

Day Break

Monday, 31 July 2017

Strategy

Exhibit: KSE-100 & Volumes

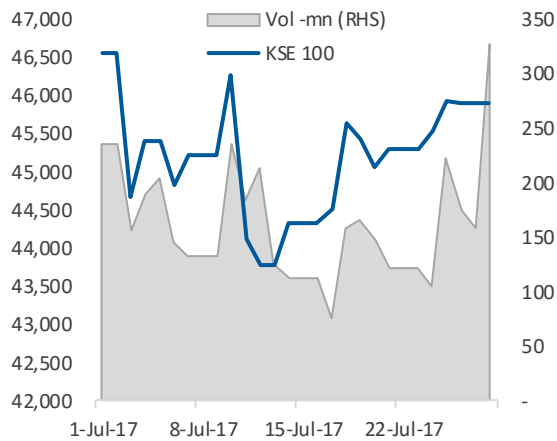


Exhibit: Recommended scrips

Scrips	P/E	D/Y
OGDC	9.6	3.6
PPL	13.3	3.6
PSO	5.7	4.1
UBL	11.0	4.9
FFC	9.6	9.0
LUCK	16.2	2.0
DGKC	9.3	3.4
INDU	10.4	5.6

Source: SBP & IGI Research

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Strategy

Political uncertainty set aside, macroeconomic concerns return to the fore

- The Supreme Court (SC) of Pakistan on Friday 28th of July, 2017 disqualified Prime Minister Nawaz Sharif from holding public office on grounds of Panama Papers case.
- However, the Nawaz Sharif and family along with ruling party members rejected JIT report findings and have shown will to submit their objections on JIT report in the SC citing that evidence rather inconclusive. Nevertheless, as per recent news the ruling party PML (N) have nominated Mr. Shahbaz Sharif (currently Chief Minister of Punjab) but does not hold a seat in National Assembly and Mr. Shahid Khaqan Abbasi (currently Petroleum Minister) as a possible replacement for carrying and interim Prime Minister.
- However, divergence is a growing following the disqualification of Nawaz Sharif and nomination of Mr. Shahbaz Sharif as the carrying Prime Minister.
- Looking ahead, we deem economic growth under CPEC wing to remain unaffected due to on-going political phase.

The Supreme Court (SC) of Pakistan on Friday 28th of July, 2017 disqualified Prime Minister Nawaz Sharif from holding public office on grounds of Panama Papers case. This will be the third time PM Nawaz Sharif has been prematurely ousted from the position of PM. Moreover, current finance minister Mr. Ishaq Dar, will also face a reference in the accountability court on corruption charges as per Supreme Court judgment issued. Nevertheless, with political uncertainty on Panama Paper Case finally taking a rest, the index reacted positively following the news flow of disqualification gaining nearly +1,670 points on a single day to close at 45,912 level. However, on closer inspection we think political uncertainty in wake of Panama Paper case and surrounding corruption charges against key government position is not a settled case as yet. We think at the brink of this political issue, key reforms, infra/power development projects may face possible delays and macroeconomic concerns are likely to return to the fore.

