

**PAKISTAN**



# Pakistan Strategy

## Institutions act to restore stability

### Political certainty to define the path

Supreme Court decision to restore the National Assembly (NA) would lower the political uncertainty as it provides sufficient time for the upcoming setup to take stability measures amid elevated commodity prices and depleting FX reserves. Earlier, the Prime Minister had dissolved the NA after speaker dismissed the no-trust motion against the PM. Clarity on the formation of new government, as probability of change in regime seems more certain after opposition members outnumber ruling party ones with the help of allies switching sides, would enhance investor confidence, in our view.

### SBP raise rate by 250bps to counter inflation & external risks

The MPS noted that the outlook for inflation has deteriorated and risks to external stability have risen since the last MPS. March inflation surprised on the upside, with core inflation in both urban and rural areas rising significantly. Heightened domestic political uncertainty contributed to a 5% depreciation in Rs-US\$ and a sharp rise in domestic secondary market yields as well as Pakistan's Eurobond yields and CDS spreads since the last MPS. There has been a decline in the SBP's FX reserves largely due to debt repayments and Gov't payments to settle Reko Dik mining project. Externally, futures markets suggest that global commodity/oil prices are likely to remain elevated for longer and the FED is likely to increase interest rates more quickly than previously anticipated, likely leading to a sharper tightening of global financial conditions. SBP is also increasing the rate of export refinance scheme and widening the set of import items (mostly luxury items) subject to cash margin requirements.

### Hike already priced into market prices

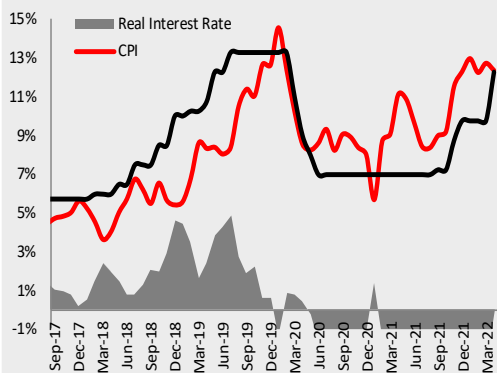
From stock market perspective, the present rate hike would impact market liquidity. The interest rates are at a level where they are likely to cause a reversal of flows to fixed-income instruments. We have kept unchanged our risk-free assumption at 11.5% as we await clarity on the economic policies of the upcoming political setup. Moreover, from valuation perspective the development is neutral as market has already priced in the rise in policy rate, in our view. However, synchronized effort to manage monetary and fiscal challenges would uplift investor sentiment.

Sector specific impact suggests Banks would be a winner given improvement in NIMs, however the impact would be somewhat diluted by NPL formations. This will be mildly positive for E&P due to higher other income. This will be majorly negative for cement and steel sector as ongoing expansionary cycle has caused their books (LT & ST) to be highly leveraged with more profound impacts on DGKC, PIOC and CHCC. On the other hand, Fertilizer would also be partially impacted (particularly EFERT and FATIMA 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 IPP's. 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, as EFS increased to 5.5%.

### Outlook

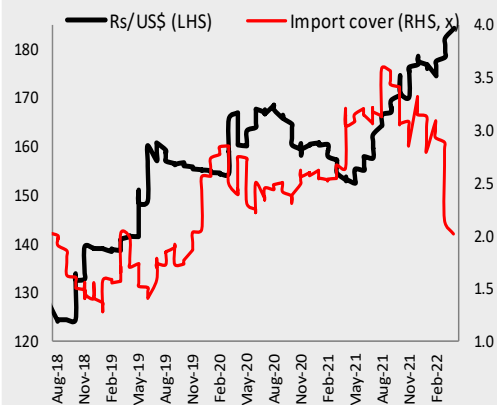
Future path of policy rate would be contingent upon CAD and cooling-off of commodity prices. Therefore, we advise to go long on sectors that are immune to elevated interest rates and least affected by fiscal consolidation. We have liking for E&P, Banks, Fertilizers and Conglomerates while advice caution towards Cements, Auto and Steel. We prefer OGDC, PPL, HBL, UBL, ENGRO, LUCK, PSO, MARI, INDU, LUCK, FFC, FFBL & APL.

