BMA Capital Management Limited

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Pakistan Strategy

Clear skies ahead

Report By

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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)

Financial Markets Association of Pakistan
Best Broker Money Market 2017
Best Broker F. Exch. 2014 (Runner-up)

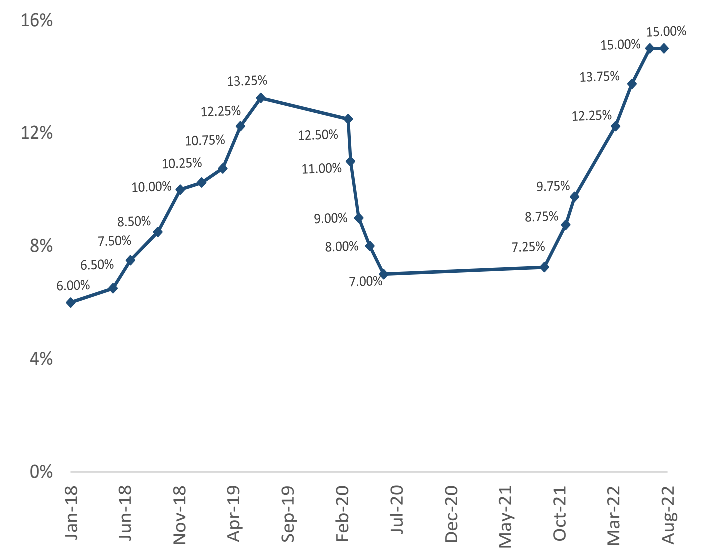
PAKISTAN IPO SUMMIT 2018
Top IPO/ SPO Book Runner
Award 2016-17-18

Out of the woods

The worst might just be over for Pakistan, in our view. Our thesis for the change in the country's fortunes is based on the following: 1) resumption of the IMF program; 2) settling external account concerns; 3) streamlining CAD and hence the pressure on the PKR; 4) interest rate seems to have peaked and 5) political noise losing steam.

- Though we agree that this will be a challenging year for the government in terms of tackling inflation, cutting expenditures and increasing revenues, the biggest concern that was of Pakistan not being able to meet its sovereign commitments has been largely silenced.
- The market seems to have found its bottom around the 40k mark and staged a strong comeback ever since and we opine sentiment will gather further momentum as economic concerns are addressed one by one.
- Like it was pointed out in our Annual Strategy report where we expected this to be another year of two halves, we believe the poor half is behind us and now things will be improving for the better.
- In the broader context of things, we stand cheaper based on multiples compared to what we were like in FY22 with our FY23 P/E standing at less than 4.0x and our expected dividend yield now touching double digits.
- Furthermore, we expect double digit earnings growth to continue in spite of the hefty taxes particularly the retrospective ones imposed by the government.
- In all, we opine this to be a good time to take fresh positions in the market with a view of 20-25% index return by the end of FY23.

Policy Rate seems to have peaked at 15%

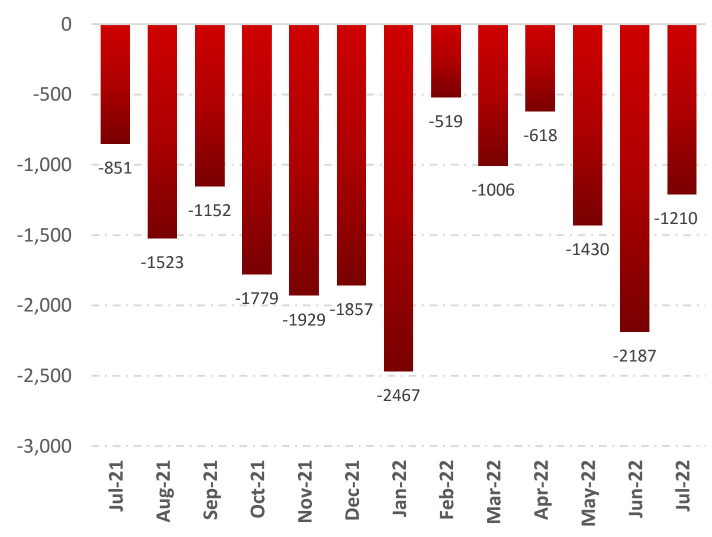


Source: SBP, BMA Research

IMF seems to be back in the fold; multilateral and bilateral flows to follow

The much awaited USD 1.2Bn tranche seems set to be released later this month when the Board meeting of the IMF takes place. Though, we are still someway off from taking some tough economic decisions put forward by the IMF, major adjustments have already been made and fiscal consolidation is well and truly at play. That said, onboarding IMF will be a huge success for Pakistan specifically given the fact that the country was marred by sovereign default concerns just a few weeks ago. Resumption of the program will also open gates for assistance from other multilateral/bilateral sources (ADB, World Bank, AIIB etc.) and friendly countries (Saudi Arabia, Qatar, UAE etc.) which would help in bridging our external funding gap which stands at around USD 30Bn for the current fiscal year. Increased enthusiasm that Pakistan is on the right track is also evident from the sharp decline in our sovereign international bond yields particularly those with near term maturities that have adjusted by ~2000bps ever since peaking at ~50%.

