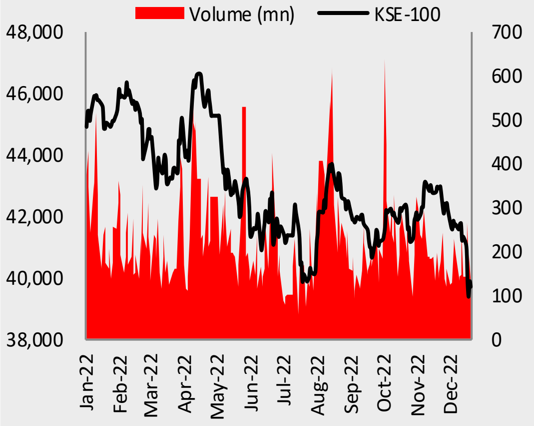
Pakistan

Inside **Page No.**

Historical Trend of KSE100



Source: PSX, Foundation Research, January 2023
All prices are as of December 30, 2022

Analysts
Research research@fs.com.pk
+92 21 35612290 EXT: 312

Pakistan Strategy

KSE-100 – A paradox of opportunity

Market to reach 47,308 by Dec-23

Pakistan equities are set to post positive returns in CY23, on the back of ease in concerns on external account along with monetary easing in 2HCY23 amid settlement of political noise post elections. We expect the KSE100 index to reach 47,308 implying a return of ~17.0% (~11.5% in US$ terms) as rebound in agriculture activity and materialization of flood aid would help in rejuvenation of economic growth. Moreover, continuation of IMF program along with strong government in the centre post elections would help the market to rally. The benchmark KSE100 is trading at 4.88x PE, which is at a 51% discount to MSCI FM index and accompanied by dividend yield of ~8.9%.

KSE100 in CY22 – A turbulent year

Exit from FATF “Grey List” was overshadowed by political uncertainty and growing concerns over depleting reserves given ballooning of Current Account Deficit and external debt payments. CY22 proved to be a turbulent year, early on turned to concerns of Russia-Ukraine war and political noise while in later half persistent inflation and mounting external debt repayments amid depleting reserves remained cause of concern. Subsequently, KSE-100 closed the year in red with return of ~9.1% in CY22 (barring dividend yield of 9.5%). Moreover, Rupee depreciation of 21.7% has aggravated the loss to 28.8% in US$ terms.

Pakistan to remain under IMF supervision with hiccups

We expect Pakistan to remain in IMF program and would have to enter the next one to build comfort of international partners in order to secure mounting external debt repayments. However, program is likely to face hiccups due to delay in implementation of unpopular decisions given heightened political noise as the country is approaching elections. Moreover, we expect government to implement conditionality of rationalization of energy prices and mobilization of revenue through non-tax revenue to meet fiscal targets along with reduction in public sector development spending.

Materialization of flood aid to ease pressure on external account

Materialization of commitments (~US$14bn) from bilateral and multilateral partners would provide much needed breather to Pakistan to meet its external debt liabilities. Meanwhile, we are confident that close friends of the country would continue to provide assistance through roll overs and enhancement of existing facilities which forms ~43% of country’s 12 months external financing needs.

Stay with quality until opportunities emerge

We look for stocks that are immune to currency depreciation and monetary tightening along with beneficiary of energy sector reforms. We are ‘Overweight’ on Banks, E&P, Fertilizer, OMCs and Textile. We are ‘Market Weight’ on Power, Cement, Autos and Engineering. While we are ‘Under Weight’ on Technology, Consumers and Chemicals as we expect slowdown in local and export destinations to hit revenue growth and slow down cash flow generation.

Top-picks

Large Cap: OGDC, PPL, MARI, ENGRO, LUCK
Mid Cap: MCB, FFC, UBL, PSO
Small Cap: ILP

Table 1: Pakistan top conviction ideas

Stock	Sector	Mcap US$ mn	Reason for liking
Large Cap			
OGDC	E&P	1,562	Largest oil (33%) and gas (34%) reserves in Pakistan Beneficiary of circular debt resolution and energy sector reforms Better pricing regime on new gas finds Expansion into Overseas offshore block in Abu Dhabi Diversification into mining through 8.33% stake in Reko Diq
PPL	E&P	914	Beneficiary of circular debt resolution and energy sector reforms Working interest in Gambat, Margand, Nashpa and Tal blocks Expansion into Overseas offshore block in Abu Dhabi Diversification into mining through 8.33% stake in Reko Diq
MARI	E&P	899	Commissioning of Sachal Gas processing facility to add 200mmcfd of gas Commencement of flows from Bannu West Potential finds in Block 28 Expansion into Overseas offshore block in Abu Dhabi
ENGRO	Fertilizer	724	Project completion of EPTL Inorganic growth in Enfrashare through acquisition Positive outcome of PDH & PP complex feasibility study Materialization of wind projects
LUCK	Cement	618	Project completion of 660MW LEPCL Decline in coal prices Resumption of exports Better than expected cement prices
Mid Cap			
MCB	Banks	599	Prudent asset deployment with IDR/ADR at 67%/42% Lower provisioning expense Sufficient CAR buffer over regulatory requirement Higher CASA
FFC	Fertilizer	574	Strong balance sheet even after payment of GIDC Urea pricing power Expansion into DAP and fertilizer plant in Tanzania Revival of dividend from FFBL, AKBL and TEL
UBL	Banks	545	Sufficient capital buffer Focus on deposit growth through current accounts Expected decline in provisioning expense given absence of one-offs
PSO	OMC	300	Circular debt resolution is key IMF reform agenda to reduce balance sheet stress Increase in OMC margins Reduction in furnace oil consumption given higher electricity generation cost Improvement in dividend payout
Small Cap			
ILP	Textile	233	Rupee devaluation Continuation of subsidized energy tariffs Diversification into apparels and aggressive expansion plan

Source: Foundation Research, January 2023

KSE-100 – A paradox of opportunity

Politics – Political noise to remain heightened

The change in political government through constitutional and democratic vote of no-confidence has shown maturity of Pakistan's political system.

- Since takeover, Government is feeling the pressure of economic adjustments which has been driven by elevated commodity cycle and backlog of prior year adjustments amid depleting country foreign exchange reserves.
- Efforts for gaining public support to win the upcoming elections would delay reform process even under the IMF program, in our view.
- Pakistan maintained enhanced frequency of high-level exchanges with friends and partners with increased in person meetings.
- Coming out of the FATF grey list, commitments of US$10.6bn for flood recovery, rollover of U$3bn Saudi deposits, commitment from UAE to rollover US$2bn with additional US$1bn loan facility, and willingness from China to rollover US$3bn deposit and US$3.3bn commercial loan with extension in trade line to US$4.2bn is the success of Pakistan's improved diplomatic relationships
- Supportive and conducive role of institutions would help the government with implementation of its consolidation policies.
- We expect political environment to remain challenging till elections while resolution of Afghanistan governance issue would ease investor's concerns.

A resilient economy

Economic growth would slowdown in CY23 with the services sector expected to make up for declines in agricultural and industrial activity.

- The main theme of CY23 would be the heightened pressure on external accounts amid hiccups in release of IMF tranches and slow debt rollovers with lingering possibility of debt repayment crisis amid continuous bleeding of FX reserves.
- Gov't agreeing to taxation measures to make up for shortfall in tax collection and circular debt management plan measures would pave the way for release of held up IMF tranche, and other multilateral and bilateral flows easing the concerns on debt repayments.
- Fiscal deficit is projected to decline to 7.0% of GDP in FY23. We believe IMF program would impose fiscal discipline on Gov't. Non-tax collection is projected to post strong growth amid likely increase in GIDC/Petroleum Levy.
- **Macro Picture**
  - ✓ Pakistan GDP growth is likely to slow down to 1.1% in FY23 vs 6.0% in FY22 given monetary and fiscal tightening along with prioritization of imports.
  - ✓ CAD is likely to decrease to US$7.4bn in FY23 (2.1% of GDP) vs US$17.3bn in FY22 (4.5% of GDP), on the back of decline in imports of goods. We expect CAD to increase to US$10.0bn in FY24 due to increase in imports as monetary easing starts.
  - ✓ Resumption of IMF program along with assistance from friendly nations would result in FX reserves of US$9.2bn despite external debt repayments of US$24.2 from Dec'22 to Nov'23.
  - ✓ Exchange rate is projected to follow a gradual depreciation in CY23 amid Gov't push to maintain stablity in FX market. We forsee the US$ to be Rs235.1 by Jun-23 while around Rs243.0 at the end of CY23.
  - ✓ Budget deficit to decline to 7.0% of GDP in FY23 from 7.9/7.1/8.1% of GDP in FY22/21/20 given higher FBR tax revenue, Petroleum Levy and GIDC collection despite higher expenditures.
  - ✓ Inflation would remain high given lagged affects of currency depreciation, supply chain disruption and rationalization of gas and electricity prices to average around 23.7% in FY23 against 12.2% YoY in FY22.
  - ✓ Central bank is expected to hold interest rates at the current level for the remainder of FY23 before beginning monetary easing in 1HFY24.

Pakistan to remain under IMF supervision with hiccups

Pakistan to remain in IMF program and would have to enter the next one to build comfort of international partners in order to secure mounting external debt repayments, in our view. At the last review (combined 7th and 8th) of the IMF program, the total size of the program was enhanced from US$6.0bn to US$6.5bn and extended from Sept'22 to Jun'23. To complete the review, the gov't took important measures to address worsened fiscal and external positions resulting from accommodative policies in FY22 and spillovers from the war in Ukraine, and which have placed significant pressure on the rupee and FX reserves. However, deviations from conditionality has prevented completion of the 9th review. The IMF program aims to restore fiscal discipline and debt sustainability while protecting social spending, safeguarding monetary and financial stability, and maintaining a market-determined exchange rate and rebuilding external buffers.

Flood aid to support external account

- During 1QFY23, torrential rains and a combination of riverine, urban, and flash flooding led to an unprecedented disaster in Pakistan. The total damage is estimated at US$14.9bn, total loss at US$15.2bn, and total needs at US$16.3bn.
- The sectors that suffered the most damage are housing at US$5.6bn; agriculture, food, livestock, and fisheries at US$3.7bn; and transport and communications at US$3.3bn.
- Pakistan will receive inflows of US$14.6bn out of which US$4.0bn pledged by international donors under emergency aid while remaining commitments were received by Pakistan at Geneva meeting.

Defensive sectors to boost index profitability

- Using FSL universe as a proxy (~65% of FF Mcap), we forecast an average earnings growth of ~17.0% in CY23.
- Bank would be the primary contributor to earnings growth, followed by E&Ps, Fertilizer, Technology, Power and Textile.
- Banks to remain beneficiary of surge in Net Interest Income (NIIs) amid higher Net Interest Margins (NIMs) due to increase in policy rate.
- E&P and OMC sector would remain primary beneficiary of resolution of circular debt and rationalization of gas prices.
- Fertilizer sector is expected to benefit from government policies to ensure food security. However, collection of GIDC would hit the sector the most.
- Textile sector is likely to remain beneficiary of govt's supportive policies and subsidized energy availability.

Approaching the stock market

- **Earnings growth approach:** We have adopted an earnings growth approach for Pakistan equities in CY23 and have arrived at a modest KSE100 index target of 47,308 by December 2023, implying a return of ~17.0% (~11.5% in US$ terms) along with an impressive dividend yield of ~8.9%.
- Moreover, we do not foresee rerating in market current PE multiple given elevated external debt repayments amid political uncertainty. However, we could not rule out rerating in the current PE multiple if the new government comes with a strong mandate, from its current value of 4.88x to 6.07x, which is still lower than one negative standard deviation of average market multiple since 2010.

Sector Position

- We are 'Overweight' on Banks, E&P, Fertilizer, OMCs and Textile, and are 'Market Weight' on Power, Cement, Engineering and Autos. We are 'Underweight' on Technology, Consumer and Chemicals.

Table 2: Valuations of stocks in the portfolio

Stocks	Reco	CMP	TP	Mkt Cap US$ mn	PE (X)		PB (X)		DY (%)	
					23E	24E	23E	24E	23E	24E
Large Cap										
OGDC	O-PR	82.3	137.8	1,562	1.9	2.0	0.3	0.3	9.7	10.9
PPL	O-PR	76.1	138.6	913	2.2	2.0	0.4	0.3	2.6	2.6
MARI	O-PR	1,528.3	2,096.6	900	3.9	3.2	1.0	0.8	9.2	9.8
ENGRO	O-PR	284.7	322.1	724	6.5	6.1	0.5	0.5	5.3	7.0
LUCK	O-PR	433.1	595.4	618	4.7	3.9	0.6	0.5	-	-
Mid Cap										
MCB	O-PR	114.5	154.0	598	3.0	3.4	0.7	0.7	21.0	21.0
FFC	O-PR	102.3	132.9	574	5.9	4.8	2.3	2.1	13.7	17.8
UBL	O-PR	101.0	143.5	545	2.9	2.7	0.5	0.5	15.8	15.8
PSO	O-PR	145.0	227.9	300	2.2	1.2	0.3	0.2	8.3	16.5
Small Cap										
ILP	O-PR	56.5	101.3	233	3.4	3.1	1.3	0.9	3.4	11.9

Source: Foundation Research, January 2023
*Prices are of December 30'2022

Political noise to remain heightened

Popular decision making for gaining masses support to slowdown reform process

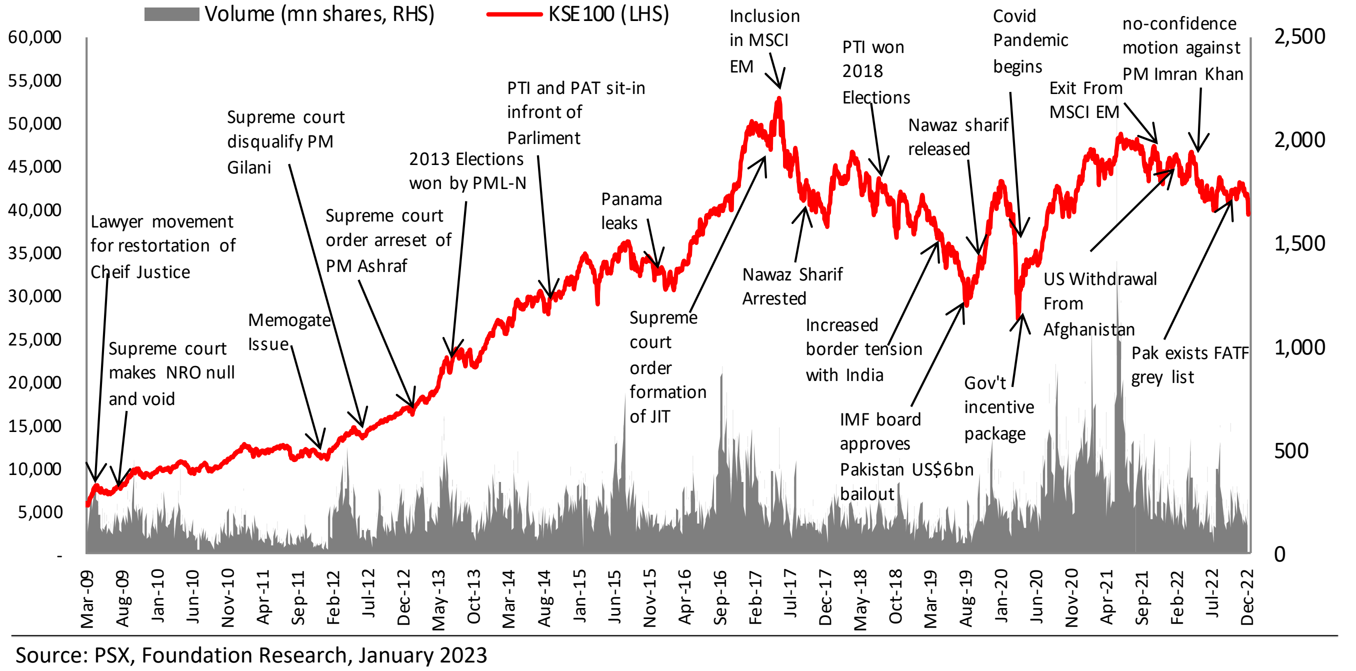
The change in political government through constitutional and democratic vote of no-confidence has shown maturity of Pakistan's political system. Ex-Prime Minister Imran Khan fell prey to the first-ever successful Vote of No Confidence in Pakistan's Parliamentary history which he lost the confidence of the house by 174 votes. Subsequently, Pakistan Democratic Movement (PDM), which is a coalition of political parties started in Sep'20, took over the office in Apr'22.

Since then, government is feeling the pressure of economic adjustments which has been driven by elevated commodity cycle and backlog of prior year adjustments amid depleting country foreign exchange reserves. The inflationary pressures are more daunting in comparison to peers as impact of elevated commodity prices becomes more aggravated due to floods and significant rupee depreciation.

Government is committed to give priority to economics over populism as it has taken number of unwelcome decisions to slowdown the pace of depleting foreign exchange reserves due to higher external debt payments and ballooning Current Account Deficit. The current economic scenario has compelled government to take unpopular decisions including rationalization of electricity and petroleum prices, monetary tightening, increased taxes on businesses, broadening taxation on real estate, bringing foreign assets under tax net, imposition of import restrictions for BOP management etc. Going forward, maintaining fiscal discipline and rationalization of gas prices along with settlement of circular debt would remain key challenge for the government while approaching elections. The situation could be more challenging when government implements the reforms needed to complete the IMF program required for external account sustainability.

However, efforts for gaining public support to win the upcoming elections would delay reform process even under the IMF program, in our view. However, legislation process would become swifter given lack of opposition in lower house as majority of the bills were brought through lower house after vote of no-confidence against earlier precedent of Presidential Ordinance.

Fig 01: Regional and internal political noises kept the index under pressure in last five years



Source: PSX, Foundation Research, January 2023

Moreover, the institutions have taken on a supportive and conducive role, to help the government with implementation of its consolidation policies. In recent National Security Committee, comprising of both elected and military leadership, meeting the members underscored that comprehensive "National Security" revolves around economic security and that sovereignty or dignity comes under stress without self-sufficiency and economic independence.

Pakistan maintained enhanced frequency of high-level exchanges with friends and partners with increased in person meetings as COVID ends. During the first half former Prime Minister visited China and Russia while in the later half current Prime Minister visited China, Saudi Arabia, United States and countries in Asia and Europe. Coming out of the FATF grey list is the success of Pakistan's improved diplomatic relationships. Moreover, visits of UN Secretary-General; Secretary General of OIC; Secretary General of SCO and UN High Commissioner for Human Rights to Pakistan also contributed to enhanced cooperation between Pakistan and these organizations.

Since Aug'21, Pakistan has pursued continuous and practical engagements with interim Afghan government for maintaining peace in the region. As a firm adherent of a regional approach to the situation in Afghanistan, Pakistan participated in meetings and mechanisms aimed at promoting peace in Afghanistan including Meetings of the Neighboring Countries of Afghanistan as well as Troika Plus in the month of March in China. Pakistan also participated in the Moscow Format talks held in Moscow on Nov'22.

Humanitarian assistance of more than US$4bn from nearly 30 countries and five multilateral institutions for flood relief operations under the umbrella of Flood Response Plan (RFP) and Urgent UN Flash Appeal is another success of the country. The UN Secretary General along with Prime Minister of Pakistan co-hosted an International Conference on Climate-resilient Pakistan in Geneva on January 9'2023 which enabled commitments of US$10.6bn for Pakistan's recovery, rehabilitation and reconstruction in climate resilient manner.

We believe elevated commodity prices and slowing economy would make it challenging to impose additional fiscal measures and structural reforms along with providing relief to the masses. Moreover, we expect political environment to remain challenging till elections while resolution of Afghanistan governance issue would ease investor's concerns.

Table 03: Will the KSE-100 history repeat itself in Election 2023?

	Prior			Post		
	9-months	6-months	3-months	3-months	6-months	9-months
General Elections 2018	0%	-8%	-10%	-5%	-3%	-12.0%
General Elections 2013	18%	25%	15%	16%	15%	30%
General Elections 2008	17%	23%	16%	4%	-12%	-18%
General Elections 2003	28%	42%	12%	13%	33%	34%
General Elections 1997	-15%	10%	13%	-6%	15%	12%
General Elections 1993	0%	22%	10%	61%	81%	72%

Source: PSX, Foundation Research, January 2023

FATF clearance reflects cohesiveness and integration of domestic institutions along with effective communication with International bodies

In Oct'22, The Financial Action Task Force (FATF) has decided by consensus that Pakistan has completed all substantial, technical and procedural requirements of both 2018 and 2021 Action Plans. Subsequently, Pakistan was taken out of the list of jurisdiction under increased monitoring after 52 months of rigorous scrutiny.

The FATF welcomed Pakistan's significant progress in improving its AML/CFT regime. Pakistan has strengthened the effectiveness of its AML/CFT regime and addressed technical deficiencies to meet the commitments of its action plans regarding strategic deficiencies that the FATF identified in June 2018 and June 2021, the latter of which was completed in advance of the deadlines, encompassing 34 action items in total.

Despite many challenges, including COVID-19 pandemic, Pakistan continued the reform trajectory and sustained the high-level political commitment of aligning its domestic AML/CFT regime with international best practices. Pakistan made enormous progress in the Anti Money Laundering and Countering Financing of Terrorism (AML/CFT) domain over the course of fulfilling requirements of both Action Plans.

Removal of Pakistan from "grey list" reflects cohesiveness and integration of country's institutions. Multiple ministries, departments and agencies, both at the Federal and Provincial levels, along with legislative bodies contributed to achieving this national objective. The engagement with FATF has led to strategic improvements in Pakistan's laws and procedures, making its domestic AML/CFT regime more resilient to cope with current and future challenges.

Pakistan's exit from FATF "grey list" was also one of the conditionality of IMF program. The impact of this significant development is undermined by deteriorating foreign exchange reserves given higher commodity prices and local production lost due to floods amid global monetary tightening and capital outflow from emerging economies, in our view. The same has been reflected in significant currency depreciation over the course of last nine months.

We believe, the impact of getting clean bill of health from International dirty money watchdog would help the country to attract Foreign Direct Investment and equity investment once international supply chain normalizes and global Central Banks start monetary easing.

Table 04: FATF/APG effectiveness and technical compliance ratings

IO.1 Risk, policy and coordination	**IO.2** International cooperation	**IO.3** Supervision	**IO.4** Preventive measures	**IO.5** Legal persons and arrangements	**IO.6** Financial intelligence
Low	**Moderate**	**Low**	**Low**	**Low**	**Low**
IO.7 ML investigation and prosecution	**IO.8** Confiscation	**IO.9** TF investigation and prosecution	**IO.10** TF preventive measures and financial sanctions	**IO.11** PF financial sanctions	
Low	**Low**	**Low**	**Low**	**Low**	

Technical compliance ratings (C – compliant, LC – largely compliant, PC – partially compliant, NC – non-compliant)

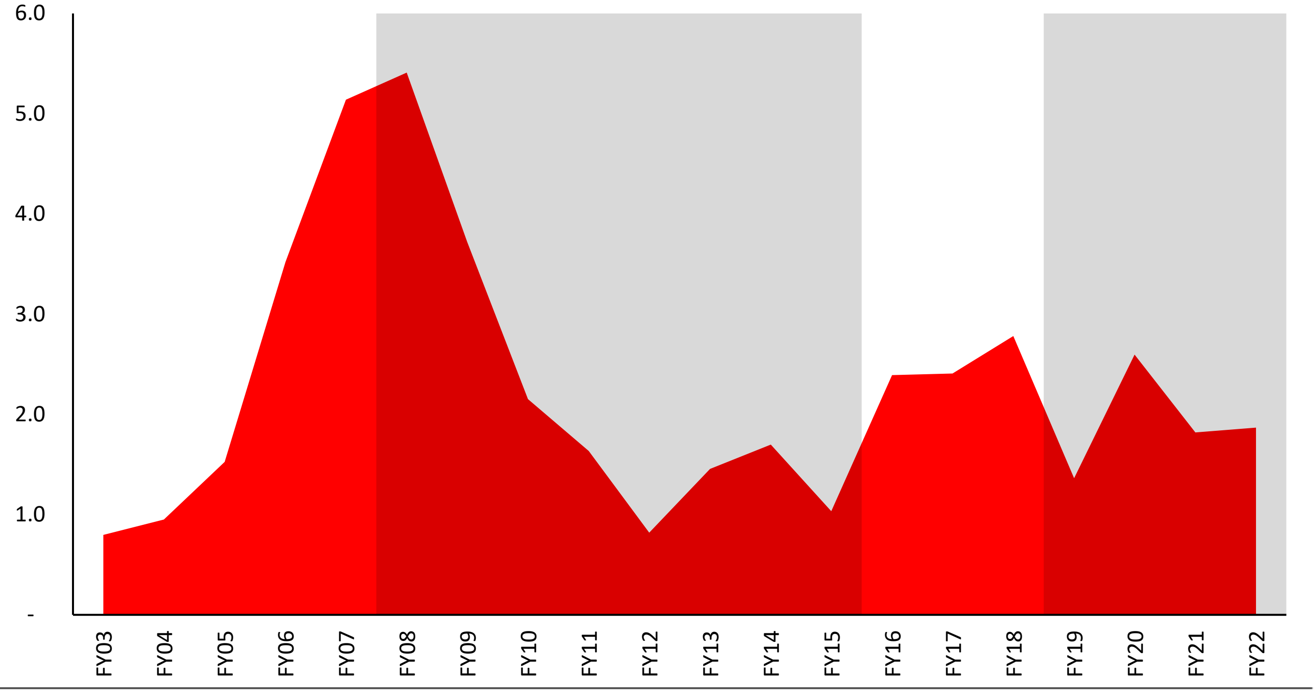
R.1 - Assessing risk & applying risk based approach	**R.2** - National cooperation and coordination	**R.3** - Money laundering offence	**R.4** - Confiscation & provisional measures	**R.5** - Terrorist financing offence	**R.6** - Targeted financial sanctions – terrorism & terrorist financing
LC	**LC**	**LC**	**LC**	**LC**	**LC**
R.7 - Targeted financial sanctions – proliferation	**R.8** - Non-profit organizations	**R.9** - Financial institution secrecy laws	**R.10** - Customer due diligence	**R.11** - Record keeping	**R.12** - Politically exposed persons
LC	**LC**	**C**	**C**	**LC**	**LC**
R.13 - Correspondent banking	**R.14** - Money or value transfer services	**R.15** - New technologies	**R.16** - Wire transfers	**R.17** - Reliance on third parties	**R.18** - Internal controls and foreign branches and subsidiaries
LC	**C**	**PC**	**LC**	**LC**	**LC**
R.19 - Higher-risk countries	**R.20** - Reporting of suspicious transactions	**R.21** - Tipping-off and confidentiality	**R.22** - DNFBPs: Customer due diligence	**R.23** - DNFBPs: Other measures	**R.24** - Transparency & BO of legal persons
C	**C**	**C**	**LC**	**LC**	**LC**
R.25 - Transparency & BO of legal arrangements	**R.26** - Regulation and supervision of financial institutions	**R.27** - Powers of supervision	**R.28** - Regulation and supervision of DNFBPs	**R.29** - Financial intelligence units	**R.30** - Responsibilities of law enforcement and investigative authorities
LC	**LC**	**C**	**PC**	**C**	**LC**
R.31 - Powers of law enforcement and investigative authorities	**R.32** - Cash couriers	**R.33** - Statistics	**R.34** - Guidance and feedback	**R.35** - Sanctions	**R.36** - International instruments
LC	**LC**	**C**	**LC**	**LC**	**LC**
R.37 - Mutual legal assistance	**R.38** - Mutual legal assistance: freezing and confiscation	**R.39** - Extradition	**R.40** - Other forms of international cooperation		
LC	**PC**	**LC**	**PC**		

Source: APG, Foundation Securities, January 2023

Revised upward in 2021

Revised upward in 2022

Fig 02: FDI (US$ bn) fell when Pakistan was in FATF Grey List or High Risk List from Feb'08-Feb'15 and Jun'18-Oct'22



Source: PSX, Foundation Research, January 2023

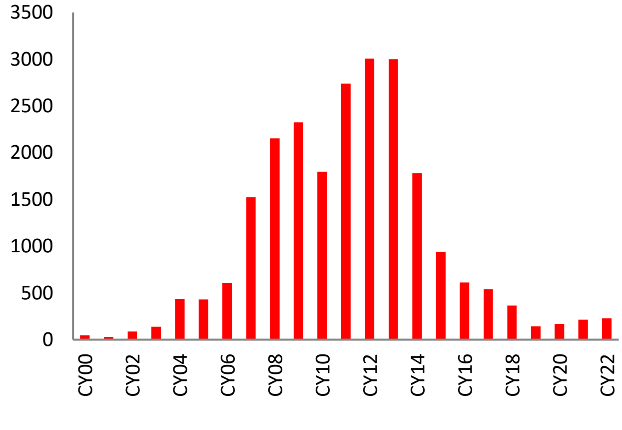
National Security Policy to consolidate improved security situation

Progress on National Security Policy (2022-26), formulated with a citizen centric 'Comprehensive National Security' aims to cater both traditional and non-traditional security challenges has cemented gains of National Action Plan. The same has been reflected in reduced number of terrorist related incidents.

