PAKISTAN INVESTMENT STRATEGY

BMA CAPITAL

Friday, December 31st, 2021

Another Tale of Two Halves

Think Investments. Think BMA

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Jama Punji

CFA Society Pakistan
Best Brokerage House 2017
Best Brokerage House 2016 (Runner-up)
Best Analyst & Trader 2013 (Runner-up)

ASIAMONEY
Best Local Brokerage 2015
(Runner-up)

Best Broker Money Market 2017
Best Broker F. Exch. 2014 (Runner-up)

PAKISTAN IPO SUMMIT 2018
Top IPO/ SPO Book Runner
Award 2016-17-18

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Another tale of two halves

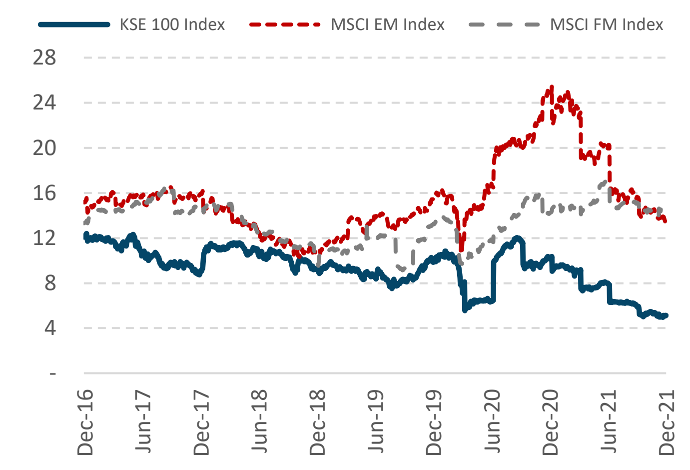
Compelling valuations lend us to give a favorable view

Undeniably attractive valuations: The Pakistan Stock Market continues to remain undervalued in spite of healthy earnings growth and attractive dividend yield. We are not publishing our KSE-100 index target for now and will reconsider it in coming few months. There will be further clarity by then on direction of international commodity prices, complete contours of the IMF program and the necessary set of monetary and fiscal measures (implementation of the recently proposed Finance Amendment Bill 2021). We believe that 2022 could be a year of two halves where we see consolidation to persist until there is clarity on the country's macroeconomic direction.

- The current price to earnings (PE) ratio of Pakistan Market is ~5x, much lower-than-average PE ratio of the market of ~8x during the last few years. Further, Pakistan Market continues to trade at a healthy discount of 50%+ to both MSCI Emerging Market and MSCI Frontier Market Indices. We like value driven, high yielding & low P/E sectors (Banks, E&Ps, Fertilizers, OMC's & Textiles). Our Top Picks among Banks are HBL, MEBL and BAFL. Among E&Ps, we like MARI while in Fertilizers and OMCs we like FFC and PSO respectively. ILP and GATM stand out among Textiles, we believe. In other sectors, we like LUCK, HUBC, INDU, SYS and MUGHAL.

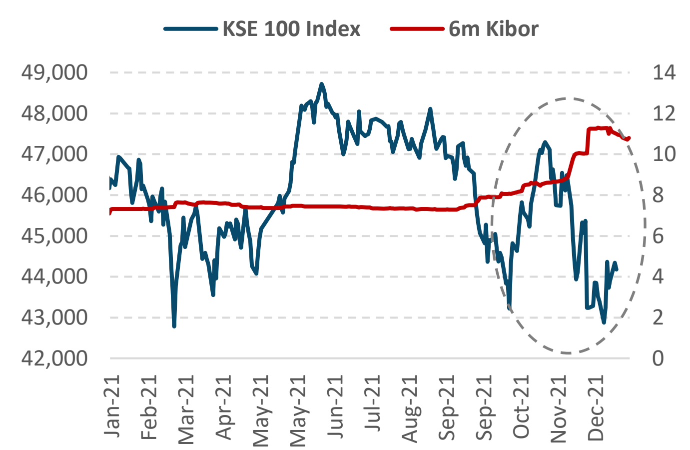
- **2021 was also a year of two halves:** We had given a KSE-100 index target of 55,000 for the current calendar year 2021 and the index was indeed on track to meet it first six months in. However, post relaxation of COVID-19 restrictions internationally coupled with continued global supply disruptions led to increase in commodity prices, where international oil prices peaked at over USD 80/barrel (West Texas Intermediate) in Nov'21 from around USD 50/barrel in Jan'21. Higher international commodity prices led to 1) a widening external account deficit, 2) runaway inflation, 3) retracement of local equity valuations in line with double digit interest rates where 6M KIBOR increased from 7.1% in Jan'21 to over 11% in Dec'21 and 4) pressure on the PKR leading to devaluation.

Market at low P/E and steep discount to MSCI EM/FM (x)



Source: Bloomberg, BMA Research

Increase in KIBOR from 3Q led to volatility in KSE-100 Index



Source: PSX, SBP, BMA Research

Another tale of two halves

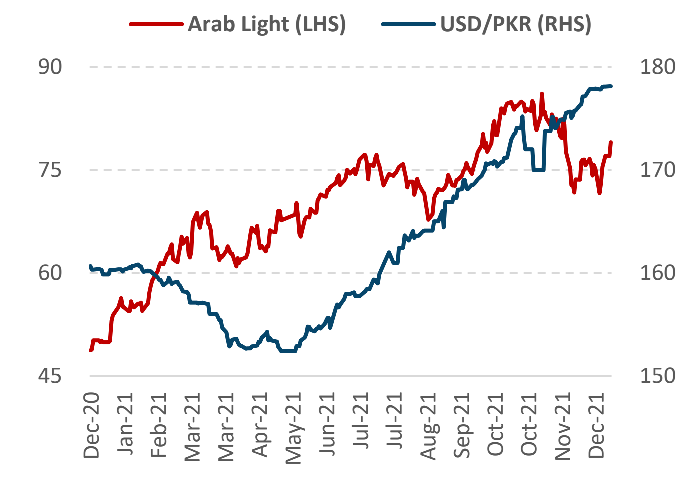
Strengthening of Pak Rupee likely

External account direction will dictate policy direction: Even though the country's Gross Domestic Product (GDP) is expected to grow by 4-5% during FY22, higher than previous year's GDP growth of around 4%, the burgeoning external account deficit will likely remain the key determinant to direction of monetary and fiscal policies during the calendar year 2022.

- Concerns are expected to remain elevated for inflation, keeping interest rates likely in double digits for the next calendar year. The exit of US/NATO troops from Afghanistan in Aug'21 and subsequent formation of Taliban led government has led to systemic issues in the country's foreign exchange markets where healthy inflows from Afghanistan have converted to outflows leading to additional pressure on the PKR. The PKR has witnessed steep devaluation since July (↓ 11.3% FYTD) and stability in the currency would be pivotal for the 2022 equity market outlook.

- **Another year split in two?** If international commodity prices soften, only then can the external account, inflation and interest rate outlook improve. Subsequently, we believe that positive sentiments in local equity markets will unfold leading to gains to potentially 55,000, considering earnings growth and dividend yield. Also, with the approval of the IMF program, the PKR could strengthen, which could lead to investment inflows from Frontier Funds. Looking at secondary market yields where 6-month government T-bills are trading close to 11%, further hike in State Bank of Pakistan's (SBP) Policy Rate (currently at 9.75%) cannot be ruled out.

Trend in International Oil Prices and PKR is similar



Source: Bloomberg, BMA Research

Earnings growth, IMF and cheap valuations

Not publishing KSE-100 Index target for now: **Given the ongoing economic uncertainties, we are not publishing the KSE-100 Index target for now and will reconsider this in coming few months. Our key themes for 2022 are very similar to our themes in 2021. These include 1) strong earnings growth, 2) resumption of IMF program and 3) cheap valuations. We will look out for 1) direction of international commodity prices, 2) extent of further interest rate hikes and 3) volatility in PKR. Furthermore, any global disruptions from the emergence of the COVID-19 Omicron variant could mute local economic activity for few months, chances of which are minimal.**

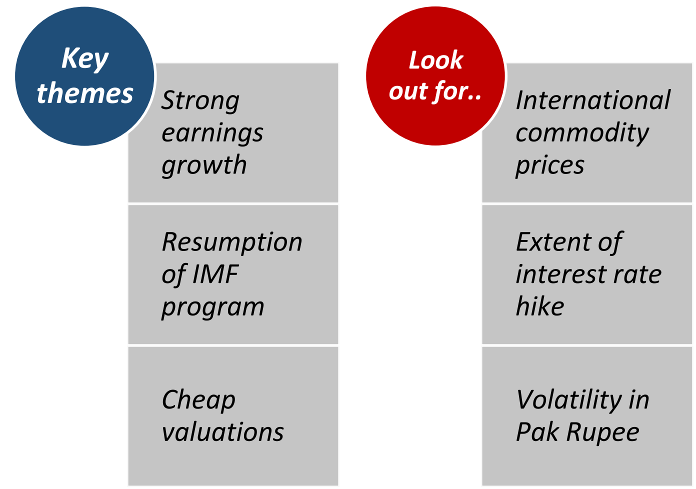
- **Earnings growth to remain strong**: Pakistan market's earnings growth will likely remain in double digits due to 1) higher interest rates; 2) resumption of global economic activities post pandemic and 3) continued stability in global commodity prices. Higher interest rates will lead to robust earnings growth for banks, which account for the highest share in the KSE-100 index (~23%) and also the overall market (~18% in terms of market capitalization). The latter two points will play out in the remaining mostly commodity producing sectors.

- The tech sector will remain the outlier and can outperform the market based on continued positivity in its global outlook post pandemic. There is also the surge in funding for local technology startups that have attracted more than USD 300Mn in 2021, which will help maintain buoyant sentiments in locally listed tech stocks as well.

- **Resumption of another IMF program:** The government reached staff level agreement with the IMF regarding the stalled program late last month. The IMF Executive Board's approval is now expected in early Jan'22. Although this is broadly expected, resumption of the program will lend support to the country's weak external outlook.

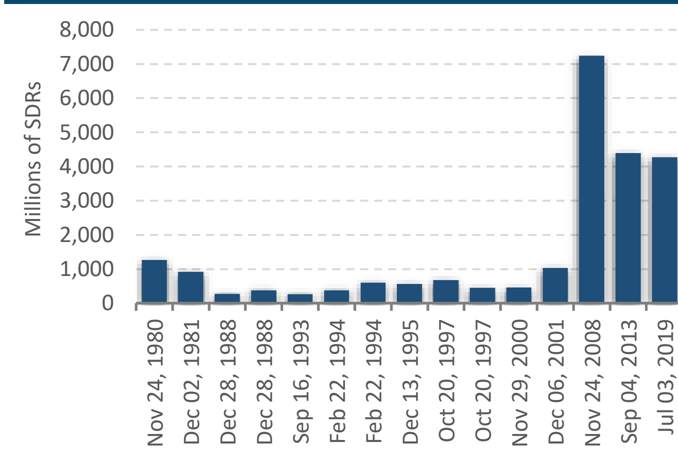
- Along with resumption of funds from the IMF, the country will also receive funding from World Bank (WB) and Asian Development Bank (ADB) and will likely float global bonds and re-start carry-trades. Total external funding could be in the range of USD 5-6Bn during 1Q2022.

Key themes and what to look out for in 2022



Source: BMA Research

IMF Programs since 1980



Source: IMF, BMA Research

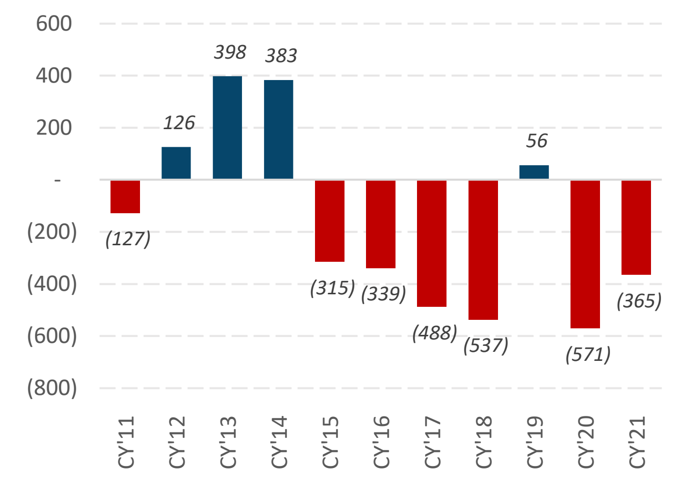
Pakistan Market Outlook

2022 could see the return of foreign inflows

- **Cheap valuations:** Pakistan Market is trading at a P/E of only ~5x, compared to an average of around 8x during the last few years. Further, on a regional and peer basis, Pakistan Market discount remains at a healthy discount of 50%+ to MSCI EM and MSCI FM Indices. Based on these threshold valuations, we are strongly of the view that any downside from current levels is limited.

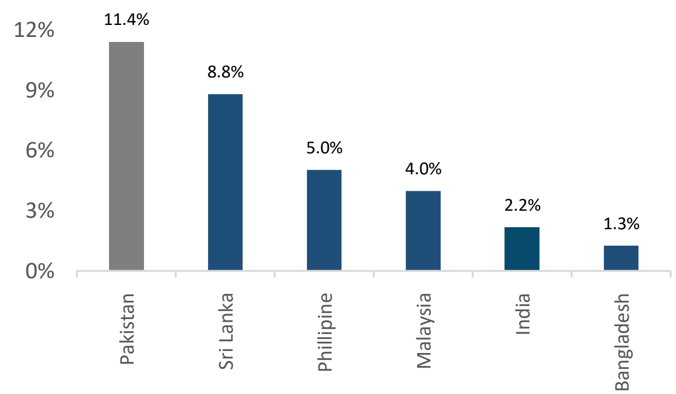
- Foreigners have been net sellers so far in 2021, with net selling of close to USD 370Mn. During the last 5 years, foreign investors have offloaded equities in excess of USD 2.0Bn, which has also been the reason for the local market's lackluster performance as the KSE-100 index has remained largely flat during this time. We believe that semblance of stability in Pak Rupee can turn the tide that could lead to net foreign buying in 2022. The downgrade to MSCI Frontier Market Index can play a positive role to this end given a higher weight in it compared to a much smaller weight in MSCI Emerging Market Index.

Foreigners have remained net sellers for years (USD Mn)



Source: NCCPL, BMA Research

PKR exhibited most weakness against the USD in 2021



Source: Bloomberg, SBP, BMA Research

Pakistan Economy

Macro theme in play – External account to remain in focus

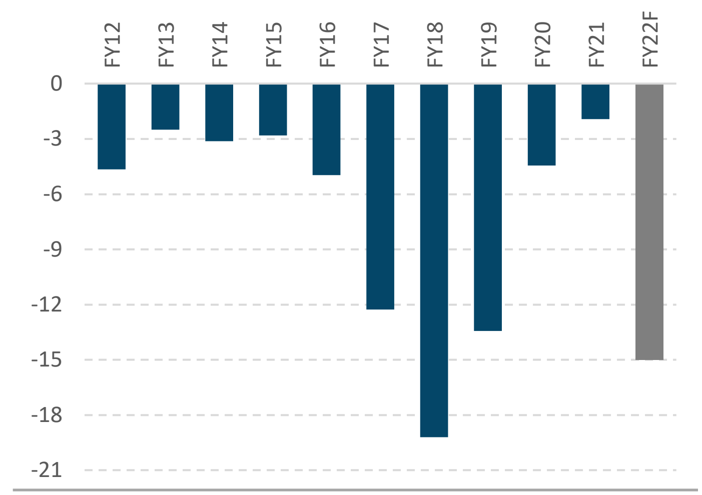
External account deficit in limelight: The CAD is expected to clock in at 4.5-5% of GDP in FY22, higher than SBP's projection of 4% (or USD 13Bn). This is because the CAD for 5MFY22 (Jul-Nov'21) was reported at over USD 7.0Bn with 7 months to go and international commodity prices including oil maintaining strength despite onset of Omicron variant of COVID-19. Furthermore, the external funding requirement will correspondingly increase from earlier estimate of USD 26.0Bn, which is based on the lower CAD estimate of SBP.

- Any strength or weakness in external account will have implications for both inflation and the exchange rate going forward. However, given the current level of Real Effective Exchange Rate (REER) for PKR is around 95, the Pak Rupee should exhibit stability once the IMF program is approved in Jan'22.

