Arguably Pakistan had its best[1] response to handling of Covid19. State Bank of Pakistan (SBP) response to Covid19 pandemic has been 'accommodative' and has deployed every means possible to keep economy up and running. But rising inflation is in coming months will be testing patience. Moreover on the government part, disbursement of social/construction/employment relief packages - ~4.0% of the GDP, during the pandemic seems to have played its due part in reinstalling confidence in market economy, but options for further relief and stimulus packages seems far cry. Hence we think, both monetary and fiscal incentives to have maxed out, further squeezing fiscal space in 2022 budget for government to maneuver.

2 #. Market Liquidity: Foreign investment looking up but not so on the local side

2020 was yet another year of foreign investors pulling out of Pakistan equity market. However the space was filled by retail/individual investor's and insurance companies. While flows from foreign investors are looking up in 2021, as lately the EM markets have started to see comeback of flows, but we remain less optimistic for local investors. Tax measures, documentation drive and reduced ROIs in previous months has led to individuals shying away from other asset classes, but we think things are likely to change (govt. construction package) and its effects are likely to show up in the 1h 2021 in a form of weak investor interest. Similarly, rising bond yields suggest asset rotation is highly likely in coming months. Mutual funds cash held in equity funds (as market proxy) has almost halved to ~4%[2] by Nov-20, rising government treasury/bond yields are suggestive of possible fund selling.

3 #. Improving corporate fundamentals may already be priced into stocks

For September ending quarter, corporate earnings have swiftly rebounded, and are close to their pre-covid levels. Bearing in mind the low base effect, earnings as we estimate are set to deliver ~13% growth in 2021 (igi estimates). Although forward P/E multiples are still below their LT average (7.4x vs. 8.6x historically), multiple revision is likely given the fact that inflation expectations and interest rates are on a rising trend.

4 #. Economic growth remain less impressive going forward

Similarly, much uncertainty remains regarding the strength and durability of the Pakistan economic cycle going forward. Some of the positive economic footings achieved so far in 2021 are likely to lose some sand beneath and will experience some degree of reverse change. Combined with limited monetary and fiscal maneuverability, economic growth going forward will be far from impressive, in our view. Not surprisingly, IMF in its latest dataset expects Pakistan's GDP to grow at a mere 1.0% compared to SBP 1.5%-2.5% in 2021 (regional average 6.0% in 2021) and onwards expects Pakistan growth will be limiting itself to 5% till 2025.

Eyeing an index target of 51,000 for 2021

By 2021, we eye an index target of 51k which is below market consensus 53k (95%), generating a total return of ~11% from its current index level of 46k. We have taken a market target P/E multiple approach as our basis for index estimation. Based on our index target of 51k market would trade at a forward P/E of 8.1x which is below LT historic average. More over at current our market dividend yld, comes at 6.2% taking total market return to ~17% in 2021.

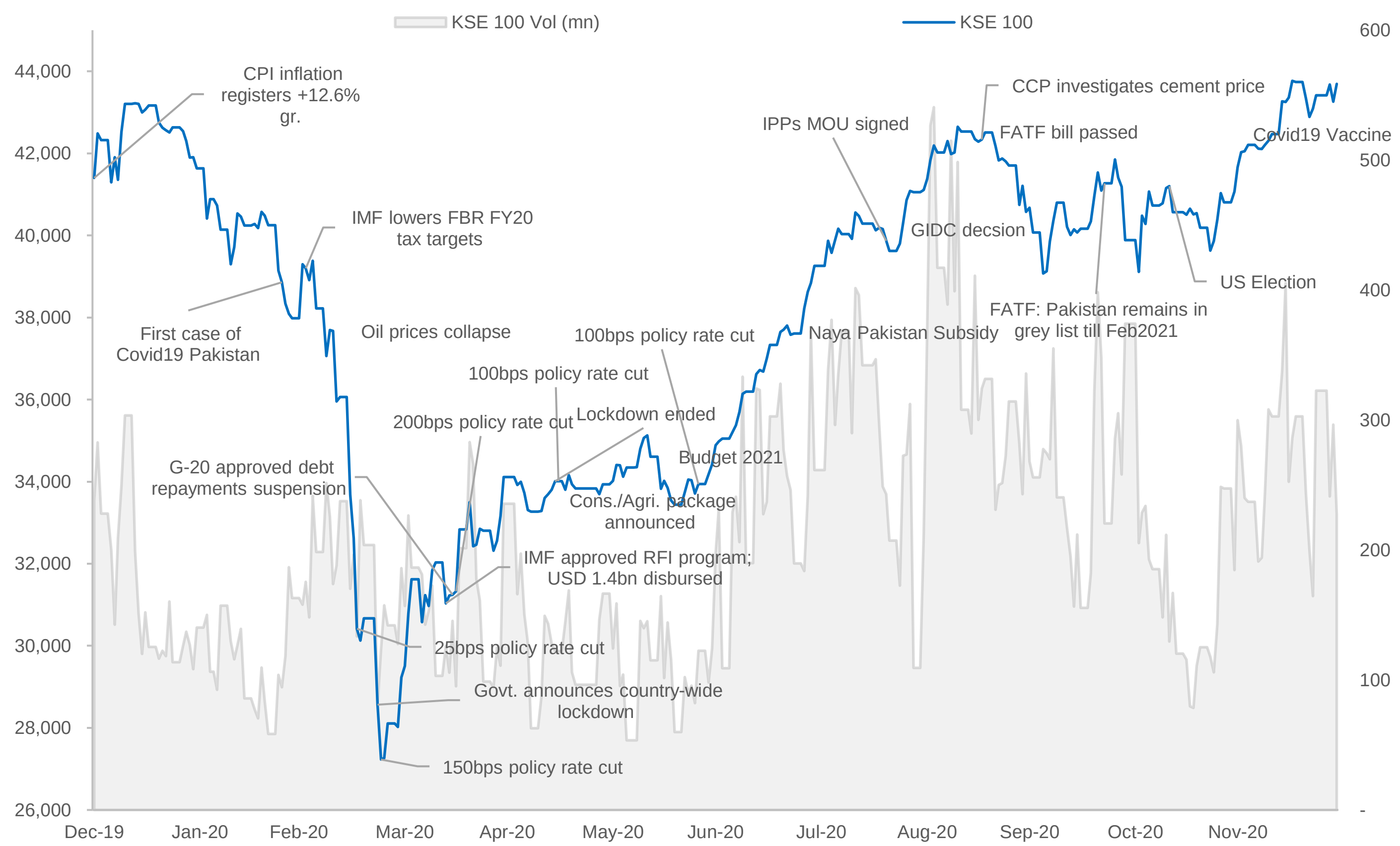
We see a year of two halves

Having said that, we see a year of two halves. The first half of 2021 looks much rosier on the domestic front, characterized by continued improvement in large-scale manufacturing, corporate earnings as low interest rates, resumption of IMF program and delayed fiscal tightening remains

[1] COVID-19 in Pakistan: WHO fighting tirelessly against the odds. https://www.who.int/news-room/feature-stories/detail/covid-19-in-pakistan-who-fighting-tirelessly-against-the-odds
[2] Based on equity funds having a market share of 85%. Nov2020

supportive. Hence we think market is likely to rejoice on this. Post this we see inflation pressure building up, causing interest rate cycle to reverse. Moreover the recent upsurge in demand in particularly cyclicals (cements, autos and steel) and improved margins will likely see some respite as global commodity prices are on the rising trend. Moreover, additional tax measures along with structural reforms post resumption of IMF will eventually seep in corporate earnings.

Exhibit: Key events that shaped the market during 2020



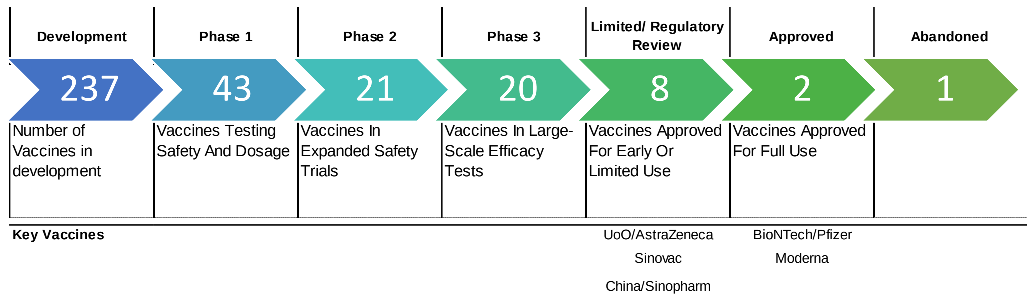
Contents

Looking past Covid19

Covid19 vaccine availability a key catalyst

At least three different vaccines have been approved or have been put on emergency use Pfizer-Biontech, Moderna, Sinopharm (~79%[3]) having nearly ~90% efficacy. As per news reports, Pakistan has also set aside, USD 250mn for procurement of initial 1.2mn doses. Although it's still in the process, Pakistan may likely get initial vaccine either from China (Sinopharm) or UK (Astrazeneca). The first up have been made available to front-line workers as early, and globally general public is expected to start benefitting from a broad roll-out of vaccines by the second quarter of 2021, suggesting a slowdown in pandemic cases from 3q 2021 onwards.

Exhibit: Coronavirus Vaccine Tracker



Source: NY Times

Visible downplay shift in Covid19…

Since outbreak of Covid19 in Mar-20 cases in Pakistan peaked around end of May-20 whereby positive ratio peaked at ~22%, which led to country-wide/micro/smart lockdown. From Jun-20 onwards, the trend reversed and cases started to recede; by Sep-20 overall positivity ratio dropped to ~2%. Nevertheless, cases started to rise from mid Oct-20, Pakistan's own Covid19 Second-Wave; and peaked around mid-December. However overall positivity ratio remained below ~10%; against earlier fears of second-wave seen as more fatal.

Exhibit: Pakistan second-wave vs. first

Based on 14days rolling, second-wave has been less severe

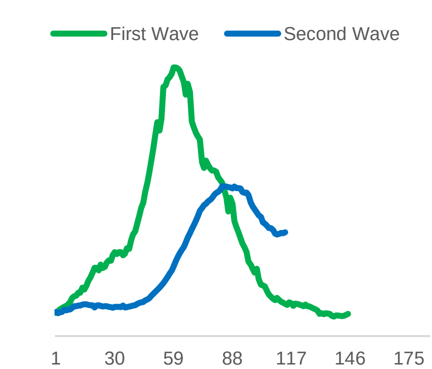


Exhibit: Cases/ fatality ratio

Cases-to-fatality ratio in Pakistan are in-line with global average but is second highest in the region

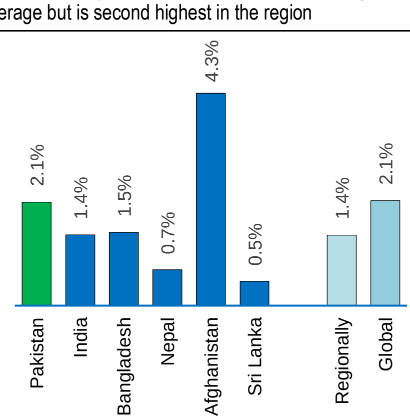
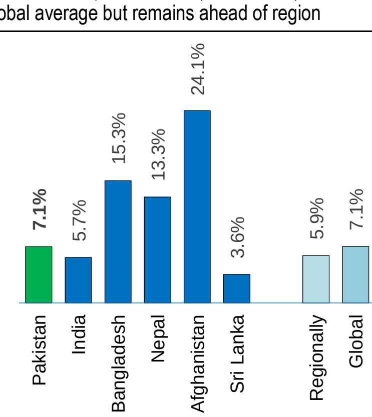


Exhibit: Positive Ratio

Also Pakistan positive ratio (Cases/tests) is in line with global average but remains ahead of region



Source: Our world in data, COVID.gov.pk, IGI Research

[3] Brazil results showed a 79% effectiveness of Chinese Sinopharm, and 50% for another Chinese base vaccine Sinovac-CoronaVac (https://www.nytimes.com/interactive/2020/science/coronavirus-vaccine-tracker.html)

…to restrict further lockdowns and keep economy wheeling

But despite low positivity ratio government restored to smart lockdowns. While these smart lockdowns have had a significant impact on overall economic activity earlier back in Mar-20, when they were first introduced. But later in Apr-20 lockdown was lifted given its negative bearing on economy and population wellbeing.

Even though we believe vaccine readiness will take some time to reach Pakistan, we opine lockdowns are a thing of past, at least in Pakistan for now, unlike seen elsewhere UK for instance. Hence with this mind, earlier negative surprises on economy are unlikely to come by in 2021; calling it an end of ‘Covid19 recession’.

2021: Economy on a path of recovery

Pakistan Covid19 response has fared well so far; in terms of economy…

Moreover, Pakistan response to Covid19 has fared much better in its region both in terms of human and economic losses. Although Pakistan GDP contracted by 0.4% in 2020 but the fall was less severe compared to its regional peer’s contracting by 5.8% on average. This seems rather striking considering Pakistan was already stemming out from a 2019 aggressive structural reform re-basing whereby GDP growth dropped to 1.9% (compared to ~5% on average in 2014-18).

In fact putting aside the GDP growth element, Covid19 has benefited on multiple economic fronts including; external account - Current account surplus after nearly a decade, Large scale manufacturing posted one of the strongest growth in years, Inflation has been tamed to single-digit numbers, policy rates reduced, external debt relief under DSSI, and FX reserves build up have kept PKR stable.

…but these positive key footings are likely to lose some sand beneath in the remainder of 2021

While some of these leading indicators are looking up, it is by no means a clean sweep. In fact, we opine in the reminder of 2021 these positive key footings are likely to lose some sand beneath and will experience some degree of reverse change. Combined with limited monetary and fiscal maneuverability, economic recovery going forward will be far from impressive, in our view.

Inflation: Disinflationary at first, but less so later on…

We expect inflation to average 8.8% (SBP 7-9%) in FY21 with 4q Fy21 average inflation to 9.8% significantly higher than average 8.5% in 6mFy21.

So far in 1h’21, higher m/m changes (averaging ~1.4%[4]) in headline inflation have largely been fueled by 'temporary factors’ particularly impacted by food prices. Other than that there was less of excitement on non-food prices, thanks to a slowdown in overall domestic economic activity amid Covid19 lockdown topped up with lower international oil prices and stable exchange rate. As a result, overall inflation has remained tepid, averaging 8.6%N[5] (7.3%U, 10.7%R) compared to food prices index averaging 13%U and 16R%.

During Dec-20 food prices depicted a downward trend, which makes us believe that food prices, in particularly perishable food items combined with a better crop expectation in 2021, should normalize overall food prices. While ease up in food prices may eventually come as a relief on inflationary front in the near-term but we are not so optimistic on non-food prices. In fact on the non-food prices, given the price gap created government has already started to pass on power tariff adjustments and has gradually increase domestic oil prices.

Looking ahead, resumption of IMF talks, negative real rates, recovering global commodity prices and an eventual pressure on exchange rate seems all inevitable, which will keep inflation

[4] Based on 3months forward inflation
[5] N=National, U=Urban, R=Rural

downward sticky. Hence post near-term we see disinflationary trend should start to fade, with economic recovery still fragile this would start to transit slowly towards a reflation-like scenario.

Monetary Policy: ...however this should not prompt any aggressive rate increases

First move of 50-100bps likely starting Sept-21 (1qFY22) onwards

Up till now, much akin to global central banks, State Bank of Pakistan's (SBP) response to Covid19 pandemic has been 'accommodative[6]' overlooking inflation as it stepped out of its comfort zone and let the real rates loose. So much so that from the period starting Covid19, real rates have remained in the negative territory averaging ~1.5%, a case which has rarely been seen in Pakistan. Moreover deferment of interest payments and other monetary relief measures have corroborated well with government ongoing Covid19 relief spending; 4.0% of the GDP, especially considering when the country was already carrying a high fiscal and debt burden (fiscal deficit recorded 8.1% in F20).

A road less travelled

Looking ahead in 2021, we view SBP is likely to carry on this new path of policymaking, overlooking inflation and facilitating the government in much needed fiscal space, by keeping the monetary policy accommodative if not ultra-accommodative. A change in policy, we think, is most likely to come around if there is a visible downplay shift in Covid19 pandemic or the output is back to pre- Covid19 levels, leading to possible emergence of risks of over-heating. However, this scenario seems unlikely to come by anytime soon but pressure from rising inflation will build-in which may influence tightening temptations. Hence, we are of the view that SBP will continue to keep policy rate unchanged at current level of 7% at least till the remainder of FY21 (consensus 50-150bps increase) and is likely make the first move of 50-100bps to 7.5-8.0% starting Sept-21 (1qFY22) onwards.

External Account: Stable for now…

For the remainder of 2021, we expect C/a balance trend to reverse, posting a deficit of USD 2.6bn (Dec-Jun), taking cumulative deficit to USD ~1.0bn or 0.4% of the GDP for FY21.