National Security Policy foresees economic growth pivotal to security. It focuses on challenges including economy, food, water, military security, terrorism, population growth and foreign affairs. The NSP seeks to leverage the symbiotic linkages among human, economic and military security with safety and prosperity of general public at the helm of the affairs.

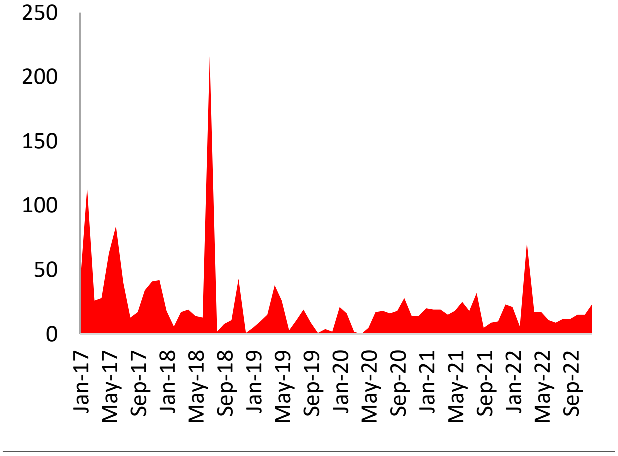
Government's continuous efforts to implement the Anti-Terrorism Act of 1997, the National Counter Terrorism Authority (NACTA) Act, the 2014 investigation for the Fair trial Act, and 2014 amendments to the Antiterrorism Act (ATA) have given law enforcement agencies, prosecutors and courts enhanced powers to counter terrorism. Alongside the aforementioned acknowledged strides in (AML/CFT) policy by FATF, the National Action Plan has similarly improved the perception of security in Pakistan.

Fig 03: Counter terrorism efforts yielding results….



Source: SATP, Foundation Research, January 2023

Fig 04: Incidents dropped during later part of the year



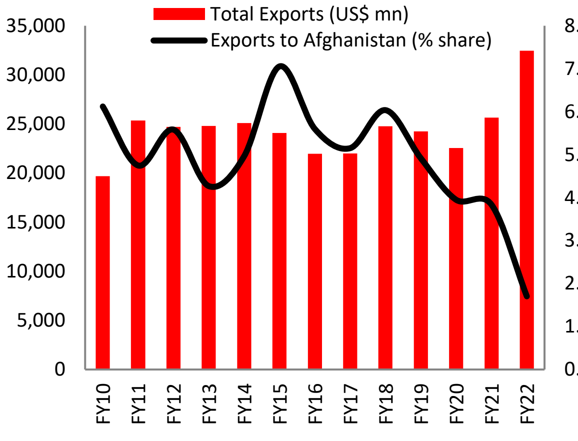
Source: SATP, Foundation Research, January 2023

Pakistan saw positive momentum in relations with the United States, especially with the visits of Foreign Minister, appointment of Ambassador and military assistance to Pakistan. US has appointed a Senate-confirmed Ambassador to Pakistan after a period of four years. United States has also agreed to Pakistan's long standing request for provision of military hardware. United States Humanitarian assistance of US$97mn after the floods is a testament of improving relations.

As a firm adherent of regional approach to the situation in Afghanistan, Pakistan participated in meetings and mechanisms aimed at promoting peace in Afghanistan including Meetings of the Neighbouring Countries of Afghanistan as well as Troika Plus in March in China. Pakistan also participated in the Moscow Format talks held in Moscow in Nov'22. However, some recent incidents on the border with Afghanistan raises concerns on security issues. Moreover, significant economic contraction in Afghanistan and financial sector crisis after the withdrawal of US forces is a concern for Pakistan.

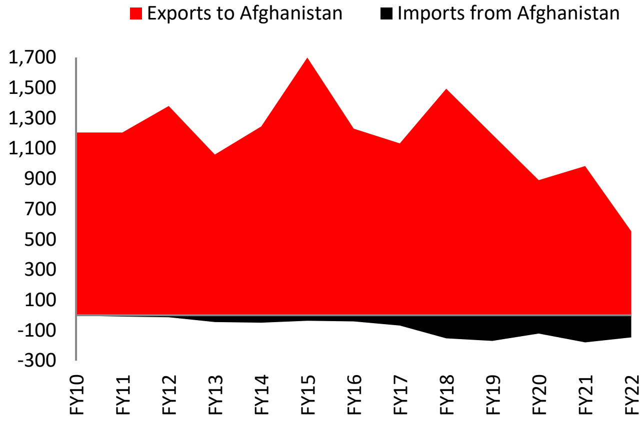
Pakistan demonstrated exemplary restraint in a reaction to incident of firing of Indian supersonic missile into its territory, which is a testament of its systematic maturity and abiding commitment to peace as a responsible nation. Notwithstanding the prevailing tensions, the Ceasefire Understanding of 2003, reaffirmed in February 2021, was upheld at the Line of Control in the interest of regional peace. As a humanitarian gesture, Pakistan allowed India to transport consignments of wheat for the people of Afghanistan. In addition to the Kartarpur Corridor, Pakistan facilitated visit of Indian pilgrims to different shrines.

Fig 05: Official exports to Afghanistan forms a minor share



Source: WB, Foundation Research, January 2023

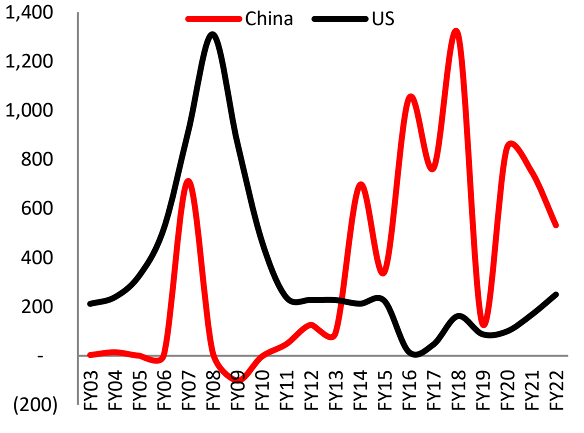
Fig 06: same with the imports (US$ bn)



Source: PBS, Foundation Research, January 2023

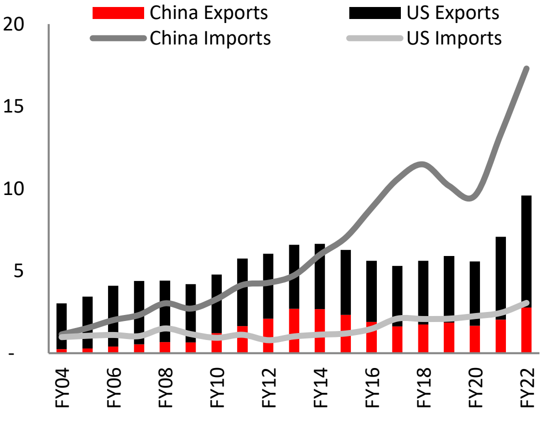
We believe Pakistan's position in the region became more valuable after US withdrawal from Afghanistan given increased reliance of US and China for securing of their vested interest. Increase of more than 50% in FDI from US which is now the highest over a decade and enhanced engagement by senior officials from the US Commerce and Financial Departments with Pakistani leaders is the reflection of Pakistan importance for US. The US's quest to safeguard its interest in the region could play out in Pakistan's favour, while Pakistan's attractive strategic position in China's plan to build greater connectivity in the region through Belt and Road initiative has increased the need of a stable Pakistan in China's interest.

Fig 07: FDI from US gaining momentum (US$ mn)



Source: SBP, Foundation Research, January 2023

Fig 08: US is still imp from trade perspective (US$ bn)



Source: SBP, Foundation Research, January 2023

A resilient economy

Economic growth would slowdown in CY23 with the services sector expected to make up for declines in agricultural and industrial activity. This is an outcome of (1) record floods and (2) Gov't policy and administrative actions to curtail runaway domestic demand and consumption amid overheating witnessed in FY22. However, long term growth potential remains robust given the large economy and population size.

The main theme of CY23 would be the heightened pressure on external accounts amid hiccups in release of IMF tranches and slow debt rollovers with lingering possibility of debt repayment crisis amid continuous bleeding of FX reserves. The current account would not be of material concern during 2023 amid import restrictions, decline in commodity prices from FY22 highs and slowdown in domestic demand amid high interest rates. Inflation is projected at multi decade highs of 23.3% in FY23 amid high fuel and energy prices, high food inflation, high core inflation and steep Rs-US$ depreciation.

Completion of IMF 9th Review is delayed on account of IMF demanding market based exchange rate, further taxation measures to make up for shortfall in tax collection and circular debt management plan. Gov't agreeing to these measures would pave the way for release of held up IMF tranche, and other multilateral and bilateral flows easing the concerns on debt repayments.

Fiscal deficit is projected to decline to 7.0% of GDP in FY23. We believe IMF program would impose fiscal discipline on Gov't. Non-tax collection is projected to post strong growth amid likely increase in GIDC/Petroleum Levy. Expenditures are unlikely to decrease as they consist of mostly current expenditiures which are fixed. Debt servicing is projected to increase substantially given higher interest rates. Whereas development spending would be axed.

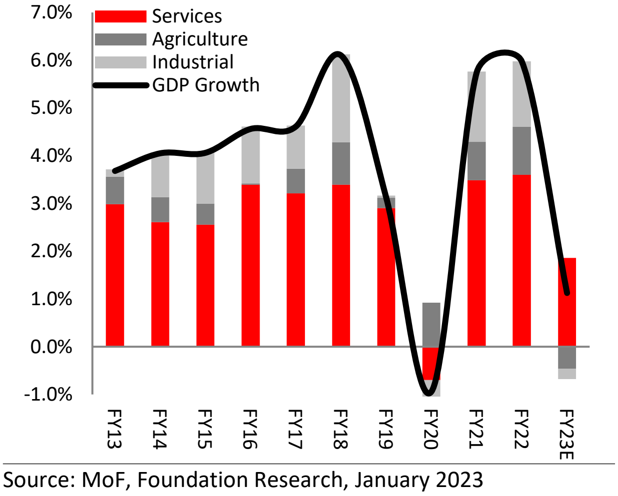
Slowdown in growth

Economic growth would moderate to a tepid pace amid (1) slowdown in domestic demand given after effects of high interest rates and inflation, (2) record floods in southern agricultural heartlands, (3) import restrictions affecting industrial output, (4) higher taxes on income, real estate and automobiles and (5) lower development spending. The hard landing is a direct result of overheating witnessed in FY22 and Gov't efforts to curtail runaway domestic demand and consumption. Some respite would come from services sector whereas agriculture and industrial sector are expected to post negative growth. Thus, we forecast GDP growth of 1.1% in FY23 vs 6.0% observed in FY22.

Large Scale Manufacturing (LSM) has seen recent downward trend with growth falling to -2.9% YoY in 4MFY23 (from 10.5% YoY in FY22) attributable to slowdown in demand, high interest rates, import restrcitions and disruption in gas supply. Segments exhibiting declines were food (↓4.9%), textile (↓24.6%), coke & petroleum (↓15.0%), iron & steel (↓8.5%), chemicals (↓7.7%), fertilizers (↓9.8%), beverages (↓1.2%), pharmaceuticals (↓18.6%), autos (↓30.6%), machinery and equipment (↓38.0%) and non-metallic minerals (↓10.1%). Whereas, electricity generation is down by 8.3% YoY in 5MFY22. Given these trends, we project that LSM would decline by 5.0% YoY in FY23. Business Confidence Index of the central bank has also seen sharp downward trend in 4MFY23.

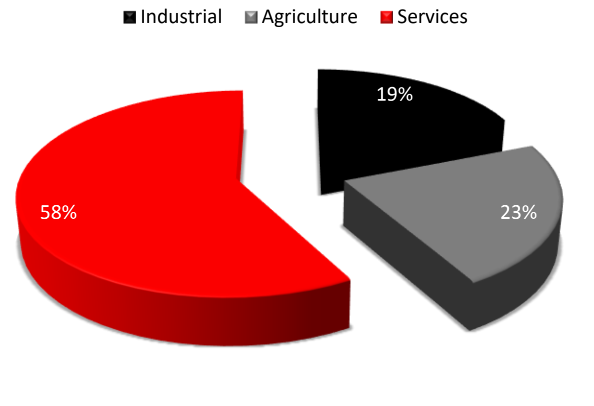
Agriculture would be impacted by the record floods in the southern agricultural heartlands affecting cotton, rice and sugar harvests. This would drive major crops to post a decline of 5.9% YoY pulling down overall agricultural growth to -2.1%. The onus of growth would once again rest with the services sector (58% weight in GDP). In the long term, we believe earnest focus on enhancing exports and structural reforms could return growth to Pakistan's true potential of ~6%.

Fig 9: GDP projected to slowdown



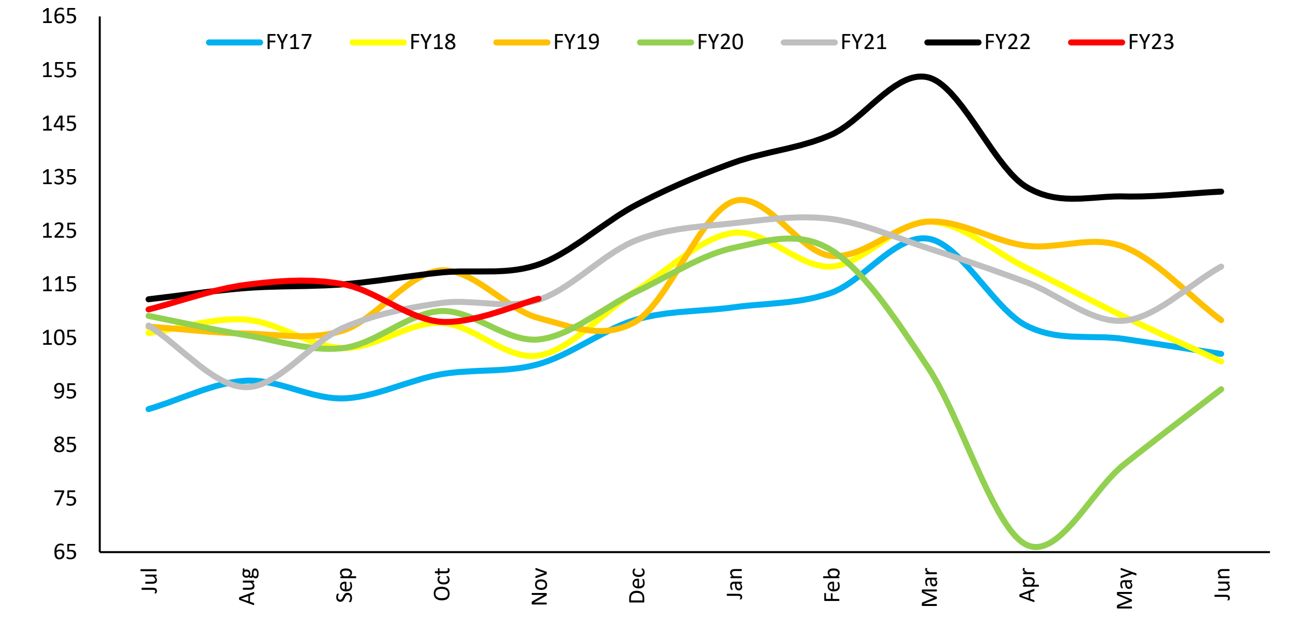
Source: MoF, Foundation Research, January 2023

Fig 10: Sectoral weights in GDP



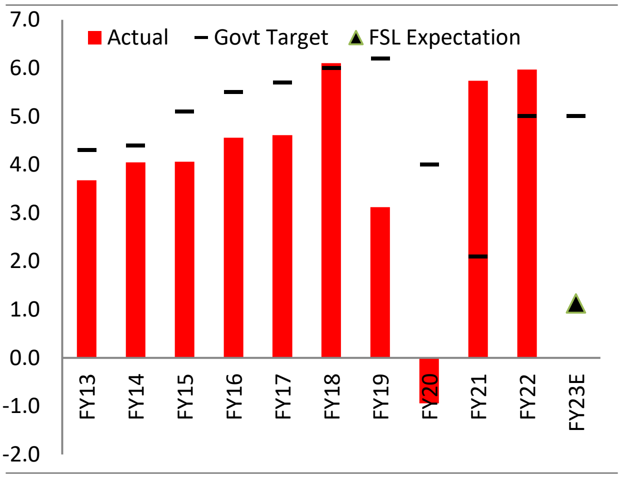
Source: MoF, Foundation Research, January 2023

Fig 11: Large Scale Manufacturing (LSM) index shows marked seasonality…



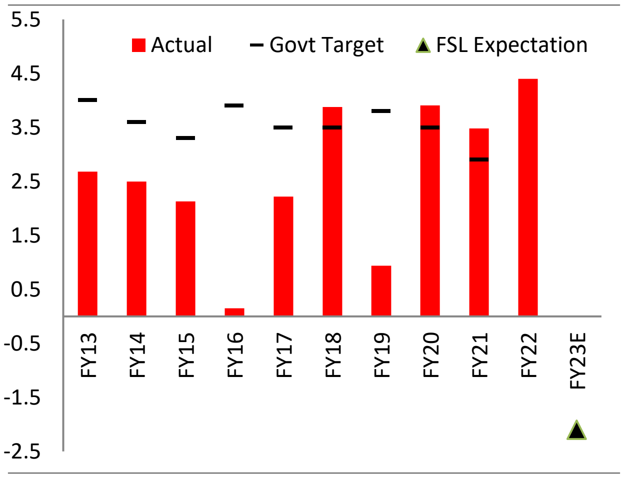
Source: PBS, Foundation Research, January 2023

Fig 12: Projected GDP to grow by 1.1% in FY23…



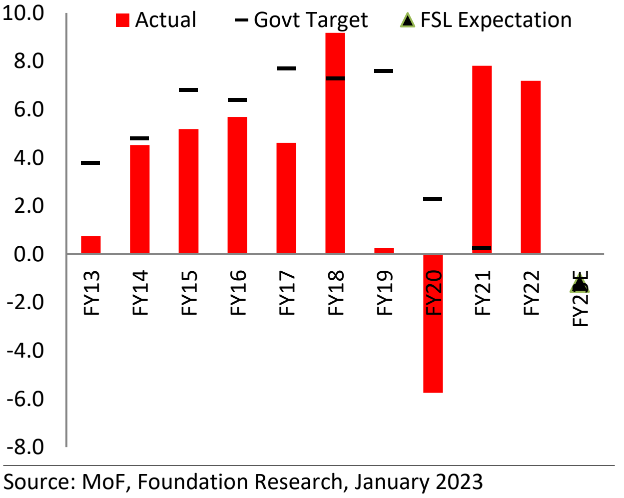
Source: MoF, Foundation Research, January 2023

Fig 13: …as agri to decline amid flood related losses



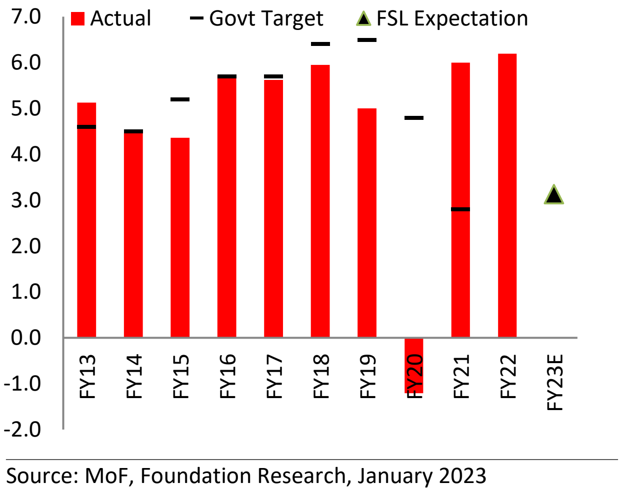
Source: MoF, Foundation Research, January 2023

Fig 14: Industrial growth to decline as well…



Source: MoF, Foundation Research, January 2023

Fig 15: Services to drive with 3.1% YoY growth



Source: MoF, Foundation Research, January 2023

External account in disequilibrium

The main theme of CY23 would be the heightened pressure on external accounts amid hiccups in release of IMF tranches and slow debt rollovers with lingering possibility of debt repayment crisis amid continuous bleeding of FX reserves (down by US$5.4/7.4bn in FY23TD/FY22 to US$4.3bn).

Total debt servicing from Dec'22 to Nov'23 is US$24.2bn which includes deposits repayments of US$9.0bn (US$4.0/3.0/2.0bn from China/Saudi Arabia/UAE). The deposit from Saudi Arabia has been rolled over for 1 year in Dec'22. Pakistan has requested these bilateral creditors to enhance their deposits with Pakistan which would be needed to pay off the short term commercial loans of US$9.0bn alongwith support from multilateral creditors. Pakistan also expects Saudi Arabia to enhance the deferred oil payment facility of US$1.5bn per year. The World Bank and Asian Development Bank have recently approved US$1.7/0.8bn in project related financing for flood affected areas.

The current account would not be of material concern during CY23 as CAD declined by 57% YoY to US$3.1bn in 5MFY23 amid import restrictions, decline in commodity prices from FY22 highs and slowdown in domestic demand amid high interest rates (policy rate up by 725bps in last 12 months). Thus, we expect CAD to clock in at a mangeable US$7.4bn (2.1% of GDP) during FY23. However, FX reserves build up is likely to remain muted amid high debt repayments.

Our FY23 projections for exports are flat YoY given decrease in others (down 32% YoY) and food (down 7% YoY) amid increase in services (up 7% YoY) and textiles (up 5% YoY). Food exports would be down owing mostly to a decline of 20% YoY in rice. Imports are expected to decline by 15% YoY in FY23 driven by double digit declines in machinery, automobiles, metal, miscellaneous and services amid import restrictions. Whereas, petroleum imports are expected to remain flat YoY in FY23 amid volumetric decline given slowdown in domestic economic activity.

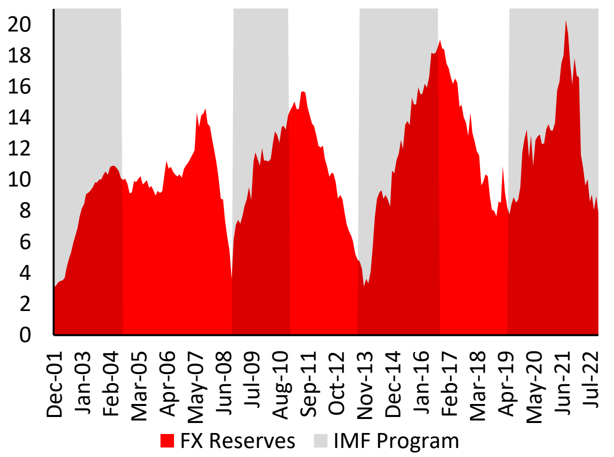
Remittances have declined by 10% YoY in 5MFY23 which we believe is due to (1) resumption of money couriers as cross border travelling returns to normalcy and (2) widening gap between official and unofficial excahnges rates incentivising alternate channels of remittances. This downtrend comes after remittances exceeded the US$2.0bn per month mark for the last 30 months. We believe this decrease is exacerbated by slowdown in global economy despite high oil prices. Thus, we assume a 9% YoY fall in FY23 remittances. It is worth noting that during 5MFY23 remittances have declined from all locations except USA which depicted a 4% YoY increase. Remittances from Middle East have a 55% market share whereas UK/EU/USA have market share of 14/11/11%.