- **Inflation to remain in double digits for a while before tapering off:** The tides of inflation turned last month when monthly inflation clocked in at 2.98% MoM resulting in Nov-21 inflation of 11.53% YoY, much higher than expectations. Going forward, we expect inflation to remain in double digits till 3QFY22 driven mainly by hike in food and energy prices and expect average inflation for FY22 to be around 11%.

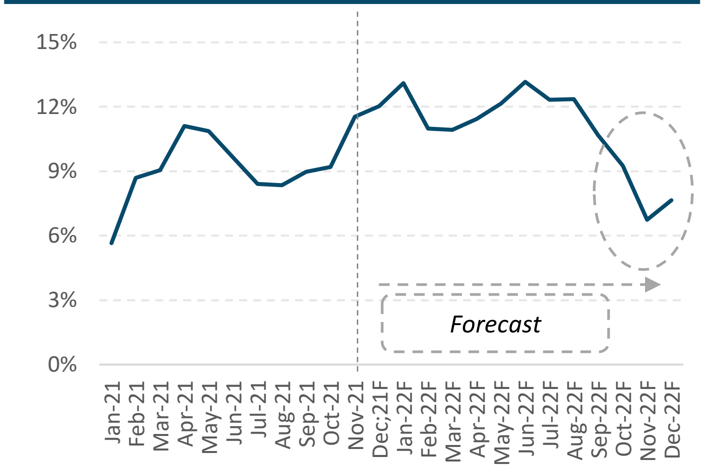
- During FY23, we expect inflation to taper off to single digits based on SBP's expectation of decline in commodity prices. Resultantly, we see the policy rate peaking in the range of 10.0-10.5% in 2022 (25-75 basis points higher than current level of 9.75%).

External deficit on the rise (as a % of GDP)



Source: SBP, BMA Research

Inflation to move from double to single digits in 2HCY22



Source: SBP, BMA Research

Pakistan Economy

Mini-budget is a step in the right direction

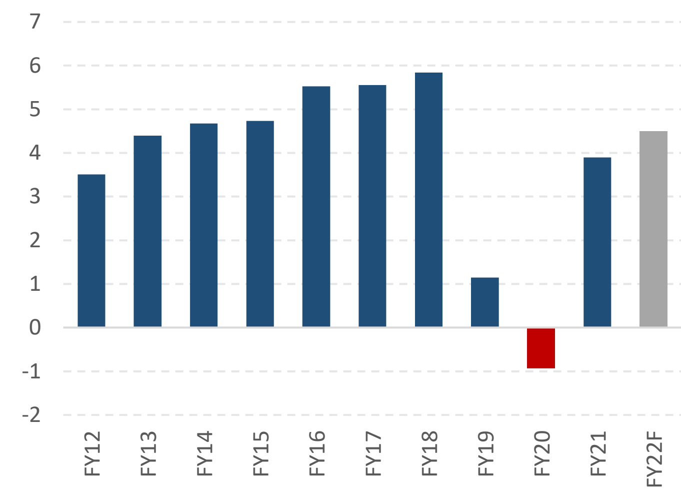
GDP growth trajectory intact: As per SBP's latest monetary policy statement, the growth expectations for the economy remain robust backed by improved power generation, cement sales, sales of consumer goods, petroleum products sales and continued rise in imports along with strong tax collection so far in the fiscal year.

- The outlook for the agriculture sector (that accounts for around 20% of GDP) is particularly strong for FY22 due to better seed availability and increase in area under cultivation. As a result, despite some slowdown in industry, which accounts for around 25% of GDP, overall economic growth for this year is targeted at a robust 4-5%.

- **Fiscal situation continues to warrant attention:** Even though Federal Board of Revenue (FBR) tax collection remains robust and exhibited growth of 36.5% YoY in 5MFY22, lower collection in petroleum development levy led to decline in non-tax revenues, which are down 22.6% in 1QFY22. Further, the recent hike in interest rates will keep debt servicing cost elevated.

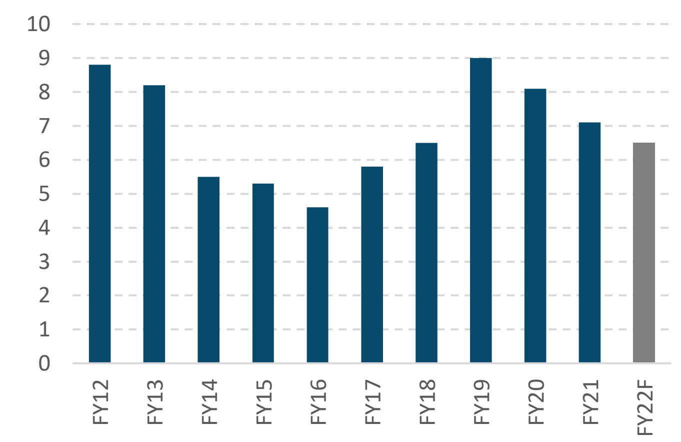
- The government has proposed a mini-budget, which includes withdrawal of exemptions of up to PKR 343Bn aimed at three broad segments, that is, Pharmaceuticals (PKR 160Bn), Plant and Machinery (PKR 112Bn) and Goods (PKR 71Bn). We are of the view that these will not be inflationary as those pertaining to pharmaceutical sector are aimed at documentation and the incremental taxes are refundable/adjustable. Also, the remaining measures are focused on reducing the import bill and are aimed mostly at luxury goods. However, to bolster non-tax revenues, the government has indicated a continued rise in petroleum development levy in coming months. We expect the fiscal deficit to be in the range of 6-7% for the current fiscal year. There is increased likelihood of achieving the 6% mark given focus on revenue collection and belt tightening measures under the IMF.

Robust GDP recovery following the lows of FY20 (%)



Source: Zakheera, BMA Research

Fiscal deficit to remain in 6-7% range in FY22 (% of GDP)



Source: Zakheera, BMA Research

SECTOR OVERVIEW & TOP PICKS

Prices are as at Dec 27th, 2021

Banks - Overweight

Riding on the macroeconomic theme

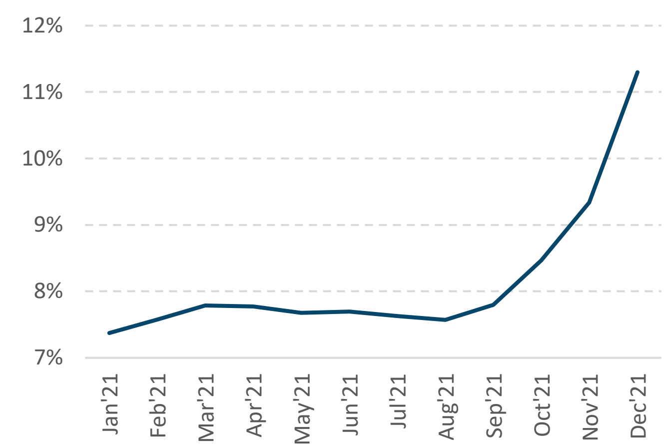
In the current economic climate, commercial banks are one of our preferred plays for CY22 with the sector well positioned to derive benefit from the interest rate up-cycle and the broader move from stabilization and towards growth. Our liking for the sector is premised upon; 1) 17.7% YoY earnings accretion in CY22 aided by NIMs expansion and balance sheet growth, 2) cheap valuation multiples with the sector trading at CY22/23 P/E, P/B of only 4.7/4.1x,0.84/0.77x respectively, 3) robust capitalization levels (CAR at 18.1%) and low chances of a NPL pile-up (Net NPL's at 0.8%) and 4) healthy dividend yield (BMA Banking Universe CY22/23E D/Y of 10.8/12.4% respectively).

- **NIMs expansion to pave the way for earnings growth:** In the wake of the above expected demand recovery from the local bourse and question marks appearing over the CAD, the State Bank of Pakistan has brought an end to the COVID-19 related stimulus package and now interest rates are on the way up. To date, the State Bank has raised policy rate by 2.75% to 9.75%. As things stand, the banking sector will be the prime beneficiary of this hike by way of NIMs expansion. Though, in the shorter term, we might see some attrition due to re-pricing of liabilities, from early next year we will see the improved margins seeping into the bottom-line. Putting it into numbers, we expect NIMs of the BMA Banking Universe to surge to 4.1% in CY22 before peaking at 4.3% in CY23.

- **How key variables of the sector are performing?** Deposits of the banking sector increased by 16.8% YoY in Nov-21 to settle at PKR 19.7Trn. On the other hand, Advances growth continued its upward momentum having shot up by 18.1% YoY to close at PKR 9.6Trn, surpassing surge in deposits. ADR, however, was largely flat at 49.0% in Nov-21 (48.6% in Oct-21) as against 48.5% in Nov-20. Despite strong advances growth, investments remained very much relevant as they clocked-in at PKR 13.6Trn (up 22.5% YoY) with IDR closing at 68.9%.

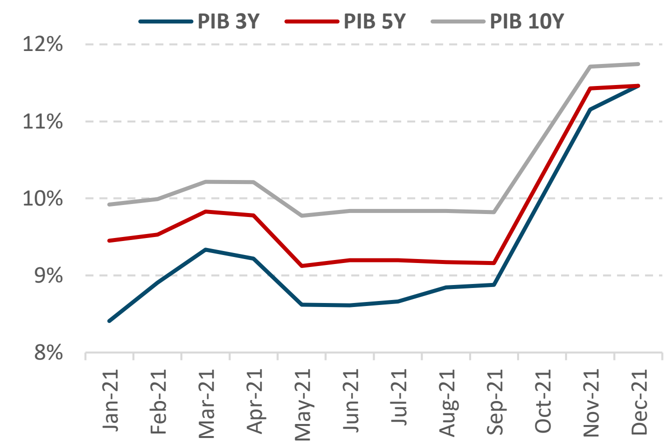
- **Do we see the momentum continuing going forward?** Moving forward, we expect deposit growth to continue to post double-digit growth aided by the recent interest rate hikes which will likely promote a savings culture and attract more money into the banking ecosystem. Furthermore, documentation drives by the government and robust remittances flow will likely continue the growth trend. On the advances front, we expect a slowdown in growth as roll-back of the fiscal stimulus previously provided by the State Bank has started and interest rates are reverting.

6M KIBOR trending high



Source: SBP, Zakheera, BMA Research

PIB yields swiftly surge to double digits

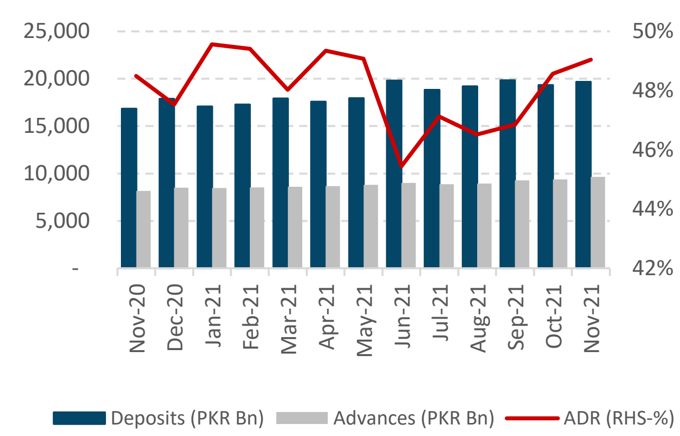


Source: SBP, Zakheera, BMA Research

With question marks still remaining on domestic inflation and hence CAD, we might see growth tapering off over the next few months. For investments, we expect them to remain in the limelight and continue to be the go-to option for financial institutions to park excess liquidity.

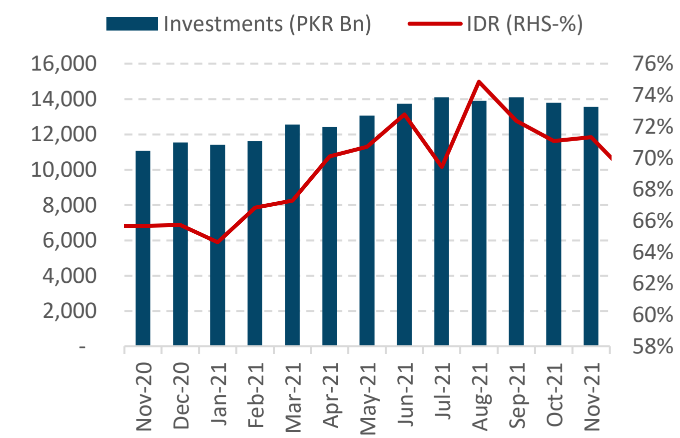
- **Banking Sector's books expected to remain clean despite the high interest rate environment:** The sector has worked rigorously on ensuring clean loan books and bad loan recoveries and as a result, infection ratio has improved to 8.9% from a peak of 16.7% in CY11. We would like to highlight that over the course of the period, there has been a change in lending strategy as well as exposure to the risky SME sector has been halved to 4.6% from 9.3% while lending to the relatively more stable and safer corporate sector has been scaled up to over 69% from 64%. At the same time, banks have been more prudent and proactive in taking provision charges with the coverage ratio now standing at a robust 91% in CY21, up from ~70% in CY11. As coverage has been scaled up, net NPL ratio of the sector has declined to only 0.8% from 5.1% a decade ago.

Banking sector Deposits and Advances (PKR Bn)



Source: SBP, BMA Research

Investments continue to remain in the limelight (PKR Bn)



Source: SBP, BMA Research

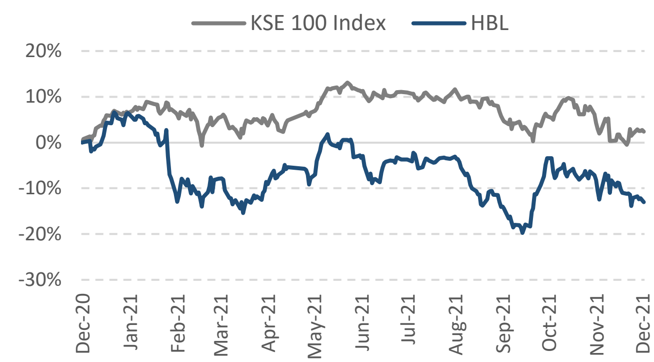
Habib Bank Limited (PSX: HBL)

Leveraging its position as the market leader

Sizable growth and customer inclusion in digital platforms, strong domestic presence, robust balance sheet footing and rapidly increasing Islamic banking network support our preference for HBL. As international concerns have subsided and domestic franchise continues to move from strength to strength, we opine current price levels offer an ideal entry point with the scrip trading at an attractive CY22/23E P/B,P/E of 0.6/0.5x, 4.0/3.6x respectively. That said, in the light of above current macroeconomic developments and improving stock fundamentals, we revise our EPS estimates for CY22/23 to PKR 29.2/32.3 respectively with our Dec-22 target price rising to PKR195.0/sh (implying an upside of 67.9%).

- **Earnings expectations scaled up for CY22/23 as interest rates increase:** In the light of current macroeconomic developments and improving stock fundamentals, we have revised our CY22/23 earnings estimates for HBL to PKR 29.2/32.3. Similarly, our pay-out assumptions have been increased to PKR 10.0/11.5 for CY22/23 respectively. Our estimates revision is premised upon 1) NIMs accretion aided by volumetric growth, 2) strengthening domestic franchise with notable strides being taken in the Islamic segment, and 3) strong fee income backed by success of IT initiatives.
- **Investment in IT bearing fruit:** The bank's continued investments in strengthening its digital presence over the past couple of years are bearing fruits as banking through digital platforms (Internet banking/mobile banking/Konnect) now make up 74% (67% in 3QCY20) of the total transactions while branch banking stands at only 26% (33% in 3QCY20). Though COVID-19 outbreak has played a significant role in limiting branch banking, we opine the IT investment will continue to drive down operating costs.
- **Focus continues on Islamic banking:** HBL has converted almost 100 conventional branches into Islamic in 9MCY21 while 19 branches have been closed. Though branch expansion is not specifically on the agenda for the management, they expect to close the year with 280 Islamic banking branches through mobilization of the existing network.

HBL vs. KSE-100



HBL Price Performance	3M	6M	12M
Absolute	6.2%	-5.1%	-12.2%
Relative	8.4%	2.2%	-12.5%

HBL - Financials Snapshot			
Y/E: Dec	CY21E	CY22E	CY23E
EPS	24.2	29.2	32.3
EPS growth (YoY)	14.9%	20.5%	10.8%
DPS	7.0	10.0	11.5
BVPS	184.9	205.6	226.6
P/E (x)	4.8	4.0	3.6
P/B (x)	0.6	0.6	0.5
D/Y (%)	6.0%	8.6%	9.9%
ROE (%)	13.4%	15.1%	15.1%
ROA (%)	0.9%	1.0%	1.0%

Source: PSX, BMA Research

That said, we expect the bank to leverage its huge market presence and branch network in the Islamic segment as well and continue to build on the promising numbers (Islamic deposits up 23.8% in 9MCY21) achieved thus far.

