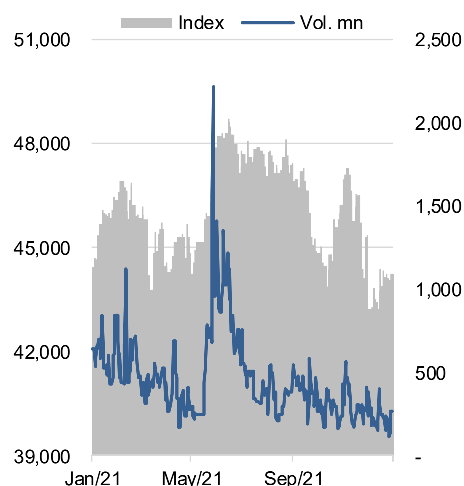
Pakistan Equity Outlook 2022

IGI Securities
SERVING YOU SINCE 1994

Tuesday, January 18, 2022 BRP-009

Strategy

Index Performance during 2021



Index Target:

Case	P/E	Index Target
Bear	6.25	45,000
Base	**7.25**	52,000
Bull	8.75	60,000

Analyst

Abdullah Farhan / Saad Khan
Saad.khan@igi.com.pk
Abdullah.farhan@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 810

At the edge of an abyss

Pakistan economy has been on lopsided lately. Initially aided by lifting of Covid19 restriction, the low base effect, supported by relaxed fiscal and monetary policy, growth in 2021 was bound to show a sharp recovery. And so it did. In 2021, Pakistan real gdp recorded +3.9% growth following a negative growth period of 2020; 0.5%.

Halfway down the road, post rate hikes, slack manufacturing growth, and inflation on the horizon, things are not looking promising as such. We think growth has reached a tipping point, and is showing signs of moderation.

As growth moderates, stocks that are sensitive to interest rates and economic activity have historically performed well. Hence for interest rates sensitive sector we have preference for banking stocks, whereas for economic activity we have selected buy in construction sector. Further along, we are also bullish on E&Ps sector mainly due to rising oil prices and their attractive valuation. More importantly, given the uncertain times selective double-digit dividend yielding stocks also tops our list.

Corporate earnings are likely moderate

In 2021, corporate earnings are headed for a home-run, with three quarters cumulative reported earnings of PKR 750bn, up +58%y. But we think the strong earnings surprises experienced in 2021 is unlikely to be the scenario in 2022. Particularly as economic activity reverts and real rates start to turn positive.

Base case: Index target of 52,000; offering a total return of +24%

By 2022, we eye an index target of 52k which is slightly below market consensus index target of 53k (95%), generating a total return of ~13% from its current index level of 46k. We have taken a market target P/E multiple approach as our basis for index estimation. Based on our index target market would trade at a forward P/E of 7.25x which slightly below its LT historic average 8.0x. Moreover at current our market dividend yld, comes at 9% taking total market return to ~24% in 2022.

Preferred stocks:

LUCK, FCCL, MUGHAL, INDU, FFBL, OGDC, POL, PSO, HUBC, TGL, HBL, BAFL

Contents

Economic Outlook 2
- Growth 2
- Covid19 3
- Inflation 3
- Policy Rate 4
- Politics 4
- IMF 5
- Current account balance 5
- Exchange Rate 6

Market Review 7
Market Outlook 8
- Corporate earnings are likely moderate 8
- Valuation at deep discount 9
- Market Liquidity 9

Index Target 10
- Base case: Index target of 52,000; offering a total return of +24% 10

Strategy 11
Sector outlook and top pick companies 12
- Cement 13
- Steel / Engineering 19
- Automobile Assembler 22
- Fertilisers & Chemicals 26
- Oil & Gas Exploration Companies 30
- Oil & Gas Marketing Companies 35
- Power Generation & Distribution Companies 38
- Glass & Ceramics 41
- Commercial Banks 44

Valuation Summary 50
Risks to our call 52

IGI Securities
SERVING YOU SINCE 1994

Economic Outlook

Growth

We expect growth to moderate to 4.5% in 2022 from 3.9% in 2021

For a starter, Pakistan economy has been on lopsided lately. Initially aided by lifting of Covid19 restriction, the low base effect, supported by relaxed fiscal and monetary policy, growth in 2021 was bound to show a sharp recovery. And so it did. In 2021, Pakistan real gdp recorded +3.9% growth following a negative growth period of 2020; 0.5%.

Contrary to the more traditional longer business cycles where supply slowly and eventually catches up with demand, this short span growth re-opening created a sudden mismatch of supply and demand. Global commodity prices responded accordingly and took the global central banks by a surprise.

On domestic front, this unwelcoming global event, welcomed-in country's long-time friends; inflation and current account deficit. As government shied away from taking any unpopular fiscal decisions, SBP with its limited resources sprang into action and raised the key policy rates shunning its pro-growth agenda, a rather unpopular decision amongst investors.

For 2022, prior to rate hikes, SBP and the government targeted gdp growth of ~4.5%. Departing from the usual sustainable growth driving sector, manufacturing, this time around SBP is putting its weight behind growth in agricultural sector. Halfway down the road, post rate hikes, slack manufacturing growth, and inflation on the horizon, things are not looking promising as such. We think growth has reached a tipping point, and is showing signs of moderation.

Exhibit: Pakistan Key Growth highlights

		2019a	2020a	2021f	2022f	2023f
Gross Domestic Product						
GDP	USDbn	280	262	298	318	350
GDP (MP)	PKRtn	38.1	41.6	47.7	55.1	64.0
GDP per capita	USD	1,367.2	1,256.7	1,405.2	1,466.6	1,574.7
Growth Rate						
Real GDP	%	2.1	(0.5)	3.9	4.4	4.9
Agriculture	%	0.6	3.3	2.8	3.3	2.5
Industries	%	(1.6)	(3.8)	3.6	3.5	5.0
Services	%	3.8	(0.6)	4.4	5.1	5.6
%age Share of GDP						
Agriculture	%	18.7	19.4	19.2	19.0	18.5
Industries	%	19.9	19.2	19.1	19.0	19.0
Services	%	61.4	61.4	61.7	62.1	62.5

Covid19

Variants of COVID-19 will likely continue to show up in 2022, but increased vaccination will eliminate potential economic derailing

Stepping out of 2020 and leaving 2021 behind, the world is still adjusting to live with COVID-19. Previously held belief that vaccination will lead to opening up of economies, seems to be taken away with a blow. The recent upsurge of Omicron variant has set the tone for fresh restrictions in Europe and travel bans in other countries. So far there is no certainty when COVID-19 chapter will be laid to rest, but what's certain is that these types of variants flare-ups will likely continue to show up. Having said that, vaccination and booster is now being rolled out much rapidly across and in 2022 it's most likely to gain further momentum. Vaccination has to an extent helped reduced overall human life damage, which should eliminate stringent economic lockdowns, and thus won't derail recovery.

Exhibit: Globally death rate has been declining as vaccination catch up

	New Cases (A)	New Deaths (B)	B / A	Vaccination (mn)
Mar/2020	6.4	0.3	5.3%	0.0
Jun/2020	70.1	3.6	5.1%	0.0
Sep/2020	174.7	3.8	2.2%	0.0
Dec/2020	364.3	6.1	1.7%	0.1
Mar/2021	338.1	7.5	2.2%	3.2
Jun/2021	409.1	7.7	1.9%	14.7
Sep/2021	383.9	6.1	1.6%	29.6
Dec/2021	403.5	4.8	1.2%	42.3
Jan/2022	70.2	0.2	0.3%	41.5

Source: https://ourworldindata.org/, Numbers in ths.

Inflation

Inflation likely to gain momentum in first half of 2022, but will eventually ease down later. For FY22, we expect average headline inflation in the range of 10.5-10.8% and 9% thereon.

On domestic front, the foremost concern for investors do deal with will be inflation. Headline inflation during 5mFy22 has averaged +9.3%y/y (+ 8.8%y/y last year) and is showing no signs of slowing down as yet (Dec-21 +12.3%y/y). Prices have accelerated in nearly all segments of inflation basket; food and lately transport sector led the pack.

But what's more concerning to us is whether inflation is becoming more persistent. Thankfully, a greater percentage of this year's price rise is temporary; means as soon as we see global commodity prices and supply-chain bottleneck easing up, we can expect domestic inflation to subside. However, there is uncertainty on how and when the supply side issues will resolve. Resurgence of

COVID-19 Omicron variant seems to be taking this to a delay. Domestically, even if were to set aside, global price factor behind current inflation woes, structural adjustments in Energy /POL / Tax poses significant headwinds on the price front. Hence we suspect this year's inflation pain is likely to continue deep into 2022.

For our base case scenario, we expect price increases and stay in double digit for at least the first half of 2022, moderating later on expected commodity prices cycle reversion, letting overall CPI inflation to cool off. This should take FY22 average headline inflation to 10.5-10.8% (SBP target of 9-11%) and under 9-8% in FY23.

Policy Rate

Rising inflation will keep rate on the higher side, but not so aggressively. Hence for 2022, we expect policy rate will peak at 10.75-11.25% (current 9.75%).

Rising inflation will make rate increase more imminent. However, we think this time around tightening won't be as sharp as seen in the later days of 2021. SBP earlier gave a clear guidance on keeping the rates unchanged in the near-term and a gradual objective to reach real positive rate in medium-term, is partially there.

Moreover, a lesson of the previous shot-lived commodity cycle (2002-2008, 2011-15) was that central banks stepped in too quickly and slowed things down too much. Whereas SBP medium term inflation target of 5-7%, certainly asserts policy rate perspective going forward. In addition, policy rate hike transmission along with fiscal tightening measures taken in recent mini-budget announcement will take some time to reflect. And similarly, we to believe that rates have a more tendency to go down once inflation fears starts to fade. However, we could be completely wrong. A key risk on our outlook is that inflation fails to moderate as expected, forcing SBP to tighten policy more aggressively subsequently hampering demand.

Exhibit: Pakistan inflation and monetary aggregates

		2019a	2020a	2021f	2022f	2023f
CPI	%	6.8	10.8	8.9	10.5	11.0
SBP Policy Rate (avg.)	%	9.9	10.1	7.0	9.4	11.3
Broad Money (M2)	PKRtrn	17.8	20.9	24.6	28.1	32.1

Politics

Domestic and international politics adds another layer of uncertainty to our outlook. 2023 is election year, tension between government and opposition are flaring up now and then. Government's weak performance on taming the

inflation, lack of policy consistency and runaway PKR has weakened its overall standing. Similarly, Pakistan international relations are in a weaker state, apart from customary China, Saudi Arabia and Middle East friendship. US-Pak relations hit a ground zero post US withdraw from Afghanistan, and since then things have not materially improved.

IMF

This political relation gap between the USA and Pakistan, can be impactful for undergoing negotiations with IMF over release of remaining tranches of US$ 6.0bn Extended Fund Facility (EFF) back in 2018. Post COVID-19, has brought back many memories, including front-loaded fiscal and external adjustments that are considered inflationary or anti-growth in nature. So far keeping up with the demands, the government recently announced a "Mini-Budget" by bringing in additional PKR ~350bn worth of tax measures addressing some of the fiscal matters and removal of external imbalances. In addition to these structural adjustments particularly in energy sector and autonomy of central bank is also under consideration and is leaving investors rather curious.

Current account balance

Global commodity prices will continue to exert pressure on trade balances at least till first half of 2022. New budgetary measures taken to close imbalance will take some time to show up.

While the government has shown much intend actions to address fiscal side, but there is still long way to go on the external side. At the backdrop of rise in global commodity prices and economy re-opening country's current deficit is close to ~6.0% of the GDP as of Nov-21, and is giving a tough time to PKR which has been failing to gain some stability since year start. Starting Jan-22, stop measures taken in the mini-budget and some prior to this, on autos and other non-essential items imports, along with expectation of softening commodity prices has build-up hopes of a slowdown C/a deficit.

Exhibit: Pakistan External accounts

		2019a	2020a	2021f	2022f	2023f
External Sector						
C/a Bal.	USDbn	(13.4)	(4.4)	(1.9)	(14.8)	(8.0)
C/a Bal. / GDP	%	(4.8)	(1.7)	(0.6)	(4.6)	(2.3)
Exports	USDbn	24.3	22.5	25.6	29.3	31.5
Imports	USDbn	51.9	43.6	53.8	69.3	65.5
Trade Bal.	USDbn	(27.6)	(21.1)	(28.2)	(40.0)	(34.0)
Remittances	USDbn	21.7	23.1	29.4	30.0	30.8
Import Cover (mnths)	x	3.6	2.4	2.0	2.5	2.5

Exchange Rate

As for now worsening C/a balance and SBP's limited chest of foreign exchange is adding further uncertainty to PKR. With a limited room to manoeuvre, Pakistan is likely to end up raising further external debt in future and hence the reason why successful negotiations with IMF are deemed important.