By contrast Covid19 pandemic had a positive outcome on current account (C/a) balance as it continues to post monthly surplus of USD ~300mn since Jun-20 to USD 1.64bn (~1.4% of the GDP). Although there is a negligible change on trade deficit (7.5% of the GDP by Nov-20 vs 7.3% last year), country remittances saw the largest increase accounting now for nearly 10.2% of the GDP (8.4% last year) or +27%y/y to USD 11.8bn.

Exhibit: Pakistan External balance looking comfortable

In USDmn	FY19	FY20	FY21e	FY22e	FY23e	FY24e
Exports	24.3	22.5	23.6	24.8	25.5	26.8
Imports	51.9	42.4	47.8	50.4	51.9	53.7
- - POL	13.9	9.2	9.3	10.8	11.7	12.9
- - Others	37.9	33.2	38.5	39.6	40.2	40.8
Trade Bal.	(27.6)	(19.9)	(24.2)	(25.6)	(26.4)	(26.9)
Remittances	21.7	23.1	27.2	28.0	28.8	29.7
Current Account bal.	(13.4)	(3.0)	(1.0)	(3.2)	(4.3)	(3.9)
Current account/GDP	-4.8%	-1.1%	-0.4%	-1.1%	-1.3%	-1.1%
Capital Account	0.2	0.3	0.3	0.3	0.3	0.3
FX Reserves	14.5	18.0	21.5	20.5	18.6	18.3

Source: SBP, IGI Research

[6] Policy rate reduced by 625bps since Jan-20 to date

Remittances and exports growth will be enough to cover up for rise in import bill

Our base case assumption incorporates a +5% y/y growth in exports to USD 24bn (USD 9.6bn in 5mFY21) and healthy remittances growth to continue, reaching a cumulative size of 27.2bn in FY21; +18% (USD 11.8bn in 5mFY21). On imports, we expect around USD 9.3bn (asm. oil USD 45/bbl[7]) worth of petroleum imports (USD 3.4bn in 5mFY21) mainly as we see demand of POL products to ramp further in next 7months. Other than petroleum imports we expect roughly +16%y/y growth to USD 38.5bn (USD 14.7bn in 5MFY21) as government mulls to support industrial growth; widening saving-investment gap and commodity prices have recovered significantly from its bottom during Mar-20, translating to an import bill of USD 47bn (+11%y/y).

Exchange Rate: However, build up in FX reserve still remains thin

We expect PKR to remain stable in Fy21, but likely to experience some pressure going forward as FX reserves drawdown and C/a reverses it trend

These monthly C/a surpluses along with debt servicing forgo, has helped build-up in FX reserves which reached USD 20.0bn by Dec-20. This has not only provided much needed relief on import cover that reach 3.5x up from 2.5x months last year, but has also with a bit of support from weak USD, led to PKR appreciate by nearly 5% in between Jun-Dec 2020, from 167 to 160 against USD. With this additional fx buffer created in 1hFy21, we expect PKR to remain stable in the latter half of Fy21 as well. Looking past Fy21 we expect PKR is likely to experience some pressure going forward as FX reserves drawdown amid C/a surpluses reveres it trend.

Recommencement of IMF Program

In this regard, recommencement of IMF Extended Fund Facility (EFF) program becomes deem important. Amid Covid19 distress IMF has lend nearly USD 1.4bn[8] to Pakistan and resumption of IMF EFF program will not only uplift some pressure on FX reserves, but it will also ensure putting much awaited structural reforms back on track. While we are not ascertain of the timing as yet, but as per SBP, talks are underway between IMF and Pakistan. Be it in the IMF program or no, some of the growth impeding legacy issues including resolution of Circular Debt is already shaping up.

Exhibit: IMF Pakistan Schedule of reviews and disbursement

Pakistan has yet to receive USD 2.2bn under IMF EFF program

Date	USDbn	Review	Progress
3-Jul-19	0.98	Approval July 2019	Received
6-Dec-19	0.45	1st Review: Sept	Received
6-Mar-20	0.45	2nd Review: Dec	Deferred due to covid19
5-Jun-20	0.45	3rd Review: Mar	
4-Sep-20	0.45	4th Review: Jun	
5-Mar-21	0.77	5th Review: Dec	
3-Sep-21	0.77	6th Review: Jun	
4-Mar-22	0.77	7th Review: Dec	
2-Sep-22	0.77	8th Review: Jun	
Total	**5.85**		

[7] For every USD 5/bbl. Increase/decrease c/a balance has a roughly USD 300mn impact based on our estimates
[8] Pakistan monetary assistant from IMF: RFCC from IMF worth USD 1.386bn, World Bank: USD 200mn, ADB: USD 2mn (USD 500mn and USD 300mn through Ehsaas Program), Other Countries: USD ~100mn

Resolution of power sector circular debt

The government finally gave a go ahead to raise electricity tariffs by PKR3.34/kwh in Dec-20 (from PKR13.35/kwh to PKR16.69/kwh), in order to bring electricity prices in-line with cost and more hikes are likely to follow in 2021.

Moreover, proposal is in place to amend NEPRA act which includes passing on losses, theft and lower recoveries to the consumers through surcharges. With respect to resolution of circular debt, the government recently inked agreements with IPPs (on pre-2015 Power Policy) to clear dues of the power sector (PKR ~450bn,), in exchange for re-negotiation of PPA terms of incumbents to the tune of PKR 675bn (GoP savings over the next 5-years). This entails reduction in tariff indexations and ROEs. Not only would this improve the ongoing liquidity crunch for the power sector it would reduce the GoP's future liability. So far negotiations between the government and IPPs have been successful, and Federal government has only recently given its consent to clear dues of IPPs in three installments by Dec-2021 to which IPPs have agreed but formal agreement is yet to be finalized.

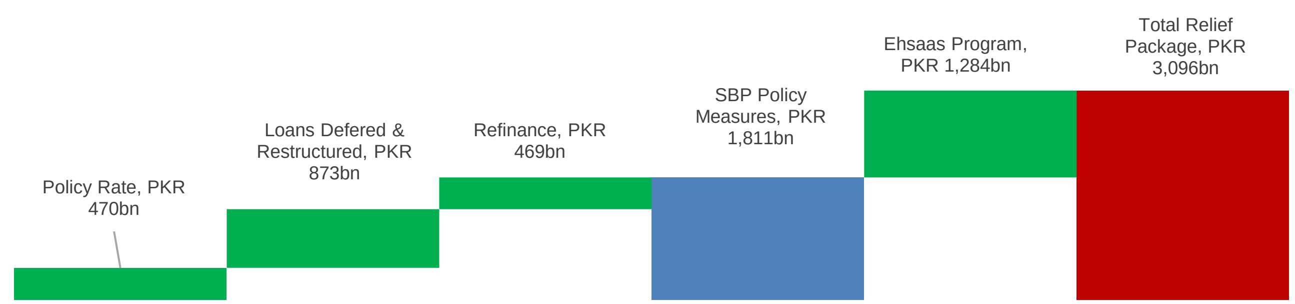
Fiscal and debt management under IMF will be tricky

Looking into 2021, we believe pr. fiscal balance will remain manageable, however external debt pressure is likely to build-up. Although government has reserve building avenues under its sleeves but this will take some time to materialize in our view.

Since the outbreak of Covid19 pandemic, IMF has shown leniency and much of the agreed fiscal/structural reforms have been put on the back burner. Hence resumption of program is likely to bring back these agreed reforms, among other fiscal consolidation being the most important.

So far in 1q of Fy21 fiscal authorities have managed to restrict pr. fiscal balance under 0.6% in line with IMF target, successfully steering away Covid19 relief package of PKR 1.8trn [9]burden onto domestic debt. As result, debt as a percentage GDP rose to 81% by Sep-20 (80% in Dec-20), contrary to IMF recommendation of annual reduction of public debt by 0.5%.

Exhibit: SBP and Government Covid19 funding package



Source: SBP

Going forward, we believe pr. fiscal balance will remain manageable in 2021. However this would require taking stringent tax measures in upcoming budget (at current rate tax to GDP for 2021 would fall under 9.9%), reducing development budget and subsidies leading to raise in power/gas tariff.

Secondly, Pakistan was able to defer external debt repayments pressure, thanks to suspension of external debt servicing (USD 3.6bn) by G20 countries and support from multilateral and bi-lateral agencies. Looking into 2021, we expect external debt pressure is likely to build-up.

[9] To date SBP policy measures has mobilised around PKR 1.8trn including government Ehsaas Program of PKR 1.3trn to total PKR 3.1trn. This amounts to roughly 6.8% of the GDP (2020)

Although government has reserve building avenues under its sleeves, including selling of LNG based power plants (USD2.0bn), issuance of Eurobond [10](estimated size USD 2.0bn) and later sale of public sector entities[11] including Pakistan International Airline, Pakistan Steel Mill and others, but this will take some time to materialize in our view. While any early development on this would be welcomed by market.

Exhibit: Pakistan key economic indicators

		2017a	2018a	2019a	2020a	2021f	2022f	2023f
Gross Domestic Product								
GDP	USDbn	305	314	279	263	276	299	329
GDP (MP)	PKRtn	31.9	34.6	38.0	41.7	45.3	50.8	57.9
GDP per capita	USD	1,467.5	1,477.9	1,280.7	1,178.1	1,208.1	1,276.5	1,372.6
Growth Rate								
Real GDP	%	5.2	5.5	1.9	(0.4)	1.8	3.1	4.7
%age Share of GDP								
Agriculture	%	19.3	19.0	18.7	19.3	18.6	18.4	18.0
Industries	%	20.8	20.6	19.7	19.3	20.5	21.0	21.3
Services	%	60.0	60.4	61.5	61.4	60.9	60.5	60.7
Prices and Monetary								
CPI	%	6.5	4.7	6.8	10.8	8.8	9.0	9.0
Discount Rate (avg.)	%	5.9	6.8	10.4	11.0	8.5	9.0	9.0
External Sector								
C/a Bal.	USDbn	(12.3)	(19.2)	(13.4)	(3.0)	(1.0)	(3.2)	(4.3)
Exports	USDbn	22.0	24.8	24.3	22.5	23.6	24.8	25.5
Imports	USDbn	48.0	55.7	51.9	42.4	47.8	50.4	51.9
Trade Bal.	USDbn	(26.0)	(30.9)	(27.6)	(19.9)	(24.2)	(25.6)	(26.4)
Remittances	USDbn	19.4	19.9	21.7	23.1	24.9	26.5	27.9
FDI	USDbn	2.4	2.8	1.4	2.6	1.8	4.4	3.1
FPI	USDbn	(0.3)	2.2	(1.4)	(0.5)	0.0	0.0	0.0
FX Reserves	USDbn	21.4	16.4	14.5	18.0	21.5	20.5	18.6
C/a Bal. / GDP	%	(4.0)	(6.1)	(4.8)	(1.1)	(0.4)	(1.1)	(1.3)
USD		104.7	109.8	136.1	158.7	164.3	170.0	176.0
Fiscal (%age of GDP)								
Tax Revenue	%	12.4	12.9	11.8	11.4	10.1	11.0	11.7
Non-tax revenue	%	3.0	2.2	1.1	3.7	3.2	3.7	3.7
Current Expenditure	%	16.3	16.9	18.7	20.4	20.4	20.2	20.0
Social Spending	%	9.3	9.6	10.2	11.3	11.0	11.0	11.0
Development Expenditure	%	5.3	4.7	3.2	2.9	1.0	2.0	2.3
Fiscal Balance	%	(5.8)	(6.5)	(9.1)	(8.1)	(8.0)	(7.5)	(7.0)
Debt (%age of GDP)								
Gross Public Debt	%	67.1	72.1	86.1	73.7	63.9	65.7	65.9

Source: IGI Research, PBS, SBP, Ministry of Finance, IMF

[10] Government plans to raise USD 1.0bn before the end of Mar-21 and second USD 1.0bn before Jun-21. Moreover ECC has also approved WAPDA of floating USD 500mn Eurobond for Diamer Bhasha Dam project.
[11] ECC recently approved sale of stakes in the Pakistan Credit Guarantee Company (PCGC) and more such deals are likely to come

Earnings to post 13% growth in 2021

We see +13% eps growth in 2021, led by cyclical sectors cements, omcs and steel sector.

Macro weakness took a slice of 2020 eps

Owing to a host of weak macroeconomic data, corporate earnings for companies under IGI coverage (taken as a proxy for market earnings) registered a decline of 2% in 2020, to PKR 458bn or EPS of 13.8 compared to growth of +10% in 2019.

2021 Earnings to depict healthy growth of +13%y/y

For year 2021, we estimate earnings growth of our coverage companies (~51% of the KSE 100 market capitalization) to post a +13% y/y growth to EPS of PKR 15.6 compared to PKR 13.8 & 14.0 in 2020 and 2019, respectively. In terms of 3yr forward outlook, we expect a ~9.7% cagr which is higher than trailing 3yr cagr of ~5.8%.

Exhibit: 2020 Sector earnings performance

%age y/y	3yr T Cagr	3yr F. Cagr
Commercial Banks	11%	4%
Oil & Gas Exploration Companies	19%	2%
Fertilizer	16%	0%
Power Generation & Distribution	32%	-8%
Cement	n.m.	n.m.
Oil & Gas Marketing Companies	n.m.	n.m.
Automobile Assembler	-47%	76%
Engineering	-85%	709%
Chemical	9%	21%

Exhibit: KSE 100 Earnings outlook (based on IGI team coverage)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Earnings Growth	0%	27%	-4%	-11%	4%	9%	10%	-2%	13%	9%	7%
EPS	10.2	13.0	12.5	11.2	11.7	12.8	14.0	13.8	15.6	17.0	18.2
DPS	6.0	7.0	7.2	6.6	6.5	6.6	5.9	5.1	6.2	7.4	8.6
Pay-out Ratio %	59	54	58	59	56	52	42	37	40	44	47
P/E x	9.8	7.7	8.0	8.9	8.6	7.8	7.1	7.2	6.4	5.9	5.5
D/Y %	6.1	7.0	7.2	6.6	6.5	6.6	5.9	5.1	6.2	7.5	8.6
P/B	2.1	1.7	1.6	1.5	1.4	1.3	1.1	1.0	0.9	0.9	0.8
ROA	3.7	4.4	3.7	2.9	2.7	2.6	2.6	2.4	2.7	2.9	3.1
ROE	21.5	24.9	20.9	17.2	16.7	16.9	16.8	14.8	15.3	15.4	15.2

Exhibit: Year 2021 Waterfall Chart of KSE 100 earnings contribution sector-wise
From Year 2020 to Year 2021

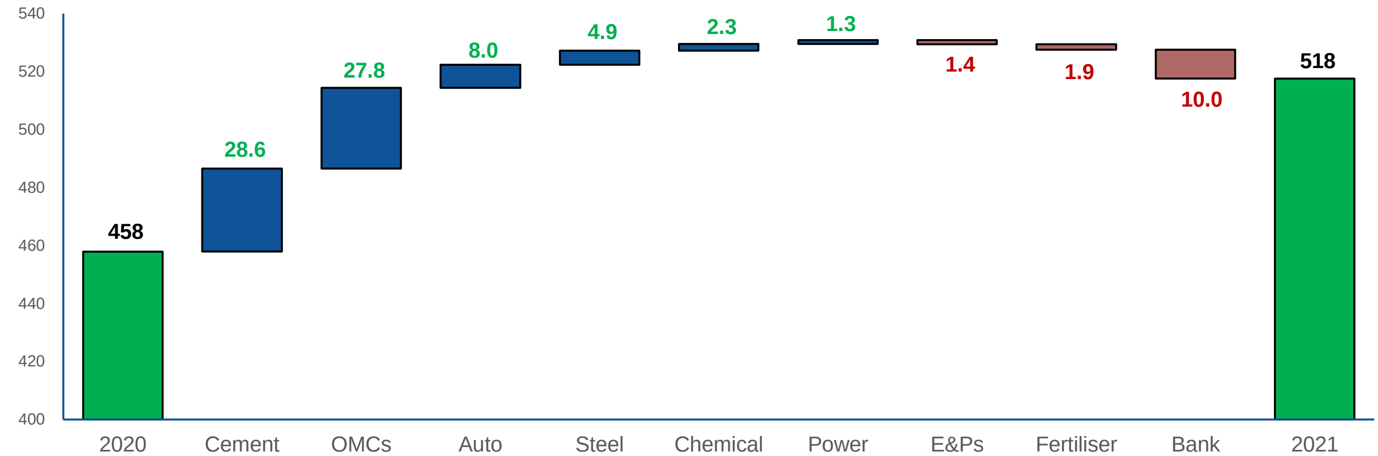


Exhibit: Year 2021 Waterfall Chart of KSE 100 earnings contribution Company-wise
From 2020 to 2021