- **Deposits surpass PKR 3.0Trn mark:** Strong performance of the domestic franchise of HBL continued to cement the bank's footing as the market leader having undergone a 15.3% YoY surge in local deposits. International deposits on the contrary increased by 18.5% over the same period resulting in overall deposit growth of 15.7% YoY. As a result, total deposits of the bank topped PKR 3.0Trn while current accounts reached PKR 1.1Trn. CASA declined to 80.4% (CA ratio: 35.2%) in 3QCY21 from 81.7% (CA ratio: 34.6%) in the SPLY due to sizable 24.4% YoY increase in fixed deposits.
- **Investment risks:** 1) Higher than expected provisioning; 2) Higher admin costs; and 3) Lower capital gains.

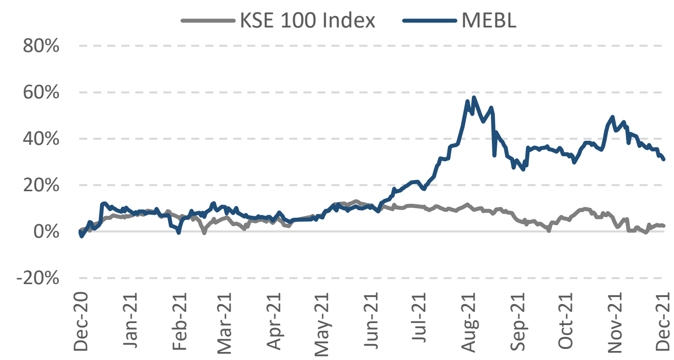
Meezan Bank Limited (PSX: MEBL)

No signs of slowing down

Our liking for MEBL is premised upon supernormal deposit growth, excellent ROE generation, rigorous branch expansion strategy and growing digital presence. Despite ever-growing deposit base and resultantly the high base effect, there seem to be no signs of slowing down for the bank which continues to go from strength to strength. That, alongside a clean loan book and coverage of over 130%, further cements our view. Furthermore, the absence of minimum deposit rate (MDR) for Islamic banks adds attraction to the scrip as interest rate up-cycle will strengthen NIMs. Keeping the aforementioned points in mind, we maintain our liking for MEBL and assign it a BUY call with a Dec-22 TP of PKR 200/sh, offering an upside of 48.0%. Our EPS estimates for the bank are PKR 16.0/20.2/22.9 for CY21/22/23 respectively with pay-out expected to be PKR 6.0/8.0/9.0 for the respective years.

- **Deposit growth showing no signs of slowing down:** Over the past five years, deposit base of the bank has almost trebled to ~PKR 1.3Trn in Sept-21 having undergone a CAGR of 21.8%, way past industry growth of 13.5% over the same period. That said, the growth is not at the expense of high cost deposits with CA ratio rising to 42% in Sept-21 from 33% in Sept-16. Similarly, CASA has risen to 80% from 74% over the said period. We credit the supernormal growth to the bank's strong brand name being the country's premier Islamic bank, persistent investment in the brick and mortar model with the addition of ~300 branches over the past 5 years and increasing digital footprint.
- **Advances growth surpasses all peers:** While banks have largely remained on the sidelines in terms of fresh lending due to COVID-19 related uncertainty and SBP backed loan deferrals/restructuring, MEBL has taken the lead. MEBL's loan book expanded by 23.2% YoY in Sept-21 compared to 14.8% growth seen by the industry. It is worth highlighting that over 70% of the bank's exposure remains in the corporate segment followed by SME/Commercial and consumer at 18% and 10% respectively. Furthermore, with an infection ratio of only 2.4% and coverage standing at over 130%, we expect limited NPL pile-up, if any.

MEBL vs. KSE-100



MEBL Price Performance	3M	6M	12M
Absolute	-3.4%	17.1%	29.4%
Relative	-1.2%	24.3%	29.0%

MEBL - Financials Snapshot			
Y/E: Dec	CY21E	CY22E	CY23E
EPS	16.0	20.2	22.9
EPS growth (YoY)	2.0%	26.7%	13.3%
DPS	6.0	8.0	9.0
BVPS	52.6	64.7	78.6
P/E (x)	8.5	6.7	5.9
P/B (x)	2.6	2.1	1.7
D/Y (%)	4.4%	5.9%	6.7%
ROE (%)	33.6%	34.5%	32.0%
ROA (%)	1.6%	1.7%	1.6%

Source: PSX, BMA Research

Meezan Bank Limited (PSX: MEBL)

- **Continued focus on their two-pronged strategy:** While banks have largely turned their focus towards digital banking as the way forward and in some cases have started closing down branches, MEBL has followed a two-pronged strategy. Having developed a strong digital platform over the past few years, the bank now stands as the top rated institution in terms of both transaction value and volume. That said, the bank's earlier focus on rigorous branch network has not taken a backseat. Note that the bank seeks to add another 100 branches in the next calendar year. Though, the continued expenditure will likely keep Cost to Income ratio on the higher side in the near to medium term, it will slowly start to taper off as the new branches become profitable that usually takes a period of 12-18 months.

- **Investment risks:** 1) higher than expected provisioning, 2) higher admin costs, 3) slower deposit growth and 4) lower fee income.

Bank Alfalah Limited (PSX: BAFL)

Ideal mix of value and growth

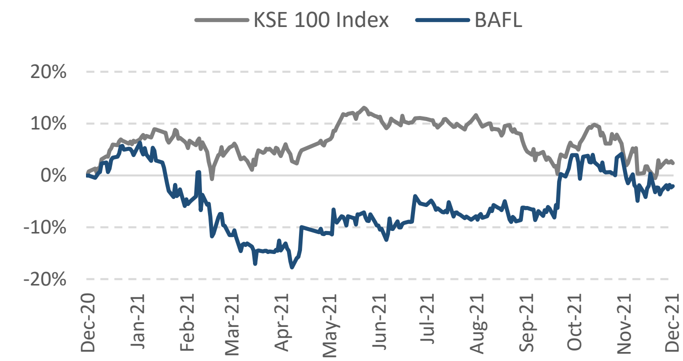
We reiterate BAFL as one of our favored picks on the back of the bank's excellent deposit growth, robust branch expansion plans, envious CA ratio and attractive dividend yield. Despite the economic headwinds and the broader laid-back approach towards lending, the bank has taken an aggressive approach and been at the forefront of enhancing its loan portfolio. On a YoY basis, balance sheet footing of BAFL has improved considerably with the bank outperforming industry both in terms of deposit and advances growth, recording numbers of 26.3% and 29.4% respectively. Taking cue from this and the cheap CY22/23E P/E,P/B multiples of only 3.5/3.2x, 0.6/0.5x, we opine current price levels offer an attractive entry point. We have a BUY call on the scrip with a Dec-22 TP of PKR 55.0/sh, offering a capital upside of 60.1% along with a healthy CY22 dividend yield of 14.6%.

- **Top notch CA ratio to provide respite to NIMs:** The bank underwent deposit growth of ~26% YoY in 9MCY21, far beating industry surge of ~16%. What is even better than the surge in growth is the fact that CA ratio stands at an envious 44.6%, making it one of the prime beneficiaries in a rising interest rates environment. CASA, however, has remained largely unchanged around the 80% as savings accounts have decreased.

- **Branch network expansion to continue:** Ever since CY19, the bank has adopted a branch expansion strategy that still remains intact. In CY19, the bank opened ~50 new branches while another ~30 were added in CY20. Fast forward to CY21, the strategy remains very much in place however, COVID fourth wave has slowed down the process as only 23 branches were opened in 9MCY21. The management, however, remains bullish on this end and expect to close the year with an addition of 70 new branches taking the tally to almost 800. That said, the strategy seems to have translated well as deposits surpassed PKR 1.0Trn for the first time in the bank's history in Jun-21.

- **Taking the lead in lending:** While the sector has largely maintained a cautious lending stance in the past year despite a number of schemes being launched by the Central Bank, BAFL has taken an aggressive stance. The loan book swelled by 29.4% YoY in 9MCY21, way over industry growth of 15.8%.

BAFL vs. KSE-100



BAFL Price Performance	3M	6M	12M
Absolute	6.2%	6.7%	-2.8%
Relative	8.4%	14.0%	-3.1%

BAFL - Financials Snapshot			
Y/E: Dec	CY21E	CY22E	CY23E
EPS	7.8	9.7	10.7
EPS growth (YoY)	31.7%	25.1%	10.4%
DPS	4.3	5.0	5.3
BVPS	53.7	58.0	62.6
P/E (x)	4.3	3.5	3.2
P/B (x)	0.6	0.6	0.5
D/Y (%)	12.4%	14.6%	15.3%
ROE (%)	14.8%	17.4%	17.8%
ROA (%)	0.9%	1.0%	1.0%

Source: PSX, BMA Research

Though incremental lending was broad based, the largest accretion was seen in the consumer segment that swelled by 48% YoY and now makes up 7% of the lending book only behind corporate and retail at 47% and 24% respectively**.** The numbers also suggest the bank's active lending strategy where in corporate is less than 50% compared to peers that have an exposure as high as 70% in this segment. The bank already seems to have greater focus on individual and retail lending which we opine will be the way forward. It is also worth mentioning that the bank's active lending and hence high ADR of 60% puts it in a very comfortable position as the incremental tax charge condition (if ADR falls below 50% and 40%) does not apply.

- **One of the best yield plays:** Though numbers suggest a growth story, healthy dividend pay-outs make the bank an attractive yield play. Balance sheet growth has enabled the bank to maintain a PKR 4.0/sh pay-out in the past two years and we expect the trend to further improve this year. Note that the bank has already paid out a PKR 2.0/sh dividend in 1H and we expect another PKR 2.25/sh in 2HCY21 which translates to an attractive annual dividend yield of 12.4%.

- **Investment risks:** 1) higher than expected provisioning; 2) higher admin costs; 3) slowdown in fee income; and 4) lower capital gains.

Oil & Gas Exploration and Production - Overweight

Compelling valuations

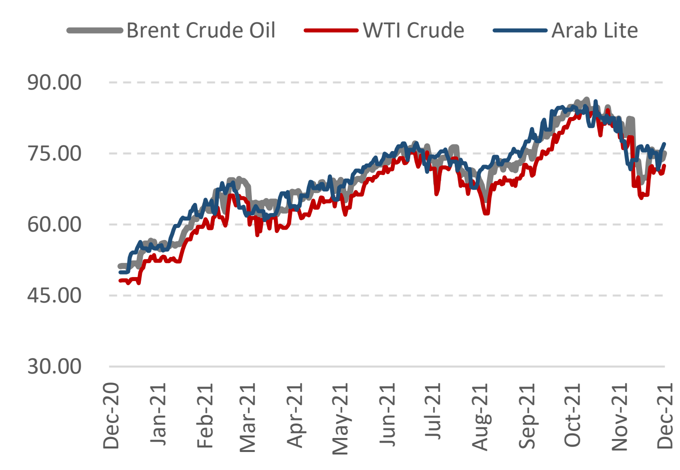
Pakistan E&P sector continues to face serious headwinds to re-rate with issues similar to previous years. 2021 saw strong recovery in oil prices from the lows seen in 2020 post Covid-19 outbreak resulting in strong earnings growth for industry players (coupled with weaker PKR). This hasn't really translated into higher cash flows as trade debts continue to pile-up. In effect, the stock of circular debt has surpassed historic highs (currently standing at PKR 2.4Trn), and with cash being stuck up, companies have cut down exploratory efforts. This is worrisome given the country has failed to strike any major hydrocarbon discovery in recent years.

- **How FY21 turned out?** Total oil production increased by 24% YoY in FY21 to surpass 75,000bpd aided by lower base effect in FY20 (↓14% YoY vs. FY19) due to COVID related shutdowns and reduction in output from two major wells namely Makhori Deep (↓37% YoY) and Mardankhel (↓14% YoY). Over FY21, a total of 28 wells were spud of which 13 were exploratory while the remainder were developmental. During the year, the government's strive to attract investment into the E&Ps sector and ramp up exploration bore little results as only 15 bids were received against the auction of 20 blocks. On the other hand, gas production underwent a slight decline of 2% YoY to 3,511mmcfd from 3,589mmcfd in the previous year.

- **Cash injection is the need of the hour:** As per news reports, the government is working towards curtailing the circular debt stock particularly in the E&P space. A cash injection in the energy chain has been proposed, wherein the E&P players will be directed towards making dividend payments (government is the major shareholder in both OGDC and PPL). While this will bring down the huge outstanding figure to a certain extent, it doesn't address the chronic issue with the energy chain – thus more concrete measures are the need of the hour. E&P scrips are expected to remain in the limelight while these payments are being processed as investors will eye dividends.

- **Top pick:** Our top picks within the sector is Mari Petroleum as it is more or less immune to circular debt as it sells to end consumers directly. Also, the company is now paying large dividends (post removal of dividend cap) and has also ramped up its exploration activities.

International Oil Prices inching up (USD/bbl)



Source: Bloomberg, BMA Research

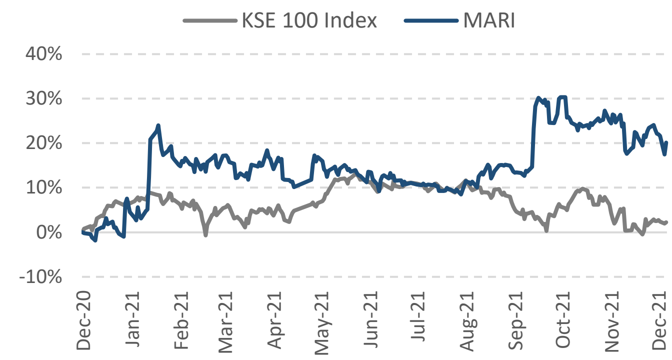
Mari Petroleum Company Limited (PSX: MARI)

Multiple triggers in the offing

We believe, price performance in MARI (up 19.7% FYTD) has not been reflective of the multiple triggers the stock has on offer as the company still trades at cheap FY22 EV/EBITDA, P/E of only 2.5x/5.1x respectively. Our preference for MARI is based on: 1) earnings accretion on the back of an uptick in production from HRL; 2) cheap trading multiples as the scrip trades at implied oil prices of only USD 25/bbl, 3) diversification into power and mining; and 4) attractive dividend yield of over 12%. We have a BUY call on MARI with Dec'22 TP of PKR 2,264/sh, offering an upside of 41.2%.

- **Uptick in production to uplift earnings:** Production portfolio of MARI has so far remained highly concentrated as 94% of its net revenues come from gas and 92% of gas is generated from Mari field. Therefore, the company witnessed an impressive surge in earnings (5-yr CAGR of 46.3%) after the dismantling of its previous Gas Price Purchase Agreement (GPA) in FY14 which was replaced by the combination of gas pricing based on Petroleum Policy (PP) 2001 and 2012. Based on this formula, incremental production from MARI fields over 525mmcfd is to be priced under the PP 2012 while the base production to be priced as per PP 2001. As a result, additional production of 150mmcfd gas from Goru-B and Tipu are likely to improve earnings by PKR 130/sh, in our view.
- **Least affected by circular debt:** While other E&P companies are facing a cash crunch after being affected by the continuous increase in circular debt, MARI stands the safest given the company's high exposure to the fertilizer sector with an allocation of ~600mmcfd. Also, the additional 150mmcfd gas is likely to be allocated to the fertilizer sector, which will only improve the cash cycle of the company.
- **Removal of dividend cap and long reserve life:** Shareholders of the company are entitled to a minimum net ROE of 30%. In case of gas or equivalent oil production beyond 425mmcfd, this return is to be increased by 1% for every 20mmcfd up to a maximum return of 45%. Following removal of its dividend cap, the company's pay-out ratio surged to ~60% in FY21 and we expect the same payout ratio to be maintained in FY22. Furthermore, as per the latest available data released by PPIS, MARI's reserve stand at 528MMBOE, which cumulates to a reserve life of around 20yrs, the highest in our BMA E&P Universe.
- **Investment risks:** 1) Lower than expected reserve life; 2) Decrease in international oil prices; and 3) Dollar appreciation.