Market Review

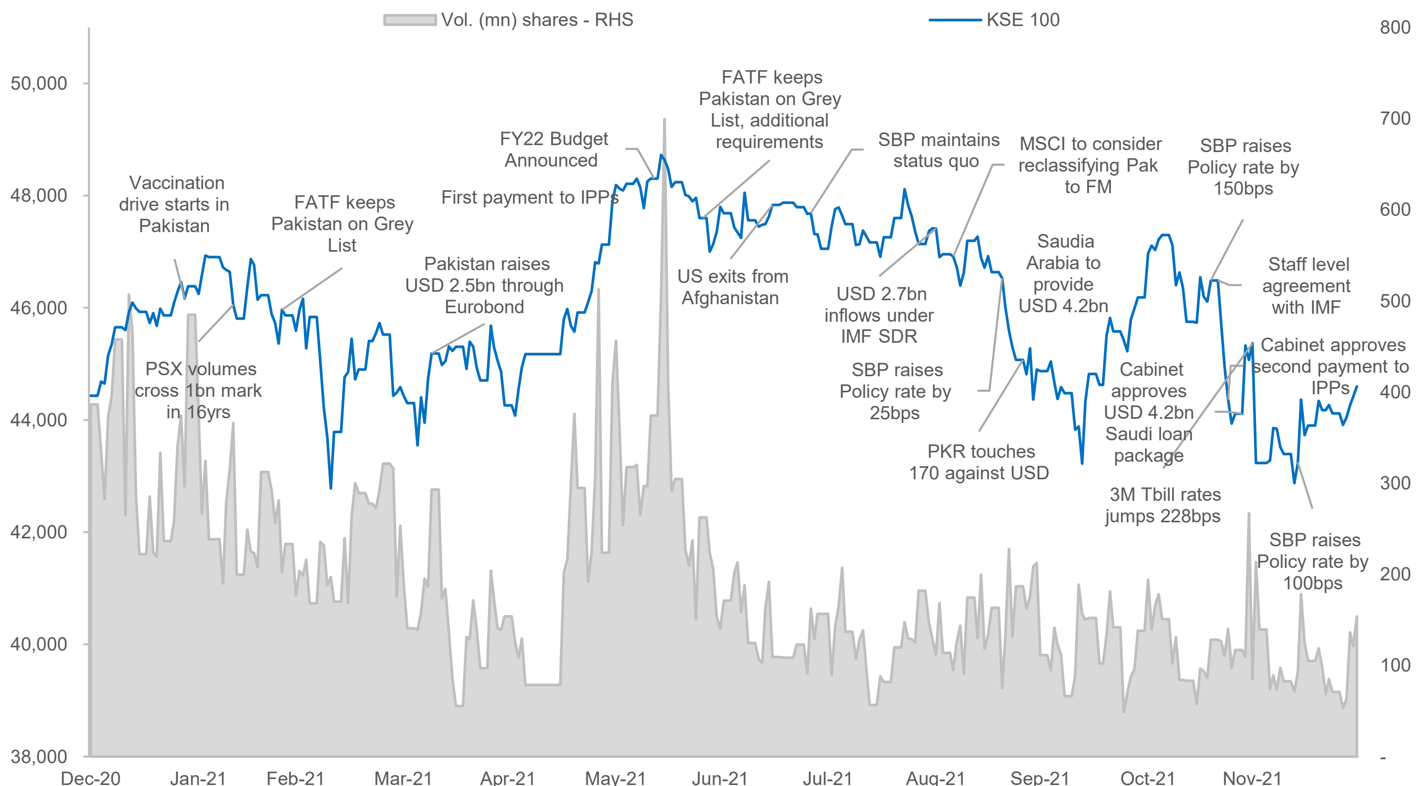
The overall performance was a meh, until the end

Globally, 2021 provided close to ideal conditions for economic growth and risk assets like equities. The evolution of vaccination campaigns, allowed the softening of pandemic-related constraints; opening up of businesses and stimulating demand.

However, at home this wasn't the case. 2021 market kicked off to a 43.7k index level, and ended at 44.6k level, putting a mere +1.9% (+841pts) return over the year; compared to a +7% & 10% in 2020, and a year before. In terms of USD based returns, the result is rather unappreciative.

This can be blamed to series of challenges faced at home, weakening economic indicators amid rise in commodity prices made its way to government tapping of monetary & fiscal support. As well stringent structural balance requirement, under IMF conditions, simply axed overall investors' confidence.

Exhibit: Key events that shaped the market during 2021



Source: News

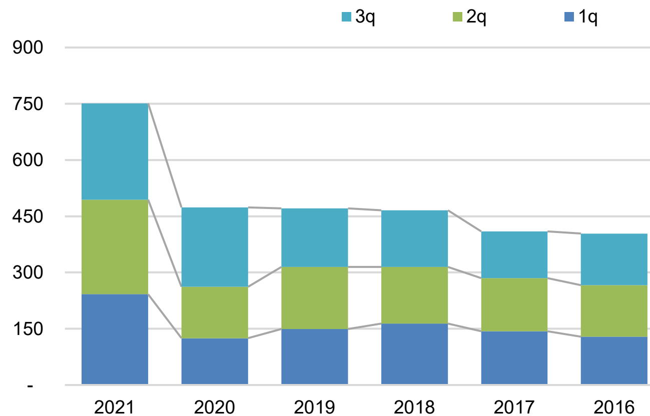
Market Outlook

Corporate earnings likely to moderate 2022

In 2021, corporate earnings are headed for a home-run, with three quarters cumulative reported earnings of PKR 750bn, up +58%y. This is more than the annual average earnings of PKR ~650bn achieved in past 5yrs. Given the current pace, market is most likely to cross PKR 1.0trn mark. More so, looking forward in 2022 average consensus earnings growth ranges in between +14%-18%y, as favourable corporate tailwinds will continue to show up at least till the first half.

Exhibit: KSE100 quarterly earnings

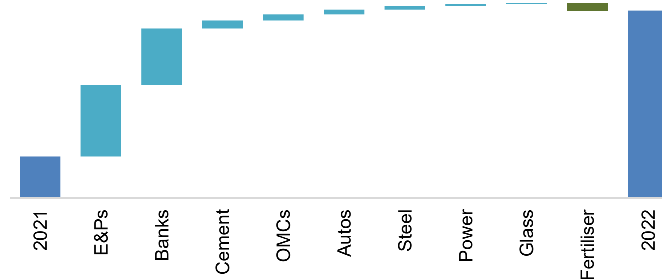
Corporate earnings are headed for a home-run, with three quarters cumulative reported earnings of PKR 750bn



Source: PSX, Company Accounts, News

While we somehow tend to have a favourable earnings outlook in 2022 as well, but we think the strong earnings surprises experienced in 2021 is unlikely to be the scenario in 2022. Particularly as economic activity reverts and real rates start to turn positive. For our coverage companies (51% of the KSE100 market capitalisation, we estimate earnings of PKR 689bn, up by 27%. In terms of 3yr forward outlook, we expect a ~13% cagr which is moderately higher than trailing 3yr cagr of ~11%.

Exhibit: Market earning contribution sector-wise
E&P and Banks to remain major contributor towards total earnings growth in 2022

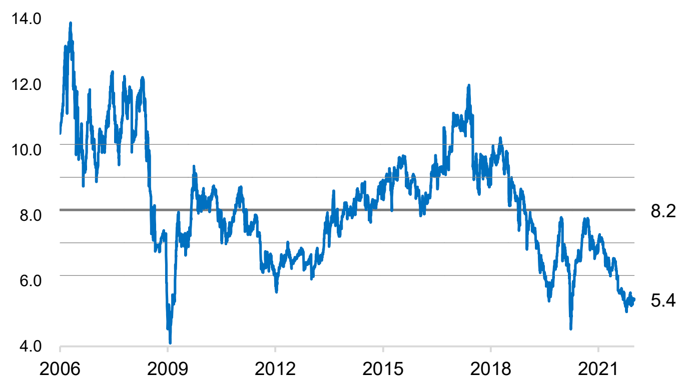


Source: Includes companies under coverage

Valuation at deep discount

Nevertheless, amid rise in earnings, market P/E has almost dropped to its lowest of 5.0x by Sep-21, and seems to have stuck around this level. This when compared to historic average of 8.0x seems to offer deep discount. From earning yld perspective, even if we were to incorporate higher rates (100-150bps), this would take LT bond ylds. c.11.7% to ~13-14%, which translates to a P/E of 7.0x. In other words, current market P/E suggests market incorporating a bond ylds climbing to 18% or 25-30% earning correction in 2022.

Exhibit: Historical Market P/E
Market P/E of 5.4x stands at a substantial discount of 34% from its historic average of 8.2x.



Source: Includes companies under coverage

Market Liquidity

2021 was yet another year of foreign investors pulling out of Pakistan equity market. A major part of this can be blamed to change in Pakistan status from

EM to FM status by MSCI (applicable Nov-21). This void created by foreign selling was largely filled by retail/individual investor's and insurance companies. While flows from foreign investors are looking up in 2022, as lately FM markets have started to see comeback of flows. Moreover, Pakistan looks relatively much better on key valuation matrices when compared to FM.

KSE 100 index target	Market Forward P/E	Dividend Yield	Total Return 2020
52,000	**7.25x**	**9%**	**~24%**

Index

Base case: Index target of 52,000; offering a total return of +24%

By 2022, we eye an index target of 52k which is slightly below market consensus index target of 53k (95%), generating a total return of ~13% from its current index level of 46k. We have taken a market target P/E multiple approach as our basis for index estimation. Based on our index target market would trade at a forward P/E of 7.25x which slightly below its LT historic average 8.0x. Moreover at current our market dividend yld, comes at 9% taking total market return to ~24% in 2022.

Exhibit: Market P/E and Index Target

Case	P/E	Index Target
Bear	6.25	45,000
Base	**7.25**	52,000
Bull	8.75	60,000

Exhibit: Sensitivity to earnings growth

P/E	-20.0%	-7.5%	0.0%	7.5%	20.0%
6.00x	34,000	40,000	43,000	46,000	52,000
6.25x	36,000	41,000	45,000	48,000	54,000
7.25x	42,000	48,000	52,000	56,000	62,000
7.75x	42,000	49,000	53,000	57,000	63,000
8.25x	45,000	52,000	56,000	60,000	67,000
8.75x	48,000	55,000	60,000	64,000	72,000

Strategy

As growth moderates, stocks that are sensitive to interest rates and economic activity have historically performed well. Hence for interest rates sensitive sector we have preference for banking stocks, whereas for economic activity we have selected buy in construction sector. Further along, we are also bullish on E&Ps sector mainly due to rising oil prices and their attractive valuation. More importantly, given the uncertain times selective double-digit dividend yielding stocks also tops our list.

