

PAKISTAN

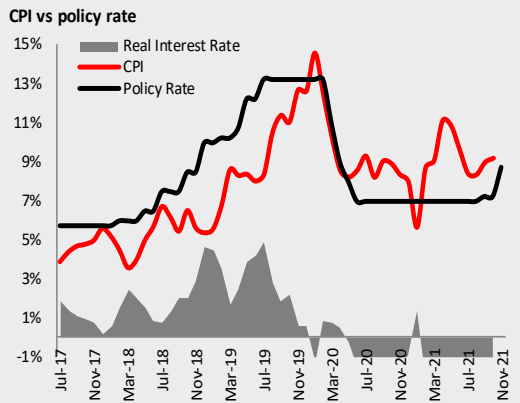


Pakistan Strategy

Whopping increase in interest rate

Policy rate rises by 150bps to address higher inflation & CAD

The central bank has decided to act proactively by taking notice of increased risks related to inflation and balance of payments while outlook for growth has continued to increase. The State Bank of Pakistan increased the policy rate by 150bps to 8.75% citing rising inflationary and balance of payment pressures given (1) higher import prices (2) emerging signs of demand side pressures and (3) higher global and domestic oil/commodity prices.

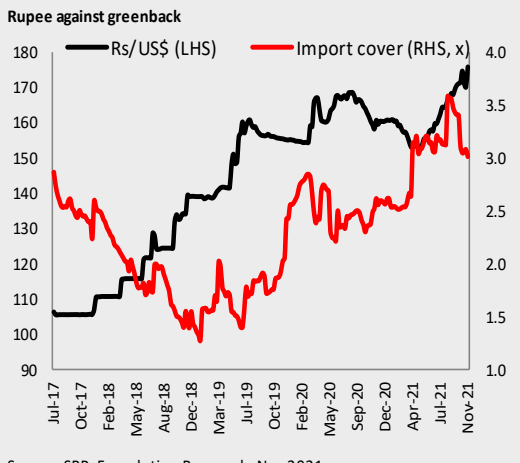


MPS points to need to move faster to counter risks

The MPS noted that the balance of risks has shifted away from growth towards inflation and the current account faster than expected. Accordingly, the MPS was of the view that there is now a need to proceed faster to normalize monetary policy to counter inflationary pressures and preserve stability with growth. Looking ahead, the MPC re-iterated that the end goal of mildly positive real interest rates remain unchanged and expects to take measured steps to that end.

Pressure on Rs-US\$ should moderate

The MPS noted that while the exchange rate has played its due role as a shock absorber, it has borne a considerable burden in terms of adjusting to the widening CAD and the fall in the value of the rupee since May has been comparatively large. As other adjustment tools normalize, including interest rates and fiscal policy, pressures on the rupee should abate.



Market liquidity to trim

From stock market perspective, the present rate hike would impact market liquidity. The interest rates are at a level where they are likely to cause a reversal of flows to fixed-income instrument. We have kept unchanged our risk-free assumption at 11.5% as we foresee further moderate increase in policy rate considering the upside risks to inflation. Moreover, from valuation perspective the development is neutral as market has already priced in the rise in policy rate, in our view.

Sector specific impact suggests Banks would be a winner given improvement in NIMs, however the impact would be diluted by NPL formations. This will be non-event for Power while higher other income would be mildly positive for E&Ps. This will be majorly negative for cement and steel sector as ongoing expansionary bandwidth has highly leveraged their books (LT & ST) with more profound impacts on DGKC, PIOC and CHCC. On the other hand, Fertilizer would also be partially impacted (particularly EFERT, FATIMA and FFBL given their leveraged balance sheet). For oil downstream (OMCs + refineries) it is negative (ex-APL) where circular debt continues to hamper PSO balance sheet despite recent payments under Gov't agreement with. Consumer durables (autos + electronics) would have -ve implications on demand due to increasing consumer financing rate (+ve for INDU/PSMC other income). For textile it would be -ve, only if govt decides to revisit its stance on the export refinance rates.