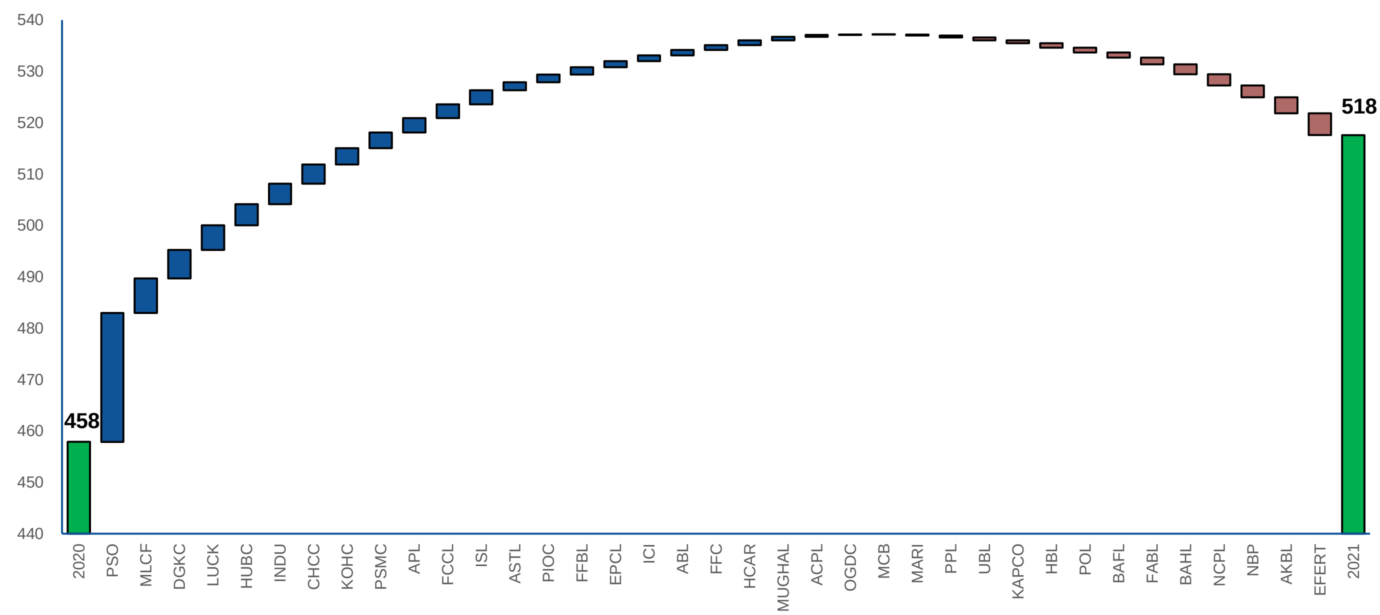


Exhibit: KSE 100 Earnings Growth Contribution (based on IGI team coverage)
Market Sector-wise contribution in percentage points

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Market	-4%	-11%	4%	9%	10%	-2%	13%	9%	7%
Commercial Banks	5%	2%	-6%	-2%	3%	14%	-2%	4%	2%
Oil & Gas Exploration Companies	-9%	-9%	9%	10%	22%	-5%	0%	4%	-1%
Fertilizer	2%	-2%	0%	4%	-1%	2%	0%	0%	1%
Power Generation & Distribution	2%	0%	0%	0%	1%	11%	0%	-2%	0%
Cement	2%	2%	-1%	0%	-2%	n.m.	n.m.	5%	3%
Oil & Gas Marketing Companies	-1%	1%	4%	-1%	-1%	n.m.	n.m.	0%	0%
Automobile Assembler	8%	0%	2%	0%	-1%	-1%	5%	1%	1%
Engineering	0%	1%	1%	1%	0%	0%	259%	0%	1%
Chemical	-2%	0%	1%	1%	0%	0%	1%	0%	0%

Market looks to trade at a discount on nearly all broader valuation matrices

Market valuation still remains below its LT average

Market P/E multiple has already re-rated nearly ~+61% from its bottom in Mar-20 and trades at a fwd 2021 multiple of 7.3x which is below its LT average of 8.6x and fwd DY of 6.2% (long-term average of 6.5%). Moreover, current market capitalization to GDP is at 17% compared to its historic average of ~22% and similarly on market capitalization to broad money (M2) basis at ~33% versus historic average of ~50%.

Regional discounts have widened up significantly despite improving dynamics

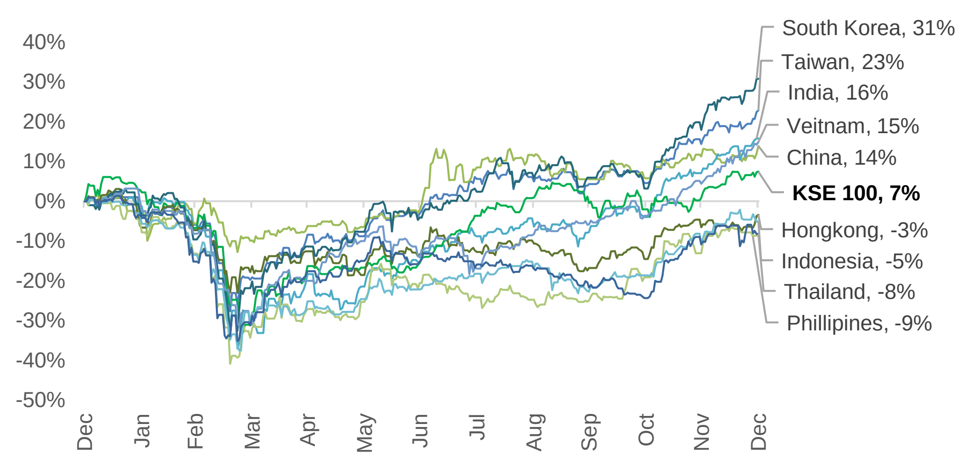
Similarly, compared to region; domestic market discounts have widened up significantly by almost 60% (historic ~40%). These discounts were justified due to a multiple of factors including, i) lower GDP growth to its region, ii) high interest rates and volatile exchange rate, iii) law and order instability, iv) inconsistent policies and regulation, v) and on a smaller scale iv) impending energy sector reforms (circular debt).

Exhibit: Relative Valuation

	P/E - x	P/B - x	D/Y - %	ROE - %	Mkt. cap. / GDP %*
Pakistan	**7.3**	**1.1**	**4.7**	**16.3**	**18.1**
Historic 10yr	8.6	1.1	6.5	22.0	22.0
Avg. (ex-China)	22.2	2.0	1.9	9.8	88.2
Taiwan	20.4	2.3	2.8	15.0	241.3
China	15.6	1.6	2.1	9.5	70.9
India	28.9	3.4	1.1	11.1	152.1
Hong Kong	14.5	1.2	2.6	9.7	1,613.3
South Korea	20.6	1.2	1.6	5.4	116.6
Vietnam	19.0	2.5	1.3	15.7	44.9
Philippines	28.4	1.7	1.6	5.8	65.6
Indonesia	25.2	2.1	1.9	11.0	30.7
Thailand	27.6	1.7	2.2	4.9	96.8

Source: Bloomberg, IGI Research, *Average excludes HK, TWN, and CHN

Exhibit: Regional market performance



Going into 2021, much of these concerns especially structural impediments have to an extent subsided or are in process of rectification. Pakistan has successfully, if not as yet fully, been compliant with FATF white-list, but has also averted downgrading to black-list. Moreover, Pakistan response to Covid19 has fared rather well in terms of economic policy making and government support. As a result gdp pain and human Covid19 related casualties/cases have been rather shallow compared to its region.

Hence we think it's high time for Pakistan market discount to region should start to narrow. With this in mind, HBL and OGDC two of the largest market capitalization stocks have faced a large foreign selling in 2020, causing a laggard performance of MSCI Pakistan. We think this is likely to reverse as fundamentals outlook has improved for both companies and as well as.

Individual investors poured in liquidity during 2020

While much of the liquidity support in 2020 was down to retail/individual investor's USD 232mn, whereas foreign investors remain yet again liquidity drainer for the third consecutive year. While EM countries in general saw an outflow in equities during the 2nd and the 3rd qtrs of 2020, however during Nov/Dec-20, flows to EM equity turned positive, unlike in Pakistan.

Exhibit: Market Liquidity

Individuals and insurance companies were the largest buyer during 2020, whereas foreign corporates seller

in USDmn	Net	Cement	Fertiliser	Food	E&Ps	OMCs	Power	Banks	Tech/Comm.	Textile	Others
Individuals	232.1	10.6	40.8	4.7	62.1	17.6	21.8	60.0	12.3	6.1	(3.7)
Insurance Companies	226.8	70.6	12.7	6.4	68.6	27.8	18.1	26.6	1.4	(15.9)	10.5
Companies	110.7	25.5	0.9	(1.8)	0.2	(14.5)	7.9	48.7	4.0	16.3	23.6
Mutual Funds	29.2	17.2	(25.1)	1.3	(17.8)	(10.5)	(3.9)	8.3	(9.5)	4.4	64.9
Other Organization	16.7	(13.6)	3.9	(0.4)	6.5	(2.6)	(0.0)	7.0	(0.3)	1.1	15.2
Nbfc	3.1	0.2	0.3	(0.3)	0.3	(0.6)	0.9	(0.2)	1.1	0.4	1.0
Foreign Individual	0.6	0.0	(0.1)	0.0	0.1	0.3	(0.0)	(2.7)	0.0	(0.2)	3.1
Broker Proprietary Trading	(14.0)	(2.9)	(1.5)	0.4	0.8	0.0	0.2	(1.6)	(5.5)	(2.0)	(1.9)
Overseas Pakistani	(30.2)	6.1	(2.1)	(0.5)	5.2	1.4	0.9	9.9	(1.0)	1.3	(51.5)
Banks / Dfi	(33.1)	(6.7)	6.6	(3.5)	(1.0)	(3.1)	(31.7)	19.5	0.7	(2.1)	(11.8)
Foreign Corporates	(541.8)	(107.0)	(36.2)	(6.2)	(124.9)	(15.8)	(14.0)	(175.5)	(3.2)	(9.5)	(49.4)

Exhibit: Market volumes (mn)

In 2020 market volumes touched a multi-year high averaging 331mn shares, with 3q seeing the largest increment

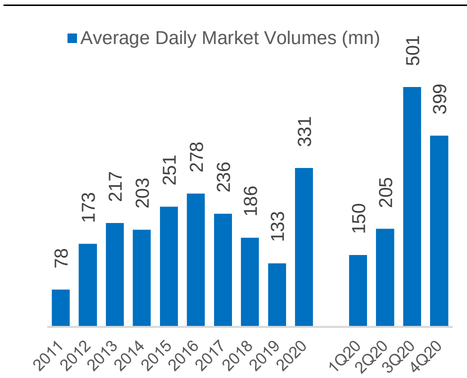


Exhibit: Market value traded (mn)

Similarly market value traded also reached multi-year high during 2020

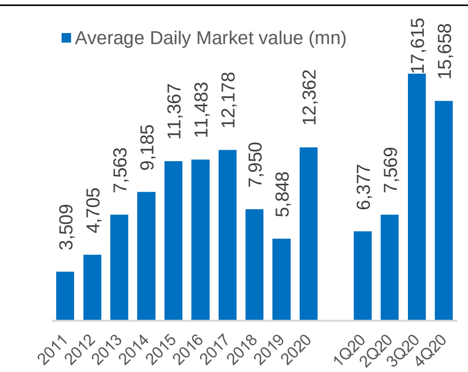
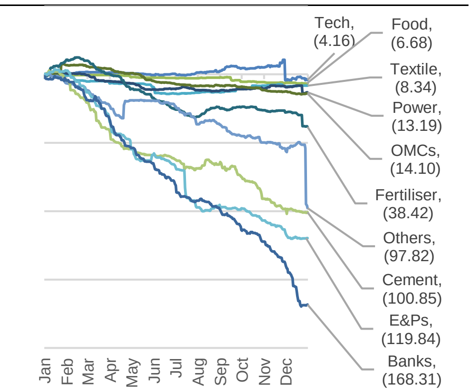


Exhibit: Foreign sector wise activity

Amongst the USD 571mn, foreign investors offloaded nearly USD 168mn in banks only during 2020



Source: NCCPL, IGI Research

We think, this can be ascribed to a i) strengthening of PKR against the greenback unlike other EM currencies, ii) there was large asset shift from debt to equity in EM compared to Pakistan that has a relatively very small portion, and iii) major influx of EM equity flows was in IT, Pharma and FMCG sector, whereby Pakistan has a relatively smaller market size. – IT sector has a total market capitalization of USD 1.24bn.

We remain conservative on market valuations re-rating to higher multiples

While we acknowledge marked improvements in overall market liquidity, strong corporate earnings rebound and attractive regional discounts do hold true in 2021, but we remain conservative on market valuations re-rating to higher multiples.

Earning yields: Interest rate cycle to reverse its course, putting pressure on earning yields

Negative real-interest rates have so far been supportive of overall re-rating of market multiples (e/ylds touched ~14.7%, compared to 12m yld of 7.5%) and we think it will continue to do so at least till the first half of 2021 whereby we see negative real-interest rates to continue. Hence we think market is likely to show new highs in 1h of 2021. Post that seeing a rate reversal cycle by 2h 2021, we suspect market e/ylds are likely to fall back causing multiples to revert to its LT average.

Growth: Economic growth remain less impressive going forward

Similarly, much uncertainty remains regarding the strength and durability of the Pakistan economic cycle going forward. Some of the positive economic footings achieved so far in 2021 are likely to lose some sand beneath and will experience some degree of reverse change. Combined with limited monetary and fiscal maneuverability, economic growth going forward will be far from impressive, in our view. Not surprisingly, IMF in its latest dataset expects Pakistan's GDP to grow at a mere 1.0% compared to SBP 1.5%-2.5% in 2021 (regional average 6.0% in 2021) and onwards expects Pakistan growth will be limiting itself to 5% till 2025.

Exhibit: IMF GDP Growth forecasts

Pakistan Recovery is more '**Flat**' than a **'V'**-shape - In 2021, Pakistan GDP is expected to show a 1.8% (IMF: 1.0% and SBP: 1.5-2.5%) growth.

	2013-2018	2019	2020	2021e	2022e	2023e	2024e	2025e
Pakistan	**4.70%**	**1.90%**	**-0.40%**	**1.00%**	**4.00%**	**4.50%**	**5.00%**	**5.00%**
Average (ex-china)	5.50%	4.30%	-3.60%	6.00%	6.00%	5.70%	5.60%	5.40%
Bangladesh	7.00%	8.20%	3.80%	4.40%	7.90%	7.30%	7.30%	7.30%
China	6.90%	6.10%	1.90%	8.20%	5.80%	5.70%	5.60%	5.50%
Vietnam	6.80%	7.00%	1.60%	6.70%	7.40%	7.20%	6.90%	6.60%
Indonesia	5.00%	5.00%	-1.50%	6.10%	5.30%	5.20%	5.10%	5.10%
Sri Lanka	4.30%	2.30%	-4.60%	5.30%	5.00%	4.60%	4.70%	4.80%
Turkey	5.00%	0.90%	-5.00%	5.00%	4.00%	3.50%	3.50%	3.50%
Malaysia	5.20%	4.30%	-6.00%	7.80%	6.00%	5.70%	5.30%	5.00%
Thailand	3.20%	2.40%	-7.10%	4.00%	4.40%	4.30%	4.30%	3.70%
India	7.40%	4.20%	-10.30%	8.80%	8.00%	7.60%	7.40%	7.20%

Source: IMF, IGI Research

KSE 100 index target	Market Forward P/E	Dividend Yield	Total Return 2021
51,000	**8.1x**	**6.2%**	**~17%**

Eyeing an Index target of 51,000

By 2021, we eye an index target of 51k generating a return of ~11% from its current index level of 46k.

Base case: Index target of 51,000; offering a total return of +17%

By 2021, we eye an index target of 51k which is below market consensus 53k (95%), generating a total return of ~11% from its current index level of 46k. We have taken a market target P/E multiple approach as our basis for index estimation. Based on our index target of 51k market would trade at a forward P/E of 8.1x which is below LT historic average. More over at current our market dividend yld, comes at 6.2% taking total market return to ~17% in 2021.

Market P/E and Index Target				Earnings Growth				
Case	P/E	Index Target	Upside	-5.0%	-2.5%	0.0%	2.5%	5.0%
Current	7.3	46,000						
Bear	7.4	47,000	2%	44,000	45,000	47,000	48,000	49,000
Base	8.1	51,000	11%	49,000	50,000	51,000	52,000	54,000
Bull	8.9	56,000	22%	53,000	54,000	56,000	57,000	59,000

We see a year of two halves

Having said that, we see a year of two halves. The first half of 2021 looks much rosier on the domestic front, characterized by continued improvement in large-scale manufacturing, corporate earnings as low interest rates, resumption of IMF program and delayed fiscal tightening remains supportive. Hence we think market is likely to rejoice on this.

Post this we see inflation pressure building up, causing interest rate cycle to reverse. Moreover the recent upsurge in demand in particularly cyclicals (cements, autos and steel) and improved margins will likely see some respite as global commodity prices are on the rising trend. Moreover, additional tax measures along with structural reforms post resumption of IMF will eventually seep in corporate earnings.

Bull Case: 56,000

For our bull case we have factored in 100bps rate cut and gdp growth of 2.25% (1.8% for base case) which fall under SBP projected growth of 1.5-2.5%. For that, we highlight declining oil price could act as a catalyst, which could drive stronger economic and corporate earnings growth than our baseline forecast. Moreover, continued capital inflows in form of FPI and uni/bi-lateral funding will continue to support external accounts and thus FX reserve build-up, which will instil confidence in both local and foreign investors. If materialized, this could stretch equity valuations to its long-term average of 8.9x, implying a target index of 56,000.