Exhibit: Preferred picks

Sym	Current Price	Target Price	Upside	P/E	D/Y	P/B	3yr - Fwd. ROE
LUCK	683	1,025	50%	12.8	0%	1.7	14%
FCCL	18	27	48%	5.5	0%	0.9	17%
HBL	122	160	31%	4.2	9%	0.6	15%
BAFL	36	55	53%	3.7	15%	0.6	17%
POL	387	519	34%	5.2	17%	2.6	44%
OGDC	88	156	76%	3.1	11%	0.4	13%
PSO	186	351	89%	2.6	11%	0.5	16%
HUBC	81	131	62%	2.9	12%	0.8	26%
TGL	115	162	41%	5.3	12%	1.3	26%
FFBL	27	35	30%	4.7	6%	1.3	18%
MUGHAL	106	140	33%	5.8	4%	3.9	71%
INDU	1,325	1,795	35%	6.7	11%	2.0	30%

Sector Outlook and Preferred Stocks

Sector	Stance	Comments	Top pick
Banks	Over-weight	Sector tailwinds, are likely to get additional boost from rate hike expected in 2022, which should help further confirm robust earnings. However, despite a strong outlook sector stock performance has been marred, primarily as key regulatory risks looms, including TSA, IFRS9, super tax and minimum ADR maintenance tax. However, at current we think banks have adequate capital reserves which could to an extent deal with such regulatory risks.	HBL, BAFL
E&Ps	Over-weight	Recovery in oil prices, PKR depreciation and modest increase in production to drive earnings growth in the near term. Settlement of dues by Government of Pakistan could act as a trigger.	POL, OGDC
Power	Market-weight	Settlement of over dues at the expense of tariff reduction has provided much need liquidity to power sector as second tranche of settlement is already due. However, going forward as new plants come online and expansion of transmission network would lead to lower generation from FO based plants. Switch to competitive market would also reduce guaranteed returns for these power plants.	HUBC
OMCs	Market-weight	Substantial recovery in oil prices, PKR depreciation and increase in levy charges have kept domestic prices upward sticky. This in turn is likely to hurt demand and increase grey market sales. However, recent regulatory changes are likely to remove earnings volatility and remove excess competition.	PSO
Cement	Over-weight	Government backed construction & infra projects, and attractive private credit off-take will continue to provide support to volumes in Fy22 and onwards. Correction in coal prices is likely to provide support to earnings.	LUCK, FCCL
Engineering	Market-weight	We draw our stance on the back of steady demand outlook, with relative better pricing for long-steel over flat-steel. Having said that, much of the sector tailwinds seems to have been in-built current valuation. Our preference in steel sector remains on company with diversified income stream, presenting limited risks amid volatile global commodity prices.	MUGHAL
Autos	Market-weight	Looking into 2022, much of these headwinds are behind us. But a new set of headwinds including tougher financing regulations, timely delivery of vehicles, and recent amendments made in finance bill which will lead to further increase in prices.	INDU
Fertilizers	Market-weight	We base our investment case on the back of a) stable urea/Dap off-take, b) potential (less probability) gas price & sales tax hikes will likely be a pass-through on retail prices, and c) dap margins are likely to soften-up. Our key investment attraction in sector is dividend yield.	FFBL
Chemical	Market-weight	Chemical companies too hit an eps home run in 2021, mainly on account improved demand, and higher international margins. However, given the limited pricing power, stable demand and margin compression outlook we have a “Market-Weight” stance on the sector.	EPCL
Glass	Over-weight	Glass sector is set to benefit from rise in construction activity with limited competition to keep pricing power of existing players strong. Also demand for tableware segment is also going to pick up on account of hospitality business and demand of glass containers from industrial consumers of food and beverage sector.	TGL

Overweight | Cement

Preferred picks:
LUCK, FCCL

Since the start of FY22, sector performance has been marred (down by 22% since Oct-21) largely by due to increase in input cost; particularly coal prices, but is mostly accounted in current valuations. For the reminder of FY22 and onwards, coal prices are expected to revert to mean, with demand staying relatively stable and limited impact of interest rate hikes, we see sector valuations will eventually catch up with earnings growth expectation of +24% / 45% in FY22f and FY23f. In general, we have an "Overweight" stance on Pakistan Cement Sector but we recommend a selectively picking; with companies having a diversified stream of income, minimal interest rate risk, and leaping on expansion cycle. Nevertheless, our investment thesis for the sector mainly relies on;

1#. **FY22 Volumes Bound To Show A Slowdown:** Following a strong volumetric growth (up by ~19.8%y) in Fy21 (Local: 48mnT; +20%y & Export: 9.3mnT; 18.5%y); Demand in Fy22 may not be as robust. However, government backed construction & infra projects, and attractive private credit off-take will continue to provide support to volumes in Fy22 and onwards.

2#. **Coal Prices In For Backwardation**: Aligned with global energy price rise, Coal price (Richard's Bay) has shown an exponential rise of 3.3x since Fy22 start, up from US$ 70/ton to peak of US$ 232/ton by mid of Oct-21. However, since then price of coal has started to descend with latest Mar-22 future price at US$ 114/ton that's almost 50% correction.

3#. **Domestic Prices**: Domestic prices have increased by ~15% to average PKR ~700/bag since FY22, justified by price impact of higher input costs (Coal/Power/Freight & PKR depreciation). These input costs, particularly energy and currency depreciation, has more or less transitioned which will keep domestic prices at current levels despite international coal price correction. Hence we see less probability of domestic cement prices coming down anytime sooner.

4#. **Expansion Cycle to Keep Prices Competitive:** Seeing a stable demand sector is yet again under expansion spell, with nearly 25mnT of capacities will be added over the next 5 years, taking total country capacity to 93.8mnT by 2025 c. 69.2mnT. Nearly all of the expansion will in North, taking its share from 76% in 2021 to 81% by 2025. Not only does these expansion cycles give a glimpse of future demand, but also as historically seen will eventually be built into domestic prices ensuring again a stable price outlook.

Key risks and catalyst

- Decline in domestic cement prices to keep a cap on cost of government-led housing projects or competition commission stepping in leading to a price war scenario
- Although we have incorporated power tariff hike into our earnings and valuation forecasts, more than anticipated power tariff hikes under IMF program will put pressure on gross margins, leaving the off-grid players.
- Upward trending intl. coal price
- And finally, rising interest rates stands a risk. Nearly all our coverage companies have some degree of debt PKR 135bn, with avg. D/E of 0.415x, changes in interest rates will certainly push finance cost, but since most of these companies are under TERF arrangement, the impact will be rather muted.

Cement

Lucky Cement Limited (LUCK)

Market Price: PKR 682.7
52 weeks: 674.9 — 696.7
Return: (3M) 1.1%, (6M) -1.1%, (12M) -1.6%
Outstanding Shares: 0.32bn (FF%: 35)
Market Capitalisation: PKR 218.3bn, US$ 1.24bn
Exchange: KSE100, KSEALL,MSCI FM,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	32.4	10.3	43.5	53.2	61.6
DPS	6.5	0.0	0.0	0.0	6.0
BVPS	291.7	306.7	350.1	403.3	459.6
ROE	11%	3%	12%	13%	13%
P/E	21.0x	66.0x	15.7x	12.8x	11.1x
DY	1.0%	0.0%	0.0%	0.0%	0.9%
P/B	2.3x	2.2x	2.0x	1.7x	1.5x

Company Financial Year end: Jun

Lucky Cement Limited (LUCK) has been growing via diversification. Its businesses now expands to include automobile assembly, mobile phone manufacturing / distribution, power, chemical and foods. As a result, the company has expanded its assets base by nearly +15% on average in the past 10yrs. Moreover, the company is sitting on pile of cash and is eyeing further expansion. These aforementioned factors along with superior power sourcing, puts LUCK as our favourite play in cement companies.

1#. **Early birds gets the 'best' worm:** First in expansion, LUCK cement is setting up a 3.2mnT brownfield plant at its Pezu Plant in North to capture the rising market demand, pushing its north market share to ~14%. Expected commencement is Dec-22 with project cost is estimated at PKR 25bn with 40% financing done under TERF arrangement with subsidized rates. Moreover, its presence in both regions gives the company an added advantage over others in terms of minimising domestic operational risks.

2#. **Diversifying business:** Expanding on its already upbeat performance in automobile assembly of KIA motors, LUCK is expected to introduce French automobile makers, Peugeot by 2022. Similarly, benefiting its Korean Kia ties, the company has already announced (PKR ~5bn) its mobile phone manufacturing of Samsung Mobile phones, having a global market share of roughly 15-16%. Similarly, its power company, LECPL is also awaited commencement of its 660mw coal power plant after resolution

interconnectivity. This as per management will aid in roughly PKR 300mn annually in terms of cost savings for LUCK Cement.

Of its core cement business, we expect it to deliver a 3yr fwd eps cagr of 24%. At current price of PKR 683/share the company is delivering an average cash flow yield of 10%. While additionally siting on a pile of cash & cash equivalents of PKR 59bn (2021). Using a 17.5% cost of equity, our valuation for Cement (PK) comes at PKR 622/share and for portfolio ICI (chemical) is adding PKR 83/share, LECPL (power) PR 175/share, International Cement (Iraq & Congo) PKR 45/share and Kia (Autos) adding 135/share. This takes its sotp valuation to PKR 1,025/share.

Recommendation: Buy

Target Price: PKR 1,025/share; Upside: 50.1%
2022: Dividend yld: 0%, P/E: 12.8x

About:

- One of the largest cement producer of Pakistan, along with operations in Congo and Iraq
- The Company has investment interests in automobile manufacturing, power, chemical, food and mobile phones manufacturing.
- Yunus Brothers Group (YBG), 35% shares

Cement

Fauji Cement Company Limited (FCCL)

Market Price: PKR 18.3
52 weeks: 18.1 — 18.7
Return: (3M) 1%, (6M) -1%, (12M) -1.7%
Outstanding Shares: 1.38bn (FF%: 55)
Market Capitalisation: PKR 25bn, US$ 0.14bn
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	2.0	0.0	2.5	3.3	4.1
DPS	1.5	0.3	0.0	0.0	0.8
BVPS	15.1	14.4	16.9	20.2	23.5
ROE	14%	0%	15%	16%	17%
P/E	8.9x	-425.0x	7.3x	5.5x	4.5x
DY	8.2%	1.4%	0.0%	0.0%	4.1%
P/B	1.2x	1.3x	1.1x	0.9x	0.8x

Company Financial Year end: Jun

Fauji Cement Company Limited (FCCL) recently announced its merger with Askari Cement Limited (ACL), which would put the company in a sweet spot, escalating its market share. Low cost structure, housing renewable energies and name recognition are some of the key ingredients of sustainable bottom-line growth.

1#. **Expand, Merge & Surge:** FCCL is taking a much quicker way to expand in North. Firstly via amalgamation of Askari Cement Limited (ACL) having current capacity size 2.8mnT and with 2.05mnT expansion inline (Jul-22) its cumulative capacity will be 4.85mnT. Secondly FCCL has planned expansion of 2.05mnT (Jun-23). These expansions and merger would take FCCL total capacity to 10.34mnT, just behind LUCK post north expansion 15.3mnT.

2#. **Cost efficient, less to go wrong:** Company generates nearly ~70% of its power needs. Beside this the company has added 2.5mw solar power plant, taking its solar power plant capacity to 17.5mw. This as per management will net bottom-line saving impact of PKR 313mn or PKR 0.2/share (~7-9% of eps) annually. Both these factors, internal power generation and solar makes it less expose to expected upward tariff revision in FY22.

3#. **Finance Cost:** At current FCCL balance sheet is nearly debt free (debt/ton of PKR 225). However eyeing expansion roughly PKR 32bn, assuming a 60:40 debt ratio PKR 19bn in debt financing will be needed. Fortunately,

the company has that covered, with nearly half or PKR 9.6bn already secured under TERF/LTF, having significantly lower interest rates.

We have not yet incorporated earnings from ACL as yet, as we await financial disclosures from FCCL. Despite that we expect eps cagr of 21% in the next 3yr. Using a 17% coe our fair value for the stock comes at PKR 27/share.

Recommendation: Buy
Target Price: PKR 27/share; Upside: 47.6%
2022: Dividend yld: 0%, P/E: 5.5x

About:

- The Company is one of the leading producer of a wide range of quality cement.
- Fauji Foundation (39.3%), FFC (6.8%), Fauji Oil Terminal (1.4%) and local public (27.8%).

Market weight | Steel / Engineering

Preferred picks:
MUGHAL

We have "**Market weight**" stance on Pakistan Steel sector. We draw our stance on the back of steady demand outlook, with relative better pricing for long-steel over flat-steel. Having said that, much of the sector tailwinds seems to have been in-built current valuation. Our preference in steel sector remains on company with diversified income stream, presenting limited risks amid volatile global commodity prices.

1#. **Steady demand outlook:** For long/flat segment we expect demand to stay steady, following a positive outlook both on construction and automobile/home appliances sector. However this time around overall growth pace won't be as sharp as witnessed in 2021 (long +51% to 4.77mnT & Flat -10% to 3.35mnT), primarily due to base effect, absence of amnesty scheme & construction package as fiscal house-ordering become priority. Having said, we remain skeptical of significant demand emanating from government led private housing projects and builder/developers amnesty schemes.