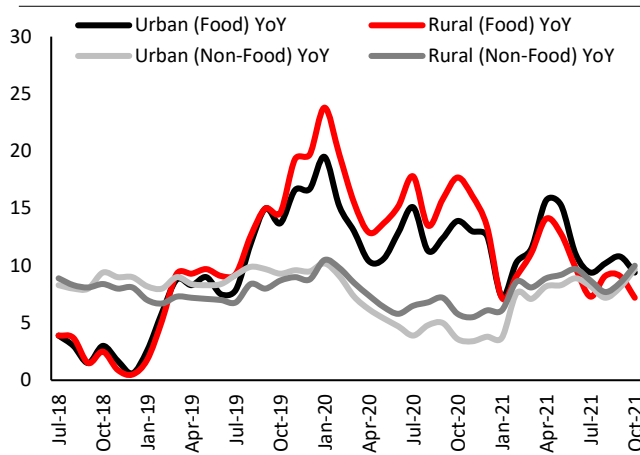
Outlook

Future path of policy rate would be contingent upon controlling inflation and CAD. Therefore, we advise to go long on sectors that are beneficiary of (1) hike in interest rates and (2) least affected by fiscal consolidation. We have our liking for E&Ps, Banks, Fertilizers and Conglomerates while advise caution towards Cements, Auto and Steel. We prefer OGDC, PPL, HBL, UBL, PSO, MARI, LUCK, FFC, FFBL & APL.

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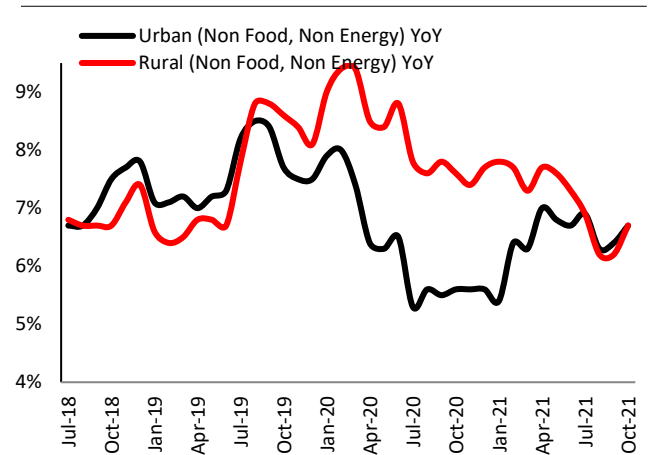
Foundation Securities (Pvt) Ltd
Friday, November 19, 2021

Fig 1: Food and non-food inflation has converged...



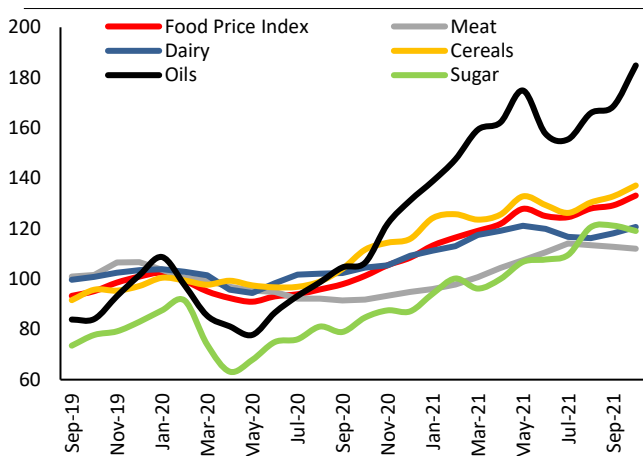
Source: PBS, Foundation Research, November 2021

Fig 2: Core inflation bouncing back...