Table 05: Current Account to substantially decline amid economic slowdown and import restrictions

	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Current Account Balance	**(19,195)**	**(13,434)**	**(4,449)**	**(2,820)**	**(17,318)**	**(7,445)**	**(10,044)**
Exports of Goods FOB	24,768	24,257	22,536	25,639	32,467	31,930	32,942
Imports of Goods FOB	55,671	51,869	43,645	54,273	72,043	62,131	66,663
Balance on Trade in Goods	**(30,903)**	**(27,612)**	**(21,109)**	**(28,634)**	**(39,576)**	**(30,201)**	**(33,721)**
Exports of Services	5,851	5,966	5,437	5,945	6,957	7,447	7,819
Imports of Services	12,277	10,936	8,753	8,461	12,087	9,646	10,343
Balance on Trade in Services	**(6,426)**	**(4,970)**	**(3,316)**	**(2,516)**	**(5,130)**	**(2,199)**	**(2,524)**
Balance on Primary Income	**(5,437)**	**(5,610)**	**(5,459)**	**(4,400)**	**(5,258)**	**(5,400)**	**(5,767)**
Balance on Secondary Income	**23,571**	**24,758**	**25,435**	**32,730**	**32,646**	**30,355**	**31,968**
Workers' Remittances	19,914	21,740	23,131	29,450	31,238	28,288	29,707

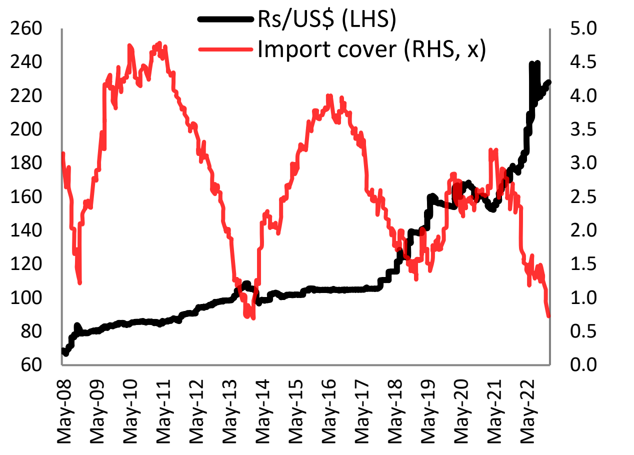
Source: SBP, Foundation Research January 2023

Fig 16: FX reserves under IMF programs (US$ bn)



Source: SBP, Foundation Research, January 2023

Fig 17: Import cover declined to ~22 days



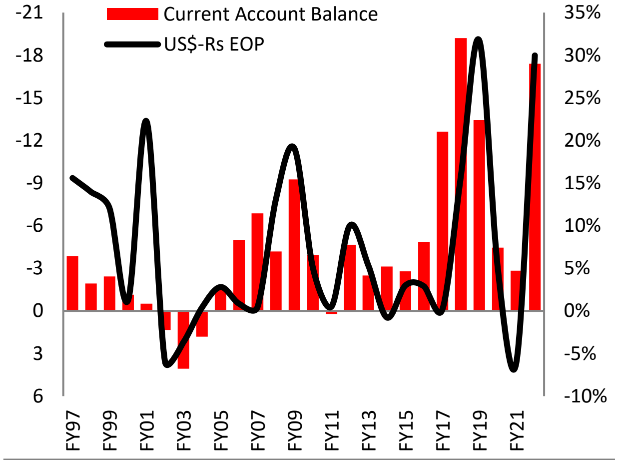
Source: SBP, Foundation Research, January 2023

Exchange rate to revert to stability amid inflows from bilateral and multilateral partners

Exchange rate is projected to follow a gradual depreciation in CY23 amid Gov't push to maintain stablity in FX market. IMF pressure to revert to a market based exchange rate would be resisted by the Gov't given expected increase in deposits from Saudi Arabia/UAE/China, inflows for flood recovery and posturing for elections in 2HCY23. We highlight that the risks to this scenario are tilted towards the downside amid low FX reserves.

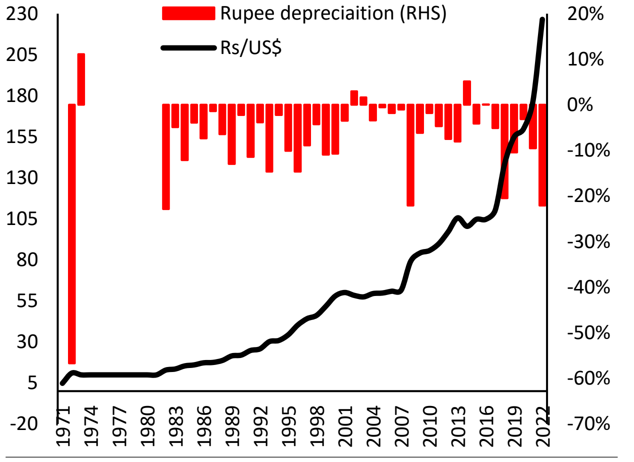
We expect that the Rupee is likely to see 6% depreciation annually (20 year average annual depreciation is ~6.5%). We forsee the US$ to be Rs235.1 by Jun-23 while around Rs243.0 at the end of CY23.

Fig 18: Current account balance (US$ bn) and Rs-US$ (RHS)



Source: SBP, Foundation Research, January 2023

Fig 19: Currency depreciated by ~22% YoY in 2022



Source: SBP, Foundation Research, January 2023

Fiscal deficit to decline amid IMF program discipline

Fiscal deficit is projected to decline to 7.0% of GDP in FY23 from 7.9/7.1/8.1% of GDP in FY22/21/20 given higher FBR tax revenue, Petroleum Levy and GIDC collection despite higher expenditures (mostly current). Debt servicing is projected to increase by 50% YoY given higher interest rates. On the revenue side, direct tax, sales tax, customs duty and excise duty are projected to post growth given 42/3/12/4% YoY growth respectively observed in 1QFY23.

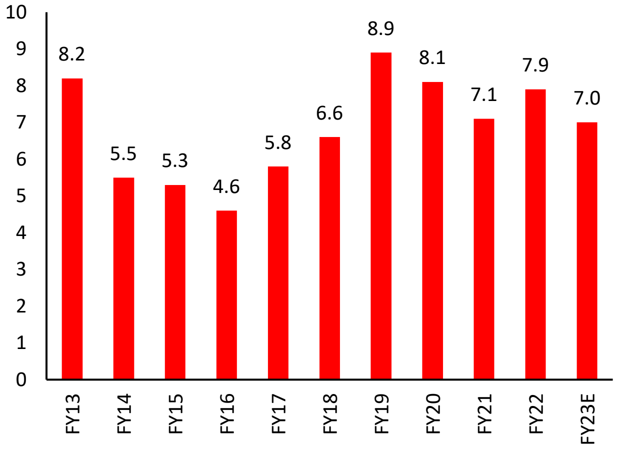
We believe IMF would impose fiscal discipline on Gov't and force it to run primary surpluses (fiscal balance which excludes debt servicing) during the remaining 6 months of the IMF program. However, it seems likely that Gov't would have to take additional tax measures for release of the current IMF tranche. Gas Infrastructure Developmet Cess (GIDC) collection in FY23 is expected to show climb to Rs250bn as Gov't would try to extract maximum collection amidst IMF budgetary requirements. Gov't has increased Petroleum Levy to Rs50/liter on MS and is likely to increase it further on HSD from Rs25/liter currently to Rs50/liter by Apr'23 as required by IMF. As such, collection under this head is projected to jump to Rs612bn in FY23.

Govt's manuverability on the fiscal side is limited as 57.5% of taxes have to be distributed to the provinces as per the National Finance Commission (NFC) award. The Federal Government also provides funds to provincial universities, vertical health programmes and certain provincial development schemes. As a result, collectively around 68% goes to the provinces leaving only 32% of revenues to meet the federal expenses (major heads in FY22 are debt servicing 24%, defence 11%, subsidies 12% and development 12%).

The main culprits of spiralling current expenditures are (1) debt servicing which is projected to increase by 50% YoY (up 53% YoY in 1QFY23) and (2) defence spending which is set to increase by 19% YoY (up 19% YoY in 1QFY23). Development spending would be curtailed at both the federal and provincial levels during this fiscal year to comply with IMF conditionality.

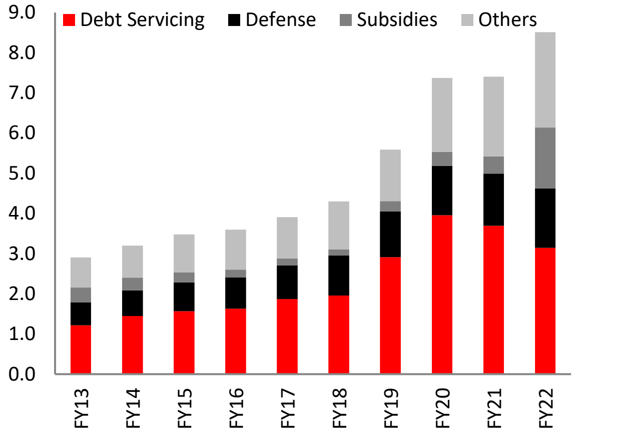
We expect that revenues would post 10% YoY growth in FY23 driven by increase in direct taxes. Whereas, non-tax collection projected to post strong growth amid likely increase in GIDC/Petroleum Levy to Rs250/612bn. However, the Gov't would not be able to curtail current expenditures given their fixed nature but anticipate that the axe would fall on development spending. Resultantly, we expect FY23 fiscal deficit to be 7.0% of GDP (vs govt target of 4.9%).

Fig 20: Fiscal roadmap (% of GDP)



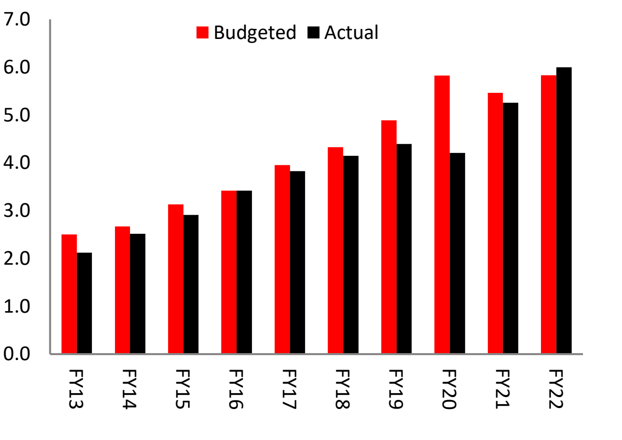
Source: MoF, Foundation Research, January 2023

Fig 21: Debt servicing remains major chunk of current exp.



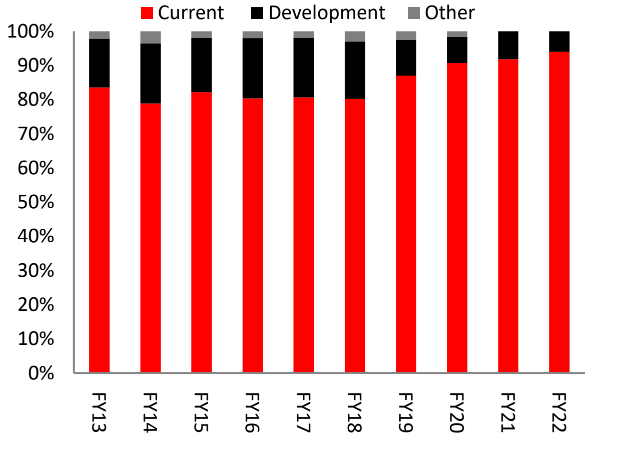
Source: MoF, Foundation Research, January 2023

Fig 22: Tax revenue exceeded target in FY22



Source: MoF, Foundation Research, January 2023

Fig 23: Current exp. eating into development exp.



Source: MoF, Foundation Research, January 2023

Changes in taxes as per IMF requirements

The Gov't took various revenue measures in the FY23 budget to satisfy IMF conditionality focusing on higher taxes on real estate, income (including super tax), fuel, automobiles and indirect taxes. Some of these measures have since faced legal challenge (eg. retrospective super tax on FY22 corporate income) or been dropped amid widespread discontent (eg. tax on retailers).

Table 06: List of FBR Revenue Measures in the FY23 Budget	Rs bn	% of GDP
Direct taxes on wealth	**133**	**0.16%**
Advanced income tax (IT) of 20% on deemed income (assumed = 1% of property value) from non-utilized immoveable property	15	
Capital gains tax (CGT), increase in rates	30	
Advanced tax upon property purchase increased from 2% to 5% for buyers who are not on the active taxpayer list	20	
Capital value tax (CVT) of 1% on foreign properties of Pakistani residents	8	
Increase in withholding tax (1% to 2%) on immoveable property purchase and sale; reduction of CGT exemption	45	
CVT of 1% on liquid foreign assets of resident Pakistanis at market value as on June 30th	10	
Increase advanced IT on luxury vehicles (above 1600cc)	5	
Direct taxes on high incomes (personal and corporate)	**211**	**0.25%**
Super tax of 1, 2 3 and 4% on earnings over PRs 150, 200, 250 and 300 million	120	
Super tax of 10% on high earnings in selected sectors (sugar, automobiles, banking, cement, cigarettes, fertilizers, oil and gas, and aerated beverages)	80	
Increase differential tax on low advance to deposit ratio of banks on income attributable to all investments	11	
Other direct taxes	**110**	**0.13%**
Personal income tax (PIT), simplification and adjustments	33	
Increase in CIT (2% to 4%) at import stage on commercial raw material imports	20	
Fixed tax on non-tier-1 retailers; tax varies by amount of electricity consumed	42	
Taxing contributions to private funded gratuity and pension schemes	10	
Removal of PIT tax credits and exemptions on allowances	5	
Indirect taxes	**45**	**0.05%**
Increase in federal excise duty on cigarettes	50	
Increase in customs duty (CD) on crude oil (2.5 to 5%)	30	
Increase in CD and regulatory duty on various items	29	
Changes to GST exemptions	-64	
TOTAL	**499**	**0.60%**

Source: IMF, Foundation Research, January 2023

Living with new inflation

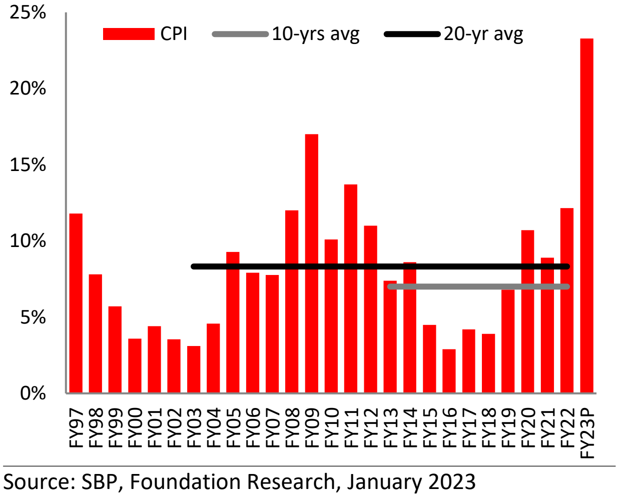
(1) Elevated food inflation amid disruptions caused by record floods and high global food prices, (2) high fuel and energy prices along with their 2nd round effects given IMF push to escalate prices further amid elevated international petroleum prices on account of Ukraine war and (3) lagged effects of sharp Rupee depreciation would keep FY23 inflation at multi decade high. Thus, we see avg. inflation rising to 23.7% in FY23 compared to 12.2% YoY in FY22. Downside risks include recession in advanced economies which would moderate commodity and oil prices. Inflation is projected to decline from Jun'23 given high base effect due to jump in electricity, petrol and diesel prices in Jun'22.

Steep upsurge in core-inflation (a relatively stable gauge of underlying inflationary pressures which excludes food and energy) to ~16.2% YoY in Nov'22 compared to ~13.8% YoY in previous 6M shows a broadening and entrenchment of inflation across multiple sectors (namely, furnishing & household equipment, clothing & footwear, recreation & culture, and misc goods and services segments) pointing to demand pull factors in play.

Monetary tightening cycle is complete

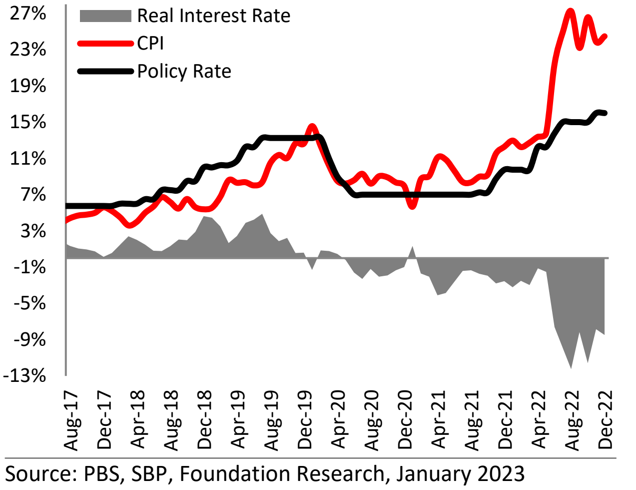
With interest rates at a 23 year high, 1-yr forward real interest rates at zero, core inflation likely abating on account of lagged effects of policy and administrative measures, and central bank objective of striking an appropriate balance between growth and inflation, we believe that the central bank would hold interest rates at the current level for the remainder of FY23 before beginning monetary easing in 1HFY24.

Fig 24: Inflation to hit multi decade high



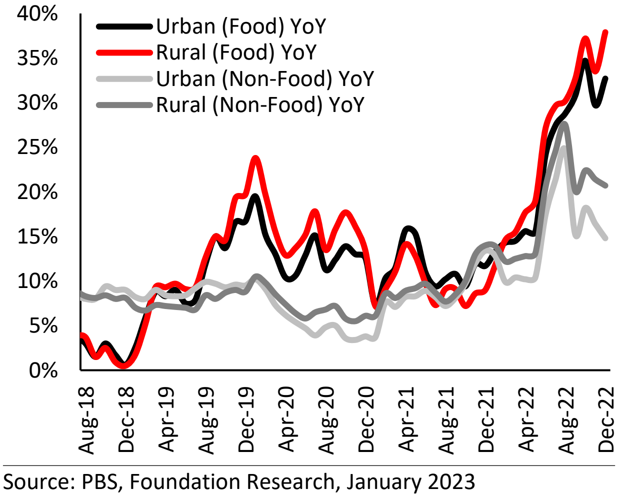
Source: SBP, Foundation Research, January 2023

Fig 25: Tight monetary stance to continue in 2023



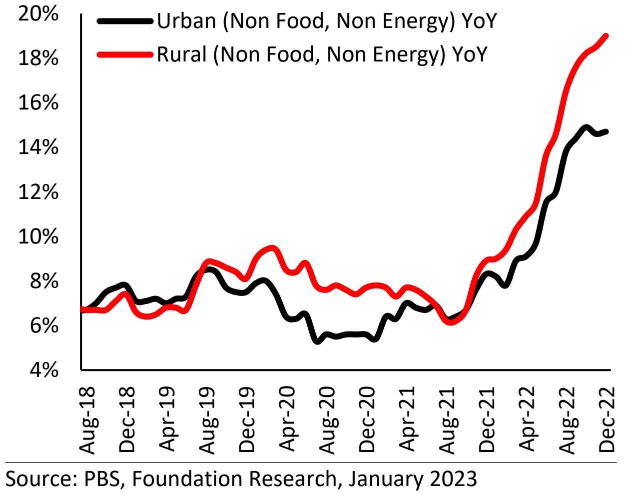
Source: PBS, SBP, Foundation Research, January 2023

Fig 26: Food and Non-Food inflation remain elevated



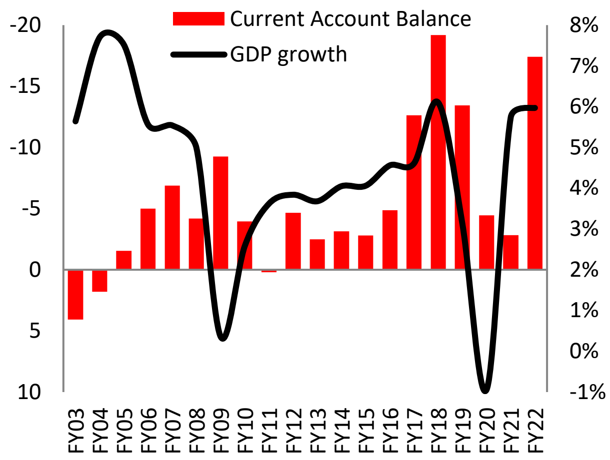
Source: PBS, Foundation Research, January 2023

Fig 27: Core inflation breaching records



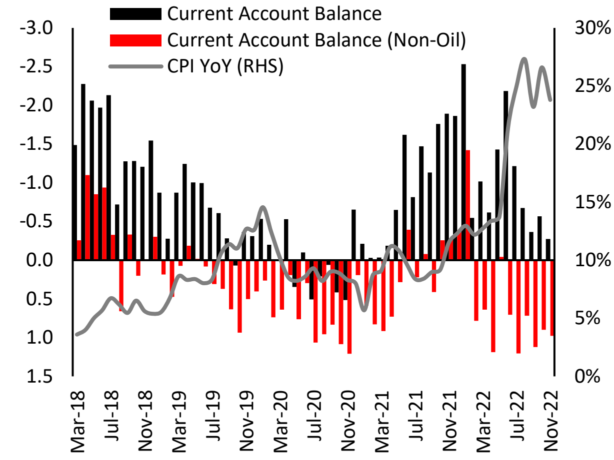
Source: PBS, Foundation Research, January 2023

Fig 28: GDP growth (RHS) and CAB in the long run…



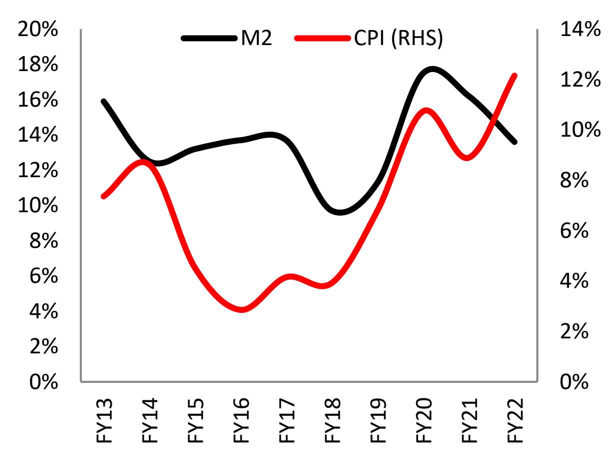
Source: SBP, PBS, Foundation Research, January 2023

Fig 29: Inflation and CAB in the short term



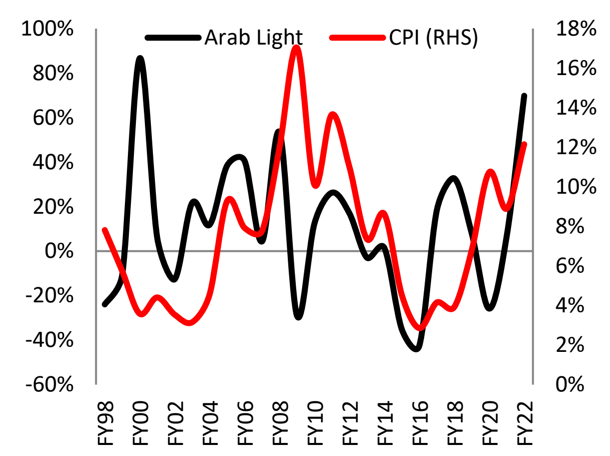
Source: SBP, PBS, Foundation Research, January 2023

Fig 30: Inflation (RHS) and Broad Money



Source: SBP, PBS, Foundation Research, January 2023

Fig 31: Inflation (RHS) and oil prices



Source: Bloomberg, PBS, FSL Research, Jan 2023

Table 07: Economic Indicators

	Unit	FY18	FY19	FY20	FY21	FY22	FY23E	FY24F
GDP growth	%	6.1%	3.1%	-0.9%	5.7%	6.0%	1.1%	3.7%
Agriculture	%	3.9%	0.9%	3.9%	3.5%	4.4%	-2.0%	4.5%
Industrial	%	9.2%	0.3%	-5.8%	7.8%	7.2%	-1.2%	2.0%
Services	%	6.0%	5.0%	-1.2%	6.0%	6.2%	3.1%	4.0%
GDP (Mkt Price)	US$ bn	313	297	300	348	383	371	389
Per Capita (US$)	US$	1,652	1,455	1,361	1,543	1,798	1,601	1,679
US$ parity - Period End	Rs	121.5	162.0	167.8	157.3	204.8	235.1	250.9
Depreciation	%	-13.7%	-25.0%	-3%	6.7%	-23.2%	-12.9%	-6.3%
CAD	US$ bn	(19.2)	(13.4)	(4.4)	(2.8)	(17.3)	(7.4)	(10.0)
CAD	% of GDP	-6.1%	-4.5%	-1.5%	-0.8%	-4.5%	-2.0%	-2.5%
Trade & Services Gap	US$ bn	(36.2)	(33.2)	(24.4)	(31.2)	(44.7)	(32.4)	(36.2)
Exports	US$ bn	30.1	29.6	28.0	31.6	39.4	39.4	40.8
Import	US$ bn	66.2	62.8	52.4	62.7	84.1	71.8	77.0
Remittance	US$ bn	19.91	21.74	23.13	29.45	31.24	28.29	29.71
FX - Period end	US$ bn	9.8	7.3	11.2	16.1	9.8	9.3	12.1
Import Cover	Months	1.8	1.4	2.6	3.1	1.4	1.6	1.9
Fiscal Deficit	% of GDP	6.6%	8.9%	8.1%	7.1%	7.9%	7.0%	6.1%
Policy Rate (period-end)	%	6.5%	12.3%	7.0%	7.0%	13.8%	16.0%	11.0%
CPI (Avg)	%	3.9%	6.8%	10.7%	8.9%	12.2%	23.7%	9.5%

Source: MoF, PBS, SBP, Foundation Research, January 2023

Pakistan to remain under IMF supervision with hiccups

IMF program strives for structural transformation

Pakistan to remain in IMF program and would have to enter the next one to build comfort of international partners in order to secure mounting external debt repayments, in our view. At the last review (combined 7th and 8th) of the IMF program, the total size of the program was enhanced from US$6.0bn to US$6.5bn and extended from Sept'22 to Jun'23. To complete the review, the gov't took important measures to address worsened fiscal and external positions resulting from accommodative policies in FY22 and spillovers from the war in Ukraine, and which have placed significant pressure on the rupee and FX reserves. However, the Gov't has deviated from its commitment under the last review to continue the steadfast implementation of the FY23 budget and adherence to a market-determined exchange rate which has prevented completion of the 9th review. The IMF program aims to restore fiscal discipline and debt sustainability while protecting social spending, safeguarding monetary and financial stability, and maintaining a market-determined exchange rate and rebuilding external buffers. At the last review in Sep'22, the main areas which IMF recommended to prioritize were:

1. Fiscal Discipline

The fiscal adjustment planned for FY23 provides a narrow path forward but would require consistent and decisive policy implementation. The FY23 budget proposes a very ambitious adjustment targeting a small primary surplus. Sustained implementation of this budget while avoiding further policy slippages is crucial to address imbalances, reduce elevated vulnerabilities and build confidence.