MARI vs. KSE-100



MARI Price Performance	3M	6M	12M
Absolute	3.2%	5.2%	19.7%
Relative	5.4%	12.5%	19.3%

MARI - Financials Snapshot			
Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	313.8	456.3	394.9
Earnings growth (%)	33.1%	45.4%	-13.4%
DPS (PKR)	195.0	275.0	235.0
D/Y (%)	12.2%	17.1%	14.7%
P/E (x)	5.1	3.5	4.1
P/B (x)	1.5	1.3	1.2
ROE (%)	32.2%	38.9%	29.4%
EV/EBITDA (x)	2.5	1.6	1.6

Source: PSX, BMA Research

Cements - Overweight

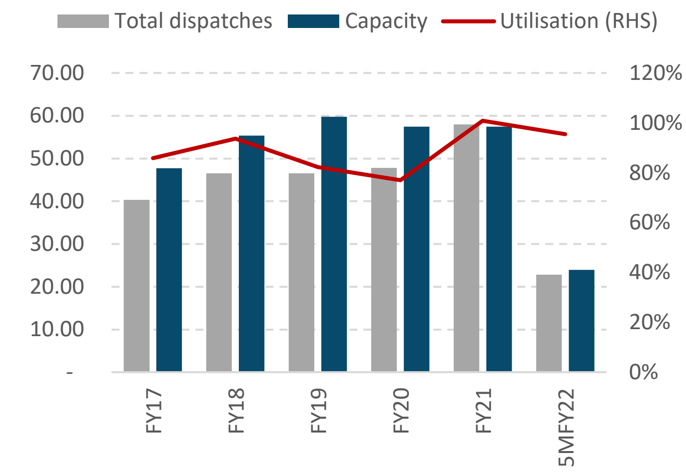
Robust demand and high utilization levels make the sector a worthy bet

Strong demand from private sector and normalized commodity prices to drive profitability: We have an Overweight stance on the cement sector as we opine recent underperformance (down 22.4% CYTD) has largely incorporated the negatives. Though we do not discount the fact that with coal prices and freight charges at elevated levels, margins can come under pressure in the near term, our liking is premised upon robust demand from the private sector, government backed initiatives like concessional housing finance schemes and pricing power of industry players given high utilization levels. Going into CY22, we expect the commodity up-cycle to ease off past the winter season thus cushioning margins while strong demand from the private sector will continue to drive volumes, though we expect lower single digit demand growth in FY22. Double digit interest rates do pose a potent threat to profitability of leveraged players, we highlight our preference for cash rich companies particularly LUCK given its strong balance sheet footing and diversified operations.

- **High utilization levels provide us comfort:** Though cement sales have undergone a mild 6.3% YoY contraction in 5MFY22, utilization levels remained intact at over 90%. High utilization levels allowed the industry players to pass on majority of negative impacts arising from PKR devaluation and multi-year high coal prices through multiple hikes in retail prices. Keeping that in mind and with no new capacity additions until the end of the CY22, we expect pricing discipline to prevail in the upcoming year. That said, we opine earnings accretion to be driven by pricing power rather than volumetric growth in FY22.

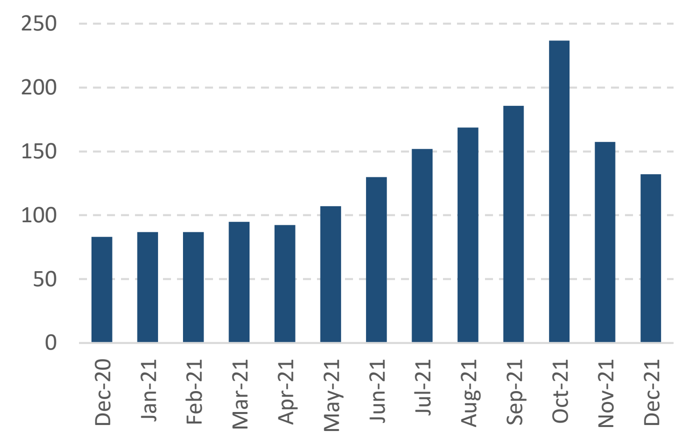
- **Public sector spending to be scaled up in FY23 while inflation is expected to backtrack to single digits:** While PSDP related expenditure is likely to be slowed down given the government has to abide by preconditions put forward by the IMF for the release of 6th tranche, we opine public sector spending will once again be scaled up as a populist measure in FY23 in the light of upcoming general elections thus boosting local demand. On the other hand, we expect interest rates to settle at ~8% in the next fiscal year as inflation falls to SBP defined range (5-7%) thus easing off pressure on leveraged players to a certain extent amid addition of concessionary debt under TERF/LTFF scheme for new expansions.

Cement sector capacity and dispatches (Mn tons)



Source: APCMA, Zakheera, BMA Research

Coal prices still pose a potent threat (USD/ton)



Source: Bloomberg, Zakheera, BMA Research

Lucky Cement Limited (PSX: LUCK)

Not resting on its laurels

We maintain our liking for LUCK which is on the back of strong foothold in the cements segment that is well supported by a robust income stream from its diversified operations in Autos, Power and Chemical sectors. We have a BUY call on the scrip with a Dec-22 TP of 960/sh (upside: 41.9%).

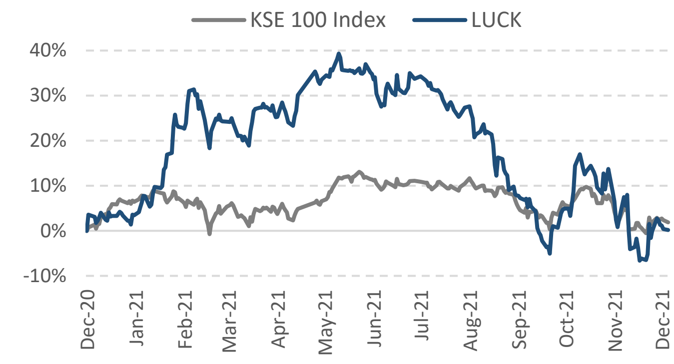
- **String of new developments on the horizon:** It is only a matter of time before the company announces COD of its long awaited 660MW coal fired power plant in the upcoming months which shall funnel through its bottom line from 2HFY22, we assume the project to add ~PKR 35/sh to the company's profits from FY23. Furthermore, addition of 3.15Mn tons cement capacity in the North (expected COD: 2HFY23) will further jack up its market share to 17% going forward and make good use of the expected surge in economic activity given the election year (FY23). The company through its subsidiary, Lucky Motor Corporation is also set to launch Samsung mobile phones in the domestic market shortly. Keeping in perspective the ongoing developments in the company without discounting the launch of Peugeot cars by its automobile arm and product portfolio enhancement by ICI Pakistan, we opine LUCK stands heads and shoulders above its competition in the cements space. Trading at FY22/23E P/E multiple of only 7.5/5.8x respectively, we opine the company to be the ideal exposure in the cements sector.

- **Low leverage levels and normalization of cost pressures to further cement earnings accretion:** LUCK has a Debt/Equity of only 0.3x (as at Sept-21) on a consolidated basis while on an individual basis it stands at less than 0.1x. That said, the company is relatively well positioned to cruise through pressure building from additional funding cost as interest rates go up. On the other hand, we opine normalization of cost pressures particularly international coal prices and freight charges will likely ease off going forward thus cushioning gross margins.

- **PKR devaluation to work in the company's favor:** As pressure continues to build on the PKR courtesy ballooning CAD, it may well turn out to be in the favor of cements in Pakistan as they will become more competitive in the international market and with LUCK being the largest player in the space, PKR devaluation might well be a silver lining for the company. Furthermore, due to rupee depreciation LUCK would benefit from its international assets and increased profitability of Lucky Electric Power given its USD denominated returns.

- **Investment risks:** 1) Slowdown in demand amid reduced PSDP releases; 2) Loss of market share as new capacities come online; 3) High coal prices and 4) Reduction in retail cement prices.

LUCK vs. KSE-100



LUCK Price Performance	3M	6M	12M
Absolute	-6.4%	-21.6%	-2.8%
Relative	-4.2%	-14.4%	-3.2%

LUCK - Financials Snapshot

Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	90.2	116.8	146.0
Earnings growth (%)	27.6%	29.5%	25.0%
DPS (PKR)	5.0	15.0	20.0
D/Y (%)	0.7%	2.2%	3.0%
P/E (x)	7.5	5.8	4.6
P/B (x)	1.2	1.1	0.9
ROE (%)	22.7%	20.7%	22.5%
EV/EBITDA (x)	6.1	5.8	4.7

Source: PSX, BMA Research

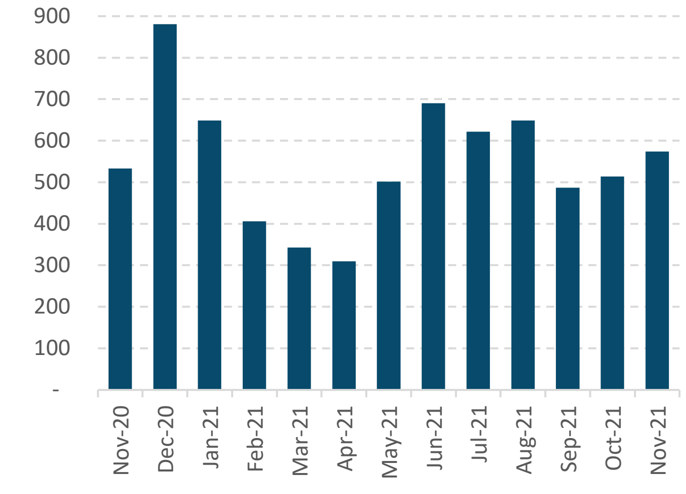
Fertilizers - Overweight

Benefitting from favorable agri dynamics

Well placed to pass on any cost pressures: Fertilizer sector finds itself at a sweet spot with the industry benefiting from 1) low inventory levels (urea inventory stood at 98k tons at Nov-21 end), 2) strong demand from the agriculture sector (urea off-take up ~11.3% YoY in 11MCY21) owing to bumper yields in major crops and 3) essentially non-existent risk from imports given the huge price disparity between the two. The aforementioned reasons also give the industry the ability to pass on any sort of price pressure be it in terms of roll back of sales tax exemptions or higher input prices particularly gas. Going into CY22, we expect production to be 6.2Mn tons while demand is expected to remain high at around 6.0Mn tons. With these figures in mind, we opine the fertilizer space will likely enjoy pricing power in the upcoming year while any negative developments will likely be easily passed on. In the current mix of things, we highlight FFC to be our top pick in the fertilizers space.

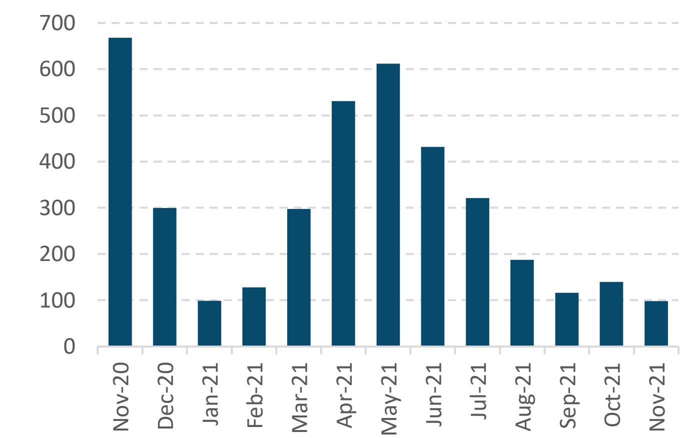
- **Low inventory levels and healthy off-take work in favor of the industry players:** The fertilizer sector has to date undergone a healthy double digit increase in offtake (up 11.3% in 11MCY21). Putting it into numbers, overall off-take has surged to 5.7Mn tons till Nov-21 (11MCY21) against 5.2Mn sold in the SPLY. This has been on the back of improving farm economics, record production of major crops and favorable government policies due to which urea inventory levels have declined to only 98k tons. Impetus has also been provided by local provincial governments that have set higher support prices for major crops (PKR 2,200/bag for wheat in Sindh) that has improved farmer's immunity to rising input costs. Taking cue from this, we expect the current hue and cry about roll-back of sales tax exemptions and higher energy tariffs will likely have minimal impact on local industry players given the sweet spot the sector is currently enjoying.
- **Likely to be unaffected by gas curtailment:** Given the low inventory levels and keeping in mind the government will look to maintain a buffer of ~200k tons (import of 150k tons incorporated) in order to negate any shortfall next year, the fertilizer sector has so far enjoyed uninterrupted gas supply despite consistent shortfall in the country. That said, the fertilizer space is well placed, and the ongoing gas crisis will likely not have any impact on the sector going into 2022.

Offtake continues to remain strong ('000 tons)



Source: NFDC, Zakheera, BMA Research

Ending inventory declines below 100k mark ('000 tons)



Source: NFDC, Zakheera, BMA Research

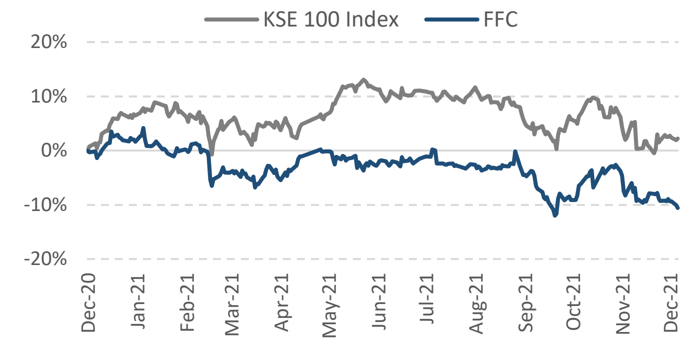
Fauji Fertilizer Company Limited (PSX: FFC)

More than just a yield play

We maintain our "Outperform" stance on FFC with a Dec'22 TP of PKR 135/sh, offering an upside of 37.4%. Our preference for FFC is mainly based on 1) cheap CY22 P/E multiple of only 4.9x; 2) healthy dividend payout with CY21 dividend yield of 14.3%; 3) higher dividend income from associated companies; and 4) power business which is expected to contribute PKR 1.3/sh to CY22 earnings and PKR 4.3/sh to our TP.

- **Favorable earnings outlook**: FFC is anticipated to showcase decent uptick in earnings with a 3-year CAGR of 8.5%. Strong fertilizer demand amidst improving agronomics will bolster top-line growth next year. Moreover, the company is likely to receive higher dividend income from its associate companies, including FFBL (49.9% ownership stake) and AKBL (43.1% ownership stake), due to an anticipated improvement in their profitability. We expect FFC's earnings to clock-in at PKR 17.4/20.1 per share in CY21/22 respectively.
- **Healthy dividend payouts to continue**: Given the extension in the GIDC payment timeline to 48 months and agreement with the government to reverse the provision against input sales tax disallowance, the major risks associated with the company have largely subsided. We expect the company to maintain its stable dividend stream with an expected payout of 80% in the coming years.
- **Investment in power business to enhance value**: FFC is poised for growth as it ventures into the power business with an aggregate investment of PKR 2.8Bn in Thar Energy Limited (TEL). The company retains a 30% equity stake in this 330 MW coal-based power plant, which is expected to commence its commercial operations next year. We expect the project to add PKR 1.3/sh to CY22 earnings and PKR 4.3/sh to our TP.
- **A safe bet**: FFC's dominant position and ability to pass on the impact of any cost increases is the key differentiating factor that keeps it safe from unexpected events. In case of increase in gas prices, we are confident that FFC will sustain its profitability and continue to deliver value to its shareholders.
- **Investment perspective**: The stock trades at a cheap CY22 P/E multiple of only 4.9x along with a healthy dividend yield of 16.3%, we recommend a long position in the scrip. We have a BUY stance on FFC with Dec'22 TP of PKR 135/sh. which offers an upside of 37.4%.
- **Investment risk**: Potential downside risks to our thesis include: 1) gas curtailment; 2) lower than expected fertilizer offtake; and 3) hike in gas tariff for feed and fuel.