2#. **Margins will remain intact, favouring long-steel over flat:** Setting away from 2021, overall sector experienced a volatile gross margins albeit on the higher end, amid rising commodity prices. The sector is well protected by multiple regulatory and anti-dumping duties, which enabled pricing power. Halfway down the roads in 2022, prices of scrap and HRC/CRC have started to show some respite (CRC prices down by +15% in 6months), which has opened up a pricing gap for importers. Rightly so, flat-steel manufacturers have recently reduced their retail prices by an average to curb import market. Whereas, rebar prices have gone up by 6.7k/ton, to PKR 198k/t. Hence going forward we expect domestic flat steel prices are likely to parallel international prices, keeping a lid on the margins. Whereas long players, given their less elastic prices, will keep the domestic prices at par, leading to expanding margins expansion (scrap prices down ~11% from its high in Jun-21).

Key risks and catalyst

- Volatile intentional prices, particularly scrap and HRC
- Increase in input prices. Given sector heavy reliance on power sources, we have incorporated 5-10% rise in power tariff.
- Exchange rate.

Engineering/Steel

Mughal Iron & Steel Industries Limited (MUGHAL)

Market Price: PKR 105.5
52 weeks: 103.9 — 109.9
Return: (3M) -1.4%, (6M) -4%, (12M) -0.5%
Outstanding Shares: 0.34bn (FF%: 25)
Market Capitalisation: PKR 34.9bn, US$ 0.2bn
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	4.1	1.8	10.2	18.3	18.6
DPS	1.2	3.0	0.0	4.5	5.5
BVPS	22.4	24.3	25.5	26.9	26.9
ROE	18%	7%	40%	68%	69%
P/E	25.8x	59.7x	10.3x	5.8x	5.7x
DY	1.1%	2.8%	0.0%	4.3%	5.2%
P/B	4.7x	4.3x	4.1x	3.9x	3.9x

Company Financial Year end: Jun

Mughal Steel (MUGHAL) has been reaping benefits of its diversified product, Copper ingots. In 2021, the company further procured melting plant to step up its non-ferrous business line catering both domestic and export market, including aluminium ingots and metal alloys. Both its ferrous and non-ferrous business are playing up in favour of earnings.

1#. Diversification sales mix to keep growth healthy and risk to minimum: The Company in its latest PSX filling has notified of securing PKR 2.9bn for installation of non-ferrous segment, expansion of its existing copper capacity and to further include including aluminium ingots, both for the purposes of exports. During 1q2022 alone the nearly 25% of the sales growth recorded (+80%y) pertained to non-ferrous segment.

2#. Sales growth: In 2022, we expect global supply to ease causing intl. prices to come down. However, market expects overall supply deficit to further deepen in 2022, (900k in 2022 from 530k in 2021) which ensures price likely to stay upbeat and similarly demand for MUGHAL copper will remain intact. On long-steel, as mentioned domestic demand is likely to stay steady. For MUGHAL, given its proximity to North construction demand, and post its recent plant debottlenecking, sales should gather support in 2022 and onwards.

3#. Gross margins: Generally non-elastic pricing in of long-steel along-with high margin non-ferrous segment will keep MUGHAL gross margins relative healthy.

Recommendation: Buy
Target Price: PKR 140/share; Upside: 32.7%
2022: Dividend yld: 4%, P/E: 5.8x

About:

- The principal activity of the Company is manufacturing and sale of mild steel products relating to ferrous segment.
- Directors/CEO/Spouses (43.2%), associated companies (32.2%) and Modarabas/Mutual Funds (10.1%).

Market weight | Automobile Assembler

Preferred picks:
INDU

We remain relatively positive on Automobile Assembler outlook, but have a 'Market weight' stance. During CY21, auto sector performance has been on a trim, as companies margins came under immense pressure rightly so on the back of rise in commodity prices and volatile exchange rates (PKR/USD and JPY). Looking into 2022, much of these headwinds are behind us. But a new set of headwinds including tougher financing regulations, timely delivery of vehicles, and recent amendments made in finance bill which will lead to further increase in prices.

1#. **New Auto Policy to cause much of a stir?** The sector has been under a government radar in a rather bad way. Firstly due to its contribution to ballooning imports & subsequently POL consumption that followed. Secondly unabated rise in passenger vehicle prices has caused a much uproar against government objective of keeping inflation low. Aiming to address these issues, the government has recently announced its new auto industry development policy (AIDEP 2021-2026). Under the policy tax incentives has been extended for environmental friendly cars, along with increased localization, which in principle should create a new market for EV/Hybrid, along with reduce POL imports and eventually open up prospects for exports.

2#. **Volumes back to its historic levels and expecting some consolidation:** Sales of passenger cars are back to normal, averaging 15.5k (3yr historic level of 15.8k units) units per month almost double of 8.7k units during covid year. While the overall pie does not seems to have grown in size, despite new entrants' into auto assembling arena of Pakistan, a look at SUV segments tells a completely different story. Overall average monthly sales in 2021 rose to 860units from 406units during covid and 550units based on a historic 3yr sales average; this is almost a +57% increase. Hence, a cheaper, EV/Hybrid and Utilitarian segment (C/SUV) will be key volume generator in 2022 and onwards.

3#. **Cheaper money supported overall volumetric recovery, but so much in 2022:** Moreover, looking back in 2021, steady remittances and cheaper financing availability has its fair share in sale of vehicles during 2021. However, this is about to change as recent interest rate hikes & further expected in 2022, tighter & targeted car financing regulations, will keep vehicle financing demand rather muted, and in particularly for high-end price bracket PC and SUV.

Key risks and catalyst

- Abrupt changes in currency JPY, USD and PKR
- Changes brought about in recent supplementary bill (30-Dec 2021)
- Model launches.

Automobile Assembler

Indus Motor Company Limited (INDU)

Market Price: PKR 1324.8
52 weeks: 1226 — 1324.8
Return: (3M) 1.3%, (6M) 6.5%, (12M) 8.1%
Outstanding Shares: 0.08bn (FF%: 17.2)
Market Capitalisation: PKR 96.4bn, US$ 0.55bn
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	174.5	64.7	163.2	199.0	216.0
DPS	115.0	30.0	103.5	140.0	150.0
BVPS	509.5	523.8	613.3	672.2	738.2
ROE	34%	12%	27%	30%	29%
P/E	7.6x	20.5x	8.1x	6.7x	6.1x
DY	8.7%	2.3%	7.8%	10.6%	11.3%
P/B	2.6x	2.5x	2.2x	2.0x	1.8x

Company Financial Year end: Jun

Amongst our coverage companies we have liking for Indus Motor Company Limited (INDU). Company's relatively strong cash generation, well established dealership market, its pricing power and diversified product ranges. Despite COVID-19, the company held retain its leading position in terms of gross margins and sales recovery was the sharpest. Largely this was due to launch of Mid-tier engine PC variant 'Yaris', and similarly expected launches in 2022 will keep sales steady.

1#. **FY22 volumes to stay steady with launch of 12th Gen Corolla:** INDU has geared up for possible launch of two new variants. Its flagship model Toyota Corolla 12th generation is expected by mid of year which will later be followed by a hybrid version locally assembled. We think given the rise in demand of hybrids in Pakistan, overall reception will be very strong.

2#. **Localising Small-size Hybrid SUV:** Similarly, after a long wait Toyota will be entering Pakistan in a small-size SUV segment that too in Hybrid space, under the nametag of Toyota Cross. Global reception of Cross has been rather weak, mainly taking a hit from Hyundai Kona, Honda C/HRV & Mazda CX3 and cheaper in price class variants such as MG, Haval etc.

3#. **Healthy cash chest will help wards-off potential depression on operating income:** Taking a call on company's operating margin outlook in 2022 will remain tricky. Although much of the headwinds seems to be behind us, reversal in current commodity downward trending cycle could reverse its course amid spread of Omicron very quickly. For INDU, this is

less of a worry since its other income earned mainly through active management of cash, in treasury bills, mutual funds will be able to make up for the reduced operating margins. In past of 3yrs company's other income makes up nearly ~32% of the EBIT.

Recommendation: Buy
Target Price: PKR 1795/share; Upside: 35.5%
2022: Dividend yld: 11%, P/E: 6.7x

About:

- Indus motors involves in assembling, manufacturing and marketing of Toyota vehicles.
- Toyota motor Corp. (25%), Toyota TSUSHO (12.5%) and Thal & Habib Insurance (6.25%).

Market weight

Fertilisers & Chemicals

Preferred Picks
FFBL

We maintain "Market Weight" stance on the Fertiliser sector. We base our investment case on the back of a) stable urea/Dap off-take, b) potential (less probability) gas price & sales tax hikes will likely be a pass-through on retail prices, and c) dap margins are likely to soften-up. Our key investment attraction in sector is dividend yield. Similar to fertiliser sector, chemical companies too hit an eps home run in 2021, mainly on account improved demand, and higher international margins. However, given the limited pricing power, stable demand and margin compression outlook we have a "Market-Weight" stance on the sector.

1#. **Demand to remain rather stable, but expect some break:** Improved agri-income in 2021, will ensure stable demand outlook for urea & dap, despite prices recording significant increase from yester-years. So far urea offtake has crossed 6.3mnT mark in 2021, in 2022 we expect some respite and likely to average 5.8-6.0mnT (5yr average). For Dap, industry sales clocked in at 1.8mnT, with Dap prices expected to slowdown, sales are likely to end up in the nearby range of 1.5-1.75mn.

2#. **Retaining pricing power:** So far in 2021, intl. urea prices in terms of PKR has gone up by 4x to PKR 8.5k/bag from PKR 2.1k/bag last year. Compared that to a +14%y increase in domestic retail prices. Although the government has mulled to increase gas tariff and remove sales tax exemptions, which as of latest mini-budget has been done as yet and we see less likelihood of this happening, unless done under IMF program whereby meeting is excepted to be held by mid of Jan-22. Even if the government does go ahead and increase input prices, urea manufacturers have enough room to pass over this additional price hike, as increased intl. urea prices implies reduced import risks & escalated RLNG will keep existing unutilised capacities at bay, fortifying our premise.

3#. **Industrial Chemicals demand won't be as robust & declining commodity prices means margins will likely stabilise:** PVC players have had a one of the best year, mainly due to demand and margins staying on the on the higher side lately. Going forward, we expect both these favourable dynamics to phase out. Firstly due to an expected slowdown in construction activity and secondly on gradual intl. margins compression following easing supply concerns. Similarly, amid rising cotton prices and textile demand, overall PSF margins have been on the uphill trajectory. But going forward, expected slowdown in general commodity prices along with flattish textile demand, will keep sector margins on the trim.

Key risks and catalyst

- Increase in gas tariff, stands a prominent risk. However as mentioned this will be less of a concern for manufacturers as this will be a pass-over.
- Reduced Dap margins, for dap producer a reduction in dap margins will lead to a major margin compression.
- Urea prices, while arguably urea manufacturers have substantial room to increase prices, we highlight RLNG based fertiliser plants becoming operational and reduced imported urea prices will limit existing players pricing power.

Fertiliser

Fauji Fertilizer Bin Qasim Limited (FFBL)

Market Price: PKR 26.9
52 weeks: 25.5 — 27.3
Return: (3M) -1.3%, (6M) -0.6%, (12M) 4.7%
Outstanding Shares: 1.29bn (FF%: 35)
Market Capitalisation: PKR 32.9bn, US$ 0.19br
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	-4.6	1.7	8.3	5.7	3.2
DPS	-	-	1.8	1.5	1.0
BVPS	5.3	10.8	16.4	20.6	22.8
ROE	-87%	16%	51%	28%	14%
P/E	-5.9x	15.8x	3.2x	4.7x	8.3x
DY	0.0%	0.0%	6.5%	5.6%	3.7%
P/B	5.1x	2.5x	1.6x	1.3x	1.2x

Company Financial Year end: Dec

Given its sole dominancy as Dap manufacturing and limited pricing risk, Fauji Fertiliser Bin Qasim Limited (FFBL) stands a core beneficiary of recent intl. dap prices trend. Moreover, its legacy portfolio has been either been restructured, sold or is in a process of selling. This product dominancy and diversified business income makes FFBL one of our top picks.

1#. **The Margin Squeeze:** In 2022, higher freight, raw material and energy prices are likely going to keep intl. dap prices on the higher side. Natural gas prices a key raw material is still at elevated levels, whereas supply disruptions are still underway due to North America anti-dumping duties which is keeping freight costs higher. Moreover, whispers of China lifting export ban until Jun-22 will keep prices elevated. Having said that, the robust margins as such seen in 2021 unlikely to come by in 2022. FFBL has roughly charged US$ 200/t in primary margins during 2021, compared to yester-years avg. of US$100-150/t. Earlier in 2021, the company notified of renewed gas price agreement (expired in Dec-20) with SSGC for another 5yr, ensuring stable production on availability of natural gas.