Bear Case: 47,000

For our bear case, we factored in slow GDP growth, early monetary tightening and delays in reforms leading to further fiscal constraints. We see less probability of this happening. Based on this our implied market multiple comes at 7.4x giving an index target of 47,000.

Exhibit: Market Index sensitivity to GDP and Policy rates 2021

		GDP				
		1.0%	1.5%	1.8%	2.0%	2.3%
SBP Policy rate	7.0%	53,000	58,000	63,000	66,000	70,000
	7.5%	48,000	53,000	56,000	59,000	62,000
	8.0%	44,000	48,000	**51,000**	53,000	56,000
	8.5%	41,000	44,000	47,000	48,000	51,000
	9.0%	38,000	41,000	43,000	45,000	47,000

Exhibit: Market historic P/E

KSe100 trading well below it's its historic p/e of 8.6x.

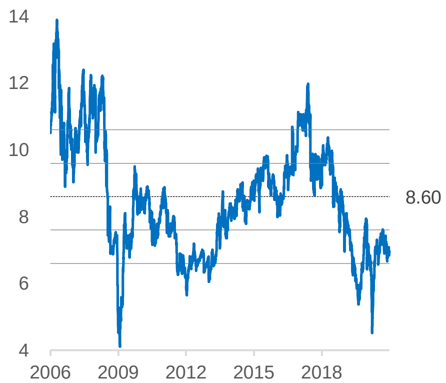
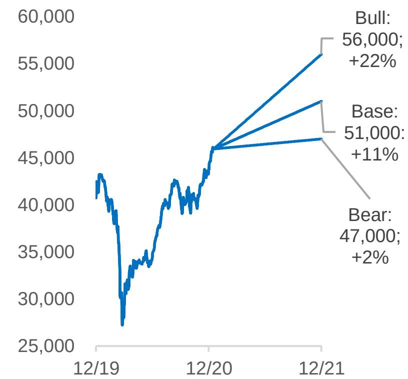


Exhibit: Market e.ylds and bond ylds.

Earnings yields (1/pE) in tandem to bond yields

Exhibit: Index target

Base case: 51,000



Source: Bloomberg, IGI Research

Sector outlook and Top Picks companies

Preferred Picks

From a market strategy standpoint, we like "growth at a reasonable price" stocks among banks, energy, materials and industrials – both large and mid-caps. Our preferred picks are as follows:

Exhibit: Preferred picks

Sym	Current Price	Target Price	Upside	P/E	D/Y	P/B	3yr - Fwd. eps gr
HUBC	86	133	55%	3.8	8.2%	1.1	17%
MARI	1,360	1,991	46%	6.0	0.5%	1.5	2%
OGDC	114	160	41%	4.9	7.0%	0.6	1%
MLCF	43	57	32%	14.7	3.5%	1.3	n.m.
INDU	1,192	1,576	32%	10.4	5.0%	2.1	33%
HBL	142	185	31%	6.7	8.8%	0.8	6%
PSO	238	306	29%	6.0	3.4%	0.9	n.m.
FFC	111	138	24%	7.6	9.2%	3.2	4%
LUCK	698	835	20%	27.5	0.7%	2.1	72%
PIOC	107	127	18%	18.8	2.6%	1.8	n.m.
EPCL	48	56	16%	7.6	3.1%	1.5	14%
POL	428	483	13%	7.9	10.5%	2.8	4%

Sector	Stance	Comments	Top pick
Banks	OW	Stepping out from 2020, we turned more positive on banks. Loan provisioning could further increase in the 4th qtr, but will peak by 2020 end. In addition banks' are favourably placed to fully benefit of the rate hike expected by 1h 2021, supporting our case for an earnings recovery for the banking sector next year.	HBL
E&Ps	OW	Recovery in oil prices and production to translate in to stable earnings in FY21 and lead to growth in FY22. Resolution of circular should act as key trigger for PPL and OGDC while new blocks to be value accretive in long term. PKR depreciation should also support earnings however diversification remains key to long term earnings sustainability due to reserve depletion.	MARI, POL & OGDC
Power	MW	Structural reforms under IMF program are likely to ease cash constraints for power companies whereas conversion of MoUs in to final agreement would also value accretive for IPPs. However reduced RoEs along with Take and Pay mechanism is likely to dent earnings and payout in long term.	HUBC
OMCs	OW	Recent pricing mechanism changes are likely to tame earnings volatility whereas resolution of payment of over dues to power sector will improve cash position of PSO. Furthermore, new regulatory changes in pipeline are likely to benefit bigger OMCs such as PSO, SHEL and APL.	PSO
Cement	OW	Favourable sector dynamics – in the shape of (a) anticipated higher volumes largely backed by government construction theme and attractive private credit off-take scenario, (b) improved margins amid increased cement price, lowered discount, and contained cost structure, (c) restricted finance cost driven by substantially reduced benchmark interest rates, are expected to present a turnaround in the sector. Prospectively, our coverage companies eps is expected to deliver a 3yr fwd cagr of ~37%.	LUCK, MLCF & PIOC
Engineering	MW	We draw our stance on the back of anticipated strong earnings display for FY21 and government incentives for construction sector. However, we believe positive seems to have priced.	
Autos	OW	We believe reviving demand may keep volumetric growth rather rosier in 2021. Although increase in interest rates seems a likely scenario in next six month or so, we believe the worst in term of sales is over.	INDU
Fertilizers	MW	We base our investment thesis on the back of (a) stable urea off-take wherein, we foresee urea off-take will be remain in the range of 5.6-5.8mn tons (5 year average) in 2021 and beyond, (b) proposed gas price hike. (c) In our opinion, the matter pertaining to GIDC have been priced in; (d) reversal of disallowance on input sales tax by GOP and lastly manageable urea inventory levels.	FFC
Chemical	OW	Our coverage company have monopoly over the products they produce, namely and therefore have the capacity to charge at premium pricing. On the other hand, We see core delta to normalize once capacities come online and demand shifts as global economy revives. Looking at the past trend of margins, we project USD 400/ton core delta, going forward.	EPCL

Exhibit: IGI Coverage Companies Recommendation and key Financial Highlights

SYM	Cur. Price	Target Price	Recom.	EPS			DPS			BVPS			Earnings Gr%		
				'20	'21	'22	'20	'21	'22	'20	'21	'22	'20	'21	'22
INDU	1,192	1,576	Buy	64.3	114.5	136.7	30	60	70	521.1	575.9	642.9	-63	78	19
HCAR	313	380	Buy	4.8	11.3	19.2	1.8	3	10	115.8	124.1	133.3	-82	136	70
PSMC	221	266	Buy	-27.6	9.8	18.9	0	2.5	4.8	284.2	257.3	261.4	n.m.	n.m.	93
Autos															
ACPL	154	176	Buy	8.1	10.8	16.4	3.5	5.3	8.3	120.8	126.3	134.4	-47	33	52
CHCC	141	163	Buy	-9.8	9.5	15.5	0	4.8	7.8	51.8	56.6	64.3	n.m.	n.m.	63
DGKC	111	151	Buy	-4.9	7.6	17.7	0	3.8	8.8	156	159.9	168.8	n.m.	n.m.	132
FCCL	22	28	Buy	0	1.9	2.9	0.3	1	1.5	14.4	15.3	16.7	n.m.	n.m.	51
KOHC	213	238	Buy	-2.2	13.6	21.1	0	6.8	10.5	93.2	100.1	110.7	n.m.	n.m.	55
MLCF	43	57	Buy	-3.2	2.9	5.2	0	1.5	2.5	31.5	33.1	35.7	n.m.	n.m.	76
PIOC	107	127	Buy	-0.9	5.7	13.6	0	2.8	6.8	57.8	60.8	67.6	n.m.	n.m.	138
LUCK	698	835	Buy	10.4	25.4	39.1	0	5	7.8	307.1	327.4	358.7	-68	145	54
Cement															
HBL	142	185	Buy	21.8	21.2	24.2	11	12.5	13.5	169.2	179.6	192.1	109	-3	14
NBP	43	60	Buy	14.4	13.3	14.6	4.8	7	12	122.9	129.3	131.9	94	-7	9
UBL	139	155	Buy	16.4	15.9	20.3	10	11	13	139.4	145.7	154.5	5	-3	28
MCB	197	230	Buy	24.7	24.7	26.5	20	20	21.5	141.8	146.5	151.4	22	0	7
ABL	88	116	Buy	14.4	15.3	16	8	8.3	9	102.2	110.2	118.3	17	6	4
BAHL	77	105	Buy	14.9	13.2	13.9	5	4.3	5.3	67.2	77.4	87.6	48	-12	6
BAFL	37	45	Buy	6.1	5.5	6.9	3.8	3.3	4.3	50.4	53.2	56.4	-15	-9	26
AKBL	24	30	Buy	7.5	5	5.2	2	1.3	2	39.4	44	48.1	34	-33	4
FABL	20	17	Sell	4.1	3.2	3	0	0	0	39.7	43.3	46.8	3	-21	-6
Banks															
EFERT	66	72	Neutral	12.5	9.3	9.1	11	4.8	4.5	34	38.6	43.1	-1	-26	-3
FFC	111	138	Buy	13.8	14.6	14.8	11	10.3	10.5	30.8	35.1	39.4	3	5	2
FFBL	27	27	Neutral	0.8	2.4	1.2	0	0	0	13.5	15.9	17.1	n.m.	179	-49
Fertilizer															
OGDC	114	160	Buy	23.3	23.3	25.3	6.8	8	9	160.2	175.8	192.9	-15	0	9
PPL	98	141	Buy	18.5	18.3	20.6	1	2	2	126.6	143.1	161.7	-18	-1	12
POL	428	483	Buy	57.7	54.4	62.8	50	45	50	141.8	151.2	164	-3	-6	15
MARI	1,360	1,991	Buy	227.9	226.7	239.3	6	6.5	6.5	700.4	936.9	1,169.80	25	-1	6
E&Ps															
PSO	238	306	Buy	-13.8	39.6	42.3	0	8	11.8	241.1	272.8	303.2	n.m.	n.m.	7
APL	376	410	Neutral	10.1	38	44.3	9	20	35	184.5	202.6	212	-75	277	17
OMC															
KAPCO	39	51	Buy	26.8	26.2	0	1.5	6.5	0	68.6	88.2	0	80	-3	-100
HUBC	86	133	Buy	19.3	22.5	29	0	7	11	58.8	74.5	93.4	123	16	29
NCPL	19	23	Buy	12.5	6.5	5.1	2	2	2.5	51.7	56.2	59.3	35	-48	-22
Power															
EPCL	48	56	Buy	5	6.3	6.5	1	1.5	2	23.5	31.6	32.8	22	27	2
ICI	777	835	Buy	25.7	37.6	47.3	16	22	28	228.3	243.9	285.1	-7	47	26
Chemical		-													
ISL	93	99	Buy	1.1	7.3	9.6	0	2.3	2.8	29.3	36.6	43.9	-81	544	31
ASTL	48	53	Buy	-3.8	1.5	2.9	0	0.5	1.3	37.4	38.4	40.1	n.m.	n.m.	97
MUGHAL	80	85	Buy	2.6	5.1	7.4	0	2	3	32.4	37.5	42.9	-53	99	44
Steel															

Exhibit: IGI Coverage Companies Valuation Highlights and price performance

SYM	P/E			DY (%)			P/B			ROE (%)			ROA (%)			52 Week		PERFORMANCE		
	'20	'21	'22	'20	'21	'22	'20	'21	'22	'20	'21	'22	'20	'21	'22	HI	LO	03M	06M	12M
INDU	18.5	10.4	8.7	2.5	5.0	5.9	2.3	2.1	1.9	12.3	19.9	21.3	6.3	11.3	13.4	18.5	10.4	-6%	21%	1%
HCAR	65.6	27.8	16.3	0.6	1.0	3.2	2.7	2.5	2.3	4.1	9.1	14.4	2.1	5.1	8.6	65.6	27.8	27%	65%	51%
PSMC		22.5	11.7	0.0	1.1	2.2	0.8	0.9	0.8		3.8	7.2		1.1	2.2		22.5	20%	49%	4%
Autos																		4%	34%	12%
ACPL	19.0	14.3	9.4	2.3	3.4	5.4	1.3	1.2	1.1	6.7	8.5	12.2	4.0	5.4	8.2	19.0	14.3	-2%	19%	45%
CHCC		14.8	9.1	0.0	3.4	5.5	2.7	2.5	2.2		16.8	24.1		5.6	9.2		14.8	25%	59%	172%
DGKC		14.6	6.3	0.0	3.4	7.9	0.7	0.7	0.7		4.8	10.5		2.7	6.3		14.6	11%	27%	52%
FCCL		11.3	7.5	1.2	4.6	6.9	1.5	1.4	1.3		12.6	17.4		9.0	13.6		11.3	9%	27%	35%
KOHC		15.6	10.1	0.0	3.2	4.9	2.3	2.1	1.9		13.6	19.1		8.6	13.3		15.6	28%	55%	181%
MLCF		14.7	8.3	0.0	3.5	5.8	1.4	1.3	1.2		8.9	14.5		4.8	8.5		14.7	25%	67%	90%
PIOC		18.8	7.9	0.0	2.6	6.3	1.9	1.8	1.6		9.4	20.1		2.6	6.3		18.8	14%	61%	226%
LUCK	67.4	27.5	17.9	0.0	0.7	1.1	2.3	2.1	1.9	3.4	7.7	10.9	2.5	6.0	9.3	67.4	27.5	8%	42%	59%
Cement																		12%	43%	75%
HBL	6.5	6.7	5.8	7.8	8.8	9.5	0.8	0.8	0.7	12.9	11.8	12.6	0.9	0.9	1.0	6.5	6.7	1%	35%	-19%
NBP	3.0	3.2	3.0	11.0	16.2	27.8	0.4	0.3	0.3	11.7	10.3	11.1	1.1	1.0	1.1	3.0	3.2	8%	64%	-3%
UBL	8.5	8.7	6.8	7.2	7.9	9.4	1.0	1.0	0.9	11.7	10.9	13.2	1.1	1.0	1.3	8.5	8.7	9%	20%	-27%
MCB	8.0	8.0	7.4	10.1	10.1	10.9	1.4	1.3	1.3	17.4	16.9	17.5	1.9	1.9	2.1	8.0	8.0	7%	15%	-11%
ABL	6.1	5.7	5.5	9.1	9.4	10.3	0.9	0.8	0.7	14.1	13.9	13.5	1.2	1.3	1.3	6.1	5.7	1%	13%	-12%
BAHL	5.2	5.8	5.5	6.5	5.5	6.8	1.1	1.0	0.9	22.2	17.0	15.9	1.1	1.0	1.0	5.2	5.8	8%	33%	-10%
BAFL	6.0	6.7	5.3	10.2	8.8	11.5	0.7	0.7	0.7	12.1	10.4	12.3	0.9	0.8	1.0	6.0	6.7	2%	5%	-24%
AKBL	3.1	4.7	4.5	8.5	5.3	8.5	0.6	0.5	0.5	19.0	11.4	10.9	1.0	0.7	0.7	3.1	4.7	26%	71%	25%
FABL	5.0	6.3	6.7	0.0	0.0	0.0	0.5	0.5	0.4	10.3	7.5	6.5	0.9	0.7	0.7	5.0	6.3	1%	27%	-10%
Banks																		5%	25%	-15%
EFERT	5.3	7.1	7.3	16.7	7.2	6.8	1.9	1.7	1.5	36.9	24.2	21.1	14.2	10.6	10.3	5.3	7.1	4%	0%	-14%
FFC	8.0	7.6	7.5	9.9	9.2	9.4	3.6	3.2	2.8	44.9	41.5	37.6	12.3	13.0	13.3	8.0	7.6	0%	-3%	6%
FFBL	32.3	11.6	22.9	0.0	0.0	0.0	2.0	1.7	1.6	6.2	14.9	7.0	1.2	3.3	1.7	32.3	11.6	26%	57%	23%
Fertilizer																				
OGDC	4.9	4.9	4.5	5.9	7.0	7.9	0.7	0.6	0.6	14.5	13.2	13.1	11.6	11.6	12.7	4.9	4.9	0%	-8%	-27%
PPL	5.3	5.3	4.7	1.0	2.0	2.0	0.8	0.7	0.6	14.6	12.8	12.8	9.3	9.2	10.4	5.3	5.3	-2%	0%	-35%
POL	7.4	7.9	6.8	11.7	10.5	11.7	3.0	2.8	2.6	40.7	36.0	38.3	17.9	16.9	19.5	7.4	7.9	-6%	12%	-14%
MARI	6.0	6.0	5.7	0.4	0.5	0.5	1.9	1.5	1.2	32.5	24.2	20.5	10.7	10.7	11.3	6.0	6.0	-2%	8%	2%
E&Ps																		-2%	-1%	-24%
PSO		6.0	5.6	0.0	3.4	4.9	1.0	0.9	0.8		14.5	14.0		5.4	5.8		6.0	8%	35%	10%
APL	37.3	9.9	8.5	2.4	5.3	9.3	2.0	1.9	1.8	5.5	18.7	20.9	2.0	7.4	8.6	37.3	9.9	-2%	12%	-9%
OMC																		1%	26%	-5%
KAPCO	1.5	1.5		3.8	16.5	0.0	0.6	0.4		39.1	29.6		17.6	17.1	0.0	1.5	1.5	3%	34%	-14%
HUBC	4.4	3.8	3.0	0.0	8.2	12.8	1.5	1.1	0.9	32.8	30.1	31.0	9.6	11.2	14.4	4.4	3.8	1%	8%	-15%
NCPL	1.5	2.9	3.7	10.5	10.5	13.1	0.4	0.3	0.3	24.3	11.6	8.6	14.9	7.8	6.0	1.5	2.9	5%	6%	-22%
Power																		2%	12%	-15%
EPCL	9.7	7.6	7.5	2.1	3.1	4.1	2.1	1.5	1.5	21.1	20.0	19.7	7.3	9.3	9.5	9.7	7.6	18%	80%	41%
ICI	30.3	20.6	16.4	2.1	2.8	3.6	3.4	3.2	2.7	11.2	15.4	16.6	5.0	7.4	9.3	30.3	20.6	5%	6%	12%
Chemical																				
ISL	82.1	12.7	9.8	0.0	2.4	2.9	3.2	2.6	2.1	3.9	20.0	21.8	1.2	7.4	9.7	82.1	12.7	21%	69%	58%
ASTL		32.6	16.5	0.0	1.0	2.6	1.3	1.3	1.2		3.8	7.3		1.2	2.4		32.6	10%	35%	28%
MUGHAL	31.0	15.6	10.8	0.0	2.5	3.8	2.5	2.1	1.9	8.0	13.7	17.3	2.5	5.1	7.3	31.0	15.6	18%	72%	81%
Steel																				