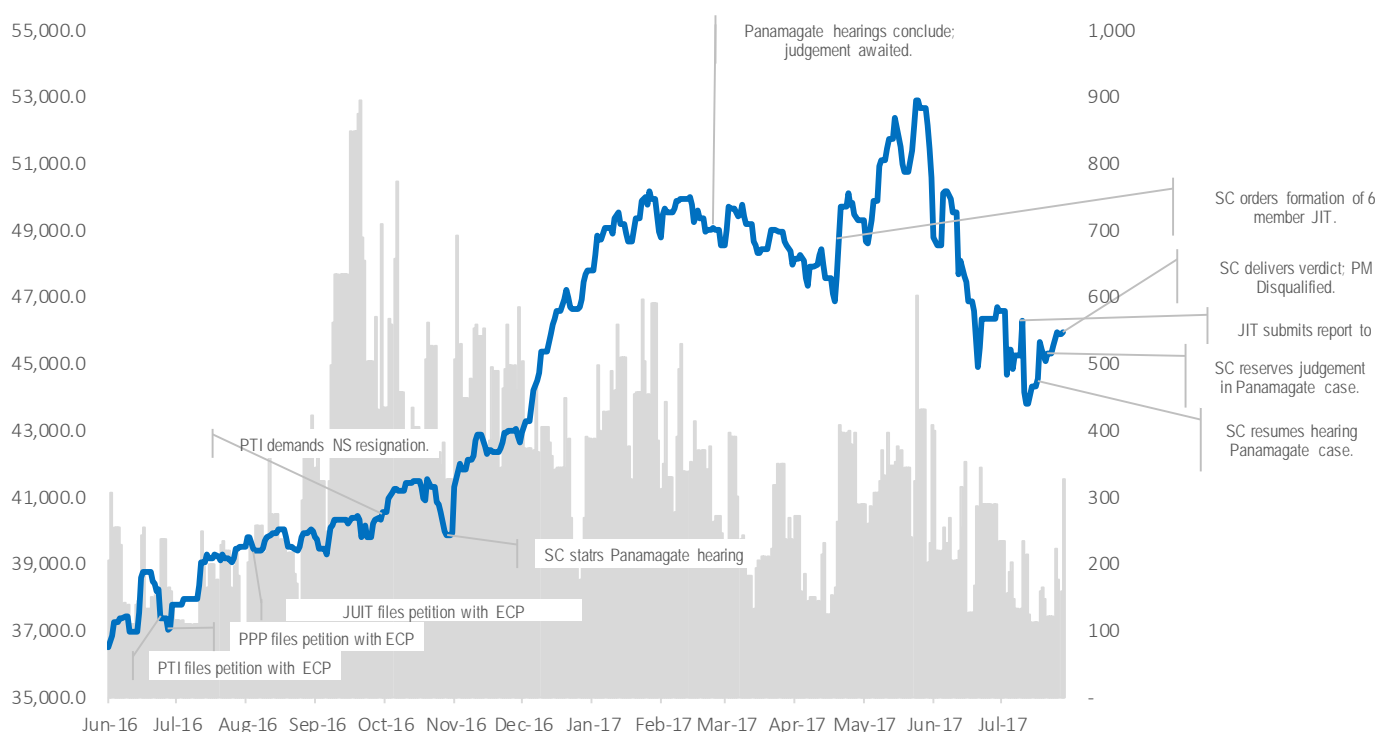
Brief background

The Supreme Court of Pakistan implementation bench headed by Justice Ejaz Afzal Khan, unanimously deemed country standing Prime Minister Nawaz Sharif disqualified by stating Nawaz Sharif unfit for holding office and also ordered accountability court to open references against him as well as his family, and other respondents including the current finance minister Mr. Ishaq Dar. Following the SC verdict the PM stepped down despite showing reservations against SC verdict. The SC verdict came following the petition earlier submitted on 20th Oct-17 by opposition parties led by Pakistan Tehreek-e-Insaf (PTI) on Panama Papers which named Nawaz Sharif and his family in possession of undeclared foreign assets. Since the petition filed, the SC later on 20th of Apr-17 ordered to form a 6-member Joint-Investigation Team (JIT) to review the claims

which finally presented its findings on claims presented by opposition parties on 10th of Jul-17. Shortly after the JIT submission of findings to SC, market touched a low of 44,337 level from 46,297 before recovering to SC reserving judgment on Panamagate case and finally on SC verdict of disqualification of Nawaz Sharif as Prime Minister.

Exhibit:

Panama Papers Case Event Timeline



Source: IGI Research, News media

Political risks eased, macroeconomic concerns return to the fore

The SC judgment makes Nawaz Sharif's third term in power to end prematurely, ahead of next year scheduled general elections. However, the Nawaz Sharif and family along with ruling party members rejected JIT report findings and have shown will to submit their objections on JIT report in the SC citing that evidence rather inconclusive. Nevertheless, as per recent news the ruling party PML (N) have nominated Mr. Shahbaz Sharif (currently Chief Minister of Punjab) but does not hold a seat in National Assembly and Mr. Shahid Khaqan Abbasi (currently Petroleum Minister) as a possible replacement for carrying and interim Prime Minister.

Growing Divergence

However, divergence is a growing following the disqualification of Nawaz Sharif and nomination of Mr. Shahbaz Sharif as the carrying Prime Minister. In the immediate instance nomination of Mr. Shahbaz Sharif is viewed positively considering his background on development works he undertook during his

tenure as CM Punjab. However, the new PM will be facing fair share of problems. Firstly to deal with allegation of 'Hudaibiya Paper Mills' as reinvestigation could follow soon and to speed up/continue infra/power development projects as election period draws in. Delays in the later could potentially have a wider macro impact starting with financing of country's twin deficit; current and fiscal. Structural weakness on external account subsequent of descending exports, weak remittances and uncertainty on Coalition Support Funds (CSF) along with upcoming debt repayments could well orchestrate pressure on country's FX reserves; with PKR as an early causality of such weakness.

Outlook

Looking ahead, we deem economic growth under CPEC wing to remain unaffected due to on-going political phase. From a market perspective we believe, clarity on SC verdict and accepting response from ruling party is taken rather positively by the market. With political uncertainty set-aside, market focus is likely to shift on macro forum with PKR seen as an early causality of external account weakness and subsequently leading to earlier than anticipated monetary tightening. Given the background we continue to suggest taking position in stocks offering attractive valuation post recent market drop and advice on selective theme play of PKR depreciation with Textiles, Power and E&Ps as major beneficiary along with banking sector on faster inflation accretion owing to PKR depreciation. On liquidity, we think domestic liquidity is likely to improve however, foreign selling may continue for some time till we see some correction in exchange rate. As of current, KSE100 is trading at current P/E ratio of 9.5x and dividend yield of ~5.1% compared to MSCI emerging market index P/E of 14.9x and dividend yield of 2.4%.

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