2. Poverty Reduction and Social Protection

More efforts are needed to reduce poverty, enhance social programs, and protect the most vulnerable by building fiscal space and improving coordination. Although staff supports using temporary measures to protect large swathes of the population against fuel price increases, it reiterated the need to enhance transfers to families already covered by BISP, especially in a high inflation environment.

3. Tight Monetary Stance

Monetary policy needs to be proactive and data-driven to reduce inflation towards target. IMF stressed the need to continue a tight monetary policy to reduce inflation and support efforts to address external imbalances.

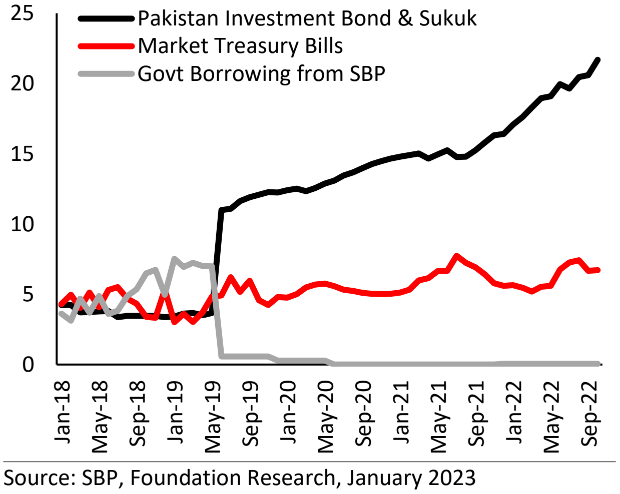
4. Market determined exchange rate

A market-determined exchange rate and limited SBP interventions remain crucial to absorb external shocks, maintain competitiveness, and rebuild international reserves. Allowing greater exchange rate flexibility to address external pressures will help safeguard and improve reserve buffers towards more prudent levels.

5. Electricity Sector Reforms

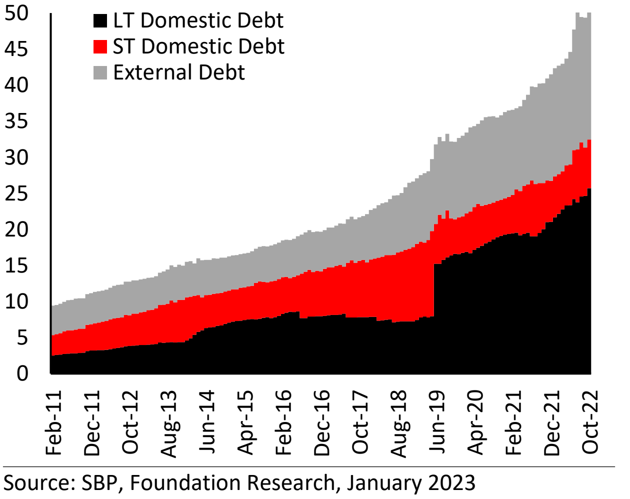
Electricity sector reforms are essential to restoring the sector's financial viability, and reducing its adverse spillovers on the budget, the financial sector, and the real economy. Timely follow through of the proposed energy tariff increases in FY23, updating the Circular Debt Management Plan for FY23 to reduce Circular Debt and costs, align power tariffs with the cost structure, and improve targeting of power subsidies to the most vulnerable.

Fig 32: Increasing reliance on longer tenor debt (Rs tn)



Source: SBP, Foundation Research, January 2023

Fig 33: Domestic debt still dominates the mix (Rs tn)



Source: SBP, Foundation Research, January 2023

Table 08. IMF Structural Benchmarks at the 7th/8th review

Actions			
Prior Actions	**Rationale**		**Status**
1.Parliamentary approval of a FY23 budget, including a personal income tax reform and in line with IMF staff agreement to meet program targets.	To ensure achievement of fiscal objectives.		Met.
2. Provincial budgets. Signature by the federal and provincial governments of Memoranda of Understanding (MoUs) on provincial fiscal targets consistent with the FY23 budget.	To ensure achievement of fiscal objectives.		Met.
3. Relief package reversal. (i) Elimination of post-tax fuel subsidies and the PRs 5/kwh blanket power subsidy by end-June 2022; (ii) increase in the petroleum development levy (PDL) on petrol by PRs 10/liter and on diesel by PRs 5/liter on July 1 2022; (iii) increase in the PDL on petrol by PRs 10/liter and on diesel by PRs 5/liter on August 1, 2022; and (iv) we commit to implement monthly PDL increases of PRs 10/liter for petrol and PRs 5/liter for diesel on September 1, 2022, followed by increases of PRs 5/liter per month for both fuels until the PDL reaches PRs 50/liter in January 2023 (petrol) and April 2023 (diesel).	To ensure achievement of fiscal objectives		Met.
4. Power price catch-up. Implementation of: (i) the first-stage increase related to the combined FYs22-23 annual rebasing (AR) (PRs 3.50/kwh) and full subsidy reform markup (PRs 0.20/kwh) on July 25, 2022; (ii) second-stage AR FYs22-23 increase (PRs 3.50/kwh) on August 1, 2022; and (iii) cabinet approval of the implementation of the third-stage AR FYs22-23 increase on October 1, 2022 (PRs 0.91/kwh).	To help restore energy-sector viability.		Met.
Structural Benchmarks	**Date**	**Revised**	**Status**
Fiscal			
1. Commit to not grant further tax amnesties.	Continuous		Not met.
2. Avoid the practice of issuing new preferential tax treatments or exemptions.	Continuous		Not met.
3. Preparation of draft personal income tax (PIT) legislation.	end-Feb 22		Not met.
Monetary and Financial			
4. Adoption of measures to strengthen the effectiveness of the AML/CFT framework to support the country's efforts to exit the Financial Action Task Force (FATF) list of jurisdictions with serious deficiencies.	end-Mar 22		Not met Delayed till June 22
5.Preparation of a plan by Ministry of Finance and State Bank of Pakistan, in consultation with other stakeholders, to establish an appropriate Development Finance Institution to support the eventual phasing out of SBP refinance facilities.	end-Apr 22	end-Dec 22	Not met.
6. Completion of the first-stage recapitalization of the two private sector banks that are undercapitalized.	end-May 22	end-Mar 23	Not met.
Energy Sector, State-Owned Enterprises, and Governance			
7. Parliamentary approval of new SOE law in line with staff recommendations.	end-Jun 22	end-Sep 22	Not met.
8. Adoption by parliament of amendments to the OGRA Act.	end-Jun 22		Met.
9. Establish a robust asset declaration system with a focus on high-level public officials (including elected and unelected members of the Federal Cabinet).	end-Mar 22	end-Sep 22	Not met.
10 Issuance of regulations by the Public Procurement Regulatory Authority (PPRA) to require collection for publication of beneficial ownership information from companies which are awarded public procurement contracts for PRs 50 million and above.	end-Mar 22		Not met. Implemented with delay till May 22
New Structural Benchmarks			
1. Targeted increase of the BISP Kafalat beneficiary base to 9 million families using the NSER.	end-Jun. 2023		
2. Finalization of the combined annual rebasings (AR) for FY22 and FY23 to take effect on October 1, 2022.	end-Sep. 2022		
3. Submission to NEPRA of petitions for the (i) FY23-July FPA by end-August; and (ii) FY23-Q1 QTA by end-October which will ensure full recovery of the revenue requirement (including lost revenue from the delayed first-stage Annual Rebasing FYs22-23 in July 2022) within FY23Q2.	end-Sep. 2022		
4. Adoption of a comprehensive strategy to address high levels of NPLs in some banks, including by requiring bank-specific plans for reducing NPLs, and to write-off of fully provisioned NPLs.	end-Jun. 2023		
5. Initiate orderly liquidation (resolution) of either or both of the two currently undercapitalized private sector banks by end-May 2023 should that they remain undercapitalized at that point.	end-May 2023		
6. Submission to Cabinet of amendments to align Pakistan's early intervention, bank resolution, and crisis management arrangements with international good practices, in line with IMF	end-Oct. 2022		
7. Operationalization of a Central Monitoring Unit (CMU) within the Ministry of Finance.	end-Jan. 2023		
8. Publication of a comprehensive review of the anticorruption institutional framework (including the National Accountability Bureau) by a task force with participation and inputs from reputable independent experts with international experience and civil society organizations.	end-Jan. 2023		

Source: IMF, Foundation Research, January 2023

Gas price increase on the cards to address circular debt to comply with IMF requirement

OGRA has notified a 74/68% increase in gas prices of SNGPL/SSGC to prevent the future build-up of circular debt as required by IMF. However, increase is effective after the approval of the federal cabinet. This would improve the cash flow position of SSGC, SNGPL, PSO, OGDC and PPL. We expect that fertilizer sector would pass on the impact while it would be negative for textile and chemical sectors. Possibility exists that Gov't might give a subsidy to zero rated sector to offset the increase in gas prices. However, the actual increase for each segment would differ from the proposal.

Table 09: Current gas prices

Rs per mmbtu	Current
System average	**623**
Domestic	354
Bulk Domestic	780
Fertilizer (Feed)	300
Fertilizer (Fuel)	1,023
IPPs	857
Commercial	1,283
Gen. industry	1,054
CNG	1,360
Zero rated	819
Captive Zero rated	852
Cement	1,277
Captive Power	1,087

Source: OGRA, Foundation Research, January 2023

Table 10: Overdue receivable of E&P sector and PSO from Sui companies

	Rs bn	Rs/sh
OGDC	334	78
PPL	375	138
PSO	306	651

Source: PSX, Foundation Research, January 2023

Table 11: Impact of Increase in gas prices

Sector/Stock	Impact(Rs/sh)	Severity	Neutralizing factor
Fertilizer			
FFC	-10.2	Low	Rs431/bag increase in Urea price
EFERT	-10.4	Low	Rs525/bag increase in Urea price
FFBL	-2.3	Low	Net beneficiary due to reliance on FPCL for fuel
Chemical			
EPCL	-3.4	High	Lower pricing power
LOTCHEM	-0.8	High	Lower pricing power
Engineering			
ISL	-0.6	Low	Rs1,223/ton increase in CRC price
Cement			
LUCK	-5.0	Moderate	Difficult to pass through due to economic slowdown
CHCC	-3.0	High	Difficult to pass through due to economic slowdown
Textile			
NML	-2.5	High	Difficult to pass through impact to customers
NCL	-0.3	High	Difficult to pass through impact to customers
GATM	-2.4	High	Difficult to pass through impact to customers
ILP	-0.4	High	Difficult to pass through impact to customers

Source: Foundation Research, January 2023

GIDC: A long-standing legal escapade that could potentially dry company's cash flows

Federal Government in Dec'11 promulgated the Gas Infrastructure Development Cess Act, 2011 to generate funds for development of gas infrastructure projects to overcome the emerging gas supply crisis given (1) depleting domestic natural gas reserves and (2) continuous decline in gas reserves replacement ratio. In this regard Federal Gov't had initiated multiple projects in collaboration with foreign partners that include (1) TAPI pipeline project, (2) IP gas pipeline project, (3) North South gas pipeline project to transport imported RLNG to up country and (4) construction of underground gas storage facilities as a part of initiatives taken to strengthen national security.

2011

- GIDC was promulgated to generate funds for building gas infrastructure projects
- Soon after its promulgation it was challenged in various Courts of Law

2012

- Through Finance Act, 2012 Gov't increased GIDC to Rs300/mmbtu for feed gas and to Rs100/mmbtu for industry/CPP/KESC/GENCO/WAPDA. However, for fertilizer Gov't subsequently reduced GIDC on feed gas to Rs197/mmbtu
- Fertilizer companies increased their prices for UREA by Rs215/bag to pass on the impact and power sector charged it as a part of tariff adjustement, while other took a hit on their profitability

2014

- GIDC rate on fertilizer feed/fuel and CPP gas increased by Rs103/50/100mmbtu to Rs300/100/200mmbtu, but remained constant for power sector
- Fertilizer manufacturers continued to withhold GIDC due to Court decision which declared GIDC Act 2011 unconstitutional

2015

- Gov't introduced GIDC Act 2015 in which rates for all sectors remained the same except for reduced rates for CNG sector and Gov't also imposed GIDC on new fertilizer plants operating on concessionary gas
- During 2015 fertilizer sector and general paid majority of outstanding GIDC relating to previous years

2016

- In Oct-16 Sindh High Court declared GIDC as unconstitutional and fertilizer sector along with other industries stopped paying GIDC after obtaining stay order from courts

2019

- In Aug-19 Government introduced GIDC amendment ordinance 2019 and reduced GIDC applicable on fertilizer by 50% contingent upon price reduction and half payment of outstanding/accrued GIDC.
- Amid public pressure Government withdrew GIDC ordinance and referred the matter to the Supreme Court

2020

- Government reduced GIDC applicable on fertilizer to Rs5/mmbtu on feed/fuel stock with condition of reduction in Urea prices by Rs400/bag
- In Aug'20 Supreme Court of Pakistan dismissed all petitions challenging applicability of GIDC Act and directed Gov't to collect outstanding dues in **24 monthly installments** and Court also barred Gov't from charging any cess till the time accrued amount will be expensed on gas infrastrucutre projects
- In Nov'20 Supreme Court dismissed all review petitions seeking review of its earlier decision

2022

- On December 27, 2022, Finance division held a meeting on GIDC
- Finance division discussed recovery of outstanding Cess equals to Rs 447bn from various entities along with GIDC Acts and Supreme Court's order in this regard

GIDC collection remained less than budgeted given technical flaws in ordinance and stay orders from various Courts

From the time when GIDC was initially imposed, its existence challenged on various forums due to legislative flaws in promulgating ordinance and slow progress on execution of proposed gas infrastructure projects. To resolve GIDC overdue issue Government has initially issued GIDC amendment act 2019 and then subsequently withdrew and referred it to the Supreme Court for urgent hearing in order to bring transparency and good governance.

As a result, Supreme Court of Pakistan has dismissed all petitions challenging applicability of GIDC Act with the conditionality of not charging any cess till the time accrued amount will be expensed out along with non-applicability of late payment surcharge. However, as a concession, Supreme Court has directed gov't to recover the outstanding amount in 24 equal installments starting from August 01'2020 without the component of late payment surcharge. To highlight, late payment surcharge would only be applicable on delayed payment of installments.

Supreme Court allowed businesses to pass on the impact of GIDC due to consumers if not passed on earlier

Furthermore, in its detailed judgments Supreme Court has also allowed all the industrial and commercial businesses which rely on natural gas for their business operations to pass on the impact to consumers in order to recover the arrears of GIDC that have become accrued upto 31 Jul'2020 and have not been recovered. In our view, it would be difficult for the industry to pass on the impact of GIDC given competitive environment in some businesses and fragmented market structure in some industries due to large number of participants.

Fertilizer and Power sector were able to pass on the impact

Fertilizer sector remained able to pass on the impact of GIDC imposition in a timely manner given pricing power due to constrained Urea supply. However, sectors like chemical, textile, steel, cements and glass manufacturers have not passed on the impact of GIDC due to lower pricing power and influx of imported products in some categories. To highlight, IPPs/KESC/GENCO/WAPDA charged GIDC as a part of tariff adjustment to consumers.

Table 12: Total collection of GIDC and overdue payment from different sectors

Sector	GIDC Accrued	GIDC Collected	GIDC Outstanding	Comment
Fertilizer – Fuel	31.8	15.2	16.6	Already passed by price hike in Urea fertilizer
Fertilizer Feed (old)	192.2	111.8	80.4	Already passed by price hike in Urea fertilizer
Fertilizer Feed (New)	68.3	1.1	67.1	Concessionary gas players sold Urea in line with prices charged by old fertilizer plants and passed on the impact of GIDC to farmers
General Industry	70.7	24.4	46.3	General industry won't be able to recover GIDC arrears given lack of pricing power
Captive Power	119.2	17.5	101.7	Captive power plants won't be able to recover GIDC arrears
IPPs	60.8	51.7	9.1	GIDC arrears will be passed on to the consumers as part of tariff adjustment
KESC	40.4	3.9	36.5	GIDC arrears will be passed on to the consumers as part of tariff adjustment
GENCO/WAPDA	67.3	44.8	22.6	GIDC arrears will be passed on to the consumers as part of tariff adjustment
CNG Region-I	53.4	11.8	41.7	Due to current pricing mechanism CNG sector won't be able to charge GIDC arrears to its customers
CNG Region-II	48.1	13.2	34.9	Due to current pricing mechanism CNG sector won't be able to charge GIDC arrears to its customers
Total	**752.3**	**295.4**	**456.9**	

Source: Supreme Court, Foundation Research, January 2023

Government geared to formulate another plan for recovery of GIDC

In a recent development Federal Minister for Finance and Revenue chaired a meeting on Gas Infrastructure Development Cess (GIDC) at Finance Division. The ministry examined the court's rulings and stay order, expressed grave concern over the non-recoveries of Cess dues, and underlined the government's intention to recover the full amount from those who had defaulted on paying the Gas Infrastructure Development Cess. Government has expedited process for recovery of the outstanding GIDC dues by developing a legal and administrative plan. In the light of the country's protracted economic crisis, the government has been compelled to source outstanding dues from defaulters amid limited fiscal space.

Table 13: Government revenue from GIDC collection in different scenarios from court decision date (Rs bn)

	FY23	FY24	FY25	FY26
GIDC payment in 24 monthly installments	456	-	-	-
GIDC payment in 48 monthly installments	333	114	10	-
GIDC payment in 60 monthly installments	266	91	91	8

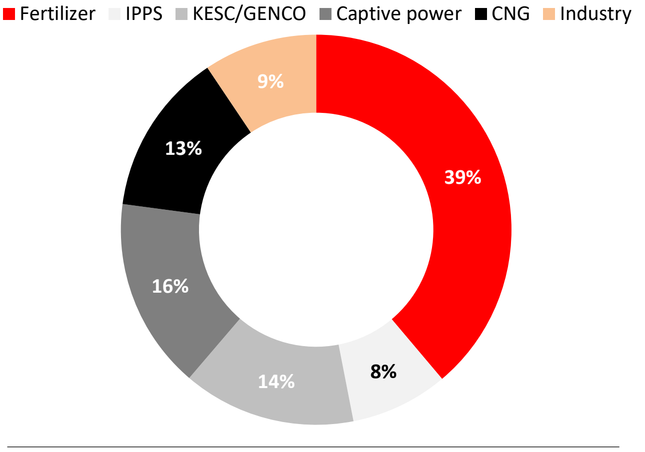
Source: Supreme Court, Foundation Research, January 2023

Table 14: Summary of expenditure and funding of gas infrastructure projects

Projects	Iran Pakistan (IP) Gas Pipeline Project	TAPI Pipeline Project	North South Gas Pipeline Project	Underground Gas Storages	Total
Estimated Project Cost	271.0	1,500.0	405.0	75.0	2,251
Pakistan share	271.0	31.4	20.3	75.0	397.6
Development expense already incurred funded by GIDC	-	0.5	-	-	0.5
Development expense already incurred funded by GHPL	3.3	0.8	0.1	0.0	4.2
Total development and construction cost to be funded by GIDC collection	271.0	30.5	20.3	75.0	396.8

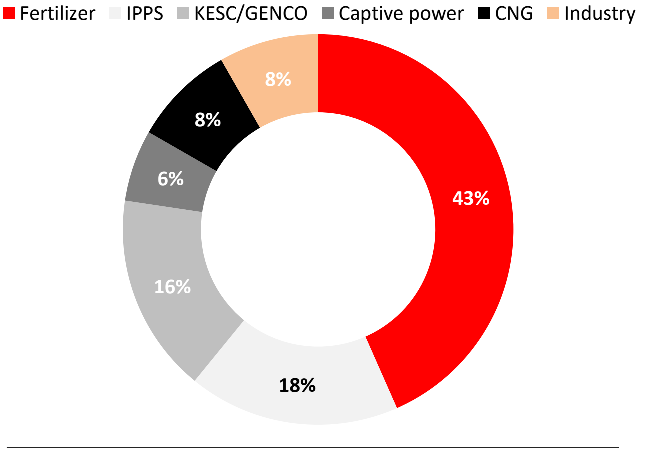
Source: Supreme Court, Foundation Research, January 2023

Fig 34: Fertilizer and Power sector have the largest amount of GIDC payable due to extensive use of gas



Source: MNSFR, Foundation Research, January 2023

Fig 35: Fertilizer, IPPs and Wapda paid the majority of amount of GIDC due



Source: MNSFR, Foundation Research, January 2023

Devastating floods add to cascading economic crisis

During 1QFY23, torrential rains and a combination of riverine, urban, and flash flooding led to an unprecedented disaster in Pakistan. The total damage is estimated at US$14.9bn, total loss at US$15.2bn, and total needs at US$16.3bn.
The sectors that suffered the most damage are housing at US$5.6bn; agriculture, food, livestock, and fisheries at US$3.7bn; and transport and communications at US$3.3bn. The transport and communications sector has the highest reconstruction and recovery needs at US$5.0bn; followed by agriculture, food, livestock, and fisheries at US$4.0bn, and housing at US$2.8bn. About 71%, 35%, 13% and 43% of the areas of Balochistan, Khyber Pakhtunkhwa, Punjab and Sindh have been affected by floods, respectively. The hardest-hit province is Sindh, with $9.1bn in damage, $11.4bn in losses, and an estimated $7.9bn in required rehabilitation. Sindh and Balochistan account for about 50% and 15% of reconstruction and rehabilitation needs, respectively. Due to floods, inflation rose significantly, adding further to the already high levels post Russia-Ukraine War to clock in at an average of 25.1% in 1HFY23 and is projected to remain high to an average of 22.5% in 2HFY23. Moreover, FSL estimates Pakistan's GDP growth to remain 1.1% in FY23 compared to 6% in FY22.

Table 15: Damage, Loss, and Needs by Region (US$ mn)

Region	Damages	Losses	Needs
Balochistan	1,625	2,516	2,286
Khyber Pakhtunkhwa	935	658	780
Punjab	515	566	746
Sindh	9,068	11,376	7,860
Cross-Provincial	2,731	67	4,540
Special Regions	32	49	48
Grand Total	**14,906**	**15,233**	**16,261**

Source: Ministry of Planning, Foundation Research, January 2023

TABLE 16: Damage, Loss, and Needs (US$ mn)

	Damages	Losses	Needs
Social Sectors	**6,261**	**896**	**3,872**
Housing	5,586	636	2,757
Health	109	34	188
Education	559	219	918
Culture and Heritage	6	7	9
Infrastructure Sectors	**3,927**	**396**	**5,437**
Transport and Communications	3,264	281	4,994
Energy	88	3	117
WASH, Municipal Services, and Community Infrastructure	575	112	327
Productive Sectors	**4,635**	**13,281**	**4,760**
Agriculture, Food, Livestock, and Fisheries	3,725	9,244	3,976
Water Resources and Irrigation	711	-	782
Commerce and Industries	186	3,527	-
Finance and Markets	3	417	-
Tourism	10	93	2
Cross-Cutting Sectors	**83**	**660**	**2,192**
Governance	60	23	88
Social Sustainability, Inclusion and Gender	0	-	96
Social Protection, Livelihoods, and Jobs	-	607	1,683
Environment and Climate Change	18	30	164
Disaster Risk Reduction and Resilience	5	-	161
Grand Total	**14,906**	**15,233**	**16,261**

Source: Ministry of Planning, Foundation Research, January 2023

Help from partners at a crucial juncture

Pakistan has asked the international community to provide half of the $8.1bn out of $16.8bn for reconstruction. However, Pakistan will receive $4.0bn in financial support from international development partners and friendly countries which has already been announced. Some installments have already been received and the rest will be delivered sequentially. The Asian Development Bank (ADB) has provided a $554mn financial package to assist the Government of Pakistan in carrying out a post-disaster needs assessment (PDNA). UN's organizations WHO, UNFPA, and FAO provided $3.06mn. China and japan provided $112.3mn and $7.0mn, respectively. The government has approved many reconstruction projects and will spend about $3bn on its resources by the end of June 2023.

Table 17: Funds Committed/Provided by the International Platform & Countries

International development partners/Countries	US$ mn
Committed	
WB	1,780.00
AIIB	500.00
ADB	1,500.00
Japan	38.90
Received	
ADB	1,500.00
AIIB	500.00
WHO, UNFPA and FAO	3.06
China	112.33
United States	95.00
Japan	7.00
Canada	4.22
Australia	3.48
European Union	19.57
ECHO-EU	30.67
UK(FCDO)	62.50
Germany	58.87
Norway	8.60
South Korea	4.86

Source: Senate Standing Committee on Planning and Development, Foundation Research, January 2023

Geneva conference – A ray of hope

On 9 January 2023, Pakistan held a meeting with the United Nations secretariat of International Development Partners and Donors in Geneva to get financial support for the reconstruction of the regions affected by floods. The major pledges made at the conference, included $4.2 billion from the Islamic Development Bank (IsDB), $2 billion from the World Bank, $1.5 billion from the Asian Development Bank (ADB), $1 billion from the Asian Infrastructure Investment Bank (AIIB) and $1 billion from Saudi Arabia. The Islamic Development Bank Group will provide $4.2bn over 3 years, which will be used to rebuild infrastructure.