CPI vs policy rate



Source: SBP, Foundation Research, Apr 2022

Rupee against greenback



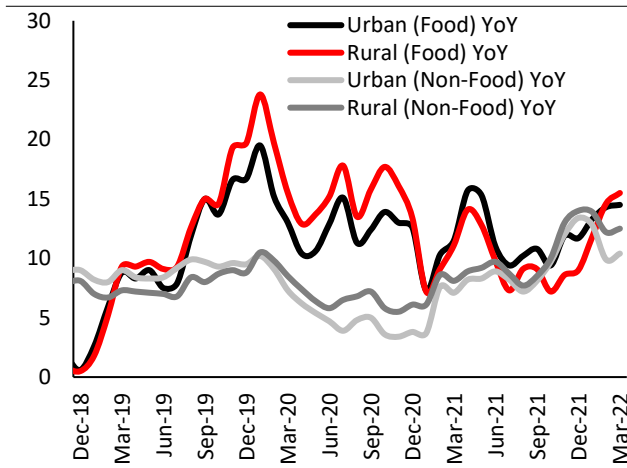
Source: SBP, Foundation Research, Apr 2022

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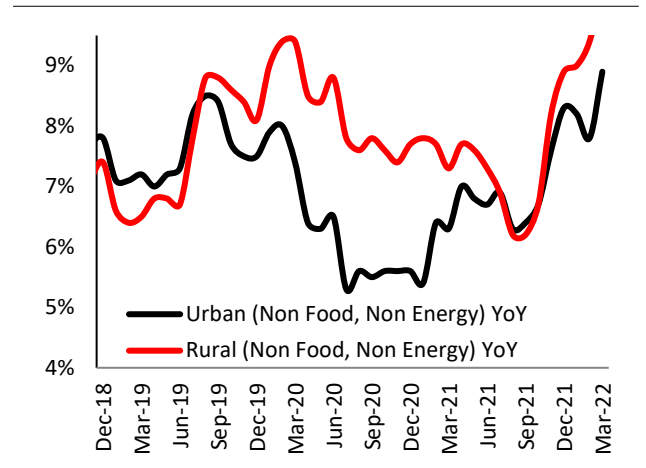
Foundation Securities (Pvt) Ltd  
Friday, April 8, 2022

**Fig 1: Food and non-food inflation trending upwards...**



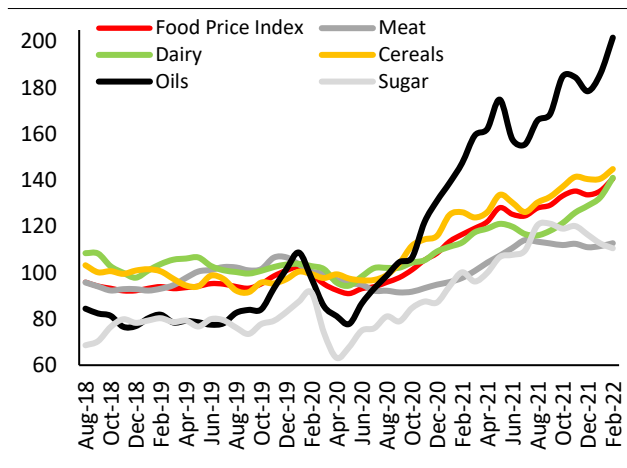
Source: PBS, Foundation Research, Apr 2022

**Fig 2: Core inflation escalating...**



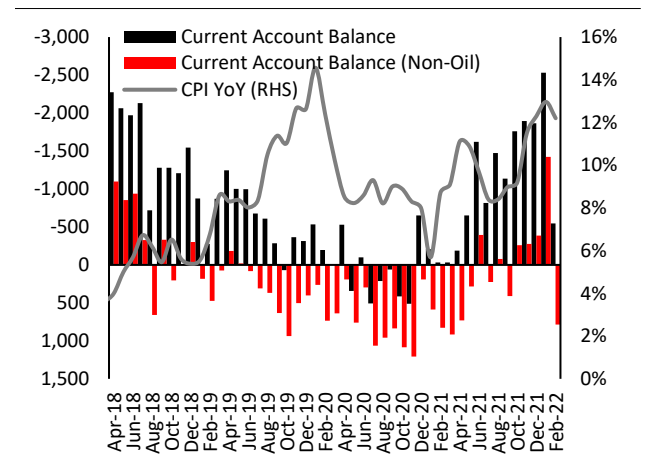
Source: PBS, Foundation Research, Apr 2022