FFC vs. KSE-100



FFC Price Performance	3M	6M	12M
Absolute	-3.8%	-7.4%	-9.5%
Relative	-1.6%	-0.2%	-9.8%

FFC - Financials Snapshot

Y/E: Dec	CY21E	CY22E	FY23E
EPS (PKR)	17.4	20.1	20.9
Earnings growth (%)	6.4%	15.5%	4.0%
DPS (PKR)	14.0	16.0	16.5
D/Y (%)	14.3%	16.3%	16.8%
P/E (x)	5.6	4.9	4.7
P/B (x)	2.7	2.6	2.5
ROE (%)	49%	52%	51%
EV/EBITDA (x)	2.8	3.2	2.9

Source: PSX, BMA Research

Power Generation & Distribution - Marketweight

Circular debt settlement remains the key

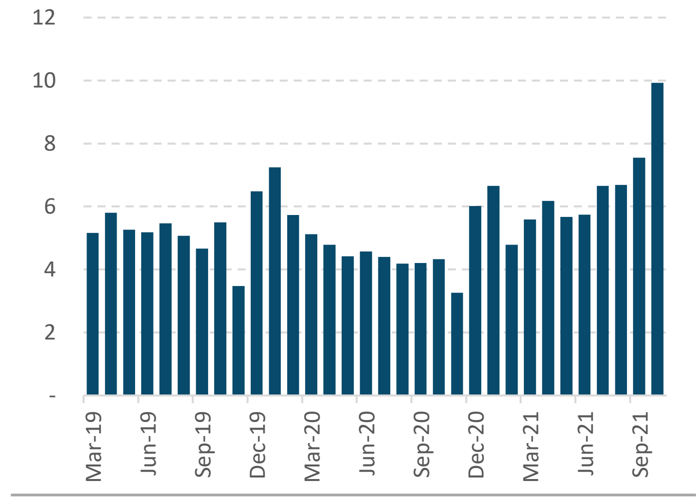
Pakistan has long suffered from the energy conundrum, where it went from not having enough capacity to surplus capacity over the last few years. However, it did come at a huge cost in the form of excess capacity payments, extensive PKR depreciation and expensive contracts on 'Take or Pay' basis that hurt the national exchequer. In addition to growing capacity payments, high T&D losses, delay in tariff notifications and inefficiencies of DISCOs led to the ever-growing circular debt, which stands at ~PKR 2.6Trn as per latest data releases.

- **Master Agreement to settle the burgeoning stock of circular debt:** The GoP took some concrete measures to slow down the pace of circular debt growth. The most important step being the signing of amended MoUs with several IPPs that led to a change in previously negotiated terms. Few prominent measures included easing the circular debt burden, fixation of USD-PKR parity for 1994 and 2002 power policy IPPs, sharing of O&M savings, and reduction in Delayed Payment Rate (DPR) amongst a few others, paving the way for value proposition in the sector.

- **Cash injection to ease liquidity concerns:** Furthermore, in a bid to curb the growth of circular debt and improve the liquidity position of cash starved IPPs, the government decided to clear overdue receivables of IPPs that belonged to 1994 and Pre-1994 Power Policies. As such, payment was made in 2 tranches to the tune of PKR 224Bn in the form of 1/3rd cash, 1/3rd Sukuks and 1/3rd PIBs with the major beneficiaries being HUBCO, KAPCO, PKGP and LPL. This allowed the IPPs to improve their liquidity position, increase their dividend payouts and reduce their payables to companies stuck in the circular debt cycle such as PSO, OGDC and PPL.

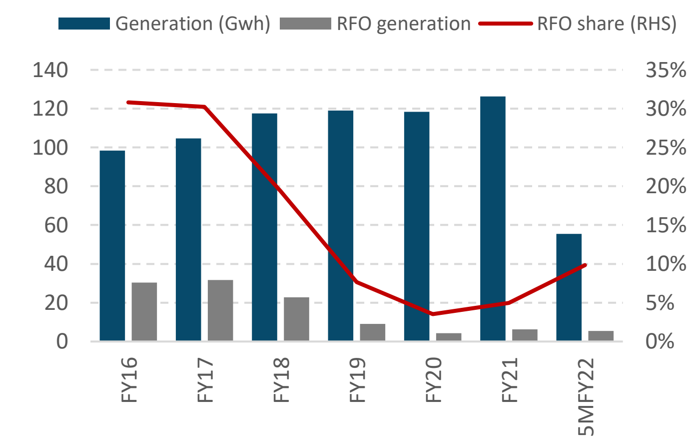
- **Future Outlook:** Strong focus of the government to reduce circular debt aided by a decline in commodity prices (oil, coal) will result in reduced costs for IPPs going forward. Furthermore, with the dollar rate fixed, the growth in circular debt will be partially managed. As such, companies with high amounts of overdue receivables might be able to resolve their liquidity crunch to a certain extent. Eventually, the govt. plans to phase out FO based plants; however, we believe that rising demand for electricity will require govt. to continue their usage in the short-medium term. Furthermore, implementation of Competitive Trading Bilateral Contract Market (CTBCM) will allow industries to shift from captive power to national grid, which will also help in reducing overall cost.

Electricity generation cost per unit (PKR)



Source: NEPRA, BMA Research

Use of RFO in Total Generation (GwH)



Source: NEPRA, BMA Research

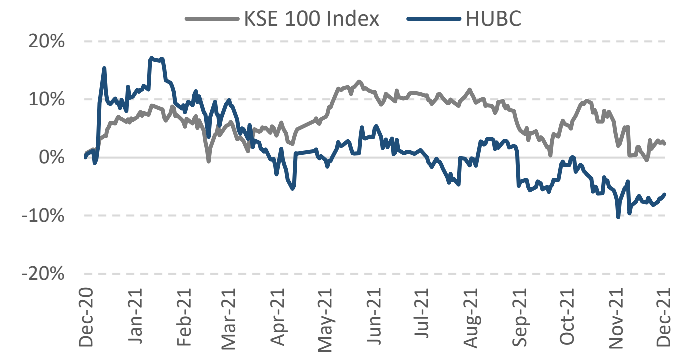
The Hub Power Company Limited (PSX: HUBC)

Diversified exposure to pave the way

HUBC is our top pick in the listed power space with a Dec-22 SOTP based TP of PKR 132/sh, offering an upside of 84%. Our thesis is premised upon i) cash inflows from GoP to ease liquidity position(entitled to PKR 34.8Bn in 2nd tranche), ii) incoming coal projects, iii) diversification into E&Ps through ENI and iv) increased dividend from CPHGC.

- **Upcoming projects to unlock value:** The company is in the process of setting up two 330MW coal power plants i.e., ThalNova Power Thar (TNPT) and Thar Energy Limited (TEL). TNPT has achieved ~46% completion and is expected to achieve COD by June'22. TEL is another lignite coal-based project expected to achieve COD by Mar'22. We expect both these projects to result in incremental earnings of PKR 3.5/sh in FY23 (PKR32.0/sh to HUBC's target price).
- **Cash injection to ease liquidity concerns:** Since the signing of MOUs with 47 IPPs, GoP/CPPA-G has taken a concrete step as the first tranche of receivables to IPPs has been released. This payment was made to IPPs falling under the 1994 Power Policy in the form of 1/3rd cash, 1/3rd PIBs and 1/3rd Sukuks on overdue receivables as of Nov'20. As expected, HUBCO received PKR 23.2Bn (PKR 17.9/sh) whereas remaining 60% amounting to PKR 34.8Bn (PKR 26.8/sh) is to be received soon as the release has been approved by the ECC. Timely payments to IPPs will help HUBCO reduce its overall debt pile and increase its payout capacity. Furthermore, IPPs falling under the 2002 Power Policy have also been cleared by NAB. As such, the Narowal plant is scheduled to receive PKR 18Bn (PKR 14/sh) as its share of overdue receivables. We expect these to be paid in the same manner as the 1994 IPPs were paid i.e., 1/3rd cash, 1/3rd PIBs and 1/3rd Sukuks.
- **Diversification into E&Ps:** ENI will be the first venture of HUBC in the E&Ps sector, as it looks to diversify its exposure in the coming years. ENI has been in Pakistan since 2000 where the company has permits to operate in Bhit/Badhra, Kadanwari, Latif, Zamzama and Sawan fields.
- **Investment risks:** i) delay in COD of new projects, ii) reduced load factor due to shift from FO based generation and iii) increase in overdue receivables.

HUBC vs. KSE-100



HUBC Price Performance	3M	6M	12M
Absolute	-2.5%	-10.0%	-9.6%
Relative	-0.3%	-2.7%	-10.0%

HUBC - Financials Snapshot			
Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	26.0	32.9	37.5
Earnings growth (%)	0.0%	26.5%	14.0%
DPS (PKR)	13.0	16.4.0	18.7
D/Y (%)	18.2%	23.0%	26.2%
P/E (x)	2.8	2.2	1.9
P/B (x)	0.8	0.7	0.7
ROE (%)	28.2%	33.4%	35.6%

Source: PSX, BMA Research

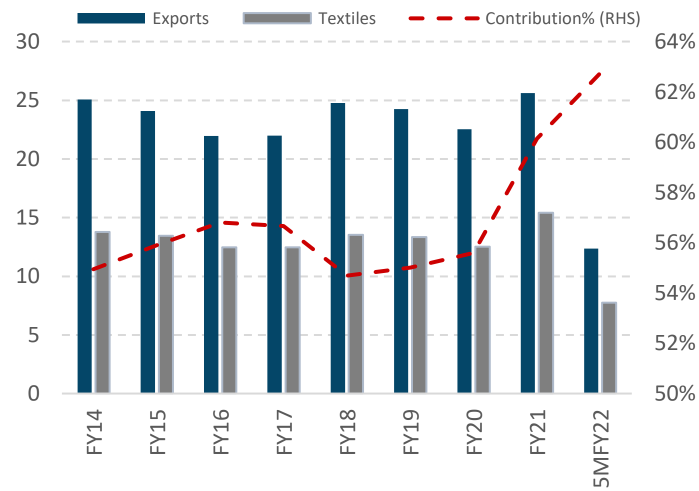
Textiles - Overweight

Conducive dynamics to keep the sector upbeat

Textile sector has long been the backbone of exports in Pakistan. With a total contribution of ~60% to overall exports in FY21, the sector holds the key in shaping up the exports and supporting the Current Account as a result.

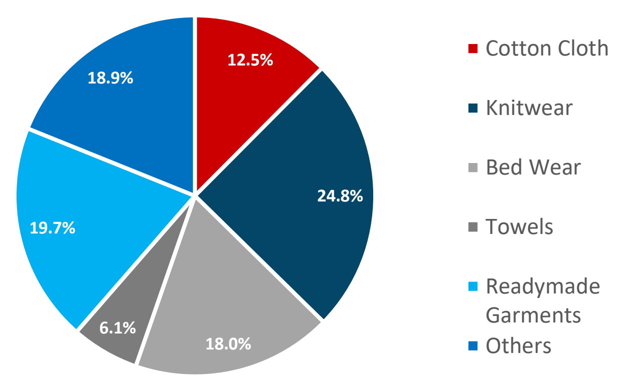
- **Value added segment leading the way:** In 4MFY22, textile exports have fetched ~USD 6.0Bn as compared to USD 4.8Bn in the SPLY, posting a growth of ~25% YoY. The growth is mainly led by the value-added segment (bedwear, knitwear, towels, and readymade garments), which have grown by ~27% YoY and have a share of 68% in total textile exports, followed by Basic textiles (raw cotton, cotton yarn, cotton cloth) at 18% and others (tents, canvas, made-up articles) at 14%.
- **Retail demand on the rise:** Resumption of economic activity in the country along with increasing digitization resulted in increased demand from the retail segment. In the BMA textile universe, retail sales grew by 35% YoY in FY21 (GATM: 13%, ILP: 46% and NML: 61%), mainly as companies increased their retail outlets, improved delivery times through efficient supply chains and ensured that e-commerce usage was put to the right use by enabling easy to use technology for the end consumer.
- **Current exchange rate regime bodes well for the sector:** Impetus from the government to increase global competitiveness and resultantly favorable policies boded well for the sector until recently COVID-19 outbreak has provided the sleeping giant a much-needed push. One such measure was the shift in exchange rate regime from fixed to market based which translated to our exports becoming more affordable globally. Secondly, RLNG was provided to the sector at subsidized rates (USD 6.5/MMBtu) and electricity at 9 cents/KwH which reduced the input costs and improved gross margins.
- **Re-routing of orders amid rising Covid cases:** As Covid-19 swept throughout the world, it led to shutdown of various countries and industries. Regional competitors i.e., China, Vietnam, Bangladesh, and India had to shut down their industries due to which the orders were rerouted to Pakistan. This provided a much-needed boost to the sector which posted highest ever exports in FY21 (USD 15.4Bn, up 23% YoY).

Textiles' contribution to Total Exports (USD Bn)



Source: PBS, SBP. BMA Research

Segmental Textile Exports (%)



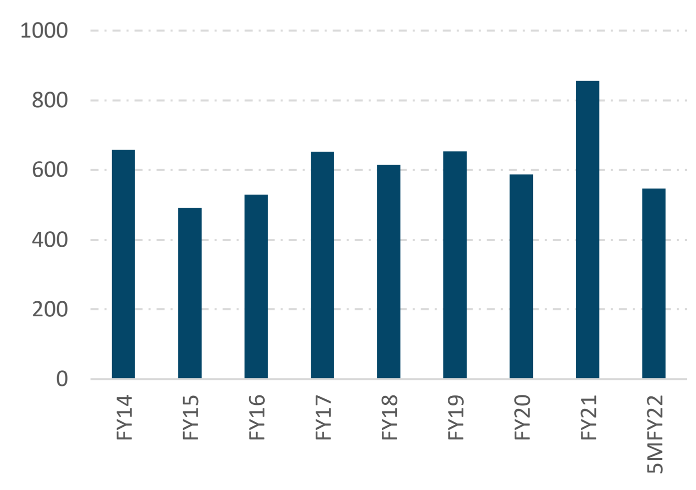
Source: PBS, SBP, BMA Research

Textiles - Overweight

- **Subsidized financing paving the way for expansions**: Another facility introduced by SBP was provision of subsidized loans to the export sector in the form of TERF. This facility allowed exporters to borrow at low markups to finance expansion projects. Most of this was availed by the textile sector amounting to ~PKR 266Bn out of total disbursements of around PKR 450Bn to date. Capacity expansion through cheap loans will allow textile exporters to further enhance their order book and tap more global markets. As at FY21, a few prominent players such as GATM and ILP had already announced their capacity expansions on the back of these loans. In 5MFY22, textile machinery imports have clocked in at USD ~550Mn, making it the highest ever figure in the country's history over a five-month period.

- **Future Outlook**: We expect textile exports to continue the growth momentum as witnessed in 4MFY22 and post exports in excess of USD 20.0Bn in FY22 as global demand is on a rising trend and most exporters have their order books filled till the end of the current fiscal year. Furthermore, machinery imports in recent months on the back of subsidized financing has helped companies to increase their production capacity through which they will be able to tap more international markets. Our top picks in the sector are GATM & ILP.

Textile Machinery Imports (USD Mn)



Source: PBS, SBP, BMA Research

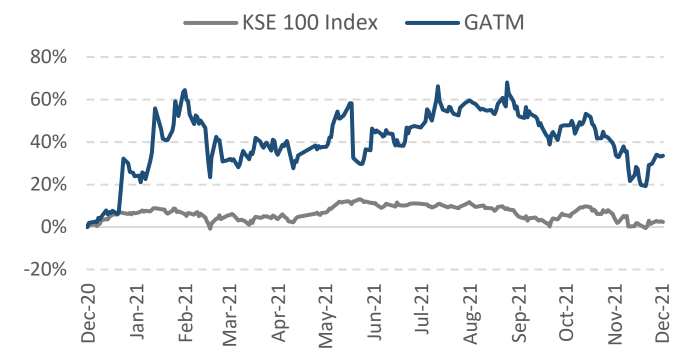
Gul Ahmed Textile Mills Limited (PSX: GATM)

Ahead of the curve

GATM is one of our favored picks in the listed textile space. Our liking for the stock is based on the following factors: i) capacity expansions in spinning and home textile segment, ii) improved retail footprint through opening of new stores, iii) IDEAS IPO to unlock further value, iv) prolific demand of home textile products and v) dollar linked revenues (exports contribute ~60%). With a Dec'22 DCF based TP of PKR 78/sh, we have a BUY call on the scrip which trades at a FY22 P/E of only 3.5x, providing an upside of 64%.

- **Capacity expansions paving the way for growth:** GATM was able to improve and upgrade its PPE through subsidized financing (markup rates ranging between 3-5%) in the form of TERF which allowed to keep its finance costs in check despite rising debt levels and interest rates. GATM has historically upgraded its PPE at a 7-yr CAGR of 23% which is the highest amongst its peers. The company has announced capacity expansions in its spinning and home textile segment by ~20% which will be fully operational by FY22 end.
- **Strong retail presence to aid core earnings:** Retail segment of the company has improved significantly over the past year owing to increased local demand. Gross margins of the segment clocked in at ~38% in 1QFY22 and the company aims to further improve revenues from this segment by opening new stores and improving its online channels. Furthermore, IPO of IDEAS is on the cards for which the company has taken relevant measures and is expected to be announced over the next two quarters. The company currently has 100+ outlets and it aims to increase this number to 140 by FY24.
- **PKR depreciation to bode well for the company:** PKR has depreciated by ~10% in CY21 owing to economic instability and worsening macro indicators. However, this has been profitable for the export industry (including GATM) in the form of higher revenues and exchange gains.
- **Investment risks:** i) reopening of India, Bangladesh and Vietnam will lead to increased supply of textile products resulting in lower demand from Pakistan, ii) uncertainty on continuation of subsidized gas and electricity tariffs and iii) delays in capacity expansions and IDEAS IPO.