Table 18: Donors pledged over $10.5bn for Pakistan

International Communities& Country	Pledge amount ($ bn)
IsDB	4.20
World Bank	2.00
ADB	1.50
Saudi Arabia	1.00
AIIB	1.00
France	0.38
China	0.10
USAID	0.10
EU	0.09
Germany	0.09
Japan	0.08
Total	**10.57**

Source: Ministry of Information, Foundation Research, January 2023

Agriculture: Indispensable sector for the country's economic growth

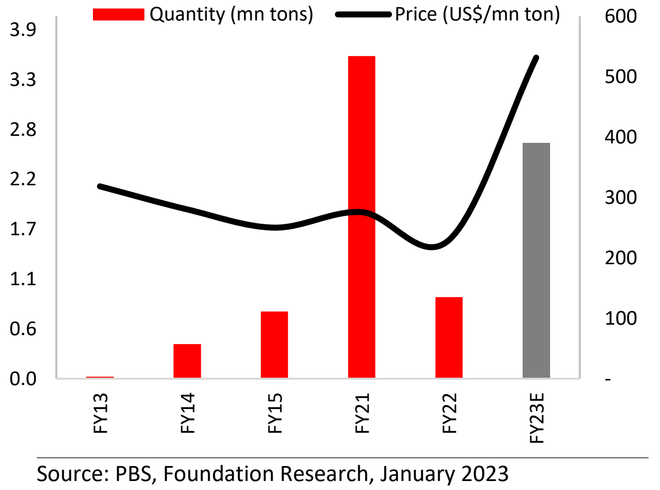
Record flooding crippled this sector with an estimated losses of US$9bn

Agriculture is one of the largest sectors of the Pakistan's economy, accounting for 24% of GDP and employing 50% of the labor force. The sector also plays a role in addressing Pakistan's currency issue, generating US$4.4bn in direct exports, import substitution, and indirect exports through the provision of basic raw materials (cotton) to Pakistan's textile sector, which is the country's largest manufacturer and exporter. Recent floods have greatly damaged Pakistan's economy which was already struggling to cope from an economic crisis and double-digit inflation. The looming shortage of essentials has sent the price of basic goods skyrocketing. An estimated 4.4mn acres of farmland which is enough to cultivate crops for 14.6 mn people were damaged, and more than 800,000 animals were lost. In all, more than $9bn in losses were incurred by the agriculture sector. Moreover, over 80 % of such losses were absorbed by the crop sub-sector, which means that food production will be compromised in the near future without substantial support. Overall decline in GDP as a direct impact of the floods is projected to be around 2.2% of GDP. Among the major sectors, agriculture sector value added is projected to decline the most at 0.9% of GDP, with floods causing the most losses to cotton, dates, sugarcane, and rice crops. Furthermore, damage in the agricultural sector is expected to have spillover effects on the industry and services sectors. As per the government estimates in 4R framework, at least $4bn are urgently needed to facilitate the immediate recovery of the agriculture sector, and to lay the foundations for lasting resilience.

Major crops outlook

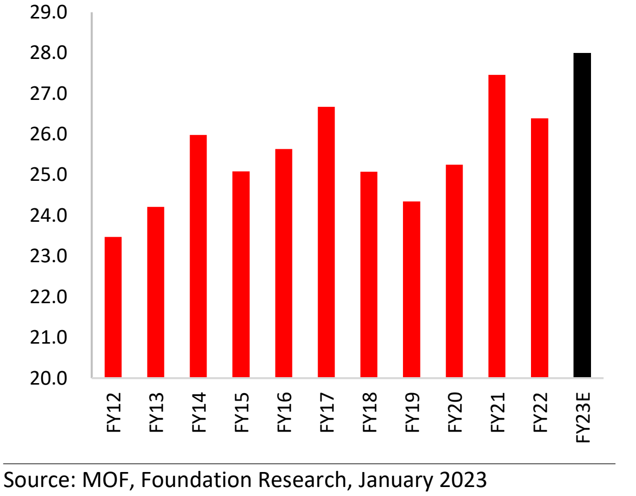
1) **Wheat:** Wheat is a main staple food crop of Pakistan, dominating all crops in acreage and production and therefore critical to the country's food security. It accounts for 9.2% of agricultural value added and 1.8% of GDP. Wheat crop production clocked in at 26.3mn ton in FY22 against all-time high of 27.3mn tons in FY21 (down by 4% YoY). Wheat production declined due to decline in area sown, shortfall in irrigation water and drought conditions at sowing, less fertilizers offtake and heat wave in March/April. The catastrophic summer floods exacerbated the situation as the wheat stocks in the flood-hit areas were badly damaged. This has delayed the wheat sowing whereby inducing the wheat growers to hold back their stocks. This created supply shortage and distort flour prices across the country. Moreover, government was claiming to have sufficient reserves and yet decided to import 2.6mn ton of wheat to build strategic reserves and to correct market prices for general public welfare. International wheat prices were already rising to record levels, but with the ongoing conflict between the Russia and Ukraine, international wheat prices are now at their highest level in the last few decades. The increased cost of production domestically, due to increased fertilizer and energy prices, are expected to raise the prices of wheat. Furthermore, the global wheat market is anticipated to tighten further in FY23 as growth in production fails to balance growth in demand. To highlight, Gov't has set wheat sowing target of 28.4mn tons (7.9% YoY growth) for FY23. However due to constrained supply of key fertilizers (Urea/DAP) required for wheat sowing given record higher prices, Gov't will not be able to meet its wheat target for FY23, in our view. Moreover, any shortage in wheat production target and food crisis in Afghanistan (4-4.5mn tons annual wheat demand) due to lower foreign aid will result in higher food inflation in 2HFY23.

Fig 36: Wheat Imports remained high amid ↑ prices



Source: PBS, Foundation Research, January 2023

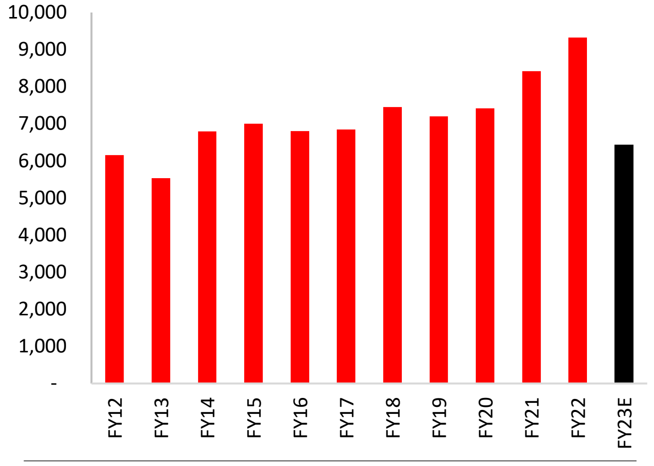
Fig 37: Wheat Production target at 28.4mn ton in FY23



Source: MOF, Foundation Research, January 2023

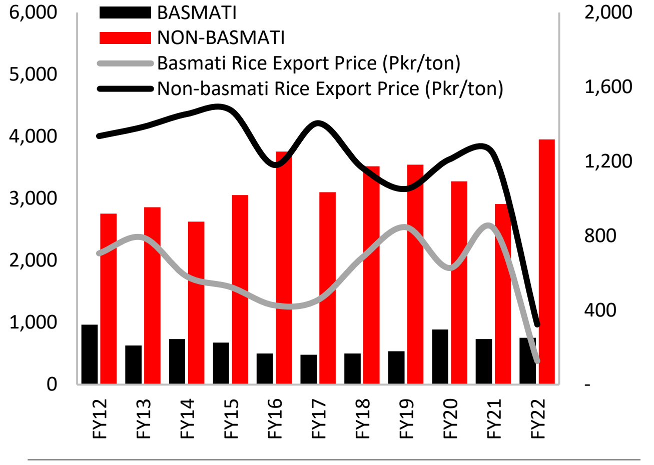
2) **Rice:** Pakistan is the world 11th largest producer of rice and it is the 2nd major staple food item consumed in the country. Pakistan's exports make up 8% of world's total rice trade and generates ~US$2.5bn in FY22. It contributes 3.5% of value added to agricultural sector and 0.7% to GDP. In FY22, Rice harvest of Pakistan made a record of 9.3mn tons as compared to 8.4mn tons FY21 (up by 13.6%). This increase can be accredited to higher area under cultivation, use of hybrid seeds and greater demand for Pakistani rice in international market. To highlight, higher income level for farmers will automatically translate into more crop cultivation resulting in higher yields. Furthermore, in 1HFY23 flood inundation is highest in the rice crop zone, which has resulted in an overall estimated loss of 1.8 million tons of Rice in Sindh province (representing 42% of country total production) i.e. 80% of total production is lost. Therefore, we expect Rice production to decline by 31% YoY to clock in at 6.4 mn ton in FY23.

Fig 38: Pakistan rice production declined due to floods



Source: MOF, Foundation Research, January 2023

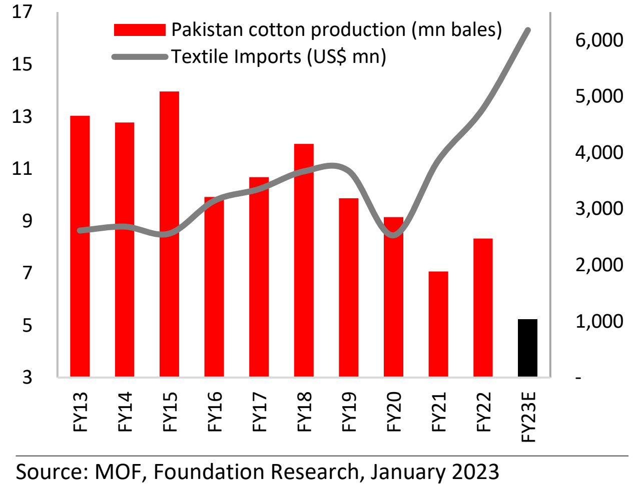
Fig 39: Basmati rice exports price declined



Source: PBS, Foundation Research, January 2023

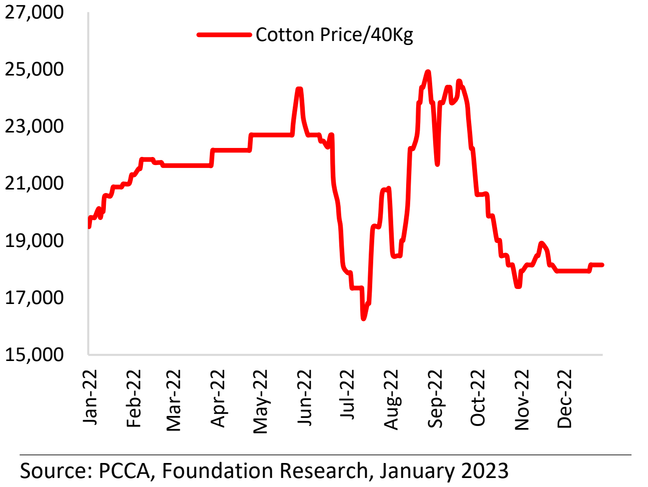
3) **Cotton:** Pakistan is 5th largest producer of cotton in the world. Cotton and textile products exports have a share of around 60% in overall exports of the country. Moreover, it contributes around 0.6% to GDP and 2.4% of the value added in agriculture. Cotton production in Pakistan has been steadily declining due to a loss of competitiveness, as cotton acreage is shrinking due to the crop's unprofitability when compared to sugarcane, paddy, and maize. Other factors affecting the decline include heat stress and extreme rainfall, poor agricultural practices, abiotic stresses such as climate change, and excessive pesticide use are all other factors. Another source of concern is the high cost of fertilizer, pesticides, and freight. However, due to continuous Gov't efforts and ~30% YoY increase in domestic prices in May'21 cotton production inclined by 18% YoY in FY22. Furthermore, in FY23 cotton production is estimated to decrease by 37.2% YoY due to extreme flooding across cotton belt in the province of Sindh. Cotton zones received exceptionally high daily rainfall spells, which completely devastated cotton crops at maturity. Around 3.5mn bales are lost due to floods. These cotton losses are expected to weigh on the domestic textile industry, as local cotton constitutes about 50% (Sindh contributes 47% of domestic needs) of the industry's required cotton input. In recent development, APTMA urged the government to let them import 10mn bales of cotton (~US$4bn) as the local production was only 5mn barrels this year. This would result in US$12bn sales as per APTMA. The industry is targeting textile exports of US$24bn in FY23 as compared to US$19.3bn last year.

Fig 40: Pakistan cotton crop destroyed by floods….



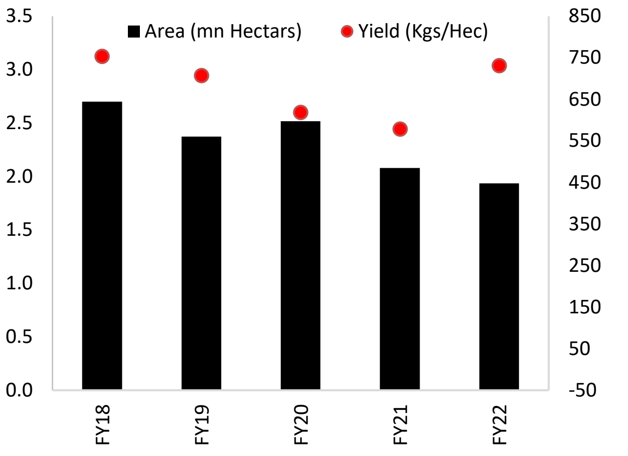
Source: MOF, Foundation Research, January 2023

Fig 41: …avg domestic cotton prices are also near high



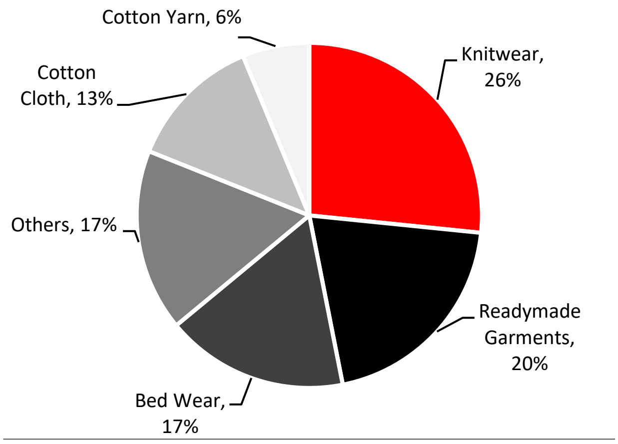
Source: PCCA, Foundation Research, January 2023

Fig 42: Pakistan cotton crop yields improved



Source: MOF, Foundation Research, January 2023

Fig 43: Knitwear has largest share in exports



Source: PCCA, Foundation Research, January 2023

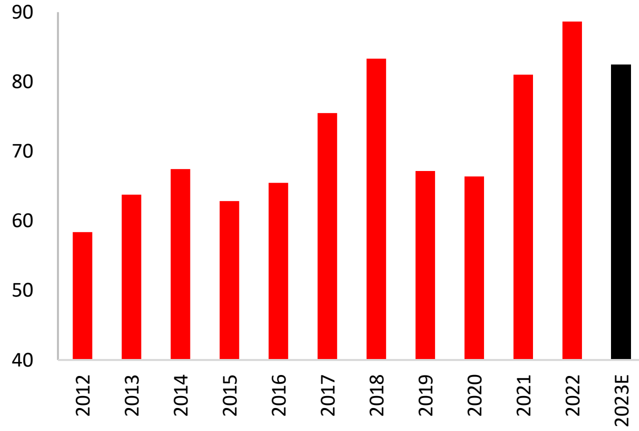
4) **Sugarcane:** Sugarcane is vital to the sugar industry and the second largest agro-based industry after textiles. Sugarcane is a high-value cash crop in Pakistan, and it is also the second largest employer of labor in the agriculture sector, both directly in fields and in manufacturing sectors such as sugar mills and FMCGs. Its output accounts for 3.7% of the value added in agriculture sector and 0.8 % of GDP. Besides, sugarcane production was at all-time high increasing by 9.4% YoY and clocked in at 88.6mn ton in FY22. This was due to the higher domestic sugar price and better sugarcane procurement price incentivized growers to dedicate more area to sugarcane. Moreover, high production costs i.e. Farm machinery, expensive urea/DAP as well as scarcity of water are the main challenges being faced by the farmer. Sindh constitutes 31% of total sugarcane production in Pakistan. Due to floods, around 41% of (10.5 mn tons) of sugar cane is lost this year. We expect production to decline by 7% YoY to clock in at 82.5mn tons in FY23.

Table 19: Sugarcane & sugar production

Production	Punjab		Sindh		KPK	
(mn tons)	Sugarcane	Sugar	Sugarcane	Sugar	Sugarcane	Sugar
FY15	41.07	2.97	16.61	1.82	5.11	0.02
FY16	41.97	2.84	17.98	2.23	5.50	0.03
FY17	49.61	4.31	20.21	2.23	5.63	0.04
FY18	55.07	3.87	20.61	2.28	7.61	0.04
FY19	44.91	3.10	16.69	1.18	5.53	0.06
FY20	43.35	3.06	17.23	1.46	5.75	0.06
FY21	57.00	3.75	18.34	1.56	5.63	0.06
FY22	62.31	4.50	20.04	1.71	6.15	0.08
FY23E	**62.87**	**4.95**	**13.82**	**1.01**	**6.24**	**0.10**

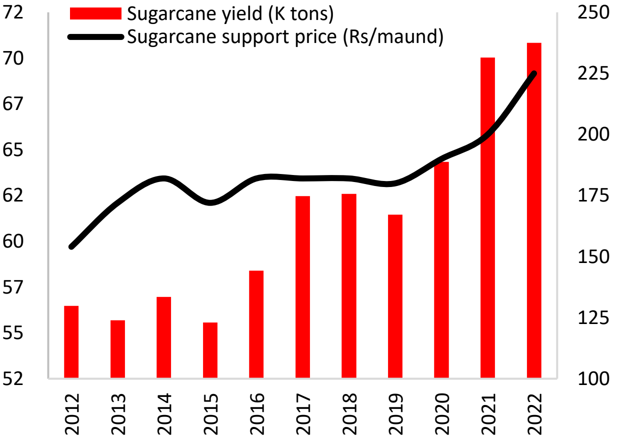
Source: MoF, Foundation Research, January 2023

Fig 44: Pakistan sugarcane production also hit by floods ...



Source: MOF, Foundation Research, January 2023

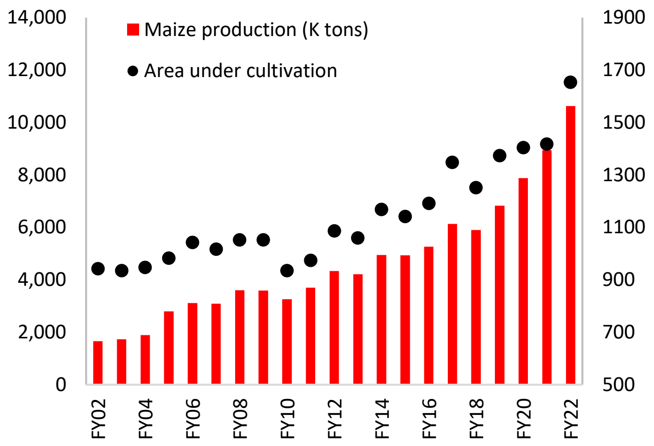
Fig 45: ...whereas yield and price at record high in FY22



Source: PBS, Foundation Research, January 2023

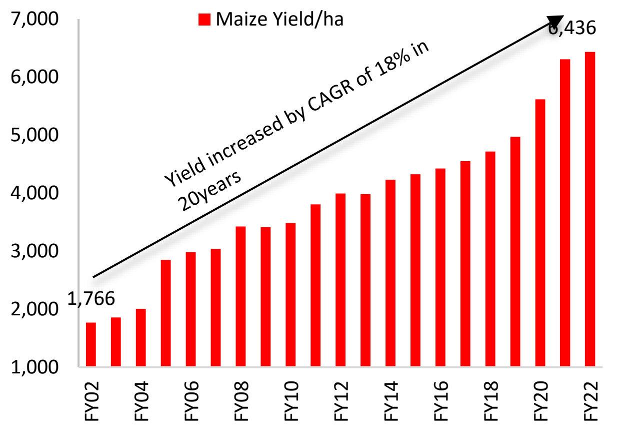
5) **Maize:** This is the third most important cereal crop of Pakistan after Wheat and Rice. Maize adds 3.2% to agricultural value added and 0.7% to GDP. Maize is a multifunctional crop that can be used for food, feed, and fodder. Maize crop output recorded at 10.6mn ton witnessing growth of 19.0% YoY against 8.9 mn ton last year. While human consumption is decreasing, its use in the feed and wet milling industries is rapidly increasing. The increase in production was mainly due to increased sown area, availability of improved high yield seed varieties, favorable weather conditions and better economic returns. To highlight, rising cost of fertilizer's and higher freight costs is major concern for this crop.

Fig 46: Growth in Maize production is higher than area…



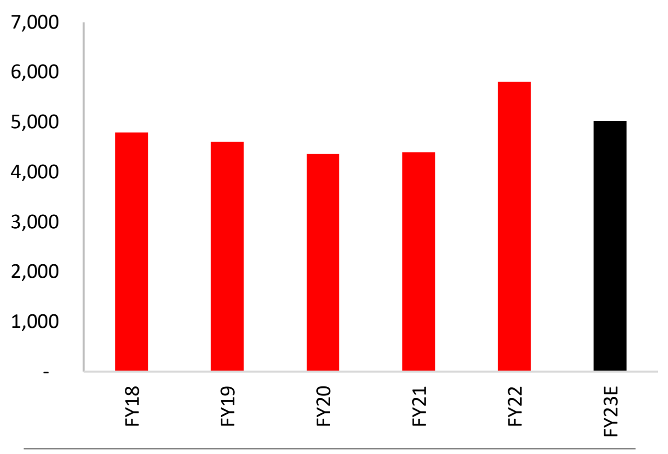
Source: MOF, Foundation Research, January 2023

Fig 47: …due to better yields given usage of hybrid seeds



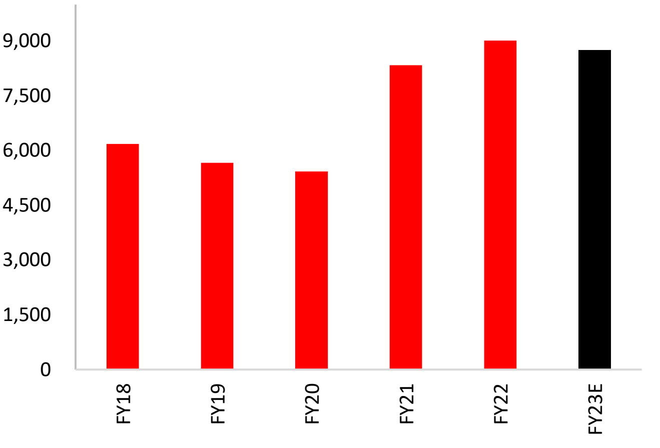
Source: MOF, Foundation Research, January 2023

Fig 48: Food exports are expected to decline…



Source: PBS, Foundation Research, January 2023

Fig 49: …whereas imports to decline amid Rs depreciation



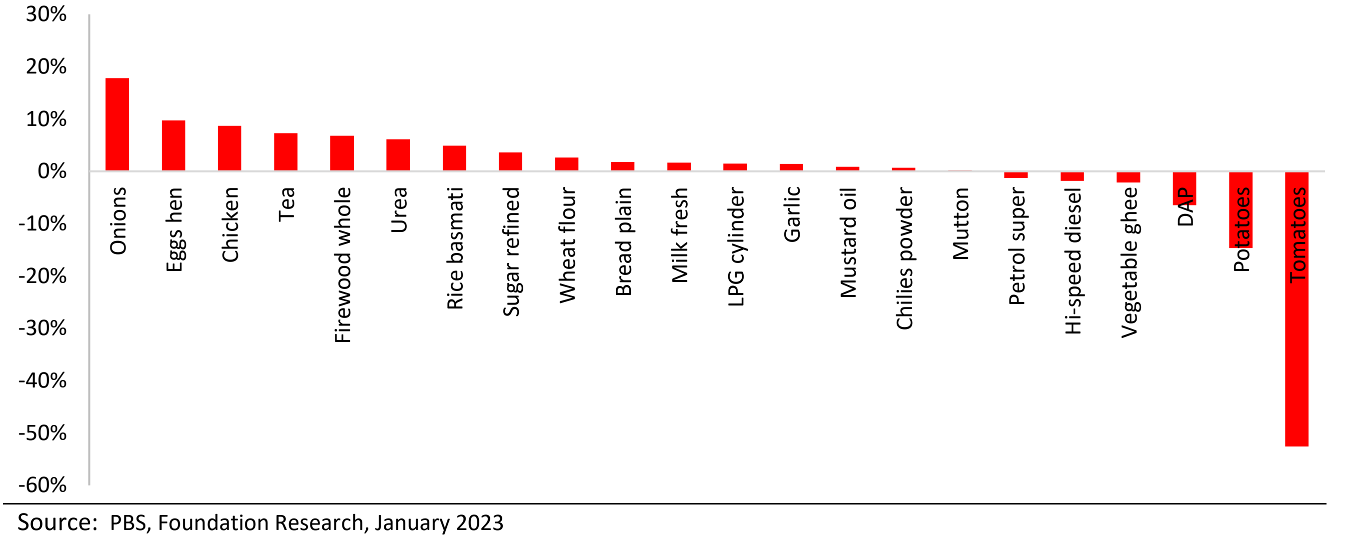
Source: PBS, Foundation Research, January 2023

Table 20 : Production of Important Crops

mn tons	Cotton (bales)	Sugarcane	Rice	Maize	Wheat
FY16	9.9	65.5	6.8	5.3	26.6
FY17	10.7	75.5	6.8	6.1	26.7
FY18	11.9	83.3	7.5	5.9	25.1
FY19	9.9	67.2	7.2	6.8	24.3
FY20	9.1	66.4	7.4	7.9	25.2
FY21	7.1	81.0	8.4	8.9	27.5
FY22	8.3	88.7	9.3	10.6	26.3
FY23E	**5.2**	**82.4**	**6.4**	**11.5**	**28.4**