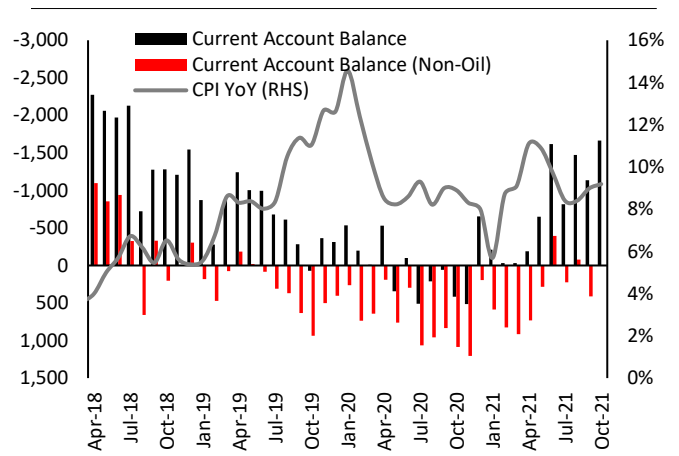
Source: PBS, Foundation Research, November 2021

Fig 3: Int'l food prices marching upwards...



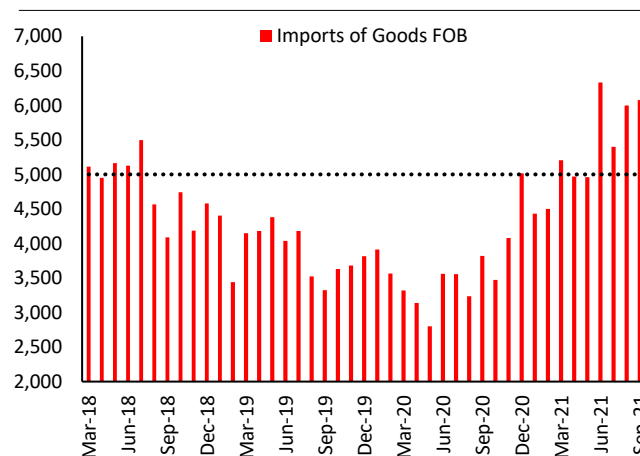
Source: FAO, Foundation Research, November 2021

Fig 4: Current account and CPI going out of control...



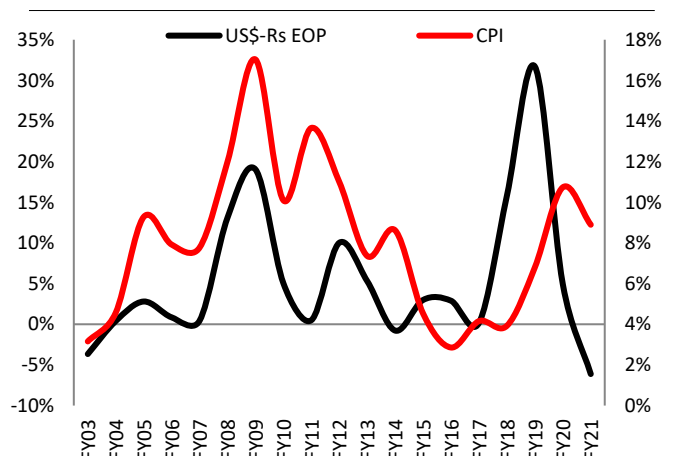
Source: SBP, PBS, Foundation Research, November 2021

Fig 5: Goods import rise above FY18 levels (US\$ bn)