OVER-WEIGHT

OIL & GAS EXPLORATION COMPANIES

Valuations Remain Cheap As Oil Prices Recover and Circular Debt Resolution on the Cards

We maintain our **'Over-weight'** stance on the E&P sector. We base our investment thesis based on attractive valuation. Although from earnings perspective, sector's profitability is likely to remain flat in 2021 as oil prices tumbled and production was also effected severely during 4QFY20. Stability in earnings would likely, emanate from full year impact of PKR depreciation as average oil prices for FY21 are likely to be lower than last year. With recent recovery in oil prices and uplift in production, the impact is likely to be more visible on earnings in FY22 in our view. However, reserve replacement remains key risk where not much has been achieved to arrest the issue of depleting reserve base and natural depletion of production from maturing fields. Thus key to long term earnings sustainability would be diversification where MARI and PPL are actively pursuing entrance in to mining business.

With oil showing signs of recovery: Oil prices have started to show signs of recovery post Covid19 outbreak on expectations of global demand recovery and availability of vaccine, arab light prices have crossed USD 46/bbl while E&P sector trading at implied oil price of below USD 30/bbl.

E&P sector remains highly undervalued: While we expect oil prices in the range of USD 50-55/bbl, the impact of recovery in oil prices would be more transitive in FY22. Henceforth, flattish earnings in FY21 and growth will likely be visible in FY22. At current prices, E&P sector is currently trading at FY21/22 P/E of 5.4/4.9x

Recovery of over dues to be positive for OGDC and PPL: Over the last 3 years, cash position for OGC and PPL has deteriorated drastically with receivables piling up by nearly 4x. This has led to restricted cash payout by OGDC and PPL. While there is no clear policy on settlement of circular debt yet, we expect cash position to remain weak. However, resumption of IMF program or any resolution in circular debt would improve cash position and also lead to multiple re-rating for OGDC and PPL.

New blocks key to arrest natural depletion and sustainability of reserves: Production enhancement and reserve replacement remains a key risk for E&P companies due to lack of sizeable discovery in recent years. While new blocks being offered, will likely be value accretive in terms of reserve base but, in case of gas discoveries it might take few years to commence production due to lack of infrastructure.

Diversification and resolution of circular debt key for long term sustainability of earnings: As current blocks have reached saturation point and production from mature fields are depleting, diversification remains key to earnings sustainability in long term. As demand for oil is also likely to fade substantially in long term, diversification in to other business holds value as MARI and PPL plan on entering in to mineral mining business.

Earnings and Valuation

We estimate sector to post a flat growth in FY21 due to lower oil prices and production in 4QFY20, while improving by 10% in FY22. The sector remain undervalued on the back of uncertain outlook on oil prices and lack of positive earning triggers in terms of production enhancement. However, recovery in oil prices are likely to support earnings whereas improved recoveries and settlement of over dues would be value accretive.

Preferred picks

POL, MARI, OGDC

We base our liking for POL and MARI on the back healthy cash flow generation with no exposure to circular debt. Any improvement in recoveries of receivables from Sui companies would be cash flow positive for OGDC and PPL.

Key Risks

a) Substantial drop in oil prices, b) Higher dry well costs amid lack of new blocks on offer, c) Further increase in circular debt, d) Delays in bidding and allocation of new blocks for exploration, e) Divestment of GoP stake to keep supply concerns at forefront.

Recommendation		**BUY**
Target Price:	Dec-21	1,991
Last Closing:	15-Jan-21	1,360
Upside (%):		46%
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			MARI PA
Shares (mn)			133.4
Free Float Shares (mn)			26.7
Free Float Shares (%)			20.0%
Market Cap (PKRbn | USDmn)		181.5	1,088
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	4.6	9.9	1.4
Lo	1,231	1,231	831
Hi	1,426	1,485	1,485

Key Company Financials

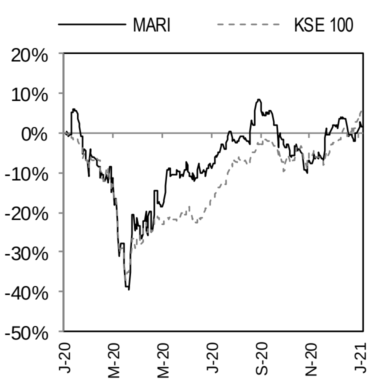
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	30.3	30.2	31.8	32.0
EPS (PKR)	227.2	226.0	238.6	239.6
DPS (PKR)	6.1	6.5	6.5	6.4
Total Assets	282	269	261	273
Total Equity	93	125	156	187

Key Financial Ratios

ROE (%)	46.8	46.9	38.7	27.7
P/E (x)	6.0	6.0	5.7	5.7
P/B (x)	4.5	2.9	1.9	1.5
DY (%)	0.4	0.5	0.5	0.5

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Mari Petroleum Company Limited (MARI)

Target Price PKR 1,991/share, upside 46%, Dividend Yield 0.5%

We base our investment case on the back of healthy cash generation with negligible exposure to circular debt. Also MARI is planning to diversify away from oil & gas exploration business and enter in to mining and renewable energy based power projects. Moreover, gas production contributes nearly 98% of the total production which further provides cushion against volatile oil prices.

Investment thesis

With limited downside earning risk, MARI remains undervalued: MARI is currently trading at FY21/22 P/E of 6.0/5.7x. Earnings are expected to grow by +6%YoY in FY22 while remaining stable there onwards. Due to major contribution of gas in total revenues, MARI remains least impacted by volatility in oil prices. Lower benchmark of 477.5mmcfd for PP12 pricing during ATA of customer's plant has also enabled higher production under PP12 pricing.

Efforts underway for sustainability of flows from MARI field: After successful completion of 19 development wells drilled in Mari field, Phase-2 which involves debottlenecking to improve hydraulics is underway to enhance production plateau beyond 2023. The project is expected to be completed by 3QFY21 whereas gateway is being established to connect Mari field with national pipeline of SNGPL to transport 150mmcfd of unutilized gas to SNGPL. This would enable MARI to achieve higher production under PP12 pricing.

Healthy FCF generation with negligible exposure to circular debt: MARI remains least exposed to circular debt owing to majority of sales to fertilizer sector where receivables account for GIDC and GDS which is reflected as payable to GoP. Only PKR 32bn is tied to circular debt with regards to sales to power sector and SNGP/SSGC. Thus FCF yield for MARI is likely to average around 10%-11% during FY20/23F

Enhancing production base in short-medium term…: The Company's main plan is to achieve 100% reserve replacement ratio while targeting frontier region with medium to high risk high reward wells. Alongside this, diversification remain key focus with development of mining assets in the country.

…while long term plan to evolve in to integrated energy company: However, in the long term the management of the company is primarily focused on realigning its local and international portfolio and become an integrated energy company with revenues derived from energy projects (mostly renewables) and mining assets. This would allow for long term sustainability of revenues.

Recommendation

We maintain MARI as one of our top picks with Dec-21 target price of PKR 1,991/share (46% upside). The company is currently trading at FY21/22E P/E of 6.0/5.7x. Key risks to our rating on MARI are a) substantial drop in production from Mari HRL field resulting in loss of additional revenue on PP12 pricing and, b) lack of substantial addition of reserves to arrest natural decline in Mari gas field.

Recommendation		**BUY**
Target Price:	Dec-21	483
Last Closing:	15-Jan-21	428
Upside (%):		13%
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			POL PA
Shares (mn)			283.9
Free Float Shares (mn)			129.8
Free Float Shares (%)			45.7%
Market Cap (PKRbn | USDmn)		121.6	729
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	10.6	16.6	(9.1)
Lo	316	316	241
Hi	426	437	468

Key Company Financials

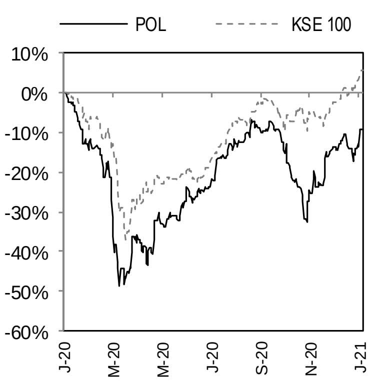
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	16.4	15.5	17.8	18.4
EPS (PKR)	57.7	54.4	62.8	64.8
DPS (PKR)	50.0	45.0	50.0	52.5
Total Assets	92	94	101	107
Total Equity	40	43	47	50

Key Financial Ratios

ROE (%)	35.4	47.6	41.8	37.1
P/E (x)	7.4	7.9	6.8	6.6
P/B (x)	3.7	3.2	3.0	2.8
DY (%)	11.7	10.5	11.7	12.3

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Pakistan Oilfields Limited (POL)

Target Price PKR 483/share, upside 13%, Dividend Yield 10.5%

We base our liking for the scrip on a) healthy cash generation with no cash tied to circular debt, b) high cash pay-out leading to decent dividend yield and c) recent discovery in Tal Block. Key triggers may include favorable decision on Tal block and development of reserves (Jhandial, Joyamair, Tal Block and Pindori) will provide an uplift to POL's earnings.

Investment thesis

Cash generation remains healthy with no exposure to circular debt: POL has remained relatively immune to cash constraints relating to circular debt compared to PPL and OGDC where trade debts as of Mar-20 only stood at PKR 30/share compared to PKR 73.2/109.9 per share for OGDC/PPL. Thus total cash as of Sep-20 stood at PKR 164/share. As a result, POL stands well poised to invest in further blocks to enhance its reserve base. In our view POL is likely to utilize the cash for development of its mature fields such as Balkassar, Jhandial, Pindori and Khaur.

Consistent dividend pay-out and higher dividend yield: As a result of higher cash generation, POL has maintained a higher cash payout which on annual basis has stood above 80% in the last few years. Thus POL remains a high dividend yield stock with FY21/22 dividend yield of 10.5%/11.7% and thus remains as a preferred dividend yield stock.

Production to normalize in FY21: We expect production from Tal Block and Adhi to gradually recover in FY21 as it dropped due to supply disruptions post Covid19 lockdowns and lower offtake from refineries. Furthermore, addition of Mamikhel South by 3QFY21 would also boost production and have a PKR 3.8/share annualized impact on earnings.

Holding steady on drilling: POL has planned to drill 2 exploratory wells in 2021 (Kirthar South and DG Khan) and also plans to participate in the upcoming auction of new blocks. While drilling plan lacks aggressiveness, heavy reliance on exploration plans by MOL in Tal Block, development of mature fields and substantial reserves at Jhandial remain impetus for long term development of reserve base.

Recommendation

Considering healthy cash generation and higher dividend yield we prefer POL as dividend yield stock as stability in oil prices have subsided risk of higher sensitivity to oil prices. Recent discovery in Tal Block is also likely to keep POL in limelight however in the long term risk of substantial depletion in reserves likely to erode earnings significantly still looms. Thus we maintain a BUY stance on POL with our Dec-21 target price of PKR 483/share offering 13% upside from last close. POL is currently trading at FY21/22 P/E of 7.9/6.8x and offers FY21/22 dividend yield of 10.5%/11.7%. Key risks to our rating on POL are a) Substantial drop in oil price, b) unfavorable decision regarding Tal Block verdict and, c) reserve write down for Jhandial.

Recommendation		**BUY**
Target Price:	Dec-21	160
Last Closing:	15-Jan-21	114
Upside (%):		41%
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data			
Bloomberg Tkr.			OGDC PA
Shares (mn)			4,300.9
Free Float Shares (mn)			645.1
Free Float Shares (%)			15.0%
Market Cap (PKRbn | USDmn)		488.5	2,929
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	7.9	(0.6)	(26.2)
Lo	89	89	75
Hi	114	118	154

Key Company Financials

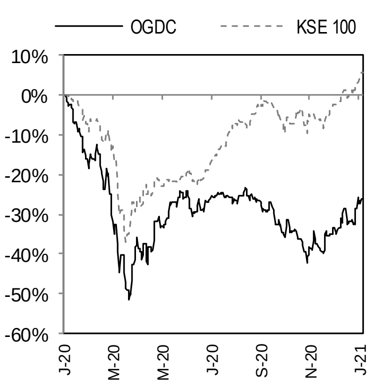
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	100.1	100.2	109.0	104.0
EPS (PKR)	23.3	23.3	25.3	24.2
DPS (PKR)	6.8	8.0	9.0	9.8
Total Assets	861	909	992	1,056
Total Equity	689	756	830	894

Key Financial Ratios

ROE (%)	14.8	20.1	15.2	13.9
P/E (x)	4.9	4.9	4.5	4.7
P/B (x)	0.9	0.8	0.7	0.6
DY (%)	5.9	7.0	7.9	8.6

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Oil & Gas Development Company Limited (OGDC)

Target Price PKR 160/share, upside 41%, Dividend Yield 7.0%

We base our investment case on healthy balance sheet with consistent cash pay-out and cheaper valuation multiples. OGDC is currently trading at FY21/22 P/E of 4.9/4.5x and offers a healthy dividend yield of 7.0%. Although cash position of the Company has been marred by substantial rise in receivables, however improvement in recoveries from Sui companies will strengthen cash position which would allow for increased expenditure on exploration assets and investment in new blocks to be offered. Development projects in pipeline are also expected arrest production decline concerns.

Investment thesis

Development projects to help sustain production flows: OGDC has planned to initiate compression project at Qadirpur to arrest the depletion of flows which is expected to be completed by Nov-21 whereas Uch Compression project is expected to be completed by Dec-22. Furthermore, Gudanwari and Chabaro Development project is expected to be completed by Feb-21 which would add 118mmcfd of gas and 25bopd of oil. Khewari project is expected to be completed by Jun-22 which would add 25mmcfd of gas. The Nashpa-Mela project is expected to add 100mmcfd of incremental gas which is anticipated for completion in Dec-20.

Any positive development on circular debt to be value accretive: OGDC's receivables have spiked to PKR 342bn as at Sep-20 from PKR 326bn as at Jun-20 (PKR 264bn as at Sep-19) out of which PKR 286bn is overdue from oil refineries and gas companies. Although there is no direction on resolution of circular debt, GoP is striving to curtail circular debt whereas resumption of IMF program may likely lead to measures which may aid in curbing circular debt. Any positive development on this would be value accretive for OGDC. As a result OGDC's payout ratio has dropped to 29% in FY20 compared to 55% in FY18. However, despite hefty buildup in receivables, OGDC's cash position is relatively better than PPL where OGDC has PKR 60bn in cash and cash equivalents.

Aggressive exploration to continue in FY21: OGDC has planned to spud 26 exploratory/appraisal wells, 12 development wells and 7 re-entry wells in Fy21. This along with auction of new blocks by GoP would allow the company to arrest the issue of low reserve replacement ratio due to its high production base. However, drilling of higher exploratory wells would increase the risk of higher dry wells costs in FY21.

With high reserve life, new blocks key to sustainability: OGDC has reserve life of nearly 16 years which mostly is due to revision in Uch gas reserves. OGDC has witnessed production decline of 12-15% in oil/gas since FY18 as new discoveries coming online have not been sizeable enough to arrest production decline. As a result, considering high production base, we view drilling in new blocks being offered by GoP remain impetus to long term sustainability of production and enhancement of reserve life.