Current Account Balance (USD Mn)



Source: SBP, BMA Research

We expect a sharp decline in CAD to USD 10Bn

In FY22, the country recorded its second highest ever CAD of USD 17.4Bn triggered primarily by a mammoth import bill exceeding USD 80Bn. Going into FY23, we opine Current Account Deficit to undergo a massive ~40% YoY decline to around USD 10Bn. Although the government is targeting increased exports and higher remittances flow, we opine the major adjustment to come from lower imports. Our thesis for the slide is premised upon: 1) demand pull measures adopted by the government particularly the policy rate adjustment; 2) streamlining international commodity prices that have undergone a sharp decline since making multi-decade highs and 3) significant PKR devaluation that has made imports dearer. We flag that rising exports and growth in remittances flow can potentially further push CAD however, that will be uphill task given economic slowdown in our major export destinations and increased global cost of living due to multi-year high inflation.

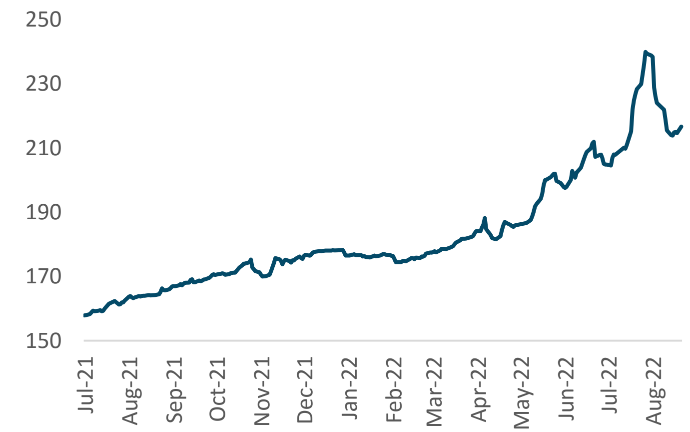
Pressure on the PKR has eased off

The PKR lost almost 30% against the greenback in FY22 before nosediving another ~17% in Jul'22 to peak at 240. Ever since, the local currency has staged a strong comeback and gained ~10% to bring parity below 218. The sizable turnaround has been backed by 1) probable resumption of the IMF program, 2) commitments from friendly countries to bridge the external funding gap and 3) easing trade deficit. Going forward, we expect the PKR to settle around the 210-220 mark and believe the volatility seen over the last few weeks to subside as the new base is formed. Settling PKR bodes well for import reliant industries particularly cements, autos and steel to name a few.

Inflation is expected to peak in the coming months before easing off from 2H

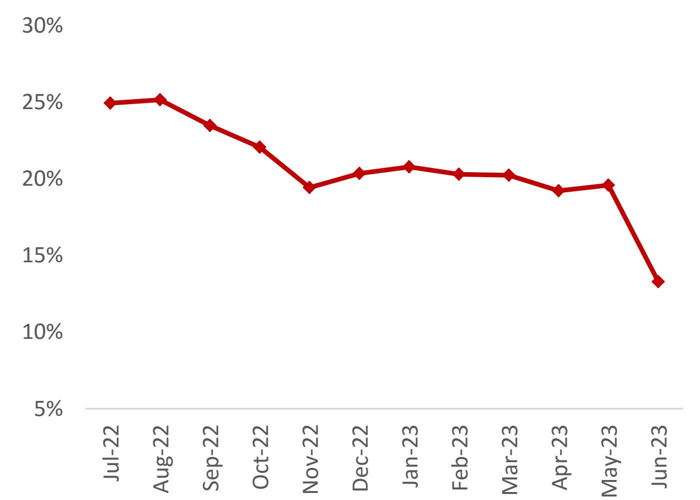
Inflation readings have consistently been on an upward trajectory ever since the fuel subsidies were removed but as per our workings, CPI inflation will start to ease off after peaking in Aug'22. Though, average inflation for FY23 is expected to be north of 20%, inflation readings are expected to soften from 2H before falling sharply to low teens in June as the high base effect comes into play. Our point here is that, as inflation peaks in the next couple of months, we can expect interest rates to come off from late 2HFY23 however, this will depend to a large extent on our external account position and international commodity prices.