2#. **Restructuring of its other business lines will ease cash constraints:** FFBL has underwent restructuring of its subsidiaries, mainly in Fauji Foods Limited (FFL) and as per management the company is expected to show positive bottom-line by 2024. In addition the company is further looking for buyers for its Fauji Meat business, by a way of sell-off, JV or revamping the complete business line, much like FFL. Moreover, recent sale of its wind energy plants, generated a healthy cash inflow of PKR 2.4bn. These

cashflows will reduce company's debt burden, making less prone to rate hikes expected in 2022. Other income from its investments in, PMP, FPCL and AKBL is expected to stay healthy.

We have valued FFBL using a coe of 18% to arrive at PKR 35/share.

Recommendation: Buy
Target Price: PKR 35/share; Upside: 29.6%
2022: Dividend yld: 6%, P/E: 4.7x

About:

- The principal objective of the Company is manufacturing, purchasing and marketing of fertilizers
- Fauji Fertilizer Company Ltd (49.9%), Fauji Foundation (18.3%) and Banks/DFIs (7.8%).

Over weight

Oil & Gas Exploration Companies

Preferred Picks
OGDC, POL

We maintain our **'Over-weight'** stance on the E&P sector. We base our investment thesis on; Valuation too Good to Ignore. Sector's profitability is estimated to show significant growth in FY22; backed by increase in oil prices and PKR depreciation. Eps sustainability depends on diversification whereby MARI and PPL are relatively more active. Reserve replacement remains key risk where not much has been achieved to arrest the issue of depleting reserve base and natural depletion from maturing fields.

1#. **Recovery in oil prices and PKR depreciation to support 2022 earnings healthy:** Sharp recovery in oil prices coupled with PKR depreciation is likely to drive earnings growth in 2022. The sector remains highly undervalued trading at an implied oil price of below USD 30/bbl. This is primarily due to build up in receivables leading to lower cash based earnings.

2#. **However, cash based earnings depend on settlement of over dues:** While E&P sector remains cheap in terms of valuation, cash based earnings are marred by substantial build-up in receivables. The Government is focusing on reducing the debt piled up, OGDC & PPL where proposal under consideration is to declare hefty dividend against settlement of their over dues by GoP. While, this may clean their books for the time being, future cash flows will depend on further pile up in receivables.

3#. **Production concerns eased albeit marginally:** Oil and gas production has witnessed a decline in last couple of years, owing to Covid-19 lockdowns and natural depletion of reserves. Kandhkot (2nd largest gas field for PPL) has witnessed consistent low production due to lower demand from CPGCL. Recently PPL proposed to push forward unutilized gas under the GSA to other buyers to increase (Sui companies) as to enhance production from Kandhkot by 100-150mmcfd. However, we foresee production to gradually pick up as new fields have been commissioned by OGDC whereas any positive results of exploration in Tal block may bode positive for POL.

Key risks and catalyst

- Substantial drop in oil prices,
- Higher dry well costs,
- Further increase in circular debt,
- Pending divestment of GoP stake in OGDC and PPL.

Oil & Gas Exploration Companies

Pakistan Oilfields Limited (POL)

Market Price: PKR 386.7
52 weeks: 371.4 — 386.7
Return: (3M) 0.5%, (6M) 2.1%, (12M) 4.1%
Outstanding Shares: 0.28bn (FF%: 45.7)
Market Capitalisation: PKR 105.4bn, US$ 0.6bn
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	59.4	57.7	47.1	74.9	72.5
DPS	50.0	50.0	50.0	65.0	62.0
BVPS	134.1	141.9	138.7	148.5	159.1
ROE	44%	41%	34%	50%	46%
P/E	6.5x	6.7x	8.2x	5.2x	5.3x
DY	12.9%	12.9%	12.9%	16.8%	16.0%
P/B	2.9x	2.7x	2.8x	2.6x	2.4x

Company Financial Year end: Jun

Company's strong cash generation and no exposure to circular debt, will ensure healthy dividend pay-outs. Moreover, favourable decision on Tal block, approval of Mamikhel South-01 to be priced under Petroleum Policy 2012 and development of reserves (Jhandial, Joyamair, Tal Block and Pindori) will up POL earnings.

1#. **Minimum exposure to circular debt:** As substantial rise in circular debt has effected cash position of E&P sector. POL however stands out, with healthy cash generation – PKR 35/share cash tied against trade debts while PKR 187/share cash available as at Sep-21. As a result this provides enough backing to company, to aggressively seek exploration or diversify in to other projects.

2#. **Steady pay-outs as dividend yield remains high:** As a result of higher cash generation, POL has maintained a higher cash payout which on annual basis has stood above 80% (106% in FY21) in the last few years. Thus POL remains a high dividend yield stock with FY22/23 dividend yield of 16.8%/16.0% and thus remains as a preferred dividend yield stock.

3#. **Tal block seems promising as drilling activity gains traction:** POL plans to drill different wells in company operated block where DG khan has already been spud while seismic data is being acquired for drilling in Jhandial. In non-operated blocks, Kirthar block NOC has been granted while seismic data is being acquired for Gurgalot, Hisal and Margala Block.

However, KOT area in Tal block remains highly promising where data processing work is under progress. Furthermore, production line has been completed at Mamikhel South-01 and Government approval is awaited for pricing under PP12 to commence production.

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

Considering healthy cash generation and higher dividend yield we prefer POL as dividend yield stock as stability in oil prices have subsided risk of higher sensitivity to oil prices. Upside potential from Tal block is likely to keep POL in the limelight as production growth would drive Company's earnings. We have a "buy" rating on company, with our Dec-22 target price of PKR 519/share.

Recommendation: Buy
Target Price: PKR 519/share; Upside: 34.2%
2022: Dividend yld: 17%, P/E: 5.2x

About:

- The Company is principally engaged in exploration, drilling and production of crude oil and gas in Pakistan. Its activities also include marketing of liquefied petroleum gas under the brand name POLGAS and transmission of petroleum
- The Company is a subsidiary of The Attock Oil Company Limited, UK and its ultimate parent is Coral Holding Limited.

Oil & Gas Exploration Companies

Oil & Gas Development Co. Limited (OGDC)

Market Price: PKR 88.4
52 weeks: 87 — 88.7
Return: (3M) -0.3%, (6M) 1.3%, (12M) 0.5%
Outstanding Shares: 4.3bn (FF%: 15)
Market Capitalisation: PKR 374.3bn, US$ 2.13bn
Exchange: KSE100, KSEALL,MSCI FM,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	27.5	23.5	21.3	28.8	27.9
DPS	11.0	6.8	6.9	10.0	12.3
BVPS	150.3	165.2	178.9	198.8	214.9
ROE	18%	14%	12%	15%	13%
P/E	3.2x	3.8x	4.2x	3.1x	3.2x
DY	12.4%	7.6%	7.8%	11.3%	13.9%
P/B	0.6x	0.5x	0.5x	0.4x	0.4x

Company Financial Year end: Jun

The company is currently trading at P/E of 3.1x, with a decent dividend yield of 11.3%. Although cash position of the Company has been marred by substantial rise in receivables, however settlement of receivables and improvement in recoveries from Sui companies will strengthen cash position. Risk of foreign selling and divestment of shares has subsided for now. Development projects in pipeline are also expected arrest production decline concerns.

1#. **Settlement of receivables to be value accretive:** OGDC's receivables have spiked to PKR 383bn as at Sep-21 from PKR 359bn as at Jun-21 (PKR 264bn as at Sep-19) out of which PKR 267bn is overdue from gas companies. Although there is no direction on resolution of circular debt, GoP is assessing different options to settle receivables of PPL and OGDC. One of the proposal under consideration is a one-time settlement of receivables which could clear the books of these companies. As a result OGDC's payout ratio has dropped to 29% in FY20 compared to 55% in FY18. However, despite hefty build-up in receivables, OGDC's cash position is relatively better than PPL (PKR 60bn in cash & cash equivalents).

2#. **Aggressive exploration to continue in FY22:** OGDC has planned to spud 55 exploratory/appraisal wells, 8 development wells and 2 re-entry wells in FY22. OGDC has also undertaken development projects at Uch, Qadirpur, KPD-TAY, Dakhni and Maru-Reti which is expected to enhance gas

production from these development wells. However, drilling of higher exploratory wells would increase the risk of higher dry wells costs in FY21.

3#. **Higher dividend yield compliments attractive earnings growth:** OGDC is likely to post earnings growth of 36% in FY22 on account of rise in oil prices and PKR depreciation. The company also offers high dividend yield of 11.3%. Furthermore, impact of newly commissioned fields in FY21 will truly reflect in FY22 earnings allowing increase in production.

We maintain a "Buy" rating on OGDC, with Dec-22 Target price of PKR 156/share, offering 84% upside from last close. Stock of OGDC has come under immense pressure due to foreign selling and non-resolution of circular debt. With former behind us OGDC is currently trading at FY22/23 P/E of 3.1/3.2x and offers a dividend yield of 11%.

Recommendation: Buy

Target Price: PKR 156/share; Upside: 76.5%
2022: Dividend yld: 11%, P/E: 3.1x

About:

- The Company was established to undertake exploration and development of oil and gas resources, including production and sale of oil and gas and related activities.
- Government of Pakistan holds nearly 85% shareholding in OGDC.

Market weight

Oil & Gas Marketing Companies

Preferred Pick
PSO

We have 'Market-weight' stance on OMC sector on the back of slowdown in sales as domestic prices remain high and rise in interest rates. However, positive regulatory changes in recent times will bode positive for OMC sector. Furthermore, we expect build up in circular debt to slow down in FY22.

1#. **Cash position to improve as settlement takes effect**: During FY21, GoP initiated and signed MoUs with IPPs to clear overdue receivables. This is turn led to improvement in cash position for OMCs as well. Furthermore, timely notification of FCA as agreed with IMF has also allowed for better recovery of cost. We expect, further improvement in cash position of IPPs and consequently OMCs leading to healthy cash generation.

2#. **OMC margins revised up by PKR 0.71/ltr:** OMC margins have been revised upwards by PKR 0.71/ltr to PKR 3.68/ltr which is nearly a 24% increase from previous. This would bode well for OMCs to cover rise in costs. This will have annualized EPS impact of PKR 8.1/share and PKR 6.9/share for PSO and APL respectively.

3#. **Regulatory changes to remove excess competition and volatility:** Recent regulatory changes have allowed OMCs lower exposure to exchange rate risk and movement in oil prices. This in turn has led to lower volatility in earnings. Furthermore, measures taken by Government to reduce sale of smuggled products has also improved local HSD sales. Moreover, minimum storage requirement for OMCs is likely to eliminate excess competition.

4#. **Higher domestic prices and rise in interest rates to hurt growth in FY22/23 –** As a result of increase in oil prices and PKR depreciation domestic prices remain high which is likely to hurt demand. Whereas rise in interest rate, drop in commercial activity, lower FO demand from power plants and slowdown in 2-wheeler sales will also take a toll on MS, HSD and FO sales. However, sales are expected to rebound in post 2022.

Key risks and catalyst

- Delays in notification of margin increase
- Substantial rise in grey market sales Substantial drop in oil prices,
- Drop in industry volumes due to lower demand
- Rise in circular debt

Oil & Gas Marketing Companies

Pakistan State Oil Company Limited (PSO)

Market Price: PKR 186
52 weeks: 183.7 — 188
Return: (3M) -0.2%, (6M) -0.1%, (12M) -1%
Outstanding Shares: 0.47bn (FF%: 45)
Market Capitalisation: PKR 86.2bn, US$ 0.49bn
Exchange: KSE100, KSEALL,MSCI FM,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	22.5	-13.8	62.1	71.1	53.7
DPS	10.0	0.0	15.0	20.0	16.0
BVPS	253.9	240.8	298.2	349.4	386.9
ROE	9%	-6%	21%	20%	14%
P/E	8.2x	-13.5x	3.0x	2.6x	3.5x
DY	5.4%	0.0%	8.1%	10.8%	8.6%
P/B	0.7x	0.8x	0.6x	0.5x	0.5x

Company Financial Year end: Jun

We base our liking for PSO on (a) improvement in cash position post settlement of dues for IPPs, (b) rising market share in the retail segment, (c) demand from the power sector amid low exposure to PKR devaluation, and (d) notification of bi-weekly pricing to eliminate volatility in earnings. All these factors in our view warrant a valuation re-rating in PSO which is trading at a FY22 P/E of 2.6x and offers healthy dividend yield of 10.8%.