Source: SBP, Foundation Research, November 2021

Fig 6: Exchange rate and inflation move in tandem



Source: Bloomberg, SBP, FSL Research, November 2021

Table 01: Impact of 150bps on company's profitability (Rs mn)

| Company/Sector | Total Debt | Cash & ST investment | Impact Rs/sh | Comment |
|-------------------|------------|----------------------|--------------|---|
| E&P | | | | |
| Positive | | | | |
| OGDC | - | 152,803 | 0.42 | Strong cash position to yields positive results |
| POL | - | 53,120 | 2.19 | Strong cash position to yields positive results |
| PPL | - | 61,321 | 0.26 | Strong cash position to yields positive results |
| MARI | 374 | 43,354 | 3.77 | Strong cash position to yields positive results |
| Banks | | | | |
| Positive | | | | |
| HBL | - | - | 3.16 | Uptick in interest rates to increase NII |
| UBL | - | - | 2.94 | Uptick in interest rates to increase NII |
| MCB | - | - | 2.06 | Uptick in interest rates to increase NII |
| MEBL | - | - | 2.27 | Uptick in interest rates to increase NII |
| BAFL | - | - | 2.58 | Uptick in interest rates to increase NII |
| AKBL | - | - | 0.69 | Uptick in interest rates to increase NII |
| FABL | - | - | 1.10 | Uptick in interest rates to increase NII |
| Fertilizer | | | | |
| Neutral | | | | |
| ENGRO | 50,468 | 113,262 | 1.28 | Includes ENGRO standalone, EFERT and EPCL debt |
| FATIMA | 13,915 | 2,539 | (0.05) | Profitability to further reduce in case of concessionary GIDC payment |
| FFBL | 35,604 | 20,543 | (0.11) | Debt adjusted for FFBL Power Supply to KEL |
| FFC | 70,018 | 87,392 | 0.20 | Strong cash position to yields positive results |
| EFERT | 19,744 | 11,894 | (0.06) | Increased working WCC to hurt trading business profitability |
| Steel | | | | |
| Negative | | | | |
| ISL | 11,793 | 220 | (0.26) | Working capital cost to increase |
| ASTL | 18,867 | 215 | (0.61) | Working capital cost to increase |
| ASL | 18,363 | 2,287 | (0.20) | Working capital cost to increase |
| MUGHAL | 24,109 | 2,809 | (0.62) | Working capital cost to increase |
| AGHA | 18,362 | 516 | (0.29) | Working capital cost to increase |
| INIL | 26,091 | 636 | (1.88) | Working capital cost to increase |
| Cements | | | | |
| Negative | | | | |
| LUCK | 27,896 | 26,888 | (0.03) | Higher cash availability and Income from investments to reduce the impact |
| GWLC | 2,330 | 881 | (0.04) | New expansion to further hurt profitability due to higher interest rates |
| KOHC | 7,628 | 5,334 | (0.11) | New expansion to further hurt profitability due to higher interest rates |
| BWCL | 15,829 | 1,942 | (0.23) | New expansion to further hurt profitability due to higher interest rates |
| ACPL | 7,590 | 2,111 | (0.39) | New expansion to further hurt profitability due to higher interest rates |
| FCCL | 1,179 | 6,449 | 0.04 | Strong cash position to yields positive results |
| POWER | 29,959 | 245 | (0.27) | Negative impact due to higher leverage |
| FLYNG | 6,005 | 56 | (0.15) | Negative impact due to higher leverage |
| MLCF | 18,318 | 684 | (0.16) | New expansion to further hurt profitability due to higher interest rates |
| DGKC | 49,498 | 312 | (1.09) | Negative impact due to higher leverage |
| PIOC | 27,035 | 1,339 | (1.10) | Negative impact due to higher leverage |
| CHCC | 16,080 | 632 | (0.78) | New expansion to further hurt profitability due to higher interest rates |
| Refinery | | | | |
| Negative | | | | |
| ATRL | 9,400 | 9,285 | (0.01) | Lower impact given strong cash position and reliance on local crude oil |
| NRL | 31,281 | 608 | (3.74) | Would increase finance cost due to high leverage |
| PRL | 11,131 | 274 | (0.17) | Would increase finance cost due to high leverage |
| BYCO | 43,073 | 1,065 | (0.08) | Would increase finance cost due to high leverage |
| Autos | | | | |
| Positive | | | | |
| HCAR | 2,448 | 25,089 | 1.86 | Earnings to increase due to strong cash position |
| PSMC | 2,028 | 31,396 | 4.18 | Earnings to increase due to strong cash position |
| AGTL | - | 2,619 | 0.53 | Earnings to increase due to strong cash position |
| MTL | 254 | 4,477 | 0.73 | Earnings to increase due to strong cash position |
| INDU | 873 | 107,484 | 15.87 | Earnings to increase due to strong cash position |