GATM vs. KSE-100



GATM Price Performance	3M	6M	12M
Absolute	-13.4%	-6.4%	29.2%
Relative	-11.2%	0.9%	28.9%

GATM - Financials Snapshot

Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	13.9	15.3	16.1
Earnings growth (%)	37.6%	10.1%	5.2%
DPS (PKR)	4.0	5.0	5.0
D/Y (%)	8.2%	10.4%	10.4%
P/E (x)	3.5	3.1	3.0
P/B (x)	1.0	0.8	0.7
ROE (%)	29.3%	26.4%	20.8%
EV/EBITDA (x)	6.2	5.5	5.6

Source: PSX, BMA Research

Interloop Limited (PSX: ILP)

At a sweet spot

Interloop, being a primarily export driven company, is well placed to encash the textile boom as over ~90% of revenue is derived from value-added products. ILP has continued its growth momentum mainly due to i) subsidized gas & electricity rates, ii) PKR depreciation, iii) rerouting of orders to Pakistan due to Covid, iv) strong customer base in the US and v) upcoming plant expansions. We have a 'BUY' rating on the company with a Dec-22 DCF based TP of PKR 96/sh, offering an upside of 34% upside. The stock is currently trading at a FY22 P/E of only 5.9x.

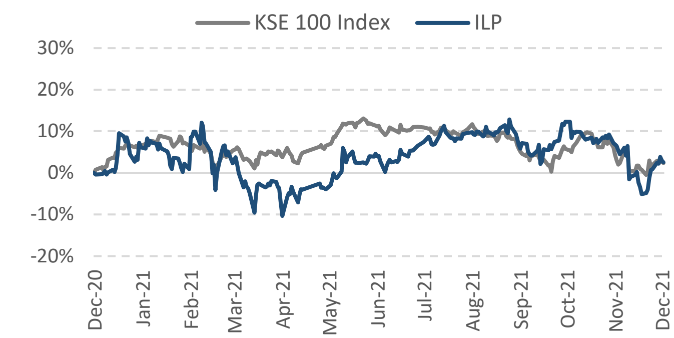
- **Upcoming expansions to aid profitability:** ILP has constantly focused on improving its plant and machinery as implied by the fact that its PPE has grown at a 7-yr CAGR of 14%. The company incurred CAPEX of PKR 4.0/6.9/3.3Bn in FY19/20/21 respectively to upgrade its hosiery segment, whereas in FY22, it has planned Capex of ~PKR 2.0Bn. Currently, the production capacity is 42k dozens/day however, it is only operating at ~29% capacity. The company plans to install ~600 new knitting machines in order to increase its utilization levels.

- **Subsidized loans to keep finance costs in check:** The company has significant leverage (D/E: 0.4x) on its balance sheet however, ~80% (PKR 6.4Bn) of it is in the form of subsidized financing (TERF & LTFF) due to which interest rate hikes do not affect the company's financial charges. Moreover, since ~90% of the revenue is driven through exports, the company is a major beneficiary of devaluation as it leads to higher exchange gains.

- **Denim segment to turn profitable:** Currently, the company faces operating losses from its Denim segment. However, this was because of Covid waves that led to cancellation of orders from the US and Europe. As per management, the company is hopeful of breaking even from this segment by FY23 through increased capacity utilization and recurring orders from its existing customers.

- **Investment risks:** i) reopening of India, Bangladesh and Vietnam will lead to increased supply of textile products resulting in lower demand for Pakistan, ii) uncertainty on continuation of subsidized gas and electricity tariffs and iii) delays in capacity expansions.

ILP vs. KSE-100



ILP Price Performance	3M	6M	12M
Absolute	0.0%	1.6%	4.5%
Relative	2.2%	8.9%	4.2%

ILP - Financials Snapshot

Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	11.8	12.7	13.3
Earnings growth (%)	63.7%	7.6%	4.7%
DPS (PKR)	4.0	4.0	5.0
D/Y (%)	5.8%	5.8%	7.2%
P/E (x)	5.9	5.5	5.3
P/B (x)	2.4	2.1	1.7
ROE	39.7%	34.2%	30.8%
EV/EBITDA (x)	7.8	5.2	5.1

Source: PSX, BMA Research

Oil & Gas Marketing - Overweight

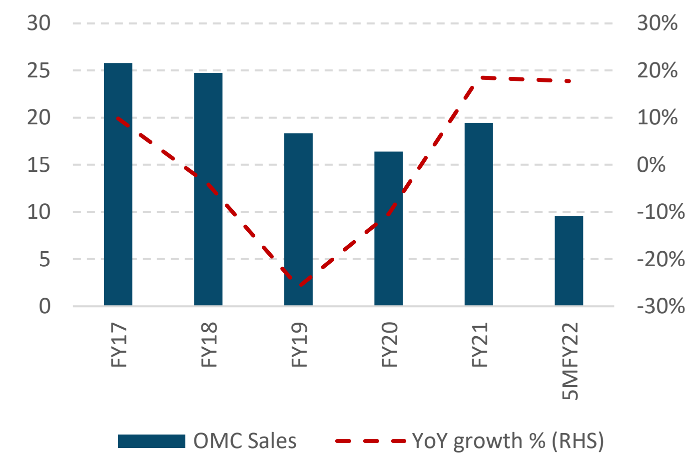
Policy changes add attraction to the sector

Recent policy changes bode well for the sector: Downstream sector has witnessed notable developments in recent years mainly pertaining to policy changes. Amongst the key changes, (i) fortnightly retail price revisions have brought down the inventory gains/loss volatility while (ii) inclusion of exchange rate changes in pricing have limited exchange losses to a large extent. More importantly, the OMC margins have recently been revised upwards (by 71 paisas per liter or 23.9%) to PKR 3.68/ltr – much higher than the FY21 CPI which clocked in at 8.9%, this is expected to further enhance sector profitability.

- **Momentum continuing in FY22, but a slowdown is expected in 2H:** Following a weak FY20 where COVID related shutdowns marred economic activity, petroleum sales regained lost ground having surged by 18.5% YoY to 19.4 Mn tons against a decline of 10.4% YoY (16.4 Mn tons) witnessed in the preceding year. The rise is primarily owed to sharp recovery in economic activity (LSM growth up ~15% YoY in FY21) and higher passenger car sales (up 57% YoY). Over the year, PSO further strengthened its position as the market leader as its share in total volumes increased to 46% from 44% in the previous year. Fast forward to FY22, the momentum has continued as petroleum sales have increased by ~18% YoY in 5MFY22 while PSO's market share has surged to ~51%. Though numbers to date have been promising, petroleum prices have touched record highs in the country due to sharp increase in international oil prices, similarly monetary stimulus has been rolled back while caps have been placed on auto-financing which will weigh down on auto sales going forward in our view. As a result, we expect volumetric growth to slow down moving onto 2HFY22, however, it is pertinent to note that the decline in demand will likely have limited impact on the bottom line given how higher OMC margins have been scaled up and exchange rate volatility has been reduced.

- **Top pick:** Within industry, PSO stands tall against the competition – the company has beefed up its market share and has delivered historical earnings. However, RLNG has impacted its liquidity position as receivables from SNGP are mounting. Combination of tariff hikes and cash injections will help with the liquidity position.

Volumes showing steady YoY growth (Mn tons)



Source: Zakheera, BMA Research

Pakistan State Oil Company Limited (PSX: PSO)

Cheap valuations not to be missed

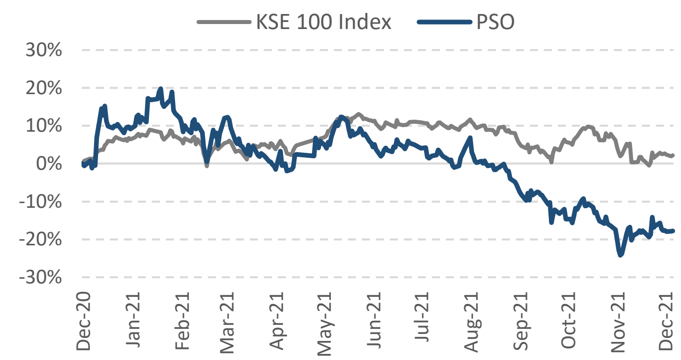
In the light of recent positive developments for the OMC's sector, we opine PSO will turn out to be a prime beneficiary. Our liking for the scrip is on the back of (i) upward revision in gross margins to PKR 3.68/ltr, (ii) releases under circular debt settlement (PKR 135Bn under 2nd tranche against 1994 policy power producers) & (iii) robust volumetric growth and hence market share. Considering these reasons, we opine the steep discount (PSO trades at FY22/23 P/E of only 2.6/3.2x respectively) are unwarranted and a re-rating might well be on the cards as circular debt dues are further eased. That said, we reiterate PSO as our top pick in the OMC's sector with a Dec-22 TP of 279/sh, implying a capital upside of 56.9%.

- **Circular debt settlement is key:** News flows with regards to settlement of PKR 135Bn circular debt of power producers pertaining to the 1994 policy comes as a welcome sign for PSO given the company still has significant exposure to the power sector. Amongst the most notable ones is HUBC which has payables outstanding amounting to PKR 20.7Bn (as at QESept21) and is due to receive ~PKR 34.7Bn from the most recent development. Keeping that in perspective, HUBC has the capacity to pay off PSO's outstanding debt in entirety, however, even if we remain prudent, a 25/50/75% debt settlement can result in cashflows of PKR 11/22/33 per share for the company, respectively.

- **Market share on the rise; revision in margins to also boost profitability:** PSO has been one of the biggest beneficiaries when it comes to economic recovery post COVID. Not only has it capitalized on higher-than-expected demand, but it has also benefited from some major industry players losing retail footing. PSO's market share has shot up to 51% in Nov-21 from 46% in FY21. Going forward, we opine PSO to maintain its market share and remain head and shoulders above the competition. Furthermore, upward revision in OMC margins will likely keep earnings ticking (FY22 EPS impact: PKR 9.7) over the coming years.

- **Investment risks:** 1) Higher than expected slow down in demand for petroleum products; 2) Further pile-up in trade debts; and 3) Increase in interest rates leading to hike in finance costs.

PSO vs. KSE-100



PSO Price Performance	3M	6M	12M
Absolute	-11.5%	-20.7%	-17.4%
Relative	-9.3%	-13.4%	-17.8%

PSO - Financials Snapshot			
Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	67.2	56.3	61.9
Earnings growth (%)	8.3%	-16.2%	9.9%
DPS (PKR)	24.0	20.0	22.0
D/Y (%)	13.5%	11.2%	12.4%
P/E (x)	2.6	3.2	2.9
P/B (x)	0.5	0.4	0.4
ROE (%)	7.7%	5.7%	5.8%
EV/EBITDA (x)	2.2	2.2	1.8

Source: PSX, BMA Research

Automobile Assemblers - Marketweight

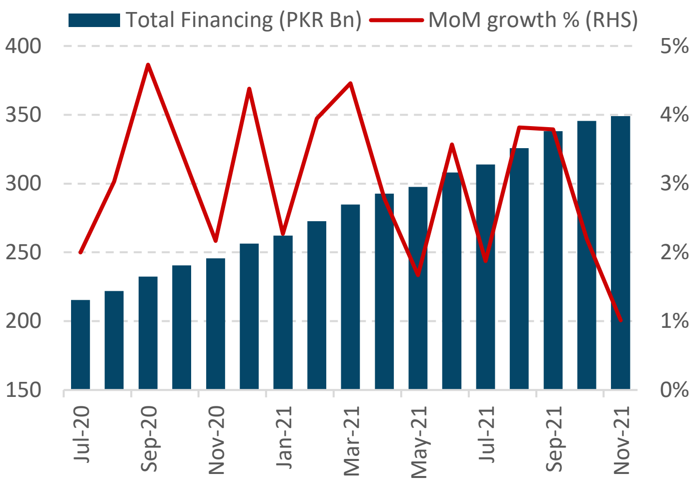
Incentivized growth momentum to aid profitability

Auto sales have been on the rise in Pakistan over the past 5 years excluding FY20 due to the pandemic. However, timely measures by the govt. helped the industry to stand back on its feet and post a V-shaped recovery in FY21 as volumes shot up by ~23% YoY. Major reasons that led to growth included i) reduction in FED and GST (on cars up to 850cc), ii) major concessions on EVs (AVT exemption of 3% uptil Jun'26), iii) reduction in interest rates, iv) increase in agricultural income and v) influx of new models in the country. In 5MFY22, auto sales have clocked in at ~90K (5MFY21: ~56k) units for passenger cars and ~22k (5MFY21: 18k) units of tractors posting a YoY growth of 60%/22%, respectively. The main driver of demand has been reduction in policy rates that has pushed auto financing to all-time highs (PKR 349Bn as at Nov-21).

- **Demand upbeat despite monetary changes:** After a period of stable policy rate at 7%, the SBP has increased rates by 275bps to 9.75% in order to keep external account in check. As such, this will increase the cost of borrowing for the end consumer due to which auto financing might begin to show a slowing trend. However, current scenario shows robust demand in the sector as evident by the fact that delivery times have increased from 2 months to 4-6 months. Furthermore, recent policy action taken by the SBP in the form of capping auto financing to PKR 3.0Mn while increasing the advance payment requirement on buyers from 15% to 30% will likely lead to a slowdown in volumetric growth in our view particularly in cars with retail prices of over PKR 4.0Mn so INDU & HCAR could face the brunt.

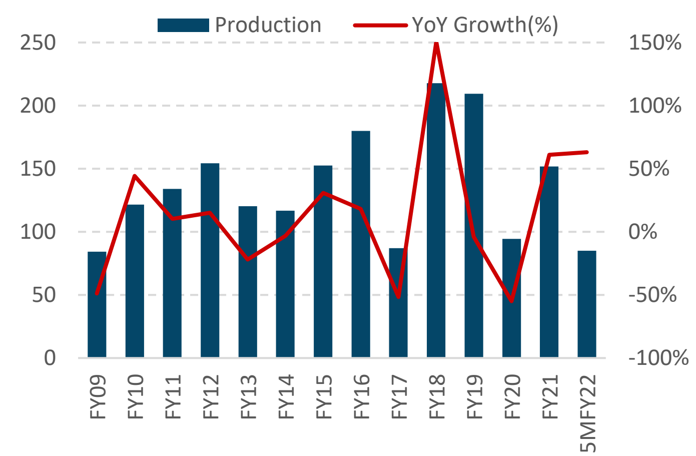
- **Import restrictions to aid local players:** A key catalyst that can prove to be an upside for the sector is the ban on financing of imported cars which will shift consumers to locally manufactured vehicles and hence prove to be beneficial for the listed space (INDU, PSMC, HCAR) due to reduced competition. However, rising input costs do pose a potent threat as they will likely result in increased car prices which can funnel to slower demand in a rising interest rate environment.

Auto financing growth tapering off



Source: SBP, BMA Research

Automobiles Production (000's)

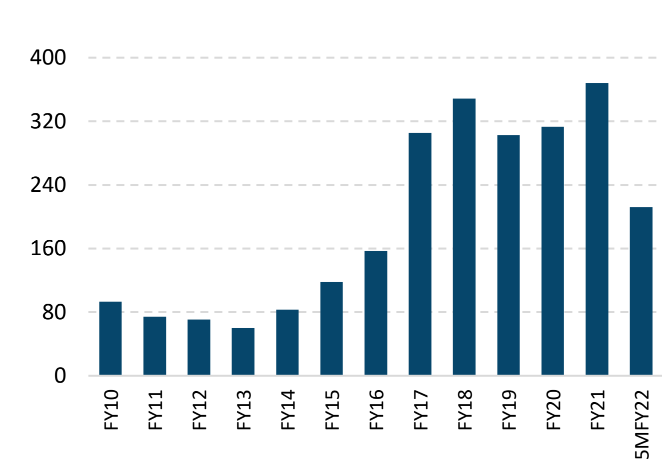


Source: PAMA, BMA Research

Automobile Assemblers - Marketweight

- **Future Outlook:** We have a market weight stance on the sector on the back of rising interest rates, weak PKR that will push production costs and financing limits placed by the SBP. Going forward, we expect a slowdown in volumetric growth as the economy moves from growth and towards stabilization. However, we do not discount the recent favorable policy measures taken by the government in terms of ban on financing of imported vehicles and EV policy.