Recommendation

We maintain our BUY stance on OGDC with Dec-21 Target price of PKR 160/share, offering 41% upside from last close. OGDC is currently trading at FY21/22 P/E of 4.9/4.5x and offers a dividend yield of 7.0%. Key risks to our rating on OGDC are a) Secondary Public Offering by GoP, b) no resolution in circular debt leading to pile up of receivables restricting growth potential and cash payouts and c) further depletion in aging wells.

OVER-WEIGHT

OIL & GAS MARKETING COMPANIES

Economic Recovery and Regulatory Changes to Bring Earnings Stability

We have '**Over-weight'** stance on OMC sector on the back of positive regulatory changes being implemented recently while new Oil Marketing and Refining Policy will further ease challenges faced by OMCs. With earnings stability as a result of exchange losses being incorporated in to pricing and notification of pricing on fortnightly basis would reduce OMCs exposure to volatility in oil prices. Furthermore, retail segment growth is likely to remain upbeat as economic activity picks up while GoP's measures to curb smuggling has also reflected in healthy HSD sales growth. Based on this, we prefer PSO as our top pick.

New pricing mechanism: Recent changes in pricing mechanism implemented by GoP are likely to bring earnings stability where notification of prices on fortnightly basis (implemented from Sep-20 onwards) will keep reduce OMCs exposure to volatility in oil prices which was reflected in hefty inventory gains/losses. Furthermore, exchange rate movement is also incorporated in to pricing which will reduce exchange losses for OMCs.

Further changes in regulatory regime for OMCs to come: GoP is also coming up with Oil Marketing and Refining Policy which may introduce a number of measures to arrest challenges faced by OMCs and ensure adequate supply is maintained. One of the key proposal is to national based minimum storage requirement for retail outlets which would allow PSO and APL to expand retail outlets with low storage. Also OMCs margins would also be increased automatically from first day of each year without approvals which has led to delays in notification in past few years. Moreover, measures would be placed to remove unnecessary competition which would benefit PSO, APL and SHEL, which meet minimum storage requirement, to grab volumes from smaller OMCs.

Retail segment to lead volumetric growth in FY21: OMC volumes took a hit during FY20 as grey market sales hurt HSD volumes and Covid19 lockdowns led to supply disruptions countrywide. We expect volumes retail segment volumes to led volumetric growth in FY21 where MS/HSD sales are estimated to grow by 10%/9%YoY primarily led by lower grey market sales due to measures taken by GoP and pick-up in economic activity reflected by higher automobile sales and LSM growth.

OMC margins linked with CPI: OMC margins for MS and HSD, which are linked with CPI, are likely to go up PKR 0.3/ltr to PKR 3.11/ltr. Notification of margin increased which was due for increase on 1st-Jul-20 has been delayed to relevant approvals required.

Recovery of receivables to improve cash position: Clearance of over dues of IPPs which was committed by GoP in recently signed MoUs could act as a key trigger for PSO especially as it payments would route through IPPs to PSO. Furthermore, Government is focused on taking measures to resolve circular debt issue which should accelerate once IMF program resumes.

Earnings and Valuation

We estimate IGI OMC sector to post healthy growth in earnings in FY21 owing to substantial drop in profitability in FY20 due to hefty exchange and inventory losses booked.

Preferred picks

PSO

We maintain our preference for PSO considering improvement in cash position and lower volatility in earnings caused by exchange and inventory losses.

Key Risks

a) Delays in notification of margin increase, b) Substantial rise in grey market sales, c) Delay in notification of new policy, d) Rise in circular debt.

Recommendation		BUY
Target Price:	Dec-21	306
Last Closing:	15-Jan-21	238
Upside (%):		29%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			PSO PA
Shares (mn)			469.5
Free Float Shares (mn)			211.3
Free Float Shares (%)			45.0%
Market Cap (PKRbn | USDmn)		111.6	669
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	14.1	44.5	10.8
Lo	186	165	114
Hi	249	249	249

Key Company Financials

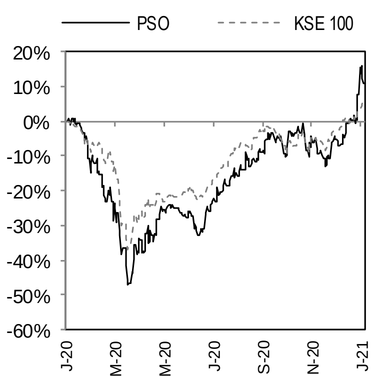
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	(6.5)	18.6	19.8	21.7
EPS (PKR)	(13.8)	39.6	42.3	46.2
DPS (PKR)	-	7.9	11.8	13.9
Total Assets	342	347	364	380
Total Equity	113	128	142	157

Key Financial Ratios

ROE (%)	14.5	9.2	(5.6)	15.4
P/E (x)	- 17.3	6.0	5.6	5.1
P/B (x)	1.0	0.9	1.0	0.9
DY (%)	-	3.3	5.0	5.8

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Pakistan State Oil Company Limited (PSO)

Target Price PKR 306/share, upside 29%, Dividend Yield 3.3%

We base our investment case on a based on improvement in cash position post Sukuk-II and recoveries from SNGP, increased contribution of retail segment in total volumes as FO sales have dropped leading to better cash flows and stability in earnings as exchange losses are incorporated in pricing and notification of prices on fortnightly basis.

Investment thesis

Increased contribution of retail segment due to drop in FO demand: Retail segment which primarily is cash based now contributes nearly 85-87% of total sales which used to be 67% back in FY18. As FO based power generation has reduced, PSO's cash flows have improved where accumulation has stalled. Furthermore, retail segment growth is likely to remain healthy as auto sales increase and economic activity picks up. Moreover, measures in new policy will likely discourage unnecessary competition which would benefit PSO in terms of grabbing higher share in retail segment growth.

Government focused on resolving circular debt: Disbursement of payments as part recently signed MoUs with IPPs and resumption of IMF program could act as key trigger in clearance of overdue receivables and curb further pile up. This would result in re-rating for PSO and unlock value in our view.

Substantial drop in ST borrowing to lift earnings: PSO's ST borrowing which stood at PKR 149bn as at Mar-20 (PKR 107bn as Jun-19) have dropped substantially to PKR 42bn as at Sep-20 (PKR 66bn as at Jun-20). Alongside, interest rates also dropped by 6.25% since Mar-20 which has led to 75%YoY drop in markup cost on ST borrowing during 1QFY20. Thus PSO's finance cost will likely reduce by PKR 5-6/share on annual basis due to reduction in ST borrowing and PKR 7-8/share through cumulative drop of 6.25% interest rates.

New pricing mechanism to bring stability in earnings: The recently made changes to pricing mechanism where exchange rate movement is now made part of pricing and notification of prices on fortnightly basis is likely eradicate volatility in earnings due to exchange and inventory losses.

Upgradation of PRL to unlock value in long term: Improvement in cash position of PSO along with clearance of over dues would allow availability of cash for investment in upgradation of Pakistan Refinery Limited (PRL) which could unlock value in long term for PSO. If incentives are offered in new policy, this could further speed up the upgradation project of PRL. However, even if over dues are recovered PSO would need additional financing for estimated USD 0.8-1bn investment in PRL. Thus we expect PSO to withhold aggressive cash payout going forward.

Recommendation

We maintain PSO as our top pick in OMC sector with our Dec-12 target price of PKR 306/share offering 29% upside from last close. PSO is currently trading at FY21/22 P/E of 6.0/5.6x. Key risks to our call, a) Increased competition leading to decline in market share, b) no resolution of overdue payments due to impasse between IPPs and GoP leading to void MoUs, c) Delays in margin revision and d) Substantial pile up in LNG receivables.

OVER-WEIGHT

CEMENTS

Riding the Strong Earnings Upgrade Momentum

We have an "Overweight" stance on the Pakistan Cement Sector. We base our investment thesis on the back of favourable sector dynamics – in the shape of (a) anticipated higher volumes largely backed by government construction theme and attractive private credit off-take scenario, (b) improved margins amid increased cement price, lowered discount, and contained cost structure, (c) restricted finance cost driven by substantially reduced benchmark interest rates, are expected to present a turnaround in the sector. Prospectively, our coverage companies eps is expected to deliver a 3yr fwd cagr of ~37%.

Construction sector boom to drive to keep sector volumes healthy: Pick-up in construction activities amid government incentive packages focusing primarily on the construction sectors along with ongoing construction of hydel-dams under CPEC, has so far resulted in a robust sector sales growth, recouping the covid dent during Mar-Apr. Looking ahead in 2021, we foresee demand dynamics to remain favourable. Firstly from public sector projects including dam construction, Karachi package and other infra development under CPEC and secondly additional demand driven from private sector mainly as we see i) extension in real estate amnesty schemes, ii) low interest environment at least till Jun-21, will attractive mortgage schemes, and iii) construction package 2020 including low-cost housing schemes.

Improving margins: Given significant demand post-covid19 and absence stiff pricing competition, manufacturers have managed to increase prices subsequently by an average PKR 560 & 634/bag in north and south respectively. Moreover this has also resulted in lesser discounts offered by company contrary to last year. These combined price moves have improved our coverage companies' retention prices by about ~15% to PKR 312 & 351/bag for FY21 &22 respectively.

Similarly, recent winter-driven coal price increase (~USD 59/ton to USD 85/ton) has further prompted rise in retail bag prices by about PKR 40-45/bag. While a rise in coal price remain key worrisome factor for cement manufacturers, we see low probability of a continued price increase happening. In fact we think post winter coal price is likely to revert to USD ~65/ton by Jun-20 (Mar-21 contract @USD 77/ton). In this scope MLCF stands the biggest beneficiary, considering the company uses Pet-Coke for its electricity needs.

Earnings and Valuation

After a submissal earnings performance in 2020, improved margin outlook and reduced financial burden, cement companies under our coverage are all set to deliver an earnings of ~PKR 24.7bn as against loss of PKR ~3.8bn in SPLY. However stock prices seems to have incorporated much of the earnings performance. As such, since Mar-20 overall cement companies have had a lucky run on the bourse, whereby market capitalization reached PKR 446bn (up by +~2.3x) and PKR ~196bn pre-Covid19. Overall cements companies are trading at a fwd 2021 P/E multiple of 18.7x (ex-luck 14.5x) which on the face of it may look rather expensive, but we view reduced capex requirements and debt, along with improved opt. cash flows have significantly raised sector free cash flow yields.

Preferred stocks

LUCK, MLCF and PIOC

For our preferred stocks we have picked LUCK: based on its diversified businesses, MLCF: less exposure to power tariff hikes, and PIOC: also based on better cost-efficiencies and PEG ratio (+77% eps 2yr-cagr).

Key Risks

i) Decline in cements prices: Companies under the review of competition commission of Pakistan, ii) Increase in raw material prices or finance costs: PKR exchange rate or coal prices, iii) Increase power tariff: govt. under IMF EFF is under intense pressure to increase power tariff. Any will however be non-impactful for off-grid plants, iv) Expansion cycle: expansion are now in a distance, however news of another leg of expansion cycle can put stock prices under pressure.

Recommendation		**BUY**
Target Price:	Dec-21	835
Last Closing:	15-Jan-21	698
Upside (%):		20%
Valuation Methodology:		Discounted Cash Flow (DCF) / SOTP
Time Horizon:		12M

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)		225.7	1,353
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	6.5	40.5	41.3
Lo	637	496	310
Hi	703	703	703

Key Company Financials

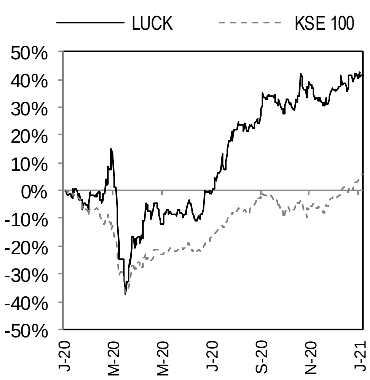
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	3.3	8.2	12.6	17.1
EPS (PKR)	10.3	25.3	39.0	52.7
DPS (PKR)	-	5.0	7.8	13.3
Total Assets	136	136	145	158
Total Equity	99	106	116	129

Key Financial Ratios

ROE (%)	14.7	11.6	3.5	8.0
P/E (x)	67.5	27.6	17.9	13.2
P/B (x)	2.6	2.4	2.3	2.1
DY (%)	-	0.7	1.1	1.9

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Lucky Cement Limited (LUCK)

Target Price PKR 835/share, upside 20%, Dividend Yield 0.7%

Investment thesis

LUCK enjoys' a high domestic market share and export market. Having a low cost structure, least leveraged balance sheet and added investment portfolio, makes it to our top liking. We expect the company to deliver an eps of PKR 46.37 (uncons. PKR 25.3) during FY21 (+50%y/y) and will continue to do so; posting healthy 5yr cagr of +51%.

Strong Operational efficiencies and low level of DEBT: Cost efficient operations (WHR + in house power generation) along with presence in both the regions gives LUCK an added advantage over other manufacturers. More so, looking forward to an interest rate hike in 2021, should be a less of concerns for LUCK, given its almost debt-free balance sheet.

Investment in LEPCL to support earnings from FY22: As a mega conglomerate, Lucky's venturing in to coal based power plant which expected to achieve its COD by Jun-2021. We estimate this project to start contributing from FY22 with an EPS of PKR 39.82/share (ROE: 29.5%) to consolidate earnings, adding PKR 255/share to our target price.

Kia Motors an added cyclical: Since its launch, Kia motors have had super sales period so far. Company has been able to roll-out around 1200-1500 units, month of 'Picanto' and 'Sportage', the flagship SUV brand, bagging on the exponential industry growth. So far, in 1q, the company has reported operating profits of PKR 1.5bn. Based on industry wide, margins and ROE, we see KLM eps contribution of PKR 10/share or (25-30%) and adds about PKR 128/share to our target Price.

Recommendation

We have used SOTP (Cement: 297; 36%, Auto: 128, 15%, Power: 255, 31%, Chemicals: 84, 10% and others: PKR 70; 8%) as a preferred valuation matrix, to arrive at a target price of PKR 835 (Dec-21); offering a decent +20%.

Recommendation		**BUY**
Target Price:	Dec-21	57
Last Closing:	15-Jan-21	43
Upside (%):		32%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			MLCF PA
Shares (mn)			1,098.3
Free Float Shares (mn)			494.3
Free Float Shares (%)			45.0%
Market Cap (PKRbn | USDmn)		47.3	284
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	12.3	48.9	90.9
Lo	37	29	17
Hi	45	45	45

Key Company Financials

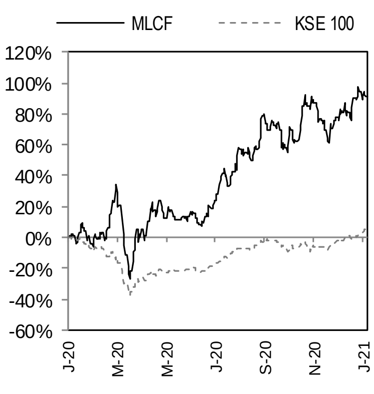
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	(3.6)	3.2	5.7	7.9
EPS (PKR)	(3.2)	2.9	5.2	7.2
DPS (PKR)	-	1.5	2.5	3.5
Total Assets	67	64	63	61
Total Equity	35	36	39	43

Key Financial Ratios

ROE (%)	16.8	7.8	(10.6)	9.1
P/E (x)	- 13.3	14.7	8.3	6.0
P/B (x)	1.5	1.5	1.4	1.3
DY (%)	-	3.5	5.8	8.1

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Maple Leaf Cement Factory Limited (MLCF)

Target Price PKR 57/share, upside 32%, Dividend Yield 3.5%

Investment Thesis

Bagging on north demand, MLCF rising market share, high retention price partially as it is the market leader in white cement and a restricted cost-structure put it in a favourable spot. During the 1h, company earnings performance has shied away from consensus expectations, but with improved sector dynamics we see this to change. We estimate, PKR 2.9/share in FY21 and PKE 5.2/share in FY22 putting it in a top spot of growth companies.

Power saving to max out eps potential: Maple Leaf Power Limited (MLPL), a 100% owned subsidiary of MLCF having 40MW coal power producing facility remain an attraction both in terms of power and tax saving (PKR 0.2-0.25/share ann.); along with potential of PKR 870mn dividend could boost bottom line. While a sharp deceleration of finance cost following early retirement of debt has reduced over cost burden. Moreover, WHR expansion from current 16mW to 25mW (Capex: PKR 1.8bn, COD Sep-21) and an existing 15.8mW captive plant, pretty much puts the company off the national grid.

Concerns on rising market share to tone down given upbeat demand. rise To note FY20 dispatches of MLCF remained higher than its capacity rated share - due to stiff market competition - but is expected to revert back to normalize capacity rated levels in FY21 and beyond as per prevailing industry dynamics.

Valuation

Our Dec-21 target price of PKR 57/share offers an upside of +32%. We have derived our target price using dcf valuation approach, assuming a coe of 17% and growth rate of 3%.