Source: Company Accounts, Foundation Research, November 2021

Table 01: Impact of 150bps on company's profitability (Rs mn)

| Company/Sector | Total Debt | Cash & ST investment | Impact Rs/sh | Comment |
|-------------------------------------|------------|----------------------|-----------------|--|
| OMCs | | | Negative | |
| APL | 6,858 | 10,536 | 0.43 | Net positive impact due to higher cash position |
| PSO | 93,182 | 44,461 | (1.01) | Would increase finance cost due to high leverage |
| SHEL | 7,467 | 2,442 | (0.23) | Working capital cost to increase |
| HTL | 1,349 | 682 | (0.05) | Working capital cost to increase |
| HASCOL | 47,256 | 3,178 | (0.43) | Would increase finance cost due to high leverage |
| Chemical | | | Negative | |
| EPCL | 17,889 | 5,206 | (0.14) | Would increase finance cost due to high leverage |
| LOTCHEM | 1,748 | 15,924 | 0.11 | Earnings to increase due to strong cash position |
| ICI | 12,754 | 241 | (1.32) | Working capital cost to increase |
| FMCG | | | Negative | |
| FCEPL | 6,184 | 3,327 | (0.04) | Working capital cost to increase |
| MFL | 7,283 | 126 | (0.57) | Working capital cost to increase |
| FFL | 14,127 | 261 | (0.17) | Working capital cost to increase |
| ASC | 1,718 | 75 | (0.05) | Working capital cost to increase |
| TOMCL | 828 | 164 | (0.05) | Working capital cost to increase |
| PREMA | 913 | 187 | (0.04) | Working capital cost to increase |
| UNITY | 17,769 | 9,898 | (0.08) | Working capital cost to increase |
| Cable & Electrical Goods | | | Negative | |
| PAEL | 19,003 | 589 | (0.36) | Take toll of reduction in consumer financing |
| PCAL | 4,278 | 120 | (1.14) | Take toll of reduction in consumer financing |
| WAVES | 6,090 | 125 | (0.21) | Working capital cost to increase |
| Technology | | | Neutral | |
| SYS | 580 | 5,980 | 0.46 | Earnings to increase due to strong cash position |
| AVN | 539 | 1,315 | 0.04 | Earnings to increase due to net cash position |
| NETSOL | 242 | 3,450 | 0.42 | Earnings to increase due to net cash position |
| TPLT | 3,198 | 239 | (0.15) | Working capital cost to increase |
| AIRLINK | 6,906 | 2,326 | (0.11) | Working capital cost to increase |
| HUMNL | 744 | 438 | (0.00) | Working capital cost to increase |

Source: Company Accounts, Foundation Research, November 2021

Abbreviations

| | |
|------|---------------------------|
| bbl | barrel |
| Bn | billion |
| bps | basis points |
| CAD | Current Account Deficit |
| CPI | Consumer Price Index |
| DR | Discount Rate |
| MPC | Monetary Policy Committee |
| MPS | Monetary Policy Statement |
| MTB | Market Treasury Bill |
| PIB | Pakistan Investment Bond |
| RIR | Real Interest Rate |
| SBP | State Bank of Pakistan |
| SPLY | Same Period Last Year |
| YoY | Year on Year |

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Recommendations definitions

| | |
|-----------------------------------|---------------|
| If | |
| Expected return >+10% | Outperform. |
| Expected return from -10% to +10% | Neutral. |
| Expected return <-10% | Underperform. |