CBU Imports (USD Mn)



Source: PAMA, BMA Research

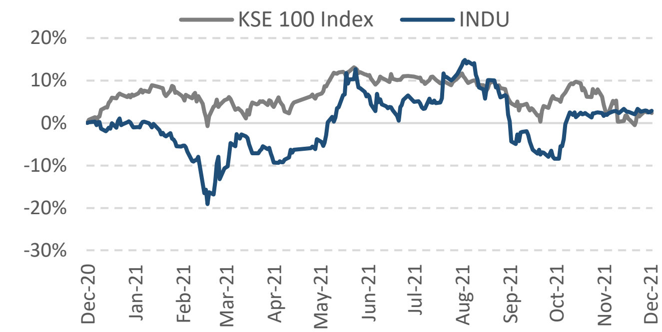
Indus Motor Company Limited (PSX: INDU)

EV penetration to unlock value

With a market share of ~20% in the automobiles space, INDU is our top pick in the sector with a Dec-22 DCF based TP of PKR 1,880/sh, providing an upside of 53%. The stock is currently trading at a forward P/E of only 4.9x.

- **The Hybrid Venture:** INDU has announced a CAPEX of USD 100Mn over the next 3 years to tap into the Hybrid Vehicles Segment. The main reason for this investment is to avail the recently announced incentives for Electric Vehicles by the govt. and grab first mover's advantage. Said policy measures include reduction in CD and GST on the import of essential parts.
- **Strong consumer base:** Despite the addition of several new brands in the country along with rising CBU imports, demand for INDU's vehicles has been on a rising trend, mainly because of its strong brand name and continued product portfolio enhancement. Yaris, its new cash cow, has moved swiftly to capture the Sedan market, posting sales in excess of ~11k units in 5MFY22. With strong domestic presence and consistent production process optimization, the company's pass on ability is relatively greater compared to peers.
- **Immune to interest rate hikes:** With total liquidity (cash & short-term investments) standing at a mammoth PKR 107Bn (PKR 1,367/sh) and negligible leverage (D/E: 0.02x), INDU is insulated from any interest rate hikes. Furthermore, investments in T-bills and mutual fund units provide ample other income each year, allowing it to continue its healthy pay-outs, new model launches and capex.
- **Navigating through supply chain disruptions:** Logistical constraints and raw material shortages have been a nuisance for automakers globally, and the impact has been felt in Pakistan as well. However, INDU has been able to manage these challenges quite effectively through efficient planning, increased localization and consistent debottlenecking. Consequently, over the past few months, INDU has been operating its plant at an annualized capacity utilization of ~107%.
- **Volume accretion expected to slow down in 2HFY22:** Due to sizable order pile-up and efficient planning, we believe the company will deliver robust double-digit growth in volumes in FY22 as witnessed by 44% YoY surge in unit sales in 5MFY22 however, auto financing caps and rising interest rates will likely slow down volumetric growth from 2HFY22.
- **Investment risks:** i) new entrants to increase competition, ii) implementation of RD of 50% on CBUs, iii) rising interest rates to slow down demand and iv) higher freight charges and delay in procurement of essential parts.

INDU vs. KSE-100



INDU Price Performance	3M	6M	12M
Absolute	5.3%	-2.0%	2.6%
Relative	7.5%	5.3%	2.3%

INDU - Financials Snapshot			
Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	248.4	262.0	276.5
Earnings growth (%)	52.2%	5.5%	5.5%
DPS (PKR)	125.0	157.0	166.0
D/Y (%)	10.1%	12.7%	13.5%
P/E (x)	4.9	4.7	4.4
P/B (x)	1.7	1.5	1.3
ROE (%)	34.2%	31.5%	29.7%
EV/EBITDA (x)	0.5	0.4	0.5

Source: PSX, BMA Research

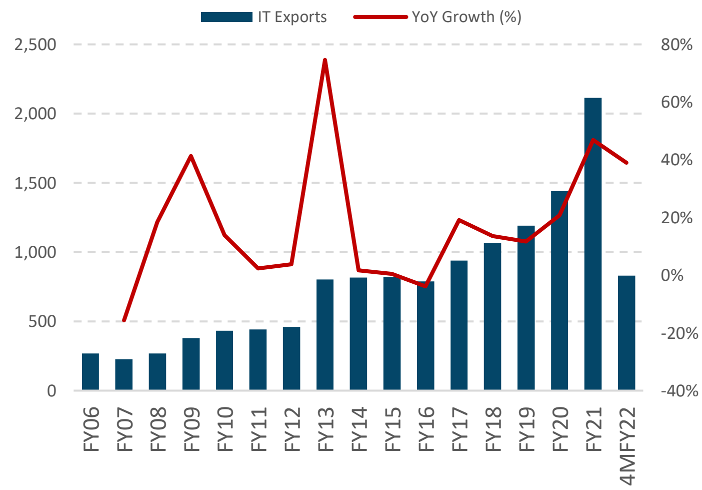
Technology - Overweight

A cure for the country's woes

Pakistan's technology sector has continued its upward momentum having grown at a 6-year CAGR (FY16-21) of 22%. As of today, tech contributes ~1% to national GDP, where domestic sales account for ~52% and exports account for ~48%. The main exporting regions include US, Europe, and Middle East. To note, exports from the sector clocked in at USD 2.1Bn in FY21, their highest ever recorded. In 4MFY22, exports of IT and IT related services have clocked in at USD 830Mn as compared to USD 596Mn in SPLY, posting a growth of ~39% YoY.

- **PKR depreciation bodes well for the sector:** Major companies in the listed space operate on export-based revenue. As a result, PKR depreciation in the past few years has allowed exports to become more competitive internationally. Furthermore, cash conversion cycle of the sector stands at ~140 days due to which they are key beneficiaries of exchange rate depreciation that results in FX gains.
- **Conducive policies to favor listed companies:** The govt. of Pakistan has introduced several measures that incentivize the technology sector. To increase the sector confidence, Digital Pakistan Policy was introduced in 2018 where the idea was to introduce a holistic strategy that improves performance of all sectors and digitizes them over the years. Measures taken in this regard included the formation of agriculture information portal, digitization of hospitals, introduction of national E-commerce gateway and aligning provincial and national databases. Other fiscal/non-fiscal incentives included the following: i) allowance of 100% foreign ownership, ii) 100% repatriation of capital and dividends, iii) income tax holiday for VCs till 2024 and iv) zero income tax on exports till 2025. In the recently announced Budget for FY22, emphasis was placed on setting up Special Technology Zones (STZs), offering incentives such as Income tax exemptions for 10 years on IT services, IT enabled exports, contracts, and technical services. In addition, sales tax on raw materials and machinery has also been abolished for companies being setup in these STZs. The govt. expects that these measures will help achieve IT exports in excess of USD 10Bn in the next 5 years.
- **Sector profitability at multi-year high:** In the listed technology space, profitability clocked in at record levels as insurgence of Covid led to increased demand for digital products and services. This was further aided by a minimum 1% turnover tax on exports. To note, profitability of the sector stood at PKR 1.4Bn in 1QFY22 compared to PKR 0.6Bn in SPLY, showing a growth of ~126%.
- **Future Outlook**: Going forward, we expect the sector to continue its upward momentum amid conducive growth policies, PKR devaluation and increased demand for IT enabled services. Our top pick in this space is SYS.

IT exports supporting the external account (USD Mn)



Source: PBS, SBP, BMA Research

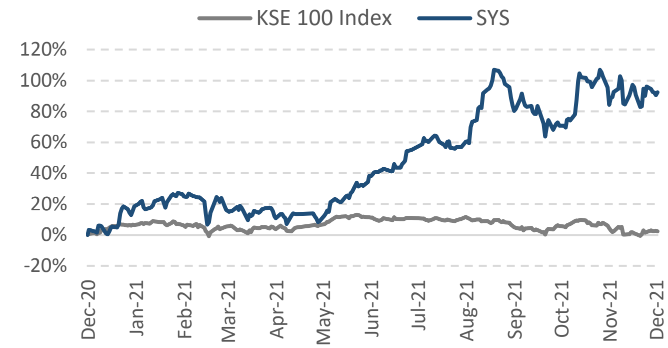
Systems Limited (PSX: SYS)

Digitizing the way forward

We have a bullish stance on SYS based on i) management's focus on key IT megatrends i.e., digital, data and cloud, ii) strong customer base in Europe, North America, and Middle East, iii) hedge against PKR depreciation and iv) increased emphasis on IT development by the govt. Assigning a Dec-22 TP of PKR 1,021/sh, we have a BUY rating on the scrip implying an upside of 36%.

- **Revenue growth to maintain upward momentum:** SYS has shown impressive revenue growth in the last 7 years (FY15-21) with a CAGR of ~31%. The company's main source of revenue is through exports to Middle East, North America and Europe, where exports account for ~65% of the total revenue. This makes it a key beneficiary of PKR depreciation where revenues increase manifold and result in significant exchange gains. To recall, exchange gain contributed ~9% to overall profits of the company in 9MCY21, amounting to ~PKR 204Mn.
- **Consistent effort to enhance its market presence:** To increase its global market presence, SYS has constantly focused on improving its service delivery to existing customers. As such, the company has placed strong emphasis on improving its operations in North America which accounts for ~55% of overall revenues followed by Middle East (20%) and Europe (10%). The company has also setup a wholly owned subsidiary in Saudi Arabia where it has already signed a few projects.
- **Skilled manpower is the biggest asset:** Systems Limited heavily relies on its employees with a particular skill set to add value to the firm. As such, it constantly enrolls and trains fresh graduates to boost its productivity. In 3QCY21, the company inducted 400 fresh graduates and are in the process of training them to expand their footprint in Pakistan. To note, this has borne desired results as revenue per employee surged from PKR 2.5Mn in 9MCY20 to PKR 2.7Mn in 9MCY21 despite the addition of around 900 new employees and is expected to reach up to PKR 5.2Mn by CY25.
- **New ventures on the cards:** In Feb-21, the company announced its partnership with SAP, a global software company to transform the digital landscape of Pakistan. This can prove to be a major revenue driver for the company and improve its earnings significantly going forward.
- **Investment risks:** i) unavailability of required talent, and ii) frequent shift in demand patterns in the sector.

SYS vs. KSE-100



SYS Price Performance	3M	6M	12M
Absolute	5.2%	36.7%	82.6%
Relative	7.4%	43.9%	82.2%

SYS - Financials Snapshot			
Y/E: Dec	CY21E	CY22E	CY23E
EPS (PKR)	26.9	31.0	41.0
Earnings growth (%)	68.1%	15.4%	32.2%
DPS (PKR)	5.0	6.0	8.0
D/Y (%)	0.6%	0.8%	1.1%
P/E (x)	28.5	24.5	18.5
P/B (x)	9.6	7.3	5.5
ROE (%)	34.3%	29.8%	30.4%
EV/EBITDA (x)	5.6	6.4	9.6

Source: PSX, BMA Research

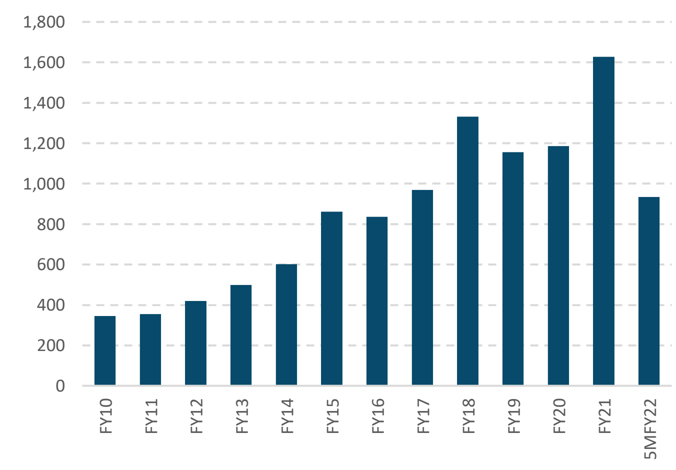
Steel - Overweight

Construction boom to lead the way

As the economy headed towards a V-shaped recovery, introduction of construction package by the govt. paved way for multiple industries to benefit. One such industry was the steel sector which is largely correlated to GDP growth and construction activity (global estimates say there is 1 ton demand of steel for every 7 tons of cements sold). As a result, after a few muted quarters, the listed steel space showed remarkable recovery in terms of sales growth and profitability. In 5MFY22, long steel production increased by ~51% to 4.7Mn tons, while total steel offtake grew by ~18% on a YoY basis over the same period.

- **Direct beneficiary of construction package:** The introduction of construction package meant that real estate was once again alive as investors rushed into the sector to grab the opportunity. As a result, demand for steel products i.e., long steel, flat steel, rebars etc. picked up. This was evident from the sector profitability which clocked in at PKR 6.4Bn in FY21 as compared to PKR 1.9Bn in FY20, posting a growth of 237%. On sovereign level, increased PSDP spending, new dam projects and multiple power projects resulted in increased demand for steel products. Low-cost housing schemes such as NPHP and Mera Ghar Mera Pakistan Scheme are also expected to keep demand outlook robust going forward.
- **Ability to pass on cost pressures amid rising demand:** Being an import dependent industry, the steel sector is subject to changes in international prices and exchange rate fluctuations. The main raw materials used are iron ore and steel scrap of which ~95% is imported from China. Recent wave of supply chain disruptions along with extensive PKR depreciation meant that prices of long & flat steel increased to multi year highs. However, the sector was able to pass on cost pressures as demand was inelastic due to increased construction activity. Going forward, the raw material prices are expected to normalize as global economies continue to operate on a higher level and hence local margins are expected to remain upwelling in the medium term before reverting to mean in the longer term.
- **Upcoming capacity expansions akin to rising demand:** As demand continues to remain robust, the average capacity utilization has improved from ~35% in FY20 to ~48% in FY21. However, the actual demand will be realized when the approved housing financing is disbursed. As a result, companies foresee a further uptick in demand in the upcoming quarters. As a result, several listed companies such as ISL and MUGHAL have announced capacity expansions to benefit from favorable sector dynamics.

Iron & Steel Scrap Imports (USD Mn)



Source: PBS, SBP, BMA Research

Mughal Iron & Steel Industries (PSX: MUGHAL)

Strong demand to keep growth momentum intact

We assign a 'BUY' rating to MUGHAL with a Dec-22 DCF based TP of PKR 148/sh. The stock is currently trading at an FY22 P/E of only 5.2x. Our liking for the stock stems from the following: i) increase in govt. backed construction activities, ii) strong export operations of the company, iii) ability to pass on cost pressures due to strong demand outlook and iv) diversified product portfolio.

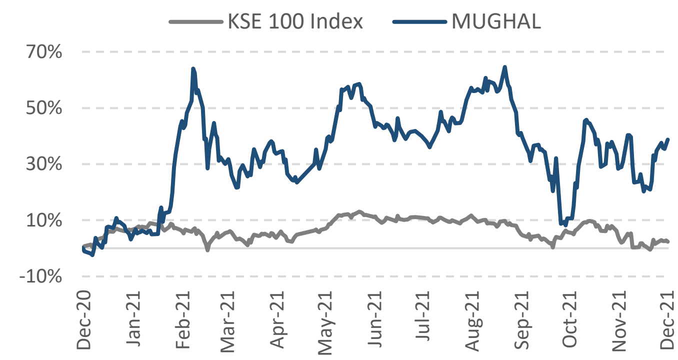
- **Key beneficiary of the Construction package:** V-shaped economic recovery after Covid led to strong activity across different sectors. With the announcement of construction package by the govt. along with increased PSDP spending, building of dams and incentivizing housing finance, demand for ferrous and non-ferrous steel products increased significantly. MUGHAL resultantly turned out to be a major beneficiary of the favorable developments having seen a remarkable recovery in its profitability led by volumetric and price growth. In FY21, sales of the company increased by 64% where local sales improved by 40% and exports improved 150% on a YoY basis.

- **Debottlenecking project to ease capacity constraints:** The company has recently conducted a BMR of its girder re-rolling mill along with debottlenecking of its melting capacity. The addition in capacity of ~630k tons will allow the company to tap into more markets and increase its market share. Furthermore, copper prices have increased by ~33% YTD to clock in at ~USD 9,300/ton which are exported to China in the form of ingots by the company.