Recommendation		BUY
Target Price:	Dec-21	127
Last Closing:	15-Jan-21	107
Upside (%):		18%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

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)		24.4	146
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	6.6	48.4	243.1
Lo	84	69	23
Hi	104	105	105

Key Company Financials

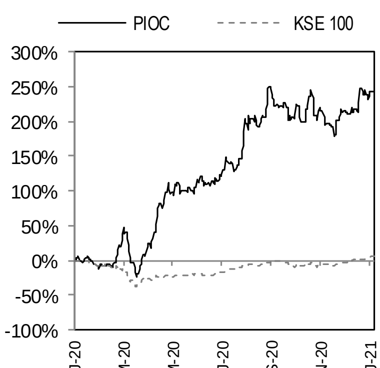
Period End: Jun

PKRbn	'20	'21f	'22f	'23f
Net Income	(0.2)	1.3	3.1	4.1
EPS (PKR)	(0.9)	5.7	13.6	17.9
DPS (PKR)	-	2.8	6.8	9.0
Total Assets	49	45	44	45
Total Equity	13	14	15	17

Key Financial Ratios

ROE (%)	12.7	5.9	(1.6)	9.6
P/E (x)	- 116.2	18.8	7.9	6.0
P/B (x)	1.8	1.8	1.9	1.8
DY (%)	-	2.6	6.3	8.4

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Pioneer Cement Limited (PIOC)

Target Price PKR 127/share, upside 18%, Dividend Yield 2.6%

Investment Thesis

PIOC had a phenomenal run with price up nearly 5x since Mar-20 cuing it to be the largest beneficiary of the sector tailwinds. With volumes to rise amid available capacity of 3mn tons p.a, FED reduced, sales prices improving gradually in the North region, discounts expected to lower, operational savings being reaped from newly inaugurated coal power plant and above all decline in interest rates by 625bps at a time when PIOC is heavily geared is more than what PIOC could ever ask for.

Efficiency measures to give respite going forward: Post impairment of 12mW WHR and CFPP, PIOC is installing another 12mW CFPP which is going to come online in a month or so. This will help in reducing grid reliance significantly as these plants will contribute 43% in the power mix. Power savings from these plants will result in eps accretion of ~4.0 in FY22 earnings due to low rate of CFPP as compared to grid.

Utilization to increase amid broadening of market base: With a recent initiation of line 3, the market share of PIOC has increased to 9% from 7%. The cost benefit of line 3 vis-a-vis old line would be PKR ~400/ton (management estimates), due to low coal requirement of PKR ~125kg/ ton as compared to 135-140kg/ton for old lines. Historically company catered to only those market near to its plant proximity in a bid to keep freight cost under control. However, management expects to broaden its market base once the aforesaid efficiency units come online, giving additional boost to its current utilization level.

Valuation

We have revised our Dec-21 target price to PKR 127/share using dcf valuation approach and used cost of equity of 16.6%

MARKET-WEIGHT

FERTILISER

On a Plateau

We maintain **“Market Weight**” stance on the Fertiliser sector. We base our investment thesis on the back of (a) stable urea off-take wherein, we foresee urea off-take will be remain in the range of 5.6-5.8mn tons (5 year average) in 2021 and beyond, (b) proposed gas price hike. (c) In our opinion, the matter pertaining to GIDC have been priced in; (d) reversal of disallowance on input sales tax by GOP and lastly manageable urea inventory levels.

Extension in GIDC payment will comes as temporary relief : The impending legacy verdict on GIDC payment has now been extended from earlier 2yrs to 4yrs, will comes as a relief for manufacturers in terms working capital management and investments. However, the risk of imposition of Gas Infrastructure Development Cess (GIDC) on EFERT (enven) and FATIMA’s plant still looms as the companies have taken stay order against GIDC (Fertilizer Policy 2001).

Demand to remain rather stable: In terms of industry demand, we expect urea sales to remain close to 5.8-6.0mn tons (5yr, avg.). This we assume is largely to do with stable if not greatly improving outlook on farmer economics (increase in wheat support prices) in the upcoming years. This will more or less be met through domestic existing manufacturers’ capacities. Moreover increased international urea prices suggests low import risk, whereas rise in RLNG will keep existing unutilised capacities at bay, fortifying our premise.

Urea and Gas Price hike: Having forgo twice in 2020 and in 2021, Gas base tariff hike for fertiliser sector is long overdue. In 2021 given the negative repercussion of COVID19 pandemic on farm economics and government pro-farmer policies, was left out. On similarly grounds, government also reversed its decision on fertilizer input sales adjustments for unregistered dealers (~75-80%) having annual turnover of less than 100mn as it was leading to potential price hike and supply disruption. Although farm economics are expected to show slight improvements it still remain at a distance from historic level. We suspect gas price hikes are unlikely to come by in the reminder of 2021, but if any will be done in a phased manner and price impact will be fully passed-over to end consumer. This will although benefit concessionary GSA producers, EFERT and FATIMA but for a shorter time as we expect the concessionary GSA will end by Jun-21.

Earnings and Valuation

We estimate sector to post +12%y/y growth in CY20, owing to sustainable fertilizer offtake and high prices. Moreover, drop in finance cost (owing to reversal in interest rates) and stable income stream from different businesses may sustain earnings, in our view.

Preferred stocks

FFC

We have picked FFC as our top pick, based i) limited cash flow risk arising from of GIDC payment, ii) diversified business, and iii) strong dividend yield and trading at low P/E compared to forward market P/E of 8.75x.

Key Risks

a) Increase in gas prices, b) Decrease in fertilizer prices, c) Increase in finance costs and d) High inventory levels from continuous operation of RLNG-based fertilizer plants.

Recommendation		BUY
Target Price:	Dec-21	138
Last Closing:	15-Jan-21	111
Upside (%):		24%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

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)		141.5	848
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	4.2	1.3	8.6
Lo	100	100	83
Hi	113	115	115

Key Company Financials

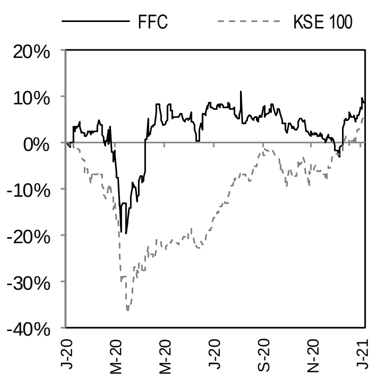
Period End: Dec

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	17.6	18.5	18.9	19.6
EPS (PKR)	13.8	14.6	14.8	15.4
DPS (PKR)	11.0	10.3	10.5	10.8
Total Assets	142	132	120	108
Total Equity	39	45	50	56

Key Financial Ratios

ROE (%)	46.0	49.6	47.0	44.2
P/E (x)	8.1	7.6	7.5	7.2
P/B (x)	4.2	4.0	3.6	3.2
DY (%)	9.9	9.2	9.4	9.7

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

Analyst
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Fauji Fertilizer Company Limited (FFC)

Target Price PKR 138/share, upside 24%, Dividend Yield 9.2%

Investment Thesis

We have a liking for FFC currently trading at forward P/E of 7.5x. The company is well placed in our fertilizer universe in terms of, i) strong pricing power, ii) diversified earnings stream, iii) limited cash flow impact of GIDC payment, and iv) stable earnings outlook (averaging 14.5/share in the next 3yrs).

Stable and dominant player in Pakistan's Urea market: The Company has managed to uphold its market share dominancy in past years taking up nearly ~45% of the market share. Company is well placed to capitalize on its 's flagship product "Sona urea" selling at premium price to the rest, maintaining its market share given supply from RLNG based fertilizer player's ceases.

GIDC matter; Positive WC Cash flow impact will be more than offsetting other income decline: With over PKR 65bn cash and short-term investments, FFC is well poised to pay off PKR 62bn on account of GIDC. We expect company to maintain its dividend yield while, corresponding reduction of short-term investment. In addition it would be potential reduction in GIDC payment if government allows to off-set it with sales tax receivable as currently the company has outstanding sales tax receivable of PKR 10.2bn 17% of accrued GIDC

Diversified business stream: FFC has heavily invested (PKR 27bn) in various sectors (banks, cements, energy and food), enjoying steady income stream, with the recent investment (PKR~ 2.0bn) made in Thar energy limited (30% stake). We expect stable income (+6% -3yr CAGR) from these portfolio to continue, contributing 14% to the earnings.

Recommendation

We have used SOTP (Fertiliser: 101/share; 72%, others: 37, 27%) as a preferred valuation matrix, to arrive a t a target price of PKR 138 (Dec-21); offering a decent +24%. The company is currently trading at CY21E P/E of 7.6x at a dividend yield of 9.2%.

OVER-WEIGHT

AUTOMOBILE ASSEMBLERS

Multiple Catalysts for the Sector to Work Through 2021

We turn positive on Automobile Assembler and have an **'Over-Weight'** stance, as we believe reviving demand may keep volumetric growth rather rosier in 2021. Although increase in interest rates seems a likely scenario in next six month or so, we believe the worst in term of sales is over.

Volumes to normalise post Covid-19 production halt and favourable macros: Automobile demand is now recovering from a secular bottom in Apr-20 at a faster than expected pace. This has been supported by pent-up demand, government stimulus package, rising remittances and monetary easing releasing sufficient liquidity. We believe, auto sales for our coverage companies to post 2 year cagr of 8% to 210kunits (2020: 164kunits) on the back of lower cost of auto financing and economic rebound. We believe, this time auto financing holds much more weigh in impacting sales than ever before due to increase in vehicle prices (PKR depreciation).

Model launches & competition: Under the passenger car segment, Honda and Toyota both are expected to launch their flagship model new/facelift in 2021, respectively. Moreover, for Toyota newly launched variant of compact SUV, 'Toyota Corolla Cross' is expected to grab market share dominated currently by Kia and Hyundai. Having said that, while we see rising treat of imported vehicles both emanating from combustion/EV based setup and new Korean/Chinese entrants, but will be less impactful on INDU sales.

Pricing and margins could come under pressure: In the past 2 years, nearly all domestic oems' have increased their product prices by ~40-50%. This along with low competition and a strong demand; domestic OEMs' enjoyed superior pricing power, reflected by the significant gross margins expansion averaging ~12% in 2015-2019 (sales CAGR: +9%) double of that achieved in 2010-2015 (sales CAGR: -0.4%) ~6%. Going forward, with an increasing competition from new entrant, decline in consumer purchasing power and limited pricing power gross margins of our coverage companies are unlikely to shoulder along their era 2015-2019. However, exchange rate stability is going to help in keeping overall cost structure in check for auto assembler in the short to medium term.

Earnings and Valuation

The combined 6m2021 passenger car sales volume of INDU, HCAR and PSMC of 88k units (+46% y/y) means trends have already recovered to pre-Covid19 level albeit slightly above that of previous year. Moreover as mentioned gross margins after a drop to 6.5% in 2020 are set to recover in 2021 and average ~8% in the next 5yrs. As a result we expect companies' eps to post ~48% cagr over the next 5yrs.

Preferred stocks

INDU

We have picked INDU as our top pick, based on i) diversified product rang, ii) dominant market position in mid/high level PC markets, iii) healthy balance sheet, iv) probable launch of Toyota corolla 'Cross' and 'X' variants.

Key Risks

a) More than anticipated PKR devaluation, b) Increase in interest rates d) Delays in new model launches.

Recommendation		**BUY**
Target Price:	Dec-21	1,576
Last Closing:	15-Jan-21	1,192
Upside (%):		32%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			INDU PA
Shares (mn)			78.6
Free Float Shares (mn)			13.4
Free Float Shares (%)			17.1%
Market Cap (PKRbn | USDmn)		93.7	562
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	(7.1)	4.9	13.7
Lo	1,144	1,138	700
Hi	1,286	1,430	1,430

Key Company Financials

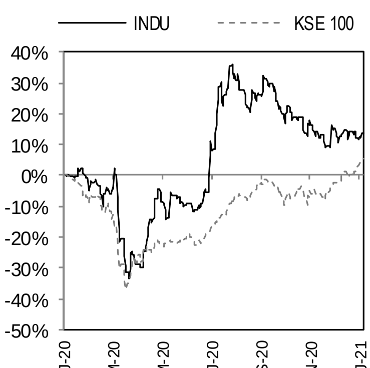
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	5.1	9.0	10.8	12.0
EPS (PKR)	64.7	115.1	137.4	152.4
DPS (PKR)	30.0	60.0	70.0	100.0
Total Assets	80	80	80	85
Total Equity	41	45	51	55

Key Financial Ratios

ROE (%)	46.4	35.7	12.5	20.9
P/E (x)	18.4	10.4	8.7	7.8
P/B (x)	2.5	2.3	2.3	2.1
DY (%)	2.5	5.0	5.9	8.4

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Indus Motor Company Limited (INDU)

Target Price PKR 1,576/share, upside 32%, Dividend Yield 5.0%

Investment Thesis

Amongst our coverage companies we have liking for INDU. The company's relatively strong cash generation, premium pricing power and flagship product warrants a bullish stance. The stock is currently trading at P/E 10.4x, offering +32% upside.

Excess Liquidity relative to its peers: With respect to liquidity INDU is better placed amongst our coverage companies having excessive cash tied up in investments (PKR 524/share) as of Jun-2020. In the recent briefing, management quoted, that this short term investment can potentially be utilized for a new corolla model.

Possible Launches in 2021: INDU plans on launching new imported CBU Toyota Corolla Cross (1500 cc SUV) in competition with Sportage and Tucson However, depending on its success Indus Motor Corporation will proceed to assemble the vehicle locally. As per management, a new model launch will entail a capex of PKR 10-13bn. More so, The Company is planning to launch Toyota Corolla facelift in competition with upcoming sedan model of KIA and Hyundai.

Recommendation

Our Dec-21 target price of PKR 1,576/share is derived by using DCF methodology. We have assumed risk free rate of 8%. Our terminal growth rate is 3%. The company is currently trading at FY21E P/E of 10.4x at a dividend yield of 5.0%

MARKET-WEIGHT

ENGINEERING/STEEL

Pro Construction Macros Appear To Be Priced-In

We have "**Market weight**" stance on Pakistan Steel sector. We draw our stance on the back of anticipated strong earnings display for FY21 and government incentives for construction sector. We believe, most of the positive have already been priced in as the engineering sector witnessed a V shaped recovery.

Long Steel: Construction activities to chart its future: Currently, the production capacity of long steel manufacturers is 5mn Tons per annum, with an equal share of graded and ungraded steel. Though the industry is protected against the anti-dumping duty, however, the supply of ungraded steel bars with lower prices than graded ones still remains a challenge. We foresee, demand dynamics to remain favorable on the back of public sector project including dam construction, Karachi transformation package including ML-1 and extension in real estate amnesty scheme. We anticipate, total demand in FY21 to clock in at ~6.4 mn tons.

Rising utilities price; the specter haunting Steel sector: Steel prices have witnessed a sharp escalation globally as many countries effected by COVID-19 pandemic. Rebar prices have been increased by PKR 5000/ton. This increase has been caused by surge in scrap prices (peaked at ~USD 470/ton) More so, CRC and HRC spread have been pushed up to USD 90/ton due to hike in raw material prices. Going forward, we believe, once the pandemic situation normalizes, long steel players will not bring down prices proportionately however, flat steel players will therefore have to match international prices once they revert.

Flat Steel: It's all about increasing demand of Automobile and home appliances: In relation to the flat steel, auto and appliances sales are co-related. As the auto sector is expected to impose growth overall along with the entrants in this sector will boost steel demand. Appliances will also be creating a major impact with the economic recovery going forward along with the purchasing power to uplift heavily. Total demand would be estimated to be close around 1 million tons by FY21.

Earnings and Valuation

After a dismal earnings performance in 2020, improved margin outlook and reduced financial burden, steel companies under our coverage are all set to show a robust earnings performance in FY21 and beyond.

Key Risks

i) Decrease in CRC/HDGC sales prices, ii) administrative increase in energy prices, iii) depreciation of PKR and iv) adverse volatility in international scrap and rebar prices

MARKET-WEIGHT

POWER

Sector Tailwinds Should Drive Re-Rating

We expect the listed IPPs to re-rate on the tailcoats of upcoming circular debt resolution, cash flow improvement across the energy and utilities chain and ongoing IMF led reforms in the Power sector space (cost recovery of electricity).

Overdue receivables to be cleared in 2021…: In 2019, The GoP had chalked out a plan to manage circular debt alongside the IMF – aiming to bring it down to PKR 130bn by FY20 and subsequently to PKR 80bn in FY21. However, Covid19 has exacerbated circular debt build-up (ballooned to PKR 2.2tn as at Jun-20). The Federal government has given consent to clear dues of IPPs in three installments by Dec-21. This is a major development for the energy space and should significantly narrow the overhang in the stock prices. To recall, the Government of Pakistan recently inked agreements with IPPs (on pre-2015 Power Policy) to clear dues of the Power sector (PKR 450bn). This was in exchange for re-negotiation of PPA terms of incumbents to the tune of PKR 675bn (GoP savings over the next 5-years). The renegotiations entailed reduction in tariff indexations and ROEs. Not only would this improve the ongoing liquidity crunch for the power sector it would reduce the GoP's future liability.