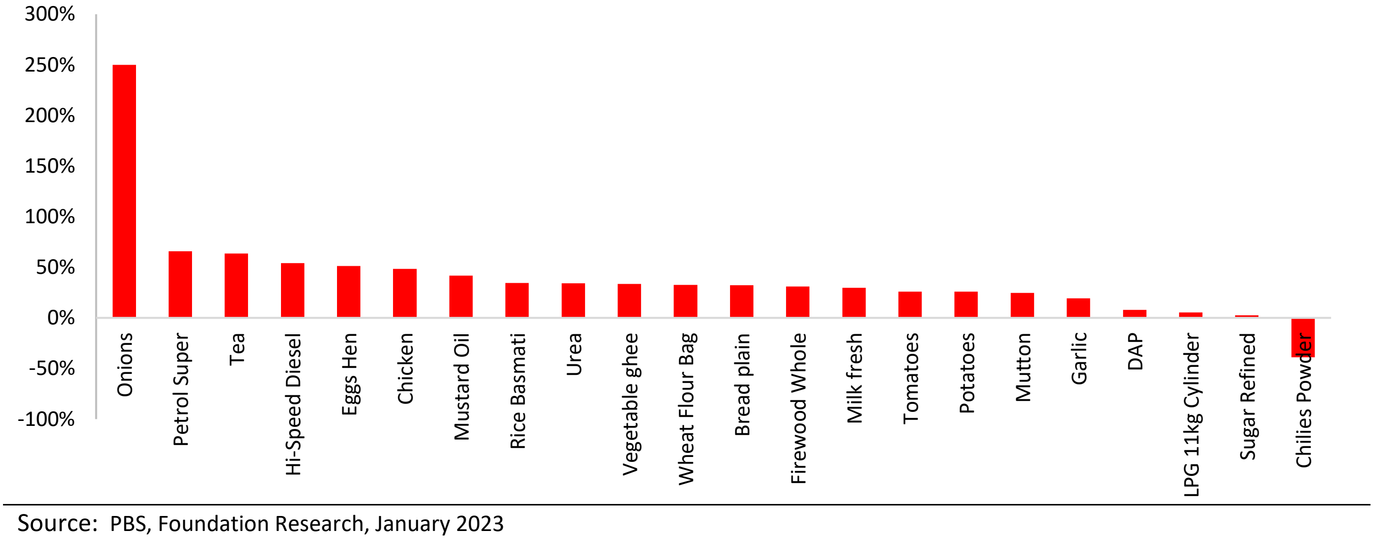
Source: MoF, PC, Foundation Research, January 2023

Fig 50: One month price change: ↓/↑ vegetable/Fertilizer prices negatively impacted farmers income



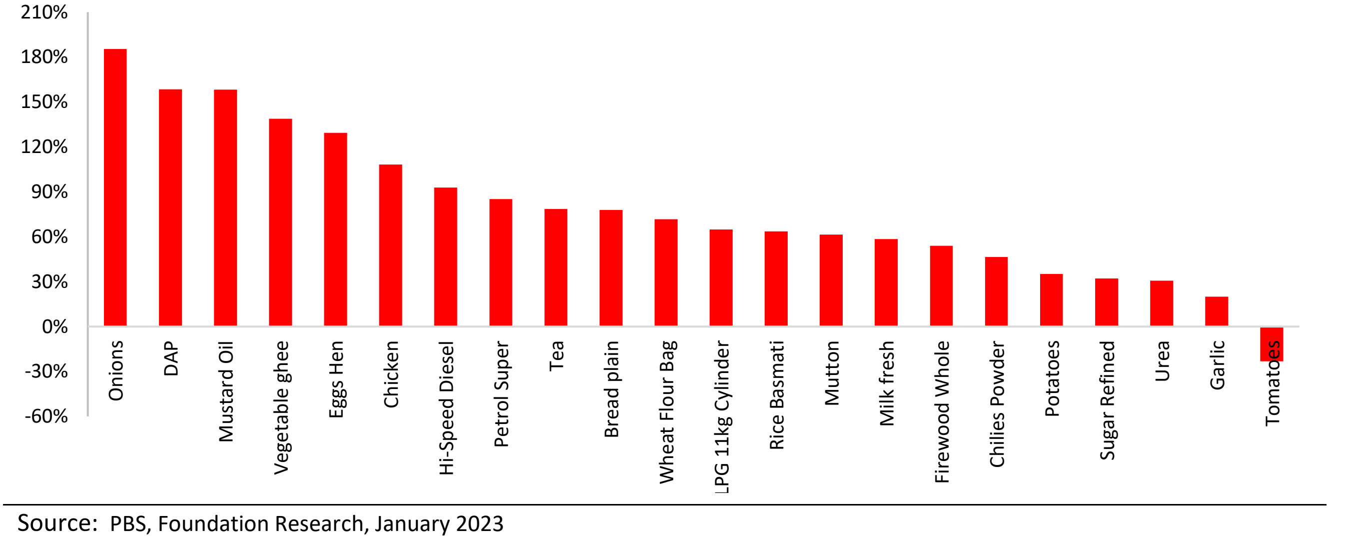
Source: PBS, Foundation Research, January 2023

Fig 51: One year price change: Impact of ↑ farmer input cost partially compensated by ↑ vegetable/crop prices



Source: PBS, Foundation Research, January 2023

Fig 52: Three year price change: Higher wheat, sugar and vegetable prices resulted in better farmers income



Source: PBS, Foundation Research, January 2023

Fig 53: Agriculture Sector of Pakistan

Top 5 Agriculture products - Production in thousand tonnes -Cotton in 000' Bales

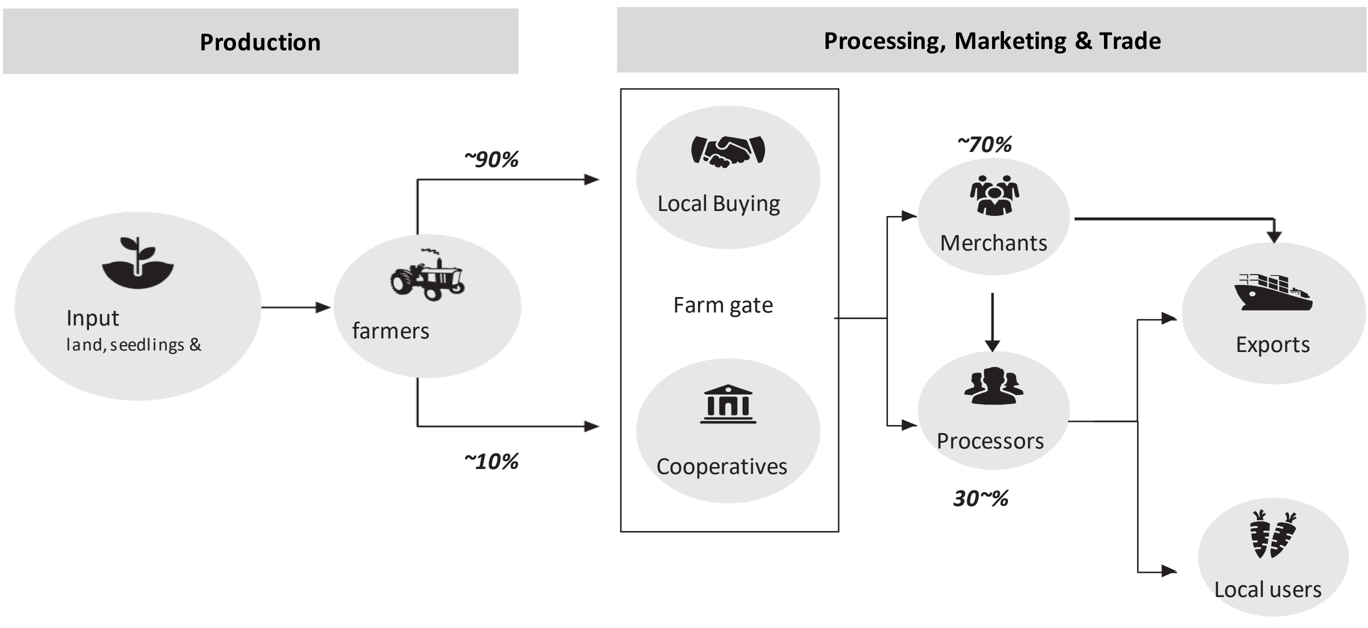
Sugar-cane	Wheat	Rice	Maize	Cotton
88,651	26,394	9,323	10,635	8,329

Top 5 Agriculture - Exports in (US$ mn)

Rice	Fruits, vegetables and nuts	Fish & Fish preparations	Meat & meat preparations	Spices
2,512	999	432	345	106

Top 5 Agriculture - Imports in (US$ mn)

Palm Oil	Wheat	Tea	Pulses	Spices
3,548	795	626	611	216



Source: MOF, MNSFR, Foundation research, January 2023

Capital Market developments to improve Liquidity

PSX, SECP, and SBP have announced a number of new platforms and systems to improve capital market liquidity and boost investor confidence. The following new products were launched during fiscal year 2022:

- ✓ Roshan Equity Investment, a Product under Roshan Digital Account
- ✓ PSX Launches Digitized Listing Process
- ✓ PSX Introduces "Property" as a New Sector Classification
- ✓ PSX Launches the First Dividend Based Index - PSX Dividend 20 Index
- ✓ PSX Offered Shariah-Compliant Trading Platform for RDA Clients
- ✓ PSX established Sahulat Account for easy access to Investors to Stock Market
- ✓ Exchange Traded Funds (ETF) to enhance liquidity in the market
- ✓ NCCPL initiated client onboarding through digitalized process

Roshan Equity Investment, a Product under Roshan Digital Account

Roshan Digital Account was a major initiative of State Bank of Pakistan, in collaboration with commercial banks operating in Pakistan. Roshan Equity Investment is an innovative product whereby non-resident Pakistanis can invest in Pakistan's stock market. It has following advantages:

- Investments can be done conveniently, swiftly and digitally
- Through this investor can avail the facilities of car financing, house financing and purchase of government bonds through their RDAs
- Provides an opportunity to non-resident Pakistanis to connect with domestic banking system and remit foreign income at their ease

Shariah-Compliant Trading Platform for RDA Clients

- PSX and MEBL signed an agreement for this offering to facilitate investors who are focused on investing in Shariah Approved securities
- This trading platform will be available through the online trading system provided by PSX called KiTS.

Sahulat Account: An overly simplified account opening platform

- It provides exceptional ease of account opening for investors whereby they can open a Sahulat Account by only submitting their CNIC/ SNIC and start investing up to an amount of Rs 800,000/
- This is an ideal account for Pakistani individuals such as students, housewives, novice investors or others wanting to invest in the stock market.

PRIDE: A digitized listing process

- PSX has digitized the process of listing through an online portal called PRIDE, i.e. Public Offerings Revolutionized through an Integrated and Digitized Experience.
- Lead Managers, Advisors or Consultants can submit online applications & documentation for listing of equity, debt, mutual funds and Exchange Traded Funds (ETFs) through PRIDE.
- It will enhance the capital raising and listing experience on the Stock Exchange.

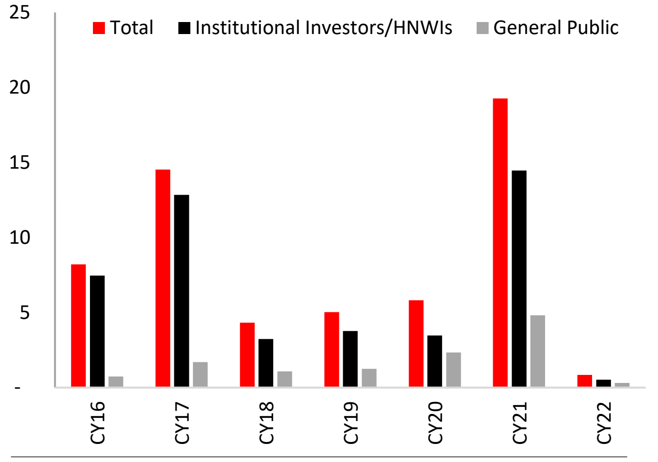
PSX Introduces "Property" as a New Sector Classification

- This is an attempt to distinctly represent the important element of real estate and construction.
- This addition takes PSX closer to a better and improved reflection of the economy in the composition of listed companies.

PSX Dividend 20 Index: first fundamental index

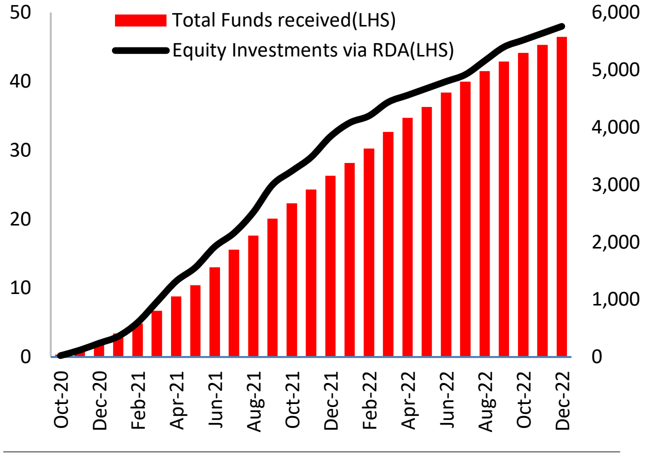
- This is designed to track the performance of the top 20 dividend paying companies at PSX.
- Companies are ranked and weighted based on their trailing 12-month dividend yield.
- It would serve as a valuable tool for market participants as it is designed to screen companies based on their cash payouts.

Fig 54: Liquidity Generated via IPO's drop in CY22 (Rs bn)



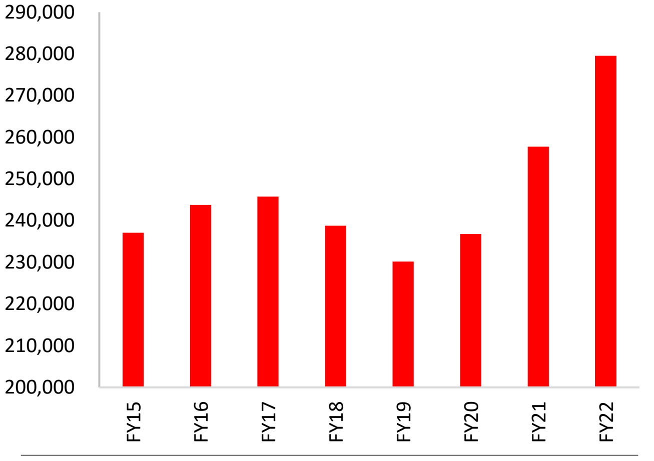
Source: PSX, Foundation Research, January 2023

Fig 55: Funds received via RDA trending upward (US Mn)



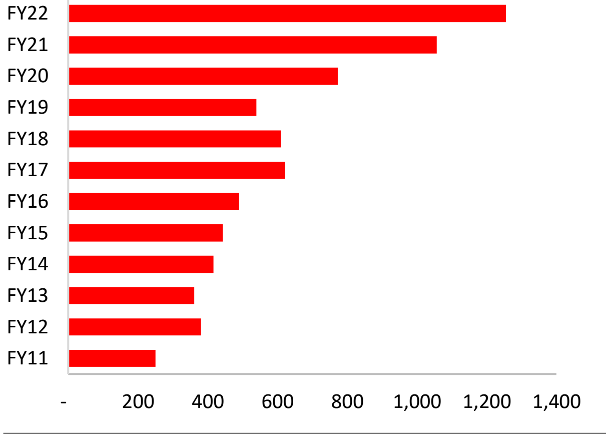
Source: PSX, Foundation Research, January 2023

Fig 56: Growth in UIN's accelerated 8.5% YoY



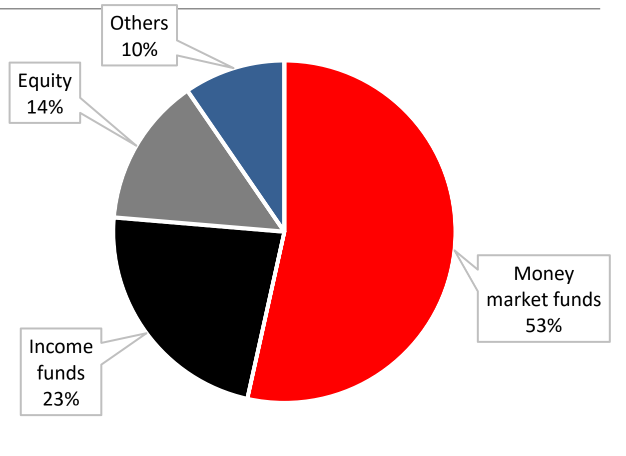
Source: PSX, Foundation Research, January 2023

Fig 57: Mutual Funds Net AUM up 18.8% (Rs bn)



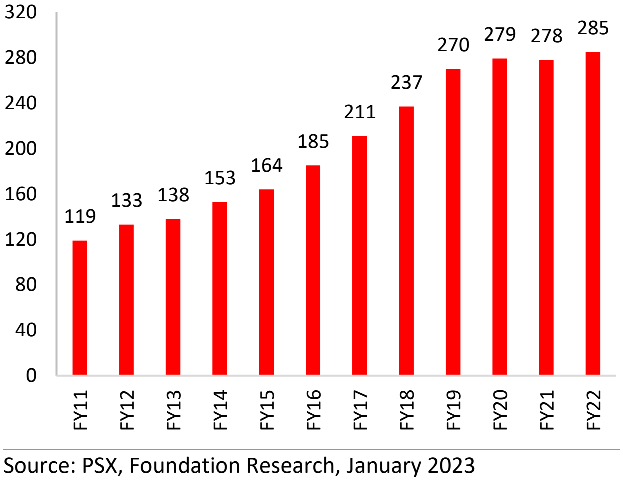
Source: PSX, Foundation Research, January 2023

Fig 58: Equity allocation drop to 14% from 21% last year



Source: MUFAP, Foundation Research, January 2023

Fig 59: Number of Mutual Funds



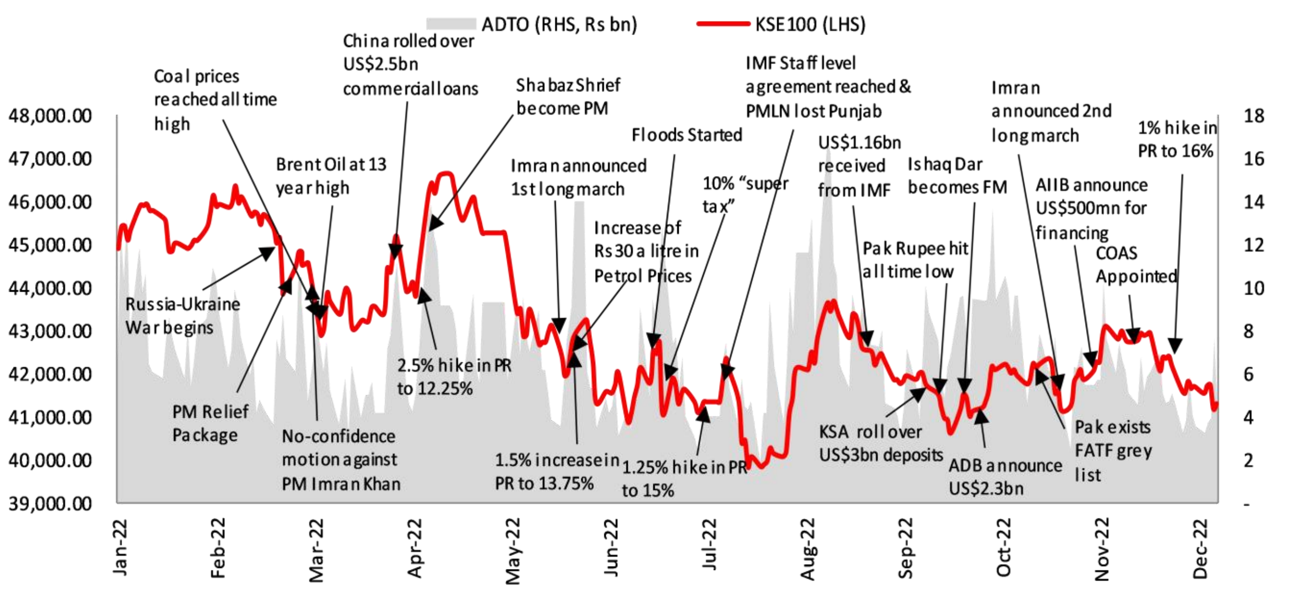
Source: PSX, Foundation Research, January 2023

KSE100 in CY22 fell prey to political tension amid monetary tightening

Exit from FATF "Grey List" overshadowed by political uncertainty and growing concerns over depleting reserves given ballooning of Current Account Deficit and external debt payments. It's been a turbulent year, early on turned to concerns of Russia-Ukraine War and heightened political noise, coupled with higher and persistent inflation driven by persistent global and domestic supply shocks and unwinding of subsidies amid depleting foreign exchange reserves has kept the market under pressure during the second half of the year.

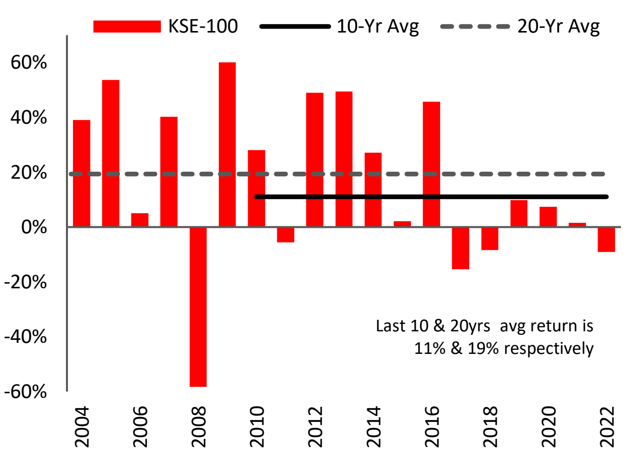
Aggressive monetary tightening and fiscal consolidation, apart from earlier slippages due to political regime change, aimed at ensuring that elevated inflation does not become entrenched and risk to financial stability particularly external account are contained. Subsequently, current account deficit moderates to US$3.1bn in 5MFY23 compared to US$7.2bn in 5MFY22 at the cost of economic slowdown. Subsequently, Large Scale Manufacturing contracted by 3.58% in 5MFY23. Because of the aforementioned factors KSE-100 closed the year in red with return of ~9.1% in CY22 (barring dividend yield of 9.5%). Moreover, Rupee deprecation of 21.7% has aggravated the loss to 28.8% in US$ terms.

Fig 60: KSE-100 remained volatile over political and macroeconomic concerns amid geo political tensions



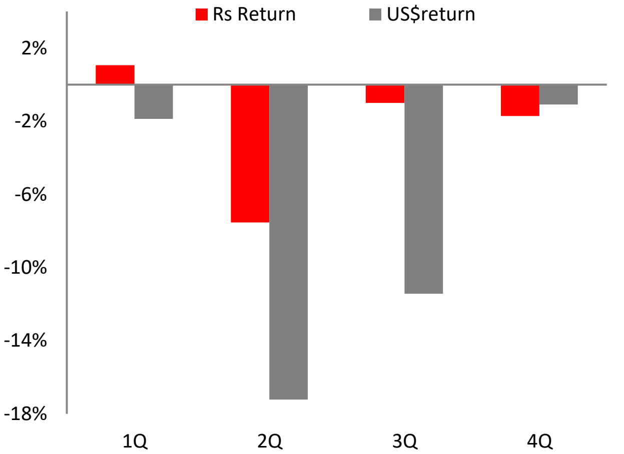
Source: PSX, Foundation Research, January 2023

Fig 61: Market posted way below than average returns in last six years



Source: PSX, Foundation Research, January 2023

Fig 62: KSE-100 provided negative return of 9.1% during CY22

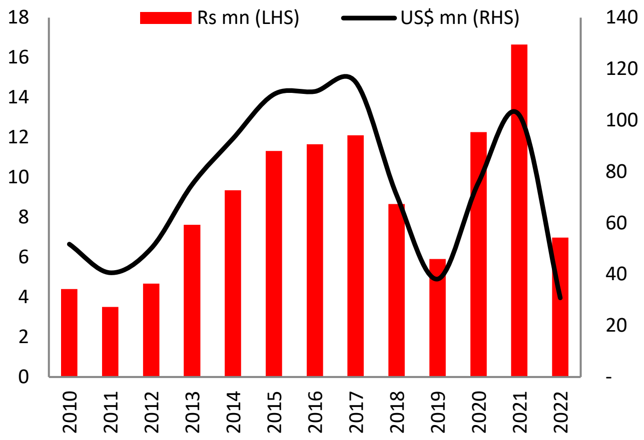


Source: PSX, Foundation Research, January 2023

Liquidity dropped significantly from all time high but remained volatile throughout the year on macroeconomic and political concerns

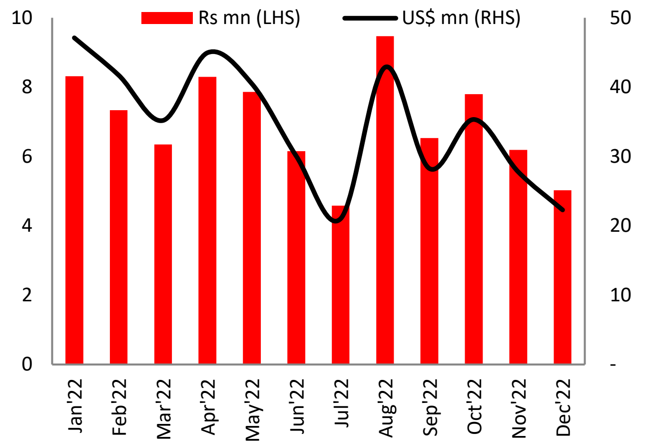
The Average Daily Turnover (ADTO) decreased by 58.0% from all time high of Rs16.6bn to Rs7.0bn (decreased 69.8% in US$ terms to US$31mn) in CY22. In dollar terms the ADTO was lowest since 2000. Market depth responded negatively to continuous political noise and deteriorating economic indicators in particular escalating inflation and depleting foreign exchange reserves during the year. This is evident from reducing market activity, where ADTO decreased by 10.6% from ~Rs7.4bn (or US$40mn) in 1HCY22 to ~Rs6.6bn (or US$30mn) in 2HCY22. During the last month of CY22 ADTO reduced to ~Rs5.0bn, down 28% when compared to full year average.