PKR is recovering lost ground against the USD (PKR/USD)



Source: SBP, BMA Research

CPI readings to soften from 2HFY22

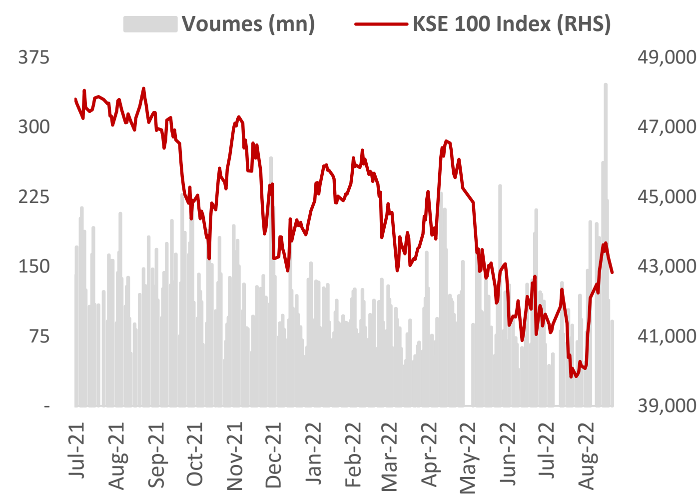


Source: SBP, BMA Research

Political noise has taken a back seat

We opine political noise has lost steam and that the current coalition government seems poised to complete its remaining tenure. Recently, KSE-100 performance has been marred by political upheaval that has consistently escalated particularly ever since the no-confidence motion was tabled against former PM Imran Khan and it continued as the PDM transitioned into power. The initial few weeks were certainly very challenging with the new government having to take some politically and economically unfavorable decisions. However, we believe that is behind us now and major political parties are now bracing for elections in roughly 12 months time. That serves to be a good omen for the market as the recent political commotion not only added fuel to fire for domestic issues but also weighed heavily on Pakistan in terms of resumption of the IMF program and foreign partnerships.

KSE 100 Index Performance



Source: PSX, BMA Research

Market vantage point

The market has seen some enthusiasm return to the bourse as economic concerns have eased off which is also evident by greater market participation and higher volumes and we expect the momentum to continue going forward. Pakistan continues to trade at attractive market multiples with a P/E of <4.0x and double digit dividend yields on offer backed by healthy earnings growth in spite of the belt tightening measures in place. We recommend long positions triggered primarily by settling economic woes. That said, our top sectoral picks are Banks, E&P's & Fertilizers. Also provided below is a list of our favored plays:

Top picks

	EPS		DPS		D/Y	
SYMBOL	FY/CY22E	FY/CY23E	FY/CY22E	FY/CY23E	FY/CY22E	FY/CY23E
EPCL	13.73	12.82	14.00	13.00	21.4%	19.9%
POL	91.37	73.92	70.00	60.00	16.5%	14.1%
EFERT	13.86	16.03	13.50	15.00	16.5%	18.3%
UBL	25.05	30.99	18.00	22.00	15.6%	19.1%
BAFL	9.83	10.88	5.00	6.00	15.5%	18.6%
MCB	26.22	31.96	20.00	22.00	15.5%	17.0%
HUBC	24.58	34.78	10.00	12.00	14.2%	17.1%
FFC	14.68	17.00	13.50	15.00	12.9%	14.4%
ENGRO	55.56	61.39	30.00	35.00	11.8%	13.7%
INDU	197.07	178.15	115.00	105.00	11.0%	10.0%
OGDC	30.06	35.55	7.00	8.00	8.3%	9.4%
MEBL	24.52	31.28	8.00	10.00	6.4%	8.0%
PPL	23.03	29.65	3.00	3.50	4.2%	4.8%
SYS	20.74	24.58	6.00	7.00	1.6%	1.8%
LUCK	91.22	116.80	0.00	15.00	0.0%	2.9%

Prices are as at August 23, 2022

Source: Companies Financials , 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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Tel: (021) 34300578

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Fax: (042) 3661 9912

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Tel: (042) 35762953-57

Lahore LSE Branch:
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Tel: (042) 36280931-34

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Fazel e Haq, Blue Area, Islamabad
Pakistan
Tel: (051) 280 2354-5
Fax: (051) 280 2356

Sialkot Branch:
2nd Floor, Sialkot Business & Commerce
Centre, Paris Road, Sialkot, Adjacent to
Sialkot Chamber of Commerce.
Tel: (052) 4260091-94

Multan Branch:
Office No. 607/A, 6th Floor,
The United Mall, Plot No. 74
Abdali Road, Multan
Tel: (061) 457 6611-15
Fax: (061) 457 6615

Sargodha Branch:
Ground floor, Shan Plaza, Block No 16,
Main Khushab Road, Near Allied Bank
Limited, Sargodha.
Tel: (048) 3767 817-18

Faisalabad Branch:
Mezzanine Floor, State Life Building #2,
Plot No. 833 Liaquat Road, Faisalabad.
Tel: (041) 2612261-5.

Gujranwala Branch:
51-H block Near Standard Chartered Bank
Trust Plaza GT road Gujranwala.
Tel: (055) 3848501-05

Chakwal Branch:
Office No. 12, 1st Floor, Ejaz Plaza,
Talagang Road Chakwal.
Tel: (0543) 553850,
0543-543720,0543-543721.

Jhelum:
2nd Floor, Khalid Plaza, Plot#7/89,
Kazim Kamal Road, Jhelum, Punjab.
Tel: (054) 4620594-97

Peshawar Branch:
Shop No.F1 & F2, 1st Floor Mall Tower 35,
The Mall Peshawar Cantt.
Tel: (091) 5274770-72

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Gohar Son's Arcade 1st Floor Office# 4,
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KPK.
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