…payment mechanism has been chalked out: GoP will settle 25-30% of the outstanding receivables (PKR 450bn) in upfront cash payment and the remaining via floating rate PIBs. The remaining two-third payments will take place in equal tranches by Jun-21 and Dec-21. This plan is likely to be finalized between the GoP and IPPs during Jan-21.

IMF reforms are also underway: Under the IMF's USD 6bn program, PM Imran Khan agreed to raise electricity tariffs by PKR 3.34/kwh in Dec-20 (from PKR 13.35/kwh to PKR 16.69/kwh), in order to bring electricity to cost recovery. That said, an additional PKR 3/kwh rise is required, which may be raised in CY21 together with amendments to the NEPRA Act (passing on losses, theft and lower recoveries to the consumers through surcharges). The Bill is yet to be approved.

IPPs should witness a broad based rally: Payment of overdue receivables should improve the cash flow situation for most IPPs particularly those with a positive net delta (receivables minus payables). In this context we think KAPCO, HUBC and Nishat IPPs all stand to benefit with transfer of dividend income to improve earnings for MCB, NML and NCL. We hold a preference for HUBC - particularly after the Govt.'s offer to bailout the company in exchange for new projects and conversion of the base plant.

Preferred picks

HUBC

We maintain our preference for HUBC on the back of new projects coming online and substantial growth in earnings as a result.

Key Risks

a) Circular debt build up, b) Reforms insufficient to address circular debt, c) revision in PPA's of existing IPP's, d) prolonged dividend amid cash constraints and e) delays in project COD.

Recommendation		**BUY**
Target Price:	Dec-21	133
Last Closing:	15-Jan-21	86
Upside (%):		55%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			HUBC PA
Shares (mn)			1,297.2
Free Float Shares (mn)			972.9
Free Float Shares (%)			75.0%
Market Cap (PKRbn | USDmn)		111.1	666
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	7.4	17.9	(17.5)
Lo	76	72	57
Hi	90	90	103

Key Company Financials

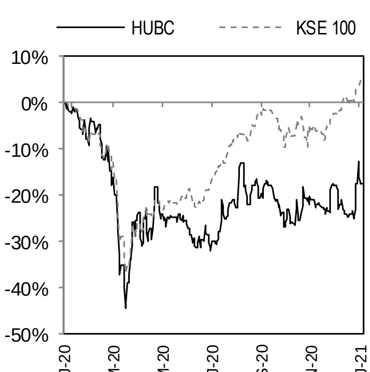
Period End: Jun

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	25.0	29.1	37.6	40.4
EPS (PKR)	19.3	22.5	29.0	31.1
DPS (PKR)	-	7.0	11.0	10.0
Total Assets	260	333	364	370
Total Equity	76	97	121	150

Key Financial Ratios

ROE (%)	32.5	26.0	39.4	33.7
P/E (x)	4.4	3.8	3.0	2.8
P/B (x)	3.1	2.2	1.5	1.1
DY (%)	-	8.2	12.8	11.7

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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The Hub Power Company Limited (HUBC)

Target Price PKR 133/share, upside 55%, Dividend Yield 8.2%

A solid earnings growth trajectory (3yrs cagr: +17%) together with expected return to dividends over the medium-term (FY22f D/Y: 12.8%) rounds up our liking for HUBC where we have TP of PKR 133/sh. HUBC trades at significantly discounted valuations (FY21f P/E of 3.8), where we think the worst is largely priced in. Receipt of overdue receivables (under recently signed MoUs) and upfront payment of PKR 65bn for the base plant are key triggers particularly for cash flows.

Investment thesis

Conversion of the base plant is a reasonable option: The GoP accepted PKR 65bn valuation (equivalent to the remaining capacity payments of the base plant till 2027) for HUBC in exchange for conversion of two out of four units of its Base plant (2x330MW) from FO to Thar coal, with the remaining funds to be utilized for installation of a water desalination plant to provide 300mn gallons of water daily to Karachi. The immediate payment would serve as an effective bailout for the Base plant, given the uncertainty of its future cash-flows. The cash injection can reduce utilization of dividends from HUBC's other projects for re-investment and potentially lead to more normalized dividend payouts going forward.

Receipt of overdue receivables is a major trigger: HUBC is set to receive payments of PKR109bn from the GoP under the recently signed MoUs. This may lead to significantly improved dividends over the medium-term as cash flow issues subside – a marked shift from the liquidity crunch in recent times (dividends skipped in 2019-20). The clearing of HUBC's overdue receivables together with potential receipt of PKR 65bn from the GoP for the base plant (1200MW plant) should also lift the overhang on the stock price.

Dividends should resume FY22f onwards: HUBC has historically been treated as a defensive stock (akin to Government bonds) due to its high payout track record (90%+ payouts during FY14-18). Under the management of Mega Conglomerate the strategy altered (dividends skipped in FY19-20) due to a shift in focus towards growth and longevity of cash flows while circular debt led to additional strain on cash flows. With the Government's focus on reducing circular debt (bringing electricity costs to recovery and offloading liabilities to IPPs) we think HUBC can once again resume dividend payouts FY22 onwards (FY22f payout: 38%, DPS PKR11/share).

Extremely cheap with key triggers ahead: HUBC trades at undemanding valuations (FY21f P/E: 3.8x). HUBC is poised to deliver a 15% 3-yr earnings CAGR with rising share of profits from its associate CPHGC plant and other projects (TNTPL, TEL). Key trigger is the resolution of circular debt on outstanding receivables under recently agreed MoUs. We maintain our liking for HUBC with a Dec-21 TP of PKR 133/sh.

Recommendation

HUBC trades at FY21/22 P/E of 3.8/3.0x and offers a FY21/22 D/Y of 8.2%/12.8% respectively. We maintain HUBC as our top pick with our Dec-21 Target price of PKR 133/share, offering +55% upside from last close.

Recommendation		**BUY**
Target Price:	Dec-21	56
Last Closing:	15-Jan-21	48
Upside (%):		16%
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		12M

Market Data

Bloomberg Tkr.			EPCL PA
Shares (mn)			908.9
Free Float Shares (mn)			318.1
Free Float Shares (%)			35.0%
Market Cap (PKRbn | USDmn)		43.9	263
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	13.4	80.0	41.3
Lo	41	28	22
Hi	50	50	50

Key Company Financials

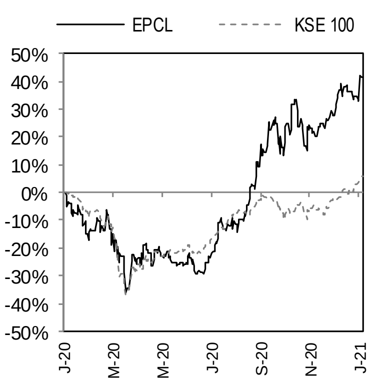
Period End: Dec

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	4.5	5.7	5.9	6.8
EPS (PKR)	5.0	6.3	6.5	7.4
DPS (PKR)	1.0	1.5	2.0	3.3
Total Assets	62	71	71	74
Total Equity	21	29	30	34

Key Financial Ratios

ROE (%)	40.1	21.5	23.1	23.0
P/E (x)	9.7	7.6	7.5	6.5
P/B (x)	2.6	2.5	2.1	1.5
DY (%)	2.1	3.1	4.1	6.7

Relative Price Performance



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Engro Polymer & Chemicals Limited (EPCL)

Target Price PKR 56/share, upside 16%, Dividend Yield 3.1%

We are **'Overweight'** on EPCL, currently trading at a P/E of 7.6x. We base our investment case on Key attributors, monopoly in PVC market, ongoing investment in different business and focus on increasing cost efficiencies.

Monopoly in PVC Market: EPCL enjoys the monopoly of being the sole producer of PVC in Pakistan having a competitive advantage to charge at premium pricing. Demand for the product has remained robust (4Yr-CAGR of 9%) spurred by strong activities in the downstream sectors (pipe and fittings, construction activities). The company is operating at full capacity and has maintained its market share of 70%.

Projects in pipeline: The Company has undertaken various projects related to process improvements and cost efficiency. As such EPCL will make use of oxygen based VCM technology, reducing its raw material consumption by 2% (annual impact PKR ~0.5/share). In addition, company also plans to decrease its gas requirement for PVC manufacturing by 10%, reducing costs by PKR 0.3/share.

Addition of caustic flake: EPCL has recently introduced caustic flake in its product portfolio, a variant of caustic soda. With this new product addition, the company can also tap in to export markets, in addition to the local industry, thereby enhancing its market share. The new variant is expected to be offered at a price of 10-15% above that of caustic soda

Potential entry in hydrogen peroxide and LABSA business: To expand its product portfolio the company eyes to enter in hydrogen peroxide (HP) business (20-25k tons of expected capacity) where DOL and SPL have dominated the market. More so, the company has recently planned for another product line, Linear Alkyl Benzene Sulphonic Acid (LABSA) with an annual capacity of 24Mtons.

Margins soared: PVC-core delta depicted healthy trend from 2q2020 due to improving demand and tightening global supply as few major global players declared force majeure in the aftermath of hurricane laura in U.S. We see core delta to normalize once capacities come online and demand shifts as global economy revives. Looking at the past trend of margins, we project USD 400/ton core delta, going forward.

OVER-WEIGHT

COMMERCIAL BANKS

Favourably Positioned To Ride Macro Tailwinds

Banking stocks have lagged every other sector during 2020, but the fundamentals do not appear to us to justify this level of underperformance. Concerns over capital preservation have led to banks being proactive in adopting early provisioning cycle and held back dividend payouts, but this has also reduced the risk of a major non-performing loan shock going forward. Although we believe loan provisioning could further increase in the 4^{th} qtr, but will peak by 2020 end. In addition banks' are favorably placed to fully benefit of the rate hike expected by 1h 2021, supporting our case for an earnings recovery for the banking sector next year.

Investment Thesis

Seeing a rise in interest rate (50-100bps): Yield curve is already incorporating the rise in interest mitigating to a large extent deposit cost adjustment pain that will follow. Additionally, while deposit growth has been overwhelming (up by +20%) overall time deposits have seen a larger decline, hence the overall cost of deposit growth will likely see a meagre increase relatively. Here large banks in our view have an upper hand over small size banks, due to better a) deposit mix and growth, b) well covered on the non-performing loan risks, and c) diversified revenue stream.

Asset growth will be driven in part through loan book: Backed by a healthy deposit growth, asset growth has been robust tilted toward government securities as corporate loan book growth tapered off due to strengthening Covid19 capital requirements (loans registered a +9% growth). On one hand this has reduced overall earnings ylds. but has led to increased provisioning buffers. As such, overall general provisioning has almost doubled by Sep-20. This combined with higher coverage ratios (~88%) caused banks to book in large provisioning charge. Looking ahead, we think this additional general provision is likely to normalize to its historic levels, and loan sheet amid pent-up demand (autos, housing, and corporates) will likely register a healthy growth close to double digit. Moreover, risk of NPL pain on income remain limited as industry coverage and infection ratio mix is placed ideally to its historic trend.

Investment yield to improve in 20201: In-line with historical trends, investments in government securities this time around too remained skewed towards govt. securities but larger spread between short-long tenure allowed for a greater investment in PIBs. Overlooking 2020, we expect investment in govt. securities to remain robust and more tilted towards treasury bills, given a rate increase expected in later half of 2021, investment in pibs are likely to gather pace.

Earnings and Valuation

We expect 3yrs eps cagr of +13% for our coverage banks. In 2020 eps was held back due to bank proactive adoption of provisioning cycle, which in 2021 will reverse. Moreover asset growth will be favoured by growth in loan book and rise in interest rates. Based on our eps estimates our banks roe is expected to recover 2021 to ~14% (c. 11%). Valuations are on historic low level, with major provisioning a bygone issue in 2021 we see valuation to ramping up.

Preferred picks

HBL

At current market prices, we prefer HBL as our top pick, mainly as we expect suspended interim dividends will result in bumper year-end dividend – current dy: >~15%, and banks looking for a fresh start on loan book, with loan-provisioning risks now in the rear mirror.

Key Risks

i) Loan growth and asset quality could come at stake amidst severity of Covid19 second wave, ii) implementation of IFRS9, b) FATF blacklisting, c) Implementation of Treasury single account (TSA), d) Major asset deterioration on domestic and international book, and d) other regulatory increments.

Recommendation				**BUY**
Target Price:	Dec-21			185
Last Closing:	15-Jan-21			142
Upside (%):				31%
Valuation Methodology:				Residual Income / Asset based Valuation / Dividend Discount Model
Time Horizon:				12M

Market Data			
Bloomberg Tkr.			HBL PA
Shares (mn)			1,466.9
Free Float Shares (mn)			733.4
Free Float Shares (%)			50.0%
Market Cap (PKRbn | USDmn)		207.6	1,244
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	3.0	31.6	(17.1)
Lo	126	106	95
Hi	140	140	172

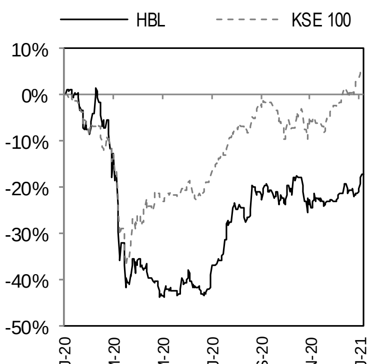
Key Company Financials

Period End: Dec

PKRbn	**'20**	**'21f**	**'22f**	**'23f**
Net Income	32.0	31.1	35.5	38.3
EPS (PKR)	21.8	21.2	24.2	26.1
DPS (PKR)	11.0	12.5	13.5	14.5
Total Assets	3,424	3,458	3,492	3,527
Total Equity	248	264	282	302

Key Financial Ratios				
ROE (%)	6.2	7.2	13.5	12.2
P/E (x)	6.5	6.7	5.8	5.4
P/B (x)	1.0	0.9	0.8	0.8
DY (%)	7.8	8.8	9.5	10.2

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Habib Bank Limited (HBL)

Target Price PKR 185/share, upside 31%, Dividend Yield 8.8%

Habib Bank Limited (HBL) eps has been under stress stuck under PKR 10/share since 2017. 2020 has turns out to be blessing and eps finally expected to normalize to its erstwhile level at PKR 21.8 (up 2x y/y). Moreover, absence 2020 shortcomings including elevated provision charge, lower fee income, business transformation costs and NY branch wrap-up, means eps is likely going sustain these levels going forward. We estimate bank's eps to display a +32% cagr over the next 3-yrs., which should be able to pull up its current ROE of ~7% on average to ~14% by 2022.

Investment Thesis

Limited worry on asset quality: Bank's asset quality is well favorable. General provisioning more than double by Sep-20, taking npl coverage ratio close to ~100%. Of the total provisioning charge of PKR 8.5bn in 9m, bank prudently took a general provision of PKR 6.0bn to absorb potential losses that could arise. On top of it bank's infection ratio have come down by 30bps to 6.7% by Sep-20 from 7.0% in Dec-19 and compared to industry average of ~10%, despite an industry wide slowdown in corporate loans during the year.

LT high yield bonds: Amid 625bps rate cut, HBL has aggressively loaded up pib on its investments book to PKR 868bn or 48% of total investment size in Sep-20 up by ~40% since Dec-19. This has withheld bank's earnings yield amid downward pressure due to slowdown in corporate loan book size and yields.

Cost/income and non-funded income to normalise: Faced with high business transformation and regulatory costs (PKR 1.0bn/1.3bn), NY branch costs (PKR2.8bn), FX losses (PKR 2bn) and ramp up of its ADC (PKR 1.2bn) HBL has been struggling to keep its cost/income down. As per bank's management, US remediation costs have evaporated by 1h 2020, while business transformation will remain but won't be that substantial, hence cost-to-income (c. 71%) should start to see a material slowdown in 2021 and onwards.

Recommendation

We value HBL stock on a Gordon growth model assuming cost of equity at 17%, giving a Dec-21 fair value of PKR 185/share. We apply exit multiple of 1.1x, derived using above assumptions, to 2020e equity base of HBL which is PKR 248bn. The stock is currently trading at 2020 P/E of 6.7x, P/B of 0.8x. Moreover the HBL in-line with SBP directives suspended its interim dividend payout in 2020, hence we at current rate bank offers a healthy ~15% dy.

Key risks to our call

Severity in Covid19: With a second wave of covid 19 around the corner, we believe any strong mutation in the country can lead to lockdown.

Oil price: We have assumed USD 45/bbl for 2021 and USD 50/bbl as our LT average for oil prices. Abrupt changes in oil prices would subsequently disrupt multiple of economic projections.

Financial Action Task Force (FATF): Failure to fully comply with FATF recommendation to set out from Grey list and worsening of AML-CFT situation may lead to Pakistan ending up in to Black list.

IMF Program: Disagreement between IMF and Gop regarding stringent condition set out by IMF such as, tariff hikes and tax measures may lead to exit from IMF program. This may hamper potential issuance of intl. Bonds and Sukuk. This may further deteriorate market sentiments.

Escalation of geopolitical tensions: Any further worsening of situation between India and Pakistan remains a significant risk. However, we rule out possibility of military conflict forming up.

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