Fig 63: ADTO decreased by 58% to Rs7.0bn (US$31mn)



Source: PSX, Foundation Research, January 2023

Fig 64: …liquidity remained volatile throughout year on political events

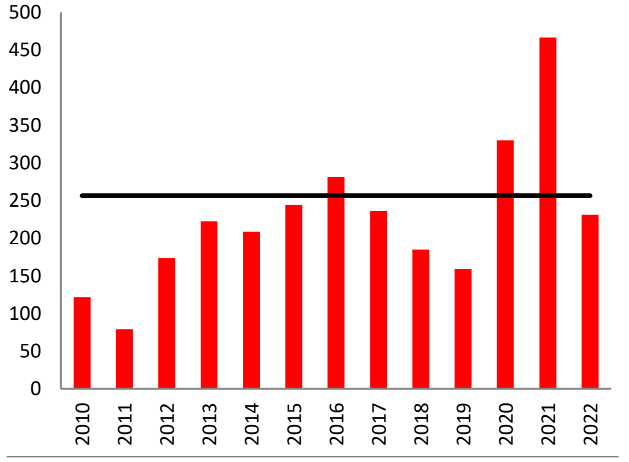


Source: PSX, Foundation Research, January 2023

In terms of shares traded (a more common liquidity barometer for domestic investors), average volumes have plunged 50.4%. Traded volume clocked in at ~231mn shares in CY22 against 466mn last year. However, significant drop in volumes was seen throughout the year with certain exceptions, averaging 246mn shares in second half vs 215mn shares in the first half of CY22. Subsequently, this made it fall below ten year average of 257mn shares.

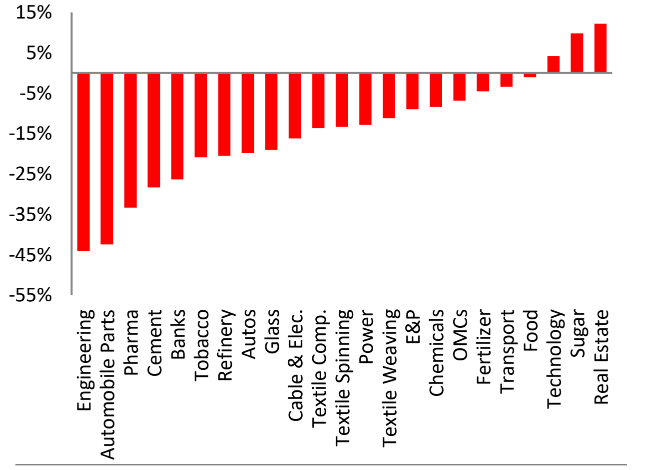
During the year cyclicals remained the worst performing on monetary tightening and continuous deterioration in economic growth prospects. However, Real Estate, Sugar and Technology yielded the positive returns in CY22. Engineering (44%), Automobile parts (42%), Pharma (33%), Cement (28%), Banks (26%), Tobacco (21%), Refinery (20%), Auto (20%), Cable and electric (16%), Textile composite (14%), Textile spinning (13%), Power (13%), Textile weaving (11%), E&P (9%), Chemical (8%), OMCs (7%), Fertilizer (5%) and Food (1%) posted negative return in CY22.

Fig 65: Volume dropped 51% from all time high of 466mn shares on monetary tightening and political unrest



Source: PSX, Foundation Research, January 2023

Fig 66: …Cyclical and financial sectors hit the most on monetary tightening amid political uncertainty

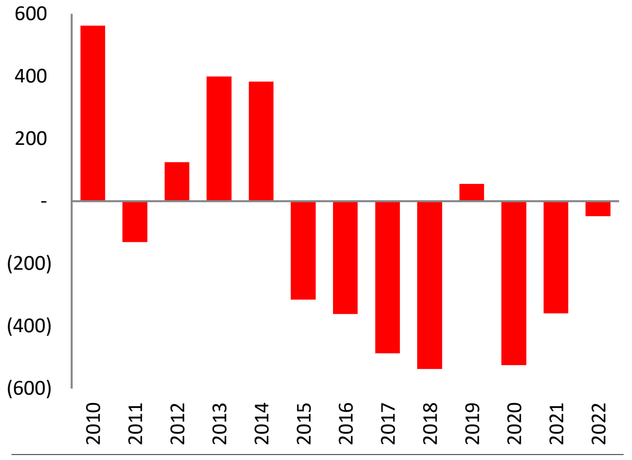


Source: PSX, Foundation Research, January 2023

Foreign selling dropped drastically during the year

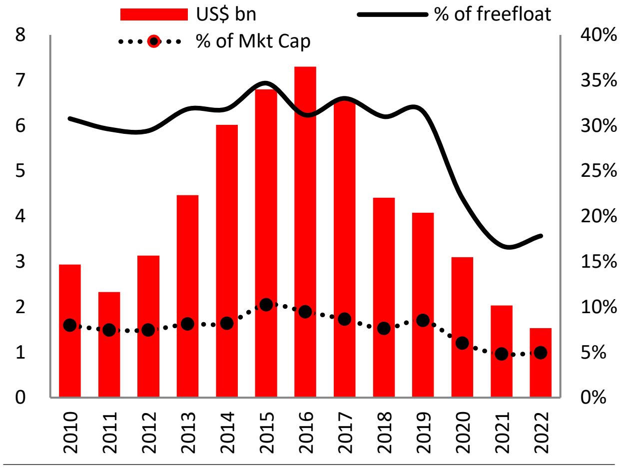
Foreign investors turned negative for the last three consecutive years given Pakistan's reclassification by MSCI and uncertain economic and political situation. However, the trend of foreign inflows remained mixed in the regional markets with markets like Japan, Thailand, Indonesia and Malaysia witnessed inflows while regional markets like Taiwan, India and South Korea witnessed foreign outflows. During the year, Foreigner's sold US$48.1mn worth of shares compared with US$353.9mn selling in CY21. However, foreigner percentage holding of market increased as stocks hold by foreigners dropped by a lesser percentage. Foreigners holding increased to 17.8% of market on free float and 4.96% of market on total market cap basis. During the last ten years foreigners trimmed position in PSX by ~US$1.8bn, half of which came in latter three years. Shifting of funds from relatively smaller Frontier Markets (FM) seems be the primary reason for foreign outflows. Removal of Pakistan from FATF grey list would provide reputational boost to the country, improve investor sentiments and allows to attract foreign inflows. However, materialization of inflows would take time given the uncertain political environment and tightening of interest rates by FED which has led to capital flight from emerging markets.

Fig 67: Foreigners selling slowdown massively as country exit from FATF grey list



Source: NCCPL, Foundation Research, January 2023

Fig 68: …continuous selling causes FII's holding to drop significantly at KSE-100

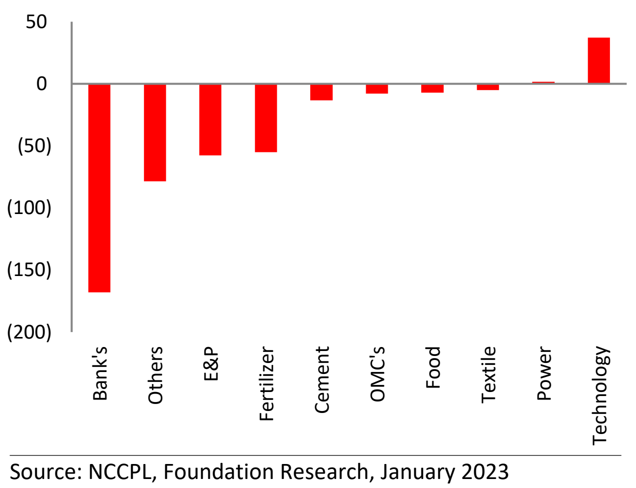


Source: SBP, PSX, Foundation Research, January 2023

Bank, Cement, Fertilizer and Food sectors witnessed net outflow during the year, with Banks seeing the majority of outflows (~US$127mn) followed by Cement (US$15mn), Fertilizer (US$13mn) and Food (US$0.3mn). On the other hand, Technology sector witnessed the majority of inflows (US$77mn) followed by E&P (US$10mn), Textile (US$7mn) and Power (US$6mn).

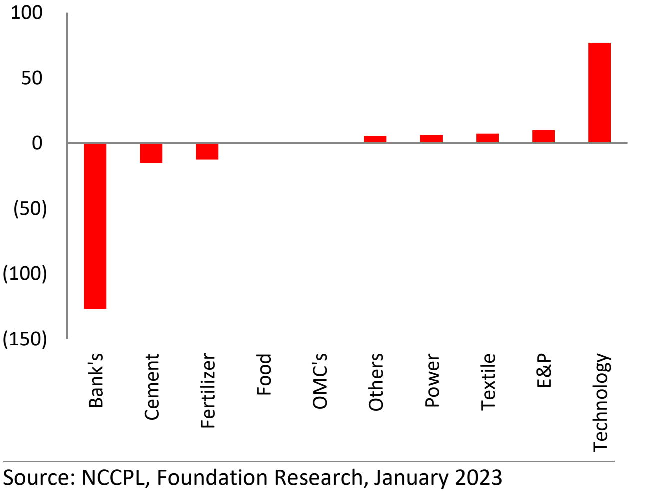
Successful completion of IMF program along with political stability in the country would help the country in achieving sustainable economic growth through focus on structural reforms. Adoption of market based exchange rate with building international reserves provides exchange rate sustainability. However, monetary tightening by FED and elevated commodity prices would keep foreign investors at bay but industry or sector specific response could not be ruled out.

Fig 69: Technology sector witnessed inflows in CY21 (US$ mn)…



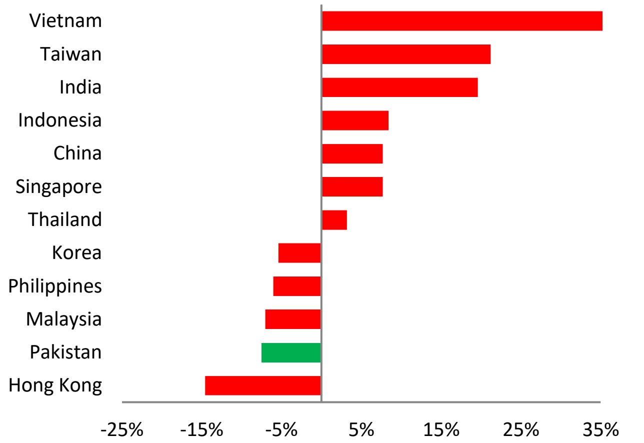
Source: NCCPL, Foundation Research, January 2023

Fig 70: …remained the leader among sector witnessed FII's inflows in CY22 (US$ mn)



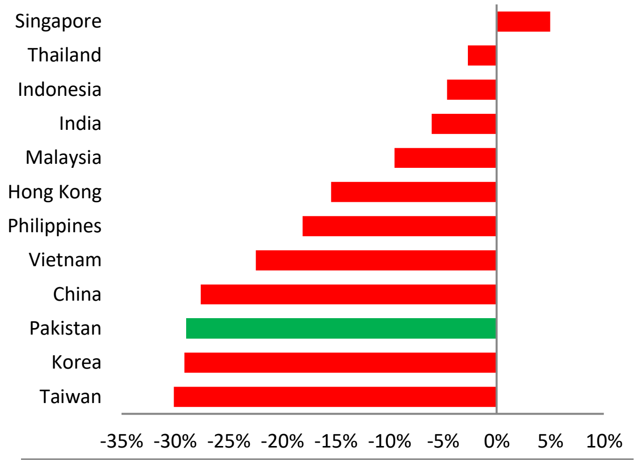
Source: NCCPL, Foundation Research, January 2023

Fig 71: … Rupee depreciation made returns negative among emerging markets in CY21…



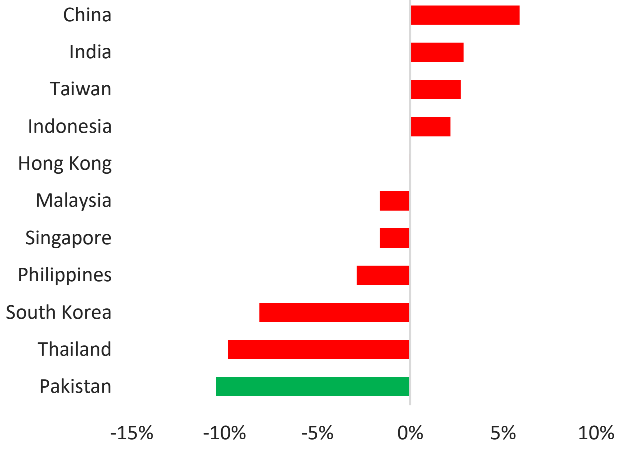
Source: Bloomberg, Foundation Research, January 2023

Fig 72: … Rupee depreciation exaggerate negative return in CY22…



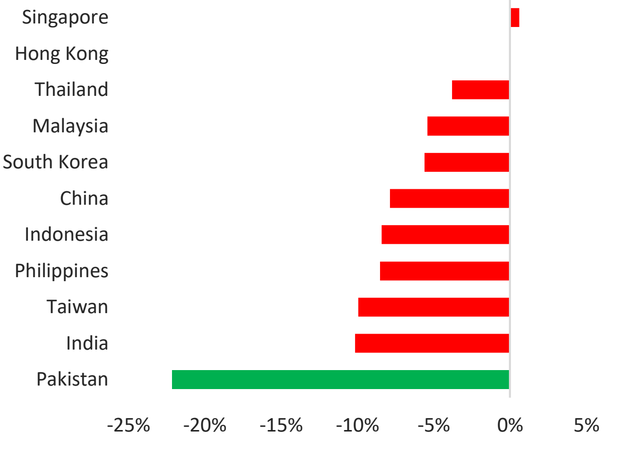
Source: Bloomberg, Foundation Research, January 2023

Fig 73: Rupee facing the brunt of higher commodity prices in CY21



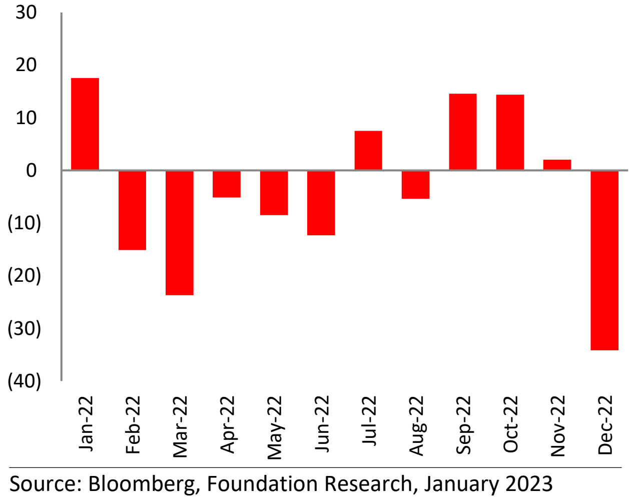
Source: Bloomberg, Foundation Research, January 2023

Fig 74: …trend continued in CY22 amid political instability



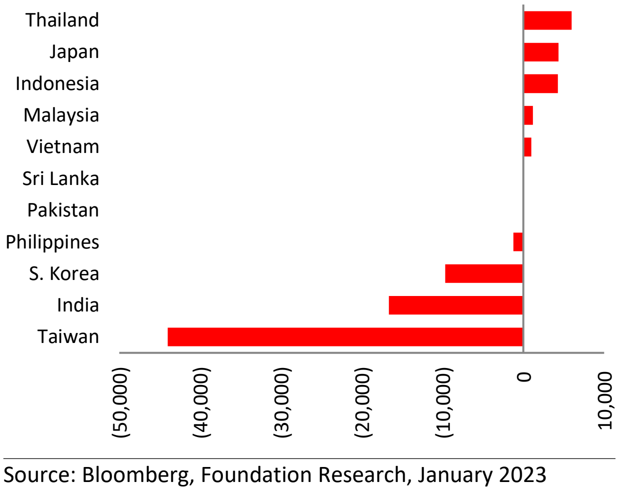
Source: Bloomberg, Foundation Research, January 2023

Fig 75: ...foreigners selling gained momentum on buy back (US$ mn)



Source: Bloomberg, Foundation Research, January 2023

Fig 76: … mix trend witnessed in regional markets during CY22



Source: Bloomberg, Foundation Research, January 2023

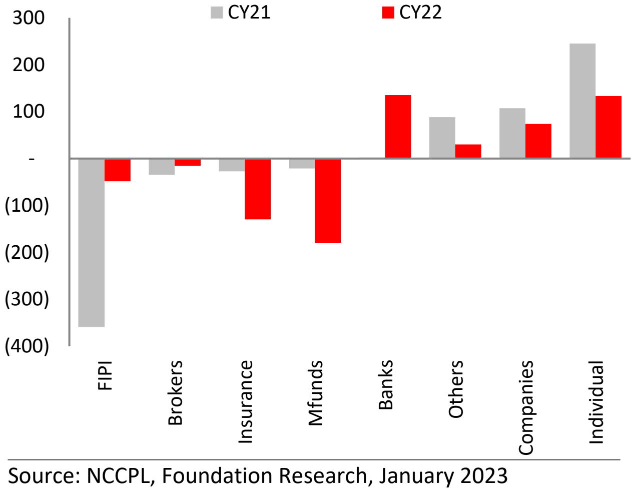
Individuals, Banks and Companies among liquidity providers

This year, Banks and Companies were key liquidity providers alongside Individuals in supporting the market and the exit of foreign investors, Mutual funds and Insurance. Interestingly, exit was provided to Foreign Investors by a mix of local participants other than Insurance, Brokers and Mutual Funds (MF). Individuals have bought US$133.4mn worth of shares, enhancing their exposure in all sectors barring Technology. They tilted towards the Others with ~US$56mn worth purchase of stocks followed by Banks, Power, OMCs, Cements and E&P with value of ~US$31mn, ~US$21mn, US$15mn, ~US$12mn and ~US$4mn respectively. Companies in Technology failed to draw interest of individuals, witnessing an outflow of ~US$23mn.

Mutual Funds reduced their equity exposure to the tune of US$180mn with selling across the board. MF mainly reduced exposure in Others, Cements and Banks with net selling of US$80mn, US$26mn and US$14mn. They also reduced exposure in Power, Textile and Technology by ~US$14mn, US$14mn and ~US$13mn respectively. On the other side, Companies and Others enhanced their exposure in equities by ~US$74mn and ~US$30mn respectively during the year. Companies enhanced their exposure across all segments barring Technology with majority of the buying in Banks of ~US$47mn. Among local participants, Insurance trimmed its exposure by US$130mn.

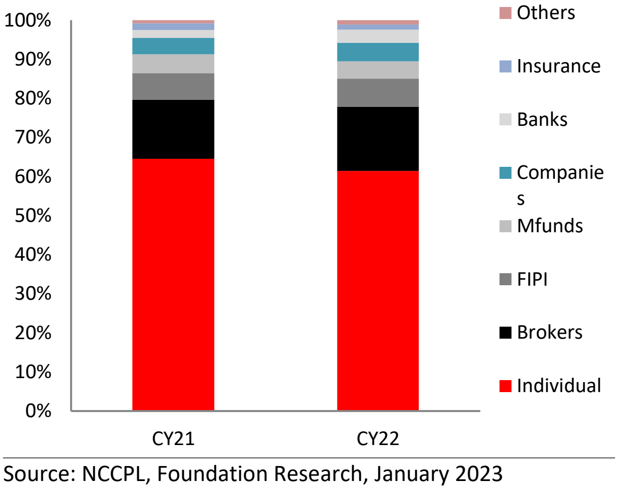
In terms of trading, individuals (including HNWI) remained the lead liquidity provider with a market participation of 61.4% in total ADTO during CY22. However, individual share dropped the most by 309bps YoY. Brokers' contribution to ADTO remained above this year with participation of 16.4% against 15.1% in CY21. Foreigner's participation witnessed increase of 40bps to 7.2% in CY22 and Banks participation improved the most by 138bps to 3.38%.

Fig 77: Individuals and Banks mainly absorbed Insurance & MF sell-off (US$ mn)



Source: NCCPL, Foundation Research, January 2023

Fig 78: Liquidity continued to be provided by individuals and brokers



Source: NCCPL, Foundation Research, January 2023

Table 21: CY22 trading activity summary

	FIPI	M. Fund	Banks	Brokers	Ind.	Ins.	Comp.	Others
Gross Activity								
Buy	951.44	509.36	525.48	2,214.12	8,391.13	114.46	679.42	162.74
Sell	(999.68)	(689.01)	(389.92)	(2,229.44)	(8,257.67)	(244.22)	(605.44)	(132.77)
Net	**(48.24)**	**(179.65)**	**135.56**	**(15.33)**	**133.46**	**(129.76)**	**73.98**	**29.97**
Sector wise position								
Banks	(126.86)	(14.07)	79.61	(0.90)	30.94	(6.69)	46.90	(9.03)
E&P	10.08	(5.27)	5.72	1.38	4.16	(26.63)	8.17	2.39
Fertilizer	(15.13)	(25.50)	20.82	(0.16)	12.13	(10.04)	12.81	5.07
Power	(12.60)	(5.60)	(7.97)	0.40	9.13	(9.42)	11.26	14.70
Cement	6.41	(13.88)	(1.31)	(1.57)	21.26	(9.31)	0.08	(1.67)
Food	0.26	(6.32)	(0.45)	1.86	14.54	(10.30)	0.57	(0.16)
OMCs	(0.28)	(2.45)	(1.09)	1.39	7.88	(7.12)	0.15	1.55
Textile	76.84	(13.20)	6.85	(16.46)	(23.21)	(9.45)	(20.46)	(0.55)
Technology	7.39	(13.81)	7.54	(0.75)	0.45	(4.08)	4.64	(1.31)
Others	5.66	(79.55)	25.85	(0.48)	56.13	(36.72)	9.86	19.00
Total	**(48.24)**	**(179.65)**	**135.56**	**(15.29)**	**133.42**	**(129.75)**	**73.97**	**29.98**

Source: NCCPL, Foundation Securities, January 2023

Table 22: Covered universe performance review for 2022

Sector/scrip	CY22 return	CY22 catalyst
Commercial Banks		
HBL	-43%	Low payout given range bound CAR and US case
MCB	-17%	Higher taxation due to lower ADR
UBL	-13%	Higher provisioning expense and taxation given lower ADR
BAFL	-1%	Earnings growth and Higher payout restricted negative return
MEBL	-10%	Fear of higher provisioning due to economic slowdown
AKBL	-9%	Absence of payout and establishment of TSA
FABL	46%	Islamic conversion and earnings growth
Fertilizer		
FFC	16%	Higher pricing power and higher income on financial assets
ENGRO	9%	Higher dividend payout and expected buyback
EFERT	24%	Delay in GIDC payment and improved Urea prices
FFBL	-42%	Further investment in FFL and decline in DAP sales
Oil & Gas Exploration		
OGDC	-8%	Delay in implementation of circular debt management plan and pilling of receivables
PPL	-25%	Delay in implementation of circular debt management plan and lower dividend payout
POL	39%	Increase in earnings given higher oil prices and strong dividend yield
MARI	1%	Imposition of super tax
Cement		
LUCK	-37%	Decline in cement and Autos demand amid higher input cost
DGKC	-42%	High leverage and higher energy cost amid decline in cement demand
FCCL	-30%	Higher energy cost and decline in cement demand
CHCC	-33%	Higher energy cost and decline in cement demand
PIOC	-47%	High leverage and higher energy cost amid decline in cement demand
KOHC	-27%	Higher energy cost and decline in cement demand
ACPL	-57%	Decline in exports and higher energy cost due to surge in coal prices
Power Generation		
HUBC	27%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
KAPCO	11%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
NCPL	121%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
NPL	27%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
PKGP	38%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
LPL	16%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
Oil & Gas Marketing		
PSO	-23%	Buildup of LNG receivables diluted the impact of hefty inventory gains
APL	36%	Higher earnings growth and strong dividend payout
Auto Assembler		
INDU	-14%	Decline in automobile sales
HCAR	-41%	Decline in sales and higher input cost
PSMC	-41%	Decline in sales and higher input cost
Food Producers		
FCEPL	-24%	Higher input cost and decline in volumetric growth
Textile		
ILP	-13%	Fear of lower exports given slowdown in US, Europe and UK
NML	-30%	Subdued portfolio performance
Chemical		
EPCL	10%	Higher dividend payout and elevated margins
LOTCHEM	166%	Possible acquisition of majority stake
Engineering		
ASTL	-60%	High leverage and lower demand
AGHA	-52%	Continuous delay in expansion, high leverage and lower demand
MUGHAL	-45%	High leverage and lower demand
ISL	-26%	Slowdown in demand and high leverage
Technology		
SYS	30%	Acquisition of Ndtech and significant growth in Middle East and North America region

Source: PSX, Foundation Research, January 2023

Table 23: Bonus shares in CY22

S. #	Symbol	Securities	Issue Date	% of Bonus
1	BIFO	Biafo Ind.	16-Feb-22	10%
2	MTL	Millat Tractors	23-Feb-22	20%
3	ATIL	Atlas Ins. Ltd	25-Feb-22	10%
4	CENI	Century Ins.	1-Mar-22	10%
5	BOK	Bank Of Khyber	4-Mar-22	5%
6	PAKOXY	Pak Oxygen Ltd.	8-Mar-22	25%
7	HINOON	Highnoon (Lab)	16-Mar-22	10%
8	RICL	Reliance Ins.	28-Mar-22	5%
9	ASIC	Asia Insurance	1-Apr-22	10%
10	AVN	Avanceon Ltd	4-Apr-22	25%
11	COLG	Colgate Palm	1-Aug-22	15%
12	PCAL	Pakistan Cables	12-Aug-22	15%
13	ATRL	Attock Petroleum	16-Aug-22	25%
14	NEXT	Next Capital	24-Aug-22	15%
15	AGIL	Agriautos Ind.	26-Aug-22	25%
16	ATBA	Atlas Battery	29-Aug-22	25%
17	FEROZ	Ferozsons (Lab)	31-Aug-22	20%
18	TGL	Tariq Glass Ind.	19-Sep-22	25%
19	FANM	AL-Noor Mod	20-Sep-22	10%
20	FCCL	Fauji Cement	21-Sep-22	12.50%
21	MTL	Millat Tractors	23-Sep-22	20%
22	ECOP	ECOPACK Ltd	26-Sep-22	15%
23	ASHT	Ashfaq Textile	27-Sep-22	10%
24	IMAGE	Image Pakistan	28-Sep-22	15%
25	PREMA	At-Tahur Ltd.	28-Sep-22	10%
26	IBLHL	IBL HealthCare	29-Sep-22	10%
27	TPLP	TPL Properties	30-Sep-22	10%
28	POML	Punjab Oil	30-Sep-22	20%
29	SEARL	The Searle Co.	3-Oct-22	25%
30	GVGL	Ghani Value Glass	4-Oct-22	20%
31	GEMSPNL	Supernet Ltd.	7-Oct-22	10%
32	KHTC	Khyber Tobacco	10-Oct-22	20%
33	MIRKS	Mirpurkhas Sugar	16-Dec-22	15%

Source: PSX, Foundation Research, January 2023

Table 24: Right Share in CY22

S.#	Symbol	Securities	Issue Date	Right Issue
1	FLYNG	Flying Cement	19-Jan-22	75.99%
2	PAEL	Pak Elektron	7-Feb-22	72%
3	EWIC	East West Ins	6-May-22	10%
4	CLVL	Cordoba Logistic	6-Jun-22	226.19%
5	GTECH	G3 Technologies	5-Sep-22	8.80%
6	ASC	Al-Shaheer Corp	28-Nov-22	25%

Source: PSX, Foundation Research, January 2023

Table 25: Buy Back Share in CY22

S.#	Symbol	Securities	Issue Date	Buy Back
1	LUCK	Lucky Cement Limited	16-Sep-22	10,000,000
2	ENGRO	Engro Corporation Limited	14-Dec-22	70,000,000
3	BAFL	Bank Alfalah Limited	7-Dec-22	200,000,000
4	JDW	JDW Sugar Mills Limited	4-Nov-22	2,000,000
5	NETSOL	NetSol Technologies Limited	10-May-22	2,000,000
6	Maple	Maple Leaf Cement Limited	17-May-22	25,000,000

Source: PSX, Foundation Research, January 2023

Defensive sectors to boost index profitability

Using the FSL universe as a proxy (~65% of KSE FF Market Cap), we forecast earnings growth of ~17.0% for the year 2023. The banking sector would be the major contributor to our universe earnings growth with increase of ~44% during next year due to (i) surge in Net Interest Income (NIIs) amid higher Net Interest Margins (NIMs) due to increase in policy rate to 16.0%, (ii) higher foreign exchange contribution, and (iii) reduction in super tax to 4%.