- **Multiple products on offer:** Furthermore, a diversified product portfolio adds immense value to the company as it gives a strong edge over its competitors. MUGHAL operates in Steel re-bars, Girders, Billets, and Copper Ingots which makes it a one-stop shop for various customers.

- **Investment risks:** i) slowdown in construction activity, ii) rise in interest rates to increase finance costs, iii) increase in international scrap prices and iv) hike in energy tariffs.

MUGHAL vs. KSE-100



MUGHAL Price Performance	3M	6M	12M
Absolute	2.2%	-4.5%	31.7%
Relative	4.4%	2.8%	31.4%

MUGHAL - Financials Snapshot

Y/E: Jun	FY22E	FY23E	FY24E
EPS (PKR)	19.4	20.9	21.3
Earnings growth (%)	51.0%	7.7%	1.9%
DPS (PKR)	5.0	5.0	5.0
D/Y (%)	4.9%	4.9%	4.9%
P/E (x)	5.2	4.8	4.8
P/B (x)	2.2	1.6	1.3
ROE (%)	29.8%	19.7%	20.2%
EV/EBITDA (x)	5.4	4.9	4.5

Source: PSX, BMA Research

SIDE PICKS

Engro Polymer & Chemicals Limited (PSX: EPCL)

Looking to capture the entire domestic PVC market

With a market share of ~94% in the local PVC market, EPCL has only strengthened its market presence in CY21. The company has been a major beneficiary of the commodity up-cycle as PVC-ethylene margins have surged to record levels. In Oct-21, PVC prices surged to its highest level of USD 1,850/ton, attributed to supply chain disruptions in USA and increased demand from Asia. As a result, EPCL's gross margins clocked in at ~33% in 9MCY21 as compared to ~22% in the SPLY whereas earnings grew by ~280% on a YoY basis.

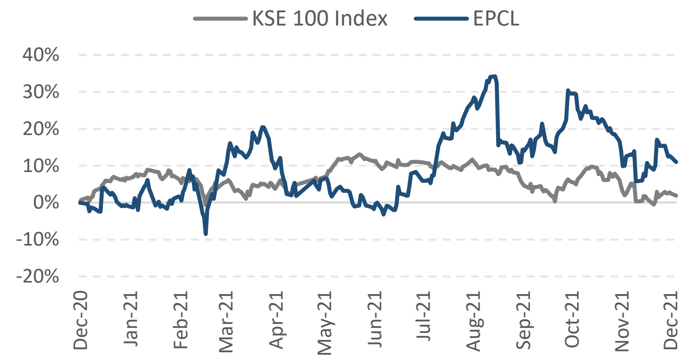
- In the light of rising demand from the local market, EPCL has expanded its PVC capacity by 100k tons to 295k tons and VCM capacity by 50k tons to 254k tons. Both of these expansions have been successfully brought online and have commenced operations in 2QCY21. These expansions will potentially enable the company to cater to 100% of the local demand in 1HCY22. This has also allowed the company to generate revenue from exports in the near future if local demand is fully met. The company has also invested in Caustic Soda segment, where it captures ~30% of the market. The segment contributes ~12% to overall revenues and mainly targets the South market. EPCL has seen significant growth in this segment (~42% YoY growth in revenues in 9MCY21) as demand for this product is directly linked to the textile sector.

- According to the management, further expansions are expected to come online by the end of CY21 and CY23, respectively. Furthermore, the company's H202 plant, requiring a capital outlay of USD 30-35Mn is also expected to commence operations from 1HCY23.

- Going forward, EPCL is expected to continue its growth momentum based on higher PVC prices to drive earnings growth, diversification into Caustic Soda segment and incremental capacity to bear fruit in the upcoming years.

- Investment risks: i) sharp decline in global PVC prices, ii) delay in projects, iii) higher than expected increase in gas prices and iv) reduction in duty protection.

EPCL vs. KSE-100



EPCL Price Performance	3M	6M	12M
Absolute	-2.8%	13.3%	12.6%
Relative	-0.6%	20.5%	12.3%

EPCL - Financials Snapshot			
Y/E: Dec	CY20	CY21	9MCY21
EPS (PKR)	4.1	6.2	8.6
Earnings growth (%)	-33.0%	52.6%	282.7%
DPS (PKR)	1.0	1.0	11.0
D/Y (%)	1.9%	1.9%	20.6%
P/E (x)	13.2	8.7	6.3
P/B (x)	2.8	1.9	1.7
ROE	20.9%	21.9%	37.1%

Source: PSX, BMA Research

Avanceon Limited (PSX: AVN)

Ready to take off

We highlight our liking for AVN premised upon i) strong revenue and earnings growth, ii) diversified range of product verticals and iii) expansion plans to achieve revenues in excess of USD 100Mn.

- AVN has shown impressive growth in revenues and earnings, posting a 5-year (CY17-21) CAGR of ~33%. With strong presence and an established customer base in Middle East, the company now aims to expand its footprint in Qatar, Saudi Arabia, and Egypt. For this purpose, it has formed JVs with multiple renowned companies. Currently, the company has set sights on the 'Road to 100' where it is targeting revenues of USD 100Mn by the end of CY24.

- Other than geographical expansions, the company is also planning to increase its product verticals. For that purpose, the company has formed an Equity JV with one of the largest firms in KSA and Egypt.

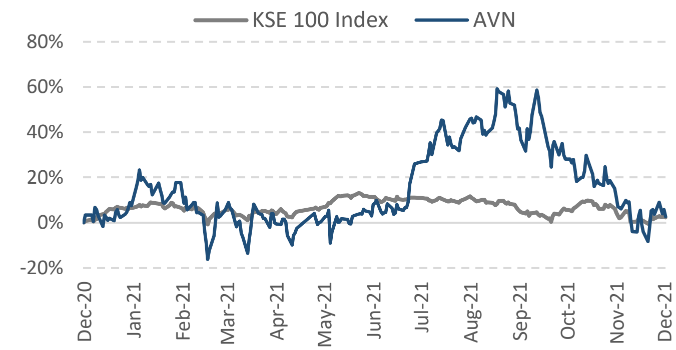
- AVN is also insulated from rising interest rates as the company believes in organic growth with minimum exposure to external debt. The balance sheet position shows that the company has decent cash resources (PKR 5.1/sh) whereas debt levels are low (D/E of 0.4x), therefore, relatively better placed to cruise through interest rate hikes. Furthermore, ~70% of revenues are through export sales which makes AVN a direct beneficiary of PKR depreciation.

- As per management guidance, the company is expecting revenues in excess of PKR 8.5Bn in CY21. The surge in 4QCY21 revenues is expected as the company has conservative revenue recognition policies, due to which its backlog of orders currently stands at ~ USD 45Mn.

- Keeping in mind the historical revenue growth and upcoming plans, we expect revenues to clock in at PKR 11.1/14.4/18.7Bn in CY22/23/24, respectively, implying a 3-year CAGR of ~30%.

- Investment risks: i) policy instability, ii) contractual revenues account for bulk of operations which are not recurring in nature and iii) delays in commencement of JVs with Saudi Arabia and Egypt.

AVN vs. KSE-100



AVN Price Performance	3M	6M	12M
Absolute	-27.8%	-2.9%	-4.1%
Relative	-25.6%	4.4%	-4.5%

AVN - Financials Snapshot

Y/E: Dec	CY19	CY20	9MCY21
EPS (PKR)	3.5	4.0	3.4
Earnings growth (%)	30.3%	13.9%	109.0%
DPS (PKR)	-	0.8	-
D/Y (%)	0.0%	0.9%	0.0%
P/E (x)	25.5	22.4	26.2
P/B (x)	5.1	4.1	3.8
ROE (%)	20.2%	18.6%	14.3%

Source: PSX, BMA Research

Image Pakistan Limited (PSX: IMAGE)

Amplifying domestic footprint

IMAGE has continued its growth trajectory in 1QFY22, where revenues have grown by ~94% on a YoY basis. The company has also improved its export share as it has grown by 52% in 1QFY22. The company is currently trading at a P/S multiple of 1.4x which is at a significant discount to regional players who are operating at an average P/S multiple of 1.8x.

- The main reason for improvement in IMAGE's operations has been its focus on strong product delivery and online presence. The company was a major beneficiary during lockdowns as its online platform was easy to access by the customers, resulting in increased orders. Along with that, the company improved its retail footprint in the country, increasing its existing branches in Karachi and expanding in Peshawar, Lahore, and Rawalpindi. It currently plans to expand and open at least 10 new branches in the coming years in addition to 2 new branches already opened. Based on company's projections, it expects revenue/branch in excess of PKR 100Mn per year.

- Along with branch expansion, the company has focused on improving its PPE as well, where it has installed new embroidery machinery to optimize operations. Furthermore, the company has strong online presence, focusing extensively on seamless returns, exchange policy, multiple payment options and top of the line user interface. The company was also the first amongst exporters to be registered on Amazon, gaining access to 300Mn+ users globally.

- Going forward, we expect IMAGE to continue its growth momentum in the wake of branch expansion and strong presence on e-commerce platforms. As of now, the company is focused on improving its retail base through branch expansion but is also planning to expand into the fragrance and halal cosmetics segment.

- Investment risks: i) changing customer preferences, ii) reduced retail demand due to decline in disposable income and iii) delay in opening of new stores.

IMAGE vs. KSE-100

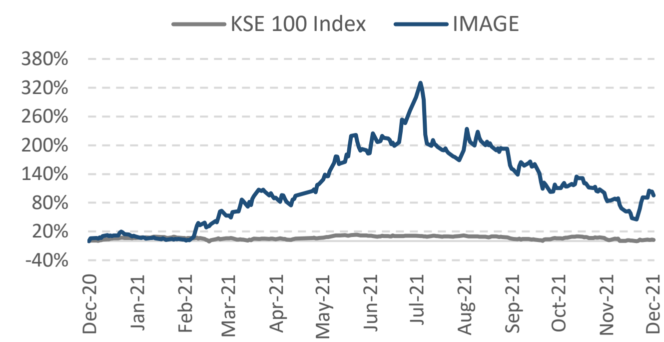


IMAGE Price Performance	3M	6M	12M
Absolute	-26.7%	-38.0%	79.6%
Relative	-24.5%	-30.7%	79.3%

IMAGE - Financials Snapshot			
Y/E: Jun	FY20	FY21	1QFY22
EPS (PKR)	0.8	0.3	1.5
Earnings growth (%)	-38.5%	-61.5%	413.3%
DPS (PKR)	0.0	0.0	1.0
D/Y (%)	0%	0%	5.9%
P/E (x)	21.8	56.7	11.0
P/B (x)	1.6	1.6	1.4
ROE (%)	5.1%	2.1%	9.4%

Source: PSX, BMA Research

Shabbir Tiles and Ceramics Limited (PSX: STCL)

Silent beneficiary of construction boom

After a few years of muted growth due to external factors, STCL has shifted gears having posted highest ever revenues of PKR 9.9Bn in FY21, ↑ 53% YoY. Several factors have contributed to driving the growth such as i) construction boom due to amnesty scheme and multiple housing schemes, ii) curbs on smuggled tiles and iii) increased duties on imported tiles.

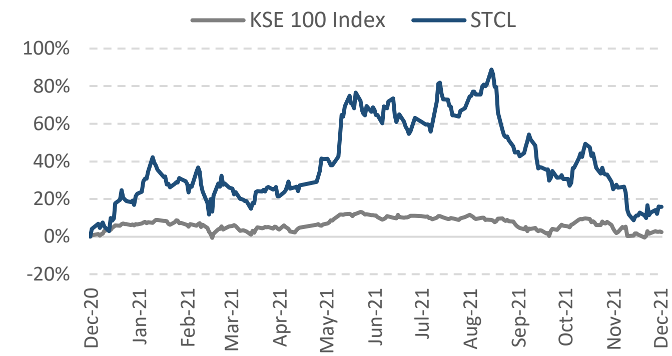
- Historically, STCL had an average capacity utilization of ~65% mainly due to influx of smuggled and imported tiles from Iran and China into the domestic market. However, the govt. increased duties on imported tiles due to which local players have begun to increase their utilization levels as competition has eased. We foresee STCL to operate at ~80% utilization given the rising demand in the country owing to multiple construction projects under Naya Pakistan Housing Scheme, Mera Pakistan Mera Ghar etc.

- Tiles manufacturing is a gas intensive process and fuel costs make up ~44% of STCL's total COGM. However, the company is a direct beneficiary of reduced gas prices in the South region (PKR 1,054/mmbtu) as compared to the North region (~USD 13/mmbtu). As a result, any increase in RLNG prices, PKR depreciation or oil prices will create arbitrage for the company to increase its retail prices as well.

- STCL operates at minimal debt levels (D/E: 0.2x) whereas the current debt is also obtained at subsidized financing of ~3% under LTFF/TERF. However, most of its cash is in the form of short-term investments (PKR 7.6/sh) in risk-free fixed income funds due to which it is a major beneficiary of interest rate hikes as it will lead to higher other income.

- Investment risks: i) increase in gas prices, ii) slowdown in construction sector, iii) elimination of anti-dumping duties on imported tiles and iv) capacity expansions by competitors to affect market share.

STCL vs. KSE-100



STCL Price Performance	3M	6M	12M
Absolute	-24.1%	-30.7%	8.8%
Relative	-22.0%	-23.4%	8.4%

STCL - Financials Snapshot			
Y/E: Jun	FY20	FY21	1QFY22
EPS (PKR)	(1.4)	3.9	0.9
Earnings growth (%)	N/A	383.8%	39.3%
DPS (PKR)	-	-	-
D/Y (%)	0.0%	0.0%	0.0%
P/E (x)	N/A	5.9	6.8
P/B (x)	3.2	2.1	1.9
ROE (%)	-19.2%	35.1%	28.4%

Source: PSX, BMA Research

Bunnys Limited (PSX: BNL)

Tapping new markets

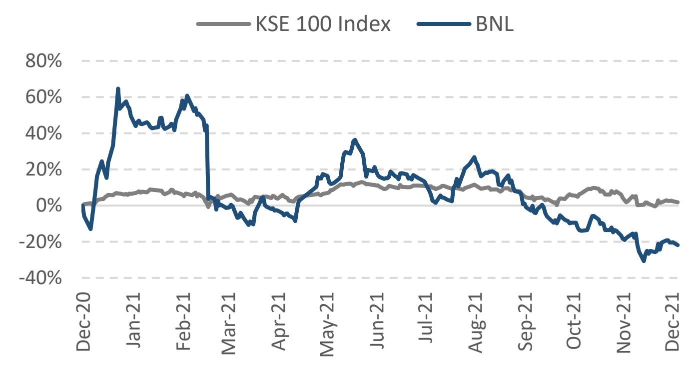
Bunnys Limited has a large customer base in the Northern region and Punjab, offering multiple premium quality bakery products. The company currently has active lines of Bakery & Snacks division operating at 89% and 43% utilization, respectively. Over the past 5 years, revenue of the company has grown at a healthy CAGR of 13% whereas earnings have grown at ~7%. Furthermore, gross margins of the company have remained stable in the range of 25-27% over the said period. The stock is currently trading at a CY21E P/E, P/S of 11.7x, 0.4x respectively.

- In order to expand its reach, the company is expanding its bun and bread line incurring capital expenditures of PKR 300Mn and PKR 600Mn, respectively. These lines have been fully installed and trial runs are underway. The company expects these lines to be fully operational in 2HFY22 which will result in additional products being offered hence, further improving revenues and profitability.

- Furthermore, BNL has planned to increase its geographical presence in order to increase its customer base. As such, plans are in place to tap growing markets of Karachi, Hyderabad, and Jhelum along with a few more. The company has also entered into a tolling contract with PepsiCo to manufacture, package and distribute snacks under the brand name of 'Kurkure'.

- Investment risks: i) hike in energy tariffs, ii) increase in input costs and iii) higher than anticipated increase in interest rates.

BNL vs. KSE-100



BNL Price Performance	3M	6M	12M
Absolute	-18.5%	-32.1%	-27.7%
Relative	-16.3%	-24.8%	-28.1%

BNL - Financials Snapshot			
Y/E: Jun	FY20	FY21	1QFY22
EPS (PKR)	1.9	2.7	0.6
Earnings growth (%)	14.2%	38.5%	-22.1%
DPS (PKR)	-	-	-
D/Y (%)	0.0%	0.0%	0.0%
P/E (x)	14.3	10.2	11.7
P/B (x)	1.1	1.1	1.0
P/S (x)	0.7	0.5	0.4
ROE (%)	8.0%	10.0%	8.6%

Source: PSX, BMA Research

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Old rating system

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including
- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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