1#. **Storage expansion and lower competition to keep market share upbeat in retail segment-** Regulatory changes in minimum storage requirement and crack down on smuggled products has led to lower competition from mushroom OMC players. Being the largest OMC, PSO has capitalized on this opportunity, gaining nearly 5% and 7% market share in MS and HSD. Moreover, PSO plans to add new storage capacity and conversion of its existing FO storage to increase its retail network and raise market share.

2#. **Concerns on circular debt pile up have subsided-** PSO's cash position is likely to improve even further once remaining 60% (PKR 135bn) is released under the settlement plan agreed with IPPs. This would result in payments from KAPCO and HUBC to PSO. Ongoing tariff increases should lead to recovery in energy costs – under the IMF program, while buildup in receivables from FO based IPPs may witness slow down. However, receivables buildup emerging from LNG remains a concern.

3#. **Earnings are less vulnerable to macro slippages –** The regulatory environment has turned in favor of OMCs where PSO stands to benefits on account of lower exposure to PKR devaluation and movement in oil prices. This in turn will provide much more stability in earnings for PSO where previously core earnings used to get clouded by exchange and inventory gain/losses.

4#. **PRL upgradation may unlock valuations but limit payout –** PRL has recently announced that it will invest nearly USD 1.2bn for upgradation and expansion to 100,000bopd deep conversion refinery. While this could potentially unlock value for the Company and in turn PSO, a 70%/30% debt/equity ratio under the draft Policy would require heavy cash influx. As a result, we expect PSO to utilize flow of cash from settlement of dues of IPPs and curtail dividends to some extent.

We maintain PSO as our top pick in OMC sector with our Dec-22 target price of PKR 351/share offering 89% upside from last close. PSO is currently trading at FY22/23 P/E of 2.6/3.5x and offers healthy dividend yield of 11%.

Recommendation: Buy
Target Price: PKR 351/share; Upside: 88.7%
2022: Dividend yld: 11%, P/E: 2.6x

About:
- The principal activities of the Company are procurement, storage and marketing of petroleum and related products. It also blends and markets various kinds of lubricating oils.
- Government of Pakistan holds 25.5% shareholding in PSO.

Market weight

Power Generation & Distribution Companies

Preferred Pick
HUBC

As new capacities are expected to come online and drop in coal prices is likely to push FO plants lower down the merit order list, the only trigger remains settlement of dues by Government under the newly signed MoUs. Furthermore, as FO plants move down the merit order list, accumulation of circular debt may witness a slowdown leading to ease in cash constraints for FO based IPPs along with notification of tariff increase to recover cost.

1#. **Furnace oil players to benefit from ongoing settlements:** Pakistan's Energy sector should witness substantial improvement in liquidity with the Government retiring dues worth PKR 225bn (in total) for Furnace oil based IPPs. So far PKR 90bn has been received as first instalment equivalent to 40% of the outstanding receivables with the remaining to be received in December 2021. This will help significantly improve liquidity within the sector and cash-flows specifically for Furnace oil and natural gas/RLNG based plants.

2#. **Energy is playing a major role in ongoing IMF talks:** Pakistan's circular debt now stands at a whopping PKR 2.5tn and has been a thorn in the negotiations with the IMF. This has led the Government to take several steps to reign in stock build up (a) raise power tariffs by ~PKR 3.6/kwh, (b) phase out subsidies, (c) initiate payment of the second tranche of settlement to IPPs in exchange for tariff negotiations and, (iv) pass the NEPRA Act in Parliament. However, annual capacity payments are still expected to rise significantly (PKR 1.45tn by 2023 vs. PKR 850bn currently).

3#. **Dividend yields are returning:** Ongoing settlement of dues should return liquidity to the Power sector. Most pre 2002 Power Policy IPPs will announce strong dividends on receipt second tranche of overdue receivables including KAPCO, PKGP and LPL (although KAPCO may pocket some funds for plant maintenance and other fixed costs). Settlement of 2002 PP plants (NCPL, NCPL, Engro) should lead to further liquidity improvement. We prefer HUBC which offers a strong upside (62%).

Key risks & catalyst:

- Circular debt build up,
- Reforms insufficient to address circular debt,
- revision in PPA's of coal based IPPs,
- Delays in payment to IPPs under Power Policy 2002 and
- Delays in project COD.

Power Generation & Distribution Companies

Hub Power Company Limited. (HUBC)

Market Price: PKR 80.8
52 weeks: 74.1 — 81.2
Return: (3M) 0.8%, (6M) 0.1%, (12M) 9%
Outstanding Shares: 1.3bn (FF%: 75)
Market Capitalisation: PKR 96.1bn, US$ 0.55bn
Exchange: KSE100, KSEALL,MSCI FM,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	8.7	19.3	26.0	27.7	29.8
DPS	0.0	0.0	12.0	10.0	12.0
BVPS	39.3	58.8	77.7	95.9	114.7
ROE	22%	33%	33%	29%	26%
P/E	9.3x	4.2x	3.1x	2.9x	2.7x
DY	0.0%	0.0%	14.9%	12.4%	14.9%
P/B	2.1x	1.4x	1.0x	0.8x	0.7x

Company Financial Year end: Jun

We base our liking for HUBC on the back of a) settlement of dues by Government where second tranche is expected to be released soon, b) steady dividend outlook in the medium term and, c) new projects to sustain earnings growth despite cut in tariff of FO based plants.

1#. **Liquidity Concerns are warning:** HUBC is our top pick amongst listed IPPs on the back of an improving dividend yield, growth projects bearing fruit (CPHGC, TEL, and TNTPL) and settlement of the first tranche of PKR 23bn in Jun-21. With PKR 35bn to be further settled, HUBC's cash flows are on track to witness sharp improvement. Payouts are coming back on track with attractive dividend yields where HUBC is now offering D/Y of 12.4% in 2022.

2#. **Timely investment in growth project:** HUBCO has made timely investments in coal fired projects – some of which have begun to bear fruit. HUBC will utilize both imported and local coal, while it is also looking to carve out its FO Base plant (1200MW) to the GOP and converting it to coal. Moreover, HUBC entered into JV agreement with ENI to acquire the entire exploration and production operations of ENI Pakistan and is also exploring opportunities in water, renewable energy and mining. These projects should ensure longevity of HUBC's cash flows till 2050.

3#. **HUBCO remains highly undervalued:** As new coal projects expected to come online, we expect earnings growth to remain strong over the next 2

years along with strong dividend payout in the medium term. While some of the cash available for distribution may be utilized for expansion project (water, energy, and mining) along with receipt of cash from second tranche, we expect dividend payout to remain steady.

We maintain our liking for HUBC with a Dec-22 TP of PKR 131/share. HUBC trades at FY22/23 P/E of 2.9/2.7x and offers a D/Y of 12.4%. We maintain HUBC as our top pick with our Dec-22 Target price of PKR 131/share, offering +62% upside from last close.

Recommendation: Buy
Target Price: PKR 131/share; Upside: 62.1%
2022: Dividend yld: 12%, P/E: 2.9x

About:

- The principal activities of the Company are to develop, own, operate and maintain power stations. The Company owns an oil-fired power station of 1,200 MW (net) in Balochistan (Hub plant).
- MEGA conglomerate (pvt.) Limited (19%), Insurance Companies (10.7%) and Financial Institutions (15.2%).

Over-weight

Glass & Ceramics

Preferred Pick
TGL

Glass sector is set to benefit from rise in construction activity with limited competition to keep pricing power of existing players strong. Also demand for tableware segment is also going to pick up on account of hospitality business and demand of glass containers from industrial consumers of food and beverage sector. In order to cater the rising demand existing players have already expanded their capacities in float glass.

1#. **Rise in construction activity to bolster glass demand:** As construction sector stands to benefit from various incentives provided by the Government such as amnesty schemes, reduced taxation, subsidized financing etc, glass sector is likely to witness significant demand growth as glass is normally required at the end. This is also evident from record cement sales in FY21.

2#. **New capacities to cater demand**: Glass sector has recently witnessed increase in capacity by 500tpd under float glass segment as total capacity now stands at 2,050tpd to cater the rise in demand from construction sector. Furthermore, capacity expansion is also expected under tableware segment where TGL has planned 60tpd of new capacity. Moreover, tableware segment will also cater to rising glass container demand from industrial consumers of food and beverage sector.

3#. **Pricing power remains strong:** Due to lower competition in the glass sector in float and tableware segment, glass manufacturers are able to pass over rising cost to sustain margins. Although international oil prices seem to have peaked and starting to settle, we expect glass sector margins to sustain.

4#. **Exports sales to provide further boost:** Although glass sector sales are prominently local based but exports sales have witnessed an increase owing to PKR depreciation and trade with Sri Lanka and other countries after halt in trade with India and slowdown of exports to Afghanistan. Improvement in trade with other countries would further bolster export sales supported by PKR depreciation

Key risks and catalyst:

- Slowdown in construction activity and reduced demand
- Increase in fuel and raw material prices and,

Glass and Ceramics Companies

Tariq Glass. (TGL)

Market Price: PKR 114.6
52 weeks: 112 — 115.1
Return: (3M) 0.4%, (6M) 0.2%, (12M) -0.4%
Outstanding Shares: 0.14bn (FF%: 40)
Market Capitalisation: PKR 15.4bn, US$ 0.09bn
Exchange: KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	9.6	5.5	15.3	21.7	25.9
DPS	4.0	0.0	12.0	13.5	16.0
BVPS	44.6	48.9	77.0	85.2	95.1
ROE	22%	11%	20%	26%	27%
P/E	11.9x	20.7x	7.5x	5.3x	4.4x
DY	3.5%	0.0%	10.5%	11.8%	14.0%
P/B	2.6x	2.3x	1.5x	1.3x	1.2x

Company Financial Year end: Jun

We base our liking for TGL on the back of a) pick up in construction activity on the back of various incentives provided by Government to boost construction activity, b) strong pricing power as TGL remain dominant player in both tableware and float glass segment, c) capacity expansions to cater with rising demand. Furthermore, different projects for value addition and bringing in cost efficiencies would further improve margins for the Company. As a result TGL is expected to post 3YR CAGR of +22% in earnings over FY22-24.

1#. **Capacity expansions to cater with rising demand:** TGL recently doubled its float glass capacity in May-21 to 1,050tpd from 500tpd. Furthermore, the Company plans to add further 60tpd of new capacity in tableware segment taking total capacity to 200tpd. These expansion have been aligned with furnace turnaround to keep minimize production halt.

2#. **Strong pricing power to keep margins afloat:** The Company enjoys strong as it is able to pass on the cost increase to end consumer. This is largely due to dominant position of TGL in both float and tableware segment. As a result, TGL has increased its prices in recent months to pass on rise in energy prices and PKR depreciation on to end consumer leading to 28% gross margins in 1QFY22. Furthermore, different projects such as Brand New High Speed Double Gob Press Machine, New Six Colour Pad Printing Production Line and Brand New Goblet Stretch Machine will

provide cost efficiencies and value addition leading to healthy and sustainable margins going forward. Installation of Solar Power Plant of 1 MW capacity will also provide some relief to rising power cost.

3#. **Superior earnings growth warrant attractive valuations:** TGL is expect to post 3YR earnings CAGR of +22% over FY22/23. This is back by capacity expansion, better pricing power, cost efficiencies due to various projects undertaken and dominant position in both float and tableware segment. As a result TGL remains highly undervalued trading at FY22/23 P/E of 4.9/4.1x and offers a FY22/23 D/Y of 12%/14% and offers healthy dividend yield of 13%.

TGL trades at FY22/23 P/E of 5.3/4.4x and offers a FY22/23 D/Y of 13%/15% respectively. We maintain TGL as our top pick with our Dec-22 Target price of PKR 162/share, offering +41% upside from last close.

Recommendation: Buy
Target Price: PKR 162/share; Upside: 41.3%
2022: Dividend yld: 12%, P/E: 5.3x

About

- The Company is principally engaged in manufacturing and sale of glass containers, opal glass, tableware and float glass.
- Omer Glass Industries Limited (10.5%), Mr.Omer Baig (45.4%) and Local Public (24.3%).