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



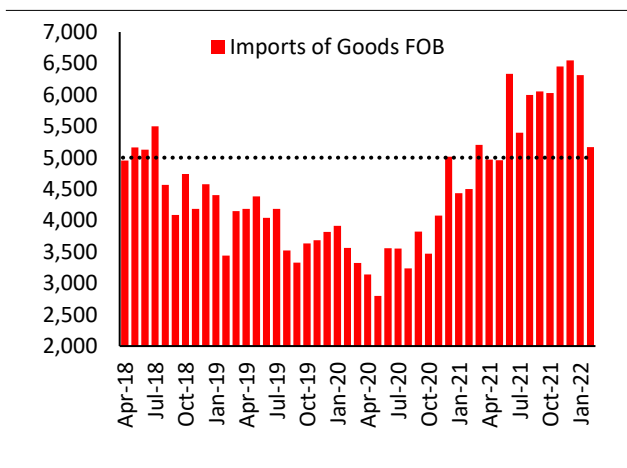
Source: FAO, Foundation Research, Apr 2022

**Fig 4: Current account and CPI**



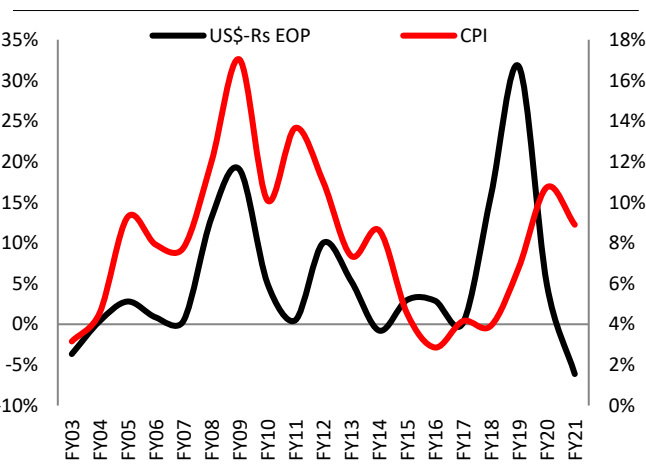
Source: SBP, PBS, Foundation Research, Apr 2022

**Fig 5: Goods import remain elevated (US\$ bn)**



Source: SBP, Foundation Research, Apr 2022

**Fig 6: Exchange rate and inflation move in tandem**



Source: Bloomberg, SBP, FSL Research, Apr 2022

Table 01: Impact of 250bps on company's profitability (Rs mn)

Company/Sector	Total Debt	Cash & ST investment	Impact Rs/sh	Comment
<b>E&amp;P</b>				
<b>Positive</b>				
OGDC	-	147,665	0.67	Strong cash position to yield positive results
POL	-	51,978	3.57	Strong cash position to yield positive results
PPL	-	57,698	0.41	Strong cash position to yield positive results
MARI	732	36,234	5.19	Strong cash position to yield positive results
<b>Banks</b>				
<b>Positive</b>				
HBL	-	-	5.02	Uptick in interest rates to increase NII
UBL	-	-	3.80	Uptick in interest rates to increase NII
MCB	-	-	3.78	Uptick in interest rates to increase NII
MEBL	-	-	5.57	Uptick in interest rates to increase NII
BAFL	-	-	2.19	Uptick in interest rates to increase NII
AKBL	-	-	1.98	Uptick in interest rates to increase NII
FABL	-	-	1.53	Uptick in interest rates to increase NII
<b>Fertilizer</b>				
<b>Positive</b>				
ENGRO	58,957	123,177	2.17	Includes ENGRO standalone, EFERT, ENGRO Enfrshare and EPCL debt
FATIMA	12,049	2,165	(0.08)	Profitability to further reduce in case of concessionary GIDC payment
FFBL	53,995	53,293	(0.01)	Debt adjusted for FFBL Power Supply to KEL
FFC	60,198	96,386	0.55	Strong cash position to yields positive results
EFERT	26,533	16,504	(0.12)	Increased working WCC to hurt trading business profitability
<b>Steel</b>				
<b>Negative</b>				
ISL	23,425	144	(0.87)	Working capital cost to increase
ASTL	19,976	185	(1.08)	Working capital cost to increase
ASL	29,141	305	(0.51)	Working capital cost to increase
MUGHAL	28,020	2,747	(1.22)	Working capital cost to increase
AGHA	23,718	476	(0.62)	Working capital cost to increase
INIL	39,675	728	(4.80)	Working capital cost to increase
<b>Cements</b>				
<b>Negative</b>				
LUCK	23,542	25,598	0.12	Higher cash availability and Income from investments to reduce the impact
KOHC	5,180	6,983	0.17	Strong cash position to yield positive results
BWCL	19,206	4,220	(0.41)	New expansion to further hurt profitability due to higher interest rates
ACPL	8,119	2,979	(0.61)	New expansion to further hurt profitability due to higher interest rates
FCCL	2,682	7,569	0.07	Strong cash position to yield positive results
POWER	27,670	245	(0.42)	Negative impact due to higher leverage
MLCF	17,813	627	(0.25)	New expansion to further hurt profitability due to higher interest rates
DGKC	47,225	3,538	(1.62)	Negative impact due to higher leverage
PIOC	27,018	1,474	(1.83)	Negative impact due to higher leverage
CHCC	15,860	139	(1.31)	New expansion to further hurt profitability due to higher interest rates
<b>Refinery</b>				
<b>Negative</b>				
ATRL	9,982	10,256	0.05	Strong cash position to yield positive results
NRL	35,324	602	(7.06)	Would increase finance cost due to high leverage
PRL	23,068	274	(0.59)	Would increase finance cost due to high leverage
BYCO	42,648	1,255	(0.13)	Would increase finance cost due to high leverage
<b>Autos</b>				
<b>Positive</b>				
HCAR	3,216	17,687	1.98	Earnings to increase due to strong cash position
PSMC	1,737	23,271	5.10	Earnings to increase due to strong cash position
MTL	3,627	690	(0.59)	Working capital cost to increase
INDU	-	98,546	24.45	Earnings to increase due to strong cash position

Source: Company Accounts, Foundation Research, April 2022

Table 01: Impact of 250bps on company's profitability

Company/Sector	Total Debt	Cash & ST investment	Impact	Comment
<b>OMCs</b>			<b>Negative</b>	
APL	6,779	13,642	1.34	Net positive impact due to higher cash position
PSO	168,223	3,531	(5.70)	Would increase finance cost due to high leverage
SHEL	9,627	4,973	(0.35)	Working capital cost to increase
HTL	1,745	619	(0.13)	Working capital cost to increase
HASCOL	68,057	1,799	(1.08)	Would increase finance cost due to high leverage
<b>Chemical</b>			<b>Negative</b>	
EPCL	25,681	15,748	(0.18)	Would increase finance cost due to high leverage
LOTCHEM	1,760	15,306	0.17	Earnings to increase due to strong cash position
ICI	12,205	246	(2.10)	Working capital cost to increase
<b>FMCG</b>			<b>Negative</b>	
FCEPL	5,531	2,346	(0.07)	Working capital cost to increase
MFL	8,205	146	(1.07)	Working capital cost to increase
FFL	8,163	1,874	(0.06)	Working capital cost to increase
ASC	2,399	17	(0.13)	Working capital cost to increase
TOMCL	751	118	(0.08)	Working capital cost to increase
PREMA	918	167	(0.06)	Working capital cost to increase
UNITY	18,198	12,627	(0.08)	Working capital cost to increase
<b>Cable &amp; Electrical</b>			<b>Negative</b>	
PAEL	18,608	613	(0.59)	Take toll of reduction in consumer financing
PCAL	4,477	122	(1.99)	Take toll of reduction in consumer financing
WAVES	6,360	125	(0.36)	Working capital cost to increase
<b>Textile</b>			<b>Negative</b>	
NML	54,332	1,703	(2.43)	Working capital cost to increase
ILP	46,458	636	(0.83)	Working capital cost to increase
<b>Technology</b>			<b>Neutral</b>	
SYS	3,065	7,845	0.34	Earnings to increase due to strong cash position
AVN	539	1,315	0.06	Earnings to increase due to net cash position
NETSOL	1,775	3,083	0.28	Earnings to increase due to net cash position
TELE	945	2	(0.05)	Working capital cost to increase
TPLT	2,609	165	(0.21)	Working capital cost to increase
AIRLINK	5,826	1,847	(0.16)	Working capital cost to increase
HUMNL	648	466	(0.00)	Working capital cost to increase

Source: Company Accounts, Foundation Research, April 2022

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