E&P sector is expected to continue its earnings growth during 2023 on elevated Arab light prices along with dollar indexed revenue. We expect an average AL price of US$95.6/bbl in FY23 and US$88.0/bbl in FY24 due to continuation of Russia Ukraine war.

Unlike 19% YoY drop in profitability of the fertilizer sector in CY22, we expect profitability to rebound in 2023 by 20% YoY as better urea pricing power would create room to pass on the impact of rationalization of gas prices amid better utilization levels despite payment of Rs187bn in lieu of Gas Infrastructure and Development Cess (GIDC).

We also expect Power sector to show significant growth of 20% given a higher dollar indexation along with expansion into cheaper coal power plants by Hub Power Company despite revision in dollar indexation mechanism of IPPs. However, energy sector reforms, in particular revision in Power Purchase Agreements (PPAs) to take and pay would substantially hit sector profitability going forward.

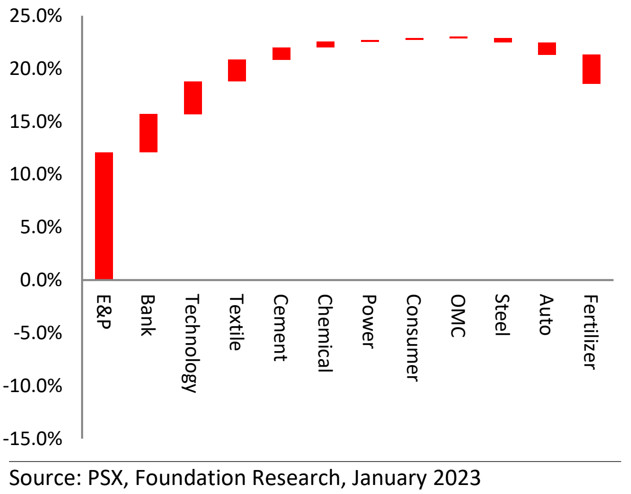
The Textile sector would remain beneficiary of (i) currency depreciation, (ii) the Government's export relief package, (iii) reduction in cotton prices, (iv) lower freight charges and (v) subsidized gas/electricity tariffs. Textile sector is also major beneficiary of TERF facility which is in addition to LTFF and ERF.

Cement sector profitability is expected to decline due to (i) lower despatches given economic slowdown, (ii) higher coal prices, (iii) higher finance cost on the back of increased debt levels to finance expansions, (iv) lower exports given dollar shortages in cement export markets and (v) price competition to gain market share after capacity additions amid lower utilization levels.

We expect OMCs earnings to drop by 29%YoY due to lower inventory gains and normalization of one-offs along with decline in MS/HSD demand due to economic slowdown and higher prices. Auto sector is expected to decline by 17% in 2023 given (i) volumetric decline due to change in priority of opening LCs, (ii) lower demand due to elevated interest rates and (iii) rupee depreciation. Technology sector profitability is likely to slow down to 26% YoY in CY23 due to lower rupee depreciation and absence of one offs along with slowdown in US and Europe. However, IT sector remains beneficiary of Government focus on digital initiatives.

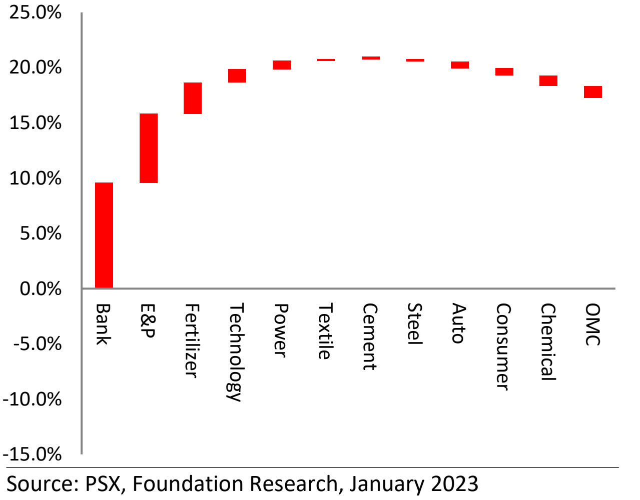
The Steel sector profitability would shrink by 13% on higher financial charges due to increased working capital requirements on the back of economic slowdown and procurement of raw material at elevated prices. The Chemical sector's profitability to post decline of 35% YoY during CY23 after having robust profitability in last two year due to normalization of margins given lower finished goods prices on global slowdown. We expect FMCG profitability to decline by 39% YoY next year due to decline in purchasing power amid higher input cost.

Fig 79: CY'22 earnings to grow over 18.7% YoY



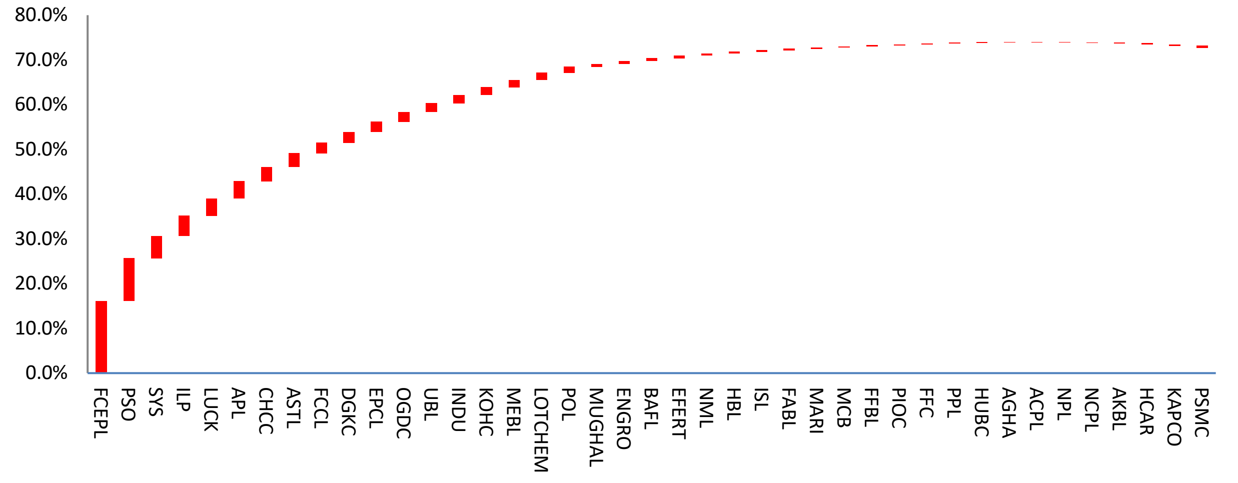
Source: PSX, Foundation Research, January 2023

Fig 80: Next year earnings growth expected to be ~17.0%



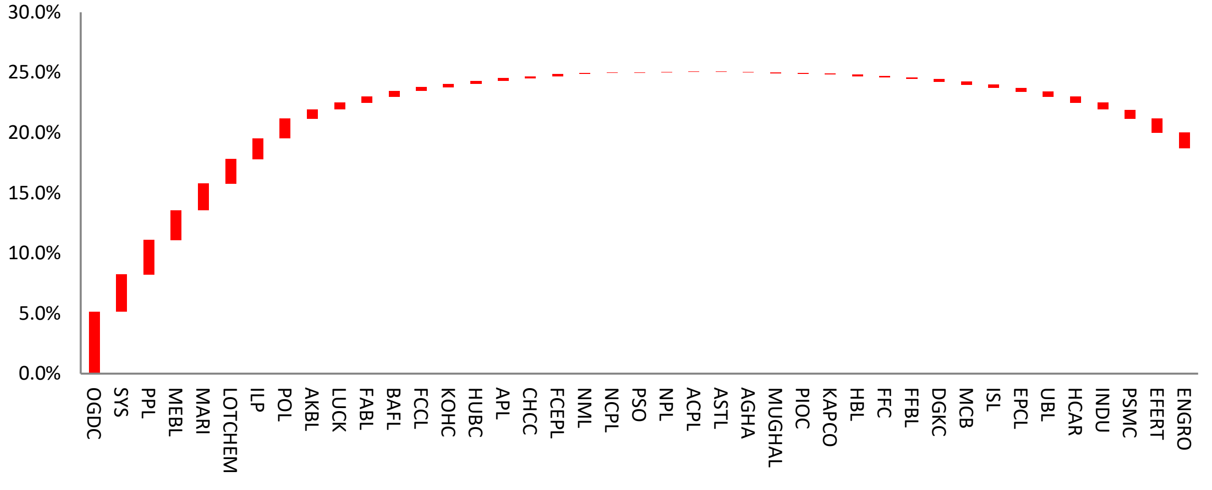
Source: PSX, Foundation Research, January 2023

Fig 81: Stock wise earning growth (2021)



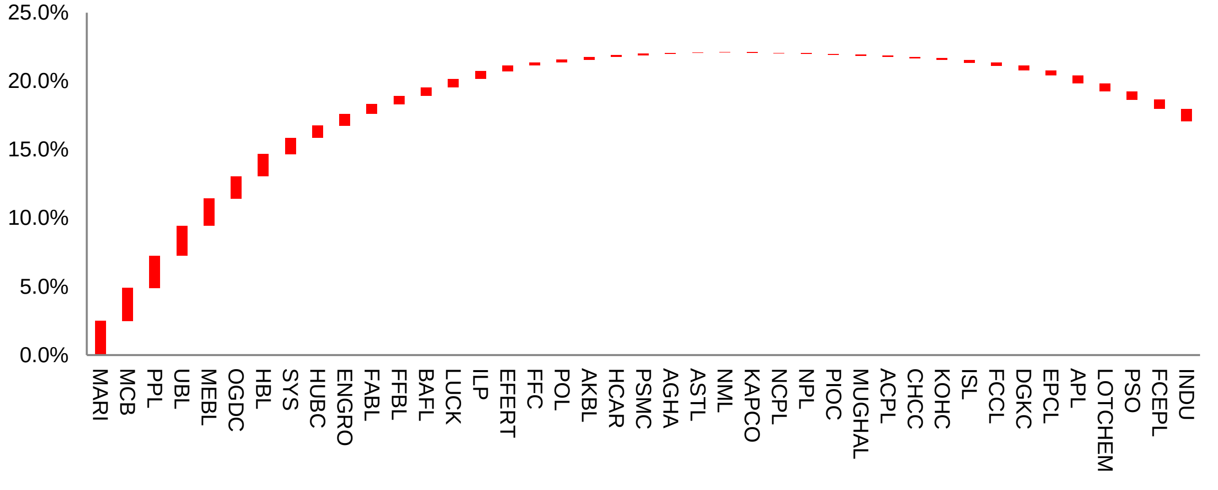
Source: PSX, Foundation Research, January 2023

Fig 82: Stock wise earning growth (2022)



Source: PSX, Foundation Research, January 2023

Fig 83: Stock wise earning growth (2023)



Source: PSX, Foundation Research, January 2023

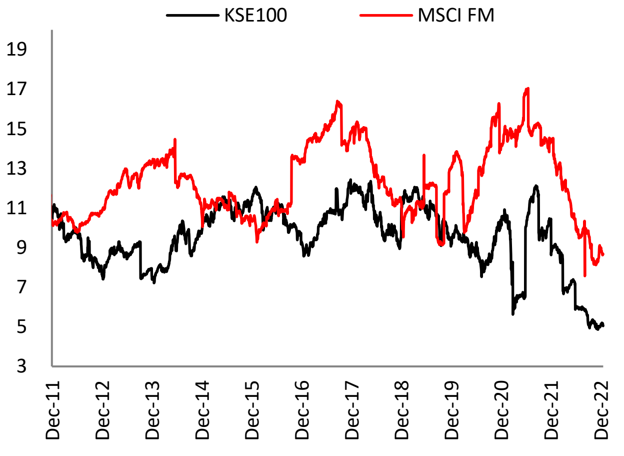
All set to outperform MSCI FM on attractive valuation

Concerns over manageability of external account, political noise and regional changing landscape along with lack of smoothness in IMF program reviews are the primary reasons behind lack of foreigner's faith in PSX. Resultantly KSE-100 under performed in comparison to the MSCI World, MSCI EM and MSCI FM indices. MSCI World and MSCI EM provided a significant negative return of ~17.7% and 20.1% while MSCI EM declined ~26.5% during the year. This has improved KSE-100 discount to 51% however remains well above against the historical average of 26%.

During the year, FATF has removed Pakistan from grey list but still KSE-100 failed to attract foreign investors given outflow from FM and EM markets on FED tightening. Two Pakistani securities are part of the MSCI Frontier Markets Index at an aggregate weight of 0.7% and eight securities are part of MSCI FM 100 Index with weight of 2.7%. The MSCI Pakistan FM index has total 20 companies (2 mid cap and 18 small cap) compared to the current 18 companies (3 mid cap and 14 small cap) in previous year. (1) Successful completion of IMF program, (2) ending of FED tightening and (3) structural reforms along with ease in regional tensions would allow KSE-100 index to outperform the MSCI FM Index.

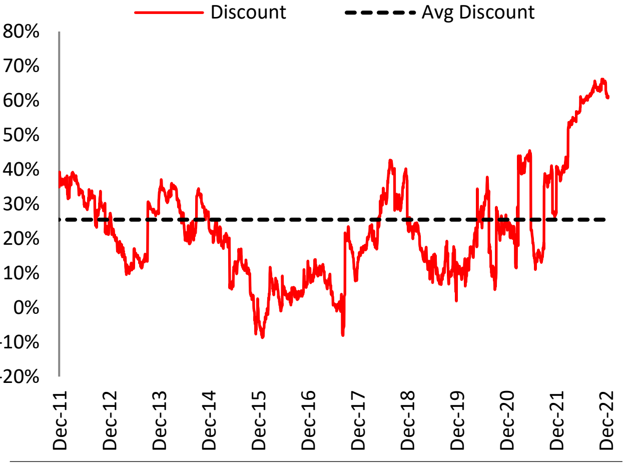
These changes, along with the improvement in balance of payment and reserve cushion ought to enhance foreigners comfort with investing in local currency assets.

Fig 84: PE comparison: KSE100 vs MSCI FM



Source: Bloomberg, FSL Research, January 2023

Fig 85: KSE100 at 51% discount vs 12yr avg of 26%



Source: Bloomberg, FSL Research, January 2023

More specifically, in the regional context, Pakistan is also attractively valued compared to rest of the region. The country offers a moderate earnings growth on a much lower PE ratio and a higher ROE at a below average PB level. Furthermore, it is currently offering an attractive dividend yield in excess of ~10% compared to the regional average of ~3.2%.

Table 26: Regional Comparison

	PER (x)		P/BVS (x)		Dividend Yield (%)	
	2022	**2023**	**2022**	**2023**	**2022**	**2023**
Pakistan	**3.52**	**3.27**	**0.65**	**0.57**	**9.74**	**10.12**
Thailand	16.08	15.35	1.67	1.58	2.68	2.88
Taiwan	10.41	12.51	1.87	1.75	4.79	4.22
Singapore	12.01	10.72	1.08	1.03	4.46	4.89
Malaysia	14.54	13.05	1.46	1.40	4.03	4.37
Indonesia	14.43	14.20	1.86	1.67	3.33	4.03
China	11.50	10.00	1.29	1.18	2.87	3.08
Korea	10.55	11.01	0.89	0.84	2.37	2.50
Hong Kong	10.90	9.61	1.14	1.06	3.38	3.70
India	22.26	18.68	3.30	2.91	1.32	1.50
Philippines	15.05	13.15	1.61	1.49	2.10	2.12
Vietnam	10.68	9.48	1.68	1.46	1.91	2.18
Regional Avg.	**13.49**	**12.52**	**1.62**	**1.49**	**3.02**	**3.22**
Discount/Premium to Region	**-73.9%**	**-73.9%**	**-59.9%**	**-61.7%**	**6.7**	**6.9**

Source: Bloomberg, Foundation Research, January 2023

Table 27: MSCI FM (Main Index) Pakistan Expected weight

Company	Free Float Market Cap (USD mn)	MSCI Weight
LUCK	255	0.4%
OGDC	211	0.3%
Total	**466**	**0.7%**

Source: MSCI, PSX, Foundation Research, January 2023

Table 28: MSCI FM (Small Cap) Pakistan Constituents

Company	Free Float Market Cap (USD mn)	MSCI Weight
ENGRO	360	1.1%
HUBC	313	1.0%
SYS	310	0.9%
UBL	236	0.7%
FFC	222	0.7%
MCB	212	0.6%
MTL	149	0.5%
MARI	182	0.6%
EFERT	181	0.6%
HBL	179	0.5%
PPL	164	0.5%
POL	172	0.5%
PSO	134	0.4%
TRG	196	0.6%
BAFL	94	0.3%
INDU	70	0.2%
EPCL	34	0.1%
SEARL	40	0.1%
Total	**3,248**	**9.9%**

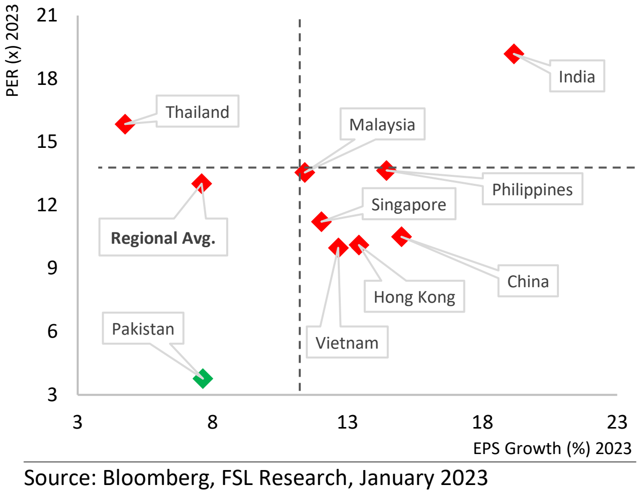
Source: MSCI, PSX, Foundation Research, January 2023

Table 29: Portfolio investments since Pakistan reclassification to MSCI Frontier market (From Sep 7'21 to Dec 31'22)

	F-Corp.	F-Indv.	O.S. Pak	F. Total	Fund's	Bank's	Broker's	Indiv.	Insur.	Comp.	Other's
Gross Activity											
Buy	482.77	64.16	1,009.26	1,556.19	883.13	716.57	3,418.89	13,164.80	301.65	1,103.55	266.73
Sell	(838.73)	(35.00)	(909.61)	(1,783.34)	(1,077.38)	(552.88)	(3,440.84)	(12,973.81)	(383.73)	(992.13)	(207.52)
Net	(355.95)	29.17	99.65	(227.14)	(194.26)	163.69	(21.96)	190.99	(82.07)	111.41	59.21
Sector wise net position											
Bank's	(287.12)	4.08	35.79	(247.25)	(4.97)	86.94	(0.47)	48.94	8.27	111.82	(3.29)
E&P	(15.73)	(0.01)	7.08	(8.66)	(2.02)	9.19	3.92	8.53	(26.30)	8.07	7.27
Cement	(59.64)	(0.09)	5.52	(54.21)	(18.12)	31.79	(0.42)	9.50	5.69	18.57	7.20
Fertilizer	(62.34)	0.21	6.73	(55.39)	2.81	(5.81)	0.50	34.51	(2.60)	5.19	20.79
Power	(5.68)	0.03	19.67	14.02	(10.35)	(9.24)	(1.81)	40.66	(17.15)	(17.58)	1.45
OMC's	(4.79)	(0.07)	3.11	(1.75)	(5.46)	1.21	0.72	16.00	(13.12)	2.33	0.07
Food	(1.55)	(0.11)	0.99	(0.67)	(7.94)	(1.23)	(1.48)	5.78	(2.07)	0.46	7.16
Technology	78.92	25.11	(7.04)	96.99	(17.51)	6.38	(20.43)	(35.36)	(3.73)	(28.78)	2.44
Textile	4.29	0.06	3.32	7.67	(13.28)	8.83	(0.63)	(2.01)	(4.31)	2.75	0.97
Others	(2.32)	(0.05)	24.48	22.12	(117.42)	35.63	(1.86)	64.46	(26.77)	8.59	15.14

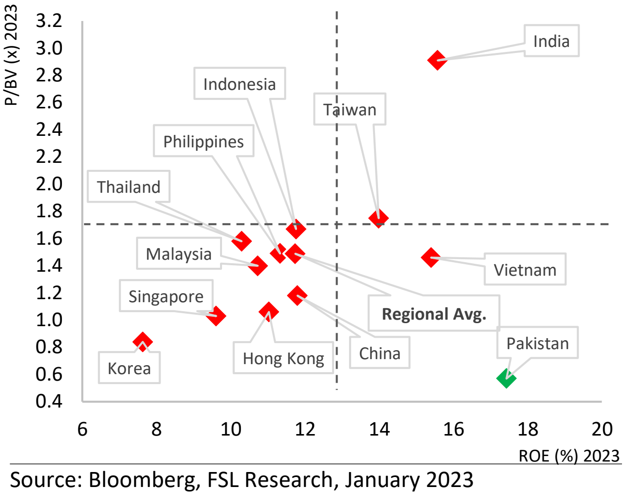
Source: NCCPL, Foundation Research, January 2023

Fig 86: Cheapest among peers on EPSg with low PE



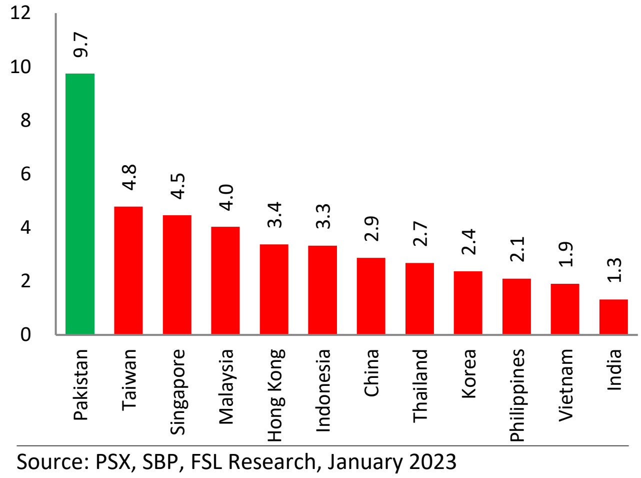
Source: Bloomberg, FSL Research, January 2023

Fig 87: …on PBV vs ROE as well…



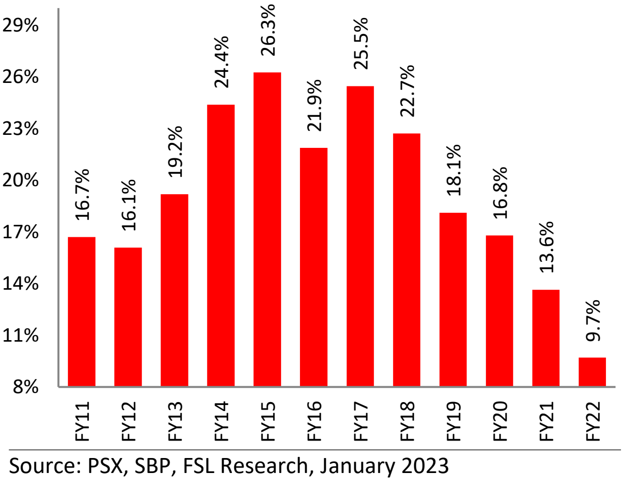
Source: Bloomberg, FSL Research, January 2023

Fig 88: …highest DY among peers (%)



Source: PSX, SBP, FSL Research, January 2023