Over-weight

Commercial Banks

Preferred Pick
HBL, BAFL

We remain 'Over-weight' on Pakistan Banks in 2022. Sector earnings has shown tremendous performance over yesteryears with asset qualities is near to optimum. Sector tailwinds, are likely to get additional boost from rate hike expected in 2022, which should help further confirm robust earnings. However, despite a strong outlook sector stock performance has been marred, primarily as key regulatory risks looms, including TSA, IFRS9, super tax and minimum ADR maintenance tax. However, at current we think banks have adequate capital reserves which could to an extent deal with such regulatory risks. In 2022, improved earnings and asset quality, we think bank stocks are waiting for re-rating.

1#. **Revenues looking healthy:** Policy rate has been raised to 9.75% up by 275bps in the later part of the 2021, and asset re-pricing is yet to reflect 4q earnings. With further rate hikes expected in 2022, and earnings yields are looking promising. In addition, lower borrowing requirements amid +17%y deposit growth and with a sizeable chunk (~35%) of deposits parked under non-remunerative the increase in cost of funding is likely to show marginal increase. This combination of healthy earnings ylds along with marginal increase in cost of funding, should up sector nims in 2022. Moreover, in past 3yrs banks have heavily invested in alternative delivery channels (ADC). This along with improved remittances and RDA initiative is all starting to show up in from of superior fee income growth.

2#. **Asset Growth**: So far in 2021, asset growth has been robust tilted toward shorter tenure government securities amid wide expectation of rate hikes. As a result at current banks stand at ~67% IDR up from 65% in 2021. This investment growth is more or less likely to compensate for expected slowdown in loan growth in 2022. In terms of asset quality, banks on average have a specific coverage ratio close 90%, with general provisioning requirement raised back 2020, total coverage comes around 100%. The bulk of this loan was for corporate/public sector (>90%), backed by government guarantees, and under SBP TERF / government subsidised rates, which limits overall reduces credit and interest risks on loan sheet.

3#. **Valuation remain well below historic average:** Due We estimate +13% 3yrs cagr earnings for our coverage banks leading to ROE recovery to >15%. As of current valuations remain well below their historic trend as of current, IGI banking sector trades at a forward 2022 P/E of 4.0x vs 3yr historic 6.5x, and P/B ratio of c. 0.6x versus 0.9x. This however, has opened

up some banks offering dividend yld in double digits average +12% in 2022.

Key risks and catalyst:

- Major asset deterioration on domestic and international book
- Implementation of IFRS9 and Treasury single account (TSA)
- Increase capital requirements.

Commercial Banks

Habib Bank Limited. (HBL)

Market Price: PKR 122.2
52 weeks: 116.7 — 123.1
Return: (3M) -0.8%, (6M) 0%, (12M) 3.9%
Outstanding Shares: 1.47bn (FF%: 50)
Market Capitalisation: PKR 171.2bn, US$ 0.97bn
Exchange: KSE100, KSEALL,MSCI FM,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	10.5	21.1	23.6	28.9	32.1
DPS	5.0	4.3	8.5	11.5	14.5
BVPS	153.2	181.0	194.5	212.0	229.6
ROE	7%	12%	12%	14%	14%
P/E	11.7x	5.8x	5.2x	4.2x	3.8x
DY	4.1%	3.5%	7.0%	9.4%	11.9%
P/B	0.8x	0.7x	0.6x	0.6x	0.5x

Company Financial Year end: Dec

We have liking for Habib Bank Limited (HBL) mainly for its improved earnings outlook, getting support from multiple areas, including, higher net interest income, limited asset quality deterioration, growing fee income and reduced costs. The bank is all set to deliver ROE close to ~18% in the next 3yrs. However, despite this HBL stock is trading well below its historic average and also compared to its peers.

1#. Limited worry on asset quality: HBL Bank's asset quality stands well favourable. General + specific provisioning remain close to 100%, with infection ratio well below industry close to 6.5%, despite a robust loan growth (12.5% 5yr cagr). HBL's fund utilisation remains above 95%, optimally allocated with 60% in investment and 40% in advances. Going forward, this optimal balance will ensure healthy earnings yld amid rate increase. Moreover, with ~40% (83% casa) of its total deposits being non-remunerative cost of funding is estimated to increase marginally. Similarly, bank sits comfortably on capital with 2022 estimated car at 17%.

2#. Fee income contribution to increase: Bank's fee income contribution to total revenue comes comfortably at 14%. HBL digital banking app and Konnect, ranks top 3 most downloaded banking and digital payment app. With improved focus on digital / ADC, fee income contribution is likely to extend going forward given growing usage.

3#. **Cost/income to see material slowdown in coming years:** In yesteryears, higher business transformation and regulatory costs, NY branch costs, and FX losses has kept bank's c/I well above 70%. In 2020, in absences of one-offs cost, and thanks to robust revenues, c/I dropped under 60%. Looking ahead in 2022, improved funded and non-funded income will further bring down banks c/i below 60%; average 55% over the next 3yrs.

We value HBL stock on a Gordon growth model assuming cost of equity at 18%, giving a Dec-22 fair value of PKR 160/share. At current bank is trading at a 2022 forward P/B multiple of 0.6x, compared other 3 large banks UBL, MCB, and ABL trading at 0.8x; ~25% discounts while delivering similar tier 1 ROE. Similarly, on forward P/E stock is trading at a 20% discount to its peers at 4.2x.

Recommendation: Buy
Target Price: PKR 160/share; Upside: 31%
2022: Dividend yld: 9%, P/E: 4.2x

About

- Having over 1640 domestic and intl. branches HBL is Pakistan's largest private bank in terms of deposit size.
- Key associates and subsidiaries include, HBL Asset Management Limited, Jubilee General /Life Insurance, and First MicroFinance Bank Limited.
- Agha Khan Foundation (51%)

Commercial Banks

Bank Alfalah Limited (BAFL)

Market Price: PKR 36.1
52 weeks: 34.2 — 36.4
Return: (3M) -0.9%, (6M) 0%, (12M) 4.6%
Outstanding Shares: 1.78bn (FF%: 35)
Market Capitalisation: PKR 60.7bn, US$ 0.34bn
Exchange: KSE100, KSEALL,

PKR/ Share	2019a	2020a	2021e	2022f	2023f
EPS	7.1	5.9	7.1	9.7	10.7
DPS	4.0	4.0	4.0	5.5	6.0
BVPS	49.5	51.1	54.6	58.8	63.5
ROE	14%	12%	13%	16%	17%
P/E	5.0x	6.1x	5.0x	3.7x	3.4x
DY	11.1%	11.1%	11.1%	15.3%	16.6%
P/B	0.7x	0.7x	0.7x	0.6x	0.6x

Company Financial Year end: Dec

Our liking for Bank Alfalah Limited (BAFL) mainly stems from its exceptionally high ratio of non-remunerative deposits, lower cost of deposits and operation. Further the bank has been catching up with large banks in terms of alternative delivery channels with its digital banking app 'Alfa'. In addition the bank maintains a high loan/deposit ratio with adequate loan quality. Moreover, bank is expected to delivery above ~20% roe, which at current P/B ratio of 0.6x begs for upward re-rating.

1#. **High current account deposits and advances makes more sensitive to interest rates**: In our coverage banks, BAFL enjoys a low cost deposit mainly due to high ratio of non-remunerative deposits; ~ 40%. Furthermore the bank also has a high advances-to-earnings asset ratio 50%, compared to industry ~40%. This makes the bank most sensitive to changes in interest rates.

2#. **Bank's asset quality:** While the bank has a high adr, it's over all loan quality remain well balanced. Its overall inflation ratio has remained well below 4.5% and 91% been provided for.

3#. **Strong rebound in fee income:** BAFL has witnessed strong rebound in fee income (up 25%y in 9MCY21) on recovering bancassurance and trade & remittance business. Fee income contribution to total revenue now stands at 14% where BAFL also continues to focus on expanding its digital footprint (IT expenses up 18%yoy in 9M). Internet banking

usage has accelerated where BAFL has leveraged its Omni-channel centric business through its app Alfa and diverse range of product offerings. To illustrate, BAFL's Alfa app has a 4.1 rating on the Google store. With improved focus on digital / ADC, fee income contribution is likely to extend going forward given growing usage.

We value BAFL stock on a Gordon growth model assuming cost of equity at 18%, giving a Dec-22 fair value of PKR 55/share. At current bank is trading at a 2022 forward P/B multiple of 0.6x. Similarly, on forward P/E stock is trading at 3.7x.

Recommendation: Buy
Target Price: PKR 55/share; Upside: 52.5%
2022: Dividend yld: 15%, P/E: 3.7x

About

- Having over 740 domestic and intl. branches BAFL is Pakistan's 8th largest bank in terms of deposit size.
- Key associates and subsidiaries include, Alfalah GHP Investment Management Limited, Alfalah CLSA Securities Limited, Saphire Wind Power Company Limited and Alfalah Insurance Company Limited.
- International Finance Corporation (14.7%), Sheikh Nahayan Mabarak (10.7%), Directors/CEO/Spouses (15.7%), Insurance Companies (6.8%).

Valuation Summary

SYM	Industry	Target Price	Recom.	Market Cap.	EPS			DPS			BVS		
				PKRbn | USDbn	'21	'22	'23	'21	'22	'23	'21	'22	'23
HCAR	Automobile Assembler	275	Buy	31.7 | 0.18	12.6	23.2	31.4	4.5	10.0	16.5	127.4	140.6	155.5
INDU	Automobile Assembler	1,795	Buy	104.1 | 0.59	163.2	199.0	216.0	103.5	140.0	150.0	613.3	672.2	738.2
PSMC	Automobile Assembler	315	Buy	18.3 | 0.1	35.0	41.2	51.3	0.0	11.0	14.0	330.9	361.1	398.3
ACPL	Cement	185	Buy	18.9 | 0.11	8.0	9.9	20.4	4.0	2.0	5.0	125.2	133.1	148.3
CHCC	Cement	200	Buy	28.6 | 0.16	16.5	20.9	28.6	2.3	3.3	4.3	69.9	87.5	111.9
DGKC	Cement	115	Buy	34.8 | 0.2	8.5	8.9	16.1	1.0	1.3	2.5	167.7	175.3	188.9
FCCL	Cement	27	Buy	25.2 | 0.14	2.5	3.3	4.1	0.0	0.0	0.8	16.9	20.2	23.5
KOHC	Cement	255	Buy	35.2 | 0.2	17.4	26.9	31.6	0.0	5.5	6.3	110.6	132.0	157.4
LUCK	Cement	1,025	Buy	220.8 | 1.25	43.5	53.2	61.6	0.0	0.0	6.0	350.1	403.3	459.6
MLCF	Cement	50	Buy	37.5 | 0.21	3.5	4.0	6.6	0.0	0.0	0.0	34.9	38.9	45.5
PIOC	Cement	120	Buy	19.4 | 0.11	8.7	9.5	16.1	0.0	1.0	1.5	66.5	74.9	89.5
EPCL	Chemical	82	Buy	51.6 | 0.29	14.5	11.6	12.1	11.5	5.3	5.3	31.7	38.0	44.6
ICI	Chemical	820	Neutral	70.1 | 0.4	56.6	61.6	65.8	40.0	38.0	41.0	244.1	307.7	370.5
ABL	Commercial Banks	115	Buy	99.4 | 0.57	14.4	20.1	21.2	7.0	10.0	11.5	120.5	130.6	140.2
AKBL	Commercial Banks	35	Buy	29.7 | 0.17	7.0	7.4	9.1	2.5	3.0	4.0	47.8	52.2	57.3
BAFL	Commercial Banks	55	Buy	64.1 | 0.36	7.1	9.7	10.7	4.0	5.5	6.0	54.6	58.8	63.5
BAHL	Commercial Banks	90	Buy	78.2 | 0.44	15.7	18.8	22.6	4.5	6.5	9.0	81.3	93.6	107.1
FABL	Commercial Banks	35	Buy	40.5 | 0.23	5.2	5.9	6.3	2.0	3.0	4.0	42.8	45.7	48.0
HBL	Commercial Banks	160	Buy	179.2 | 1.02	23.6	28.9	32.1	8.5	11.5	14.5	194.5	212.0	229.6
MCB	Commercial Banks	200	Buy	192.1 | 1.09	23.9	28.3	33.4	19.0	23.5	28.5	162.7	167.6	172.4
NBP	Commercial Banks	50	Buy	75.8 | 0.43	4.2	14.3	19.3	0.0	1.5	6.0	127.9	140.7	154.1
UBL	Commercial Banks	170	Buy	174.1 | 0.99	22.1	27.0	30.8	15.5	19.0	21.5	154.5	162.6	171.9
ISL	Engineering	105	Buy	30.6 | 0.17	17.2	19.7	17.1	10.0	8.0	7.0	40.6	47.5	57.7
MUGHAL	Engineering	140	Buy	35.4 | 0.2	10.2	18.3	18.6	0.0	4.5	5.5	25.5	26.9	26.9
EFERT	Fertilizer	80	Neutral	107.5 | 0.61	15.3	13.5	15.3	15.3	12.8	14.5	33.7	34.4	35.3
FFBL	Fertilizer	35	Buy	34.7 | 0.2	8.3	5.7	3.2	1.8	1.5	1.0	16.4	20.6	22.8
FFC	Fertilizer	140	Buy	134.1 | 0.76	17.1	15.6	16.1	12.9	11.8	11.3	37.5	41.4	46.3
TGL	Glass & Ceramics	162	Buy	15.8 | 0.09	15.3	21.7	25.9	12.0	13.5	16.0	77.0	85.2	95.1
MARI	Oil & Gas Exploration Companies	2,113	Buy	223.7 | 1.27	235.7	319.0	331.7	141.0	175.0	182.0	866.1	956.7	1105.9
OGDC	Oil & Gas Exploration Companies	156	Buy	380.2 | 2.16	21.3	28.8	27.9	6.9	10.0	12.3	178.9	198.8	214.9
POL	Oil & Gas Exploration Companies	519	Buy	109.8 | 0.62	47.1	74.9	72.5	50.0	65.0	62.0	138.7	148.5	159.1
PPL	Oil & Gas Exploration Companies	148	Buy	216.2 | 1.23	19.3	26.9	27.2	3.5	5.0	7.0	143.5	164.4	184.3
APL	Oil & Gas Marketing Companies	455	Buy	32.3 | 0.18	69.7	89.5	72.7	27.0	50.0	42.0	228.3	241.8	251.4
PSO	Oil & Gas Marketing Companies	351	Buy	87.3 | 0.5	62.1	71.1	53.7	15.0	20.0	16.0	298.2	349.4	386.9
HUBC	Power Generation & Distribution	131	Buy	104.8 | 0.6	26.0	27.7	29.8	12.0	10.0	12.0	77.7	95.9	114.7
NCPL	Power Generation & Distribution	22	Buy	6.2 | 0.04	6.8	6.0	5.5	0.0	0.0	2.5	58.5	64.4	69.9

SYM	Industry	P/E			DY			P/B			52 Week		PERFORMANCE		
		'21	'22	'23	'21	'22	'23	'21	'22	'23	L	H	03M	06M	12M
HCAR	Automobile Assembler	17.7	9.6	7.1	2.0	4.5	7.4	1.7	1.6	1.4	221.6	241.8	0.9%	1.9%	9.1%
INDU	Automobile Assembler	8.1	6.7	6.1	7.8	10.6	11.3	2.2	2.0	1.8	1226.0	1324.8	-1.2%	-6.1%	-7.5%
PSMC	Automobile Assembler	6.3	5.4	4.3	0.0	4.9	6.3	0.7	0.6	0.6	220.3	227.9	1.2%	1.2%	2.4%
ACPL	Cement	17.2	13.9	6.8	2.9	1.5	3.6	1.1	1.0	0.9	135.4	138.9	1.0%	-1.1%	0.7%
CHCC	Cement	8.9	7.1	5.1	1.5	2.2	2.9	2.1	1.7	1.3	146.5	152.0	-0.4%	0.8%	3.3%
DGKC	Cement	9.4	9.0	4.9	1.3	1.6	3.1	0.5	0.5	0.4	79.5	83.7	0.6%	3.1%	5.2%
FCCL	Cement	7.3	5.5	4.5	0.0	0.0	4.1	1.1	0.9	0.8	18.1	18.7	-1.0%	1.0%	1.7%
KOHC	Cement	10.1	6.5	5.5	0.0	3.1	3.6	1.6	1.3	1.1	175.0	188.0	0.4%	5.1%	7.4%
LUCK	Cement	15.7	12.8	11.1	0.0	0.0	0.9	2.0	1.7	1.5	674.9	696.7	-1.1%	1.1%	1.6%
MLCF	Cement	9.8	8.6	5.2	0.0	0.0	0.0	1.0	0.9	0.8	34.1	35.9	-0.1%	2.9%	5.0%
PIOC	Cement	9.8	9.0	5.3	0.0	1.2	1.8	1.3	1.1	1.0	85.4	91.8	0.9%	5.6%	7.4%
EPCL	Chemical	3.9	4.9	4.7	20.3	9.3	9.3	1.8	1.5	1.3	56.0	57.1	0.3%	-0.1%	-0.4%
ICI	Chemical	13.4	12.3	11.5	5.3	5.0	5.4	3.1	2.5	2.0	756.2	775.6	0.1%	1.3%	2.2%
ABL	Commercial Banks	6.0	4.3	4.1	8.1	11.5	13.2	0.7	0.7	0.6	83.4	88.2	1.0%	0.2%	-4.0%
AKBL	Commercial Banks	3.4	3.2	2.6	10.6	12.7	17.0	0.5	0.5	0.4	22.3	23.6	-0.2%	-1.9%	-5.5%
BAFL	Commercial Banks	5.0	3.7	3.4	11.1	15.3	16.6	0.7	0.6	0.6	34.2	36.4	0.9%	0.0%	-4.4%
BAHL	Commercial Banks	4.5	3.7	3.1	6.4	9.2	12.8	0.9	0.8	0.7	68.5	70.3	-0.4%	-0.6%	-1.9%
FABL	Commercial Banks	5.1	4.6	4.2	7.5	11.3	15.0	0.6	0.6	0.6	23.8	26.8	-0.5%	0.3%	-10.0%
HBL	Commercial Banks	5.2	4.2	3.8	7.0	9.4	11.9	0.6	0.6	0.5	116.7	123.1	0.8%	0.0%	-3.7%
MCB	Commercial Banks	6.8	5.7	4.9	11.7	14.5	17.6	1.0	1.0	0.9	153.9	162.3	0.0%	0.1%	-5.1%
NBP	Commercial Banks	8.6	2.5	1.8	0.0	4.2	16.8	0.3	0.3	0.2	34.2	35.6	-0.5%	-1.6%	-3.4%
UBL	Commercial Banks	6.4	5.3	4.6	10.9	13.4	15.1	0.9	0.9	0.8	137.2	143.1	0.0%	0.6%	-3.5%
ISL	Engineering	4.1	3.6	4.1	14.2	11.4	9.9	1.7	1.5	1.2	70.4	73.4	0.8%	3.6%	2.2%
MUGHAL	Engineering	10.3	5.8	5.7	0.0	4.3	5.2	4.1	3.9	3.9	103.9	109.9	1.4%	4.2%	0.5%
EFERT	Fertilizer	5.3	6.0	5.2	19.0	15.9	18.0	2.4	2.3	2.3	77.8	81.3	0.0%	-1.2%	-3.4%
FFBL	Fertilizer	3.2	4.7	8.3	6.5	5.6	3.7	1.6	1.3	1.2	25.5	27.3	1.3%	0.6%	-4.5%
FFC	Fertilizer	6.2	6.7	6.5	12.2	11.2	10.7	2.8	2.5	2.3	101.3	105.4	-0.4%	-1.3%	-3.8%
TGL	Glass & Ceramics	7.5	5.3	4.4	10.5	11.8	14.0	1.5	1.3	1.2	112.0	115.1	-0.4%	-0.2%	0.4%
MARI	Oil & Gas Exploration Companies	7.1	5.3	5.1	8.4	10.4	10.9	1.9	1.8	1.5	1648.6	1676.5	-0.1%	-1.7%	-0.4%
OGDC	Oil & Gas Exploration Companies	4.2	3.1	3.2	7.8	11.3	13.9	0.5	0.4	0.4	87.0	88.7	0.3%	-1.3%	-0.5%
POL	Oil & Gas Exploration Companies	8.2	5.2	5.3	12.9	16.8	16.0	2.8	2.6	2.4	371.4	386.7	-0.5%	-2.0%	-3.9%
PPL	Oil & Gas Exploration Companies	4.1	3.0	2.9	4.4	6.3	8.8	0.6	0.5	0.4	78.0	79.6	0.2%	-1.8%	-0.5%
APL	Oil & Gas Marketing Companies	4.7	3.6	4.5	8.3	15.4	12.9	1.4	1.3	1.3	324.3	327.0	0.6%	0.2%	-0.2%
PSO	Oil & Gas Marketing Companies	3.0	2.6	3.5	8.1	10.8	8.6	0.6	0.5	0.5	183.7	188.0	0.2%	0.1%	1.1%
HUBC	Power Generation & Distribution	3.1	2.9	2.7	14.9	12.4	14.9	1.0	0.8	0.7	74.1	81.2	-0.8%	-0.1%	-8.3%
NCPL	Power Generation & Distribution	2.5	2.9	3.1	0.0	0.0	14.7	0.3	0.3	0.2	16.1	17.1	0.1%	0.2%	-5.4%

Risks to our call

Although market remain highly undervalued compared to its historic P/E and the earnings growth expected, however we highlight key risks that may impact the market performance.

- Stricter conditions imposed by IMF which could have inflationary impact. Power tariff and gas price hike are also part of it. The already announced mini budget to meet IMF condition prior to its board meeting also indicates Governments commitment towards IMF program.
- Rising commodity prices especially oil prices remain a key risk for both current account and inflation. The soaring current account deficit is already building pressure on forex reserves and rising oil prices may offset the measures taken in Mini Budget to curb imports.
- With rising oil prices and inflation not showing signs of easing, we may see further hike in Interest rates.
- Political pressure builds ahead of 2023 elections.
- Although risks of lockdown remain highly unlikely however pressure on healthcare system leading to cut down in staff and supply chain disruptions remains a risk which could push commodity prices and dent exports as well.
- Failure to meet additional requirement set out by FATF and worsening AML/CFT conditions could potentially lead to Pakistan remaining in grey list for a prolonged period.

IGI Securities
SERVING YOU SINCE 1994

Important Disclaimer and Disclosures

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

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

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

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

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

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

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009
© Copyright 2020 IGI Finex Securities Limited

Contact Details

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 38303559-68	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Syeda Mahrukh Hameed	Branch Manager (Lahore)	Tel: (+92-42) 38303564	mahrukh.hameed@igi.com.pk
Shakeel Ahmad	Branch Manager (Faisalabad)	Tel: (+92-41) 2540843-45	shakeel.ahmad1@igi.com.pk
Zaid Farook	Branch Manager (Stock Exchange) Karachi	Tel: (+92-21) 32462651-52	zaid.farook@igi.com.pk
Asif Saleem	Equity Sales (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Equity Sales (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Ajay Kumar	Analyst	Tel: (+92-21) 111-234-234 Ext: 912	ajay.kumar@igi.com.pk
Huzaifa Yaseen	Analyst	Tel: (+92-21) 111-234-234 Ext: 912	huzaifa.yaseen@igi.com.pk

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

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

Stock Exchange Office
Room # 134, 3rd Floor, Stock Exchange Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2
Fax: (+92-21) 32429607

Lahore Office	**Islamabad Office**
Shop # G-009, Ground Floor, Packages Mall Tel: (+92-42) 38303560-69 Fax: (+92-42) 38303559	Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza, Block- B, Jinnah Avenue, Blue Area Tel: (+92-51) 2604861-2, 2604864, 2273439 Fax: (+92-51) 2273861
Faisalabad Office	**Rahim Yar Khan Office**
Room #: 515-516, 5th Floor, State Life Building, 2- Liaqat Road Tel: (+92-41) 2540843-45 Fax: (+92-41) 2540815	Plot # 12, Basement of Khalid Market, Model Town, Town Hall Road Tel: (+92-68) 5871652-3 Fax: (+92-68) 5871651
Multan Office	
Mezzanine Floor, Abdali Tower, Abdali Road Tel: (92-61) 4512003, 4571183	

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009
© Copyright 2022 IGI Finex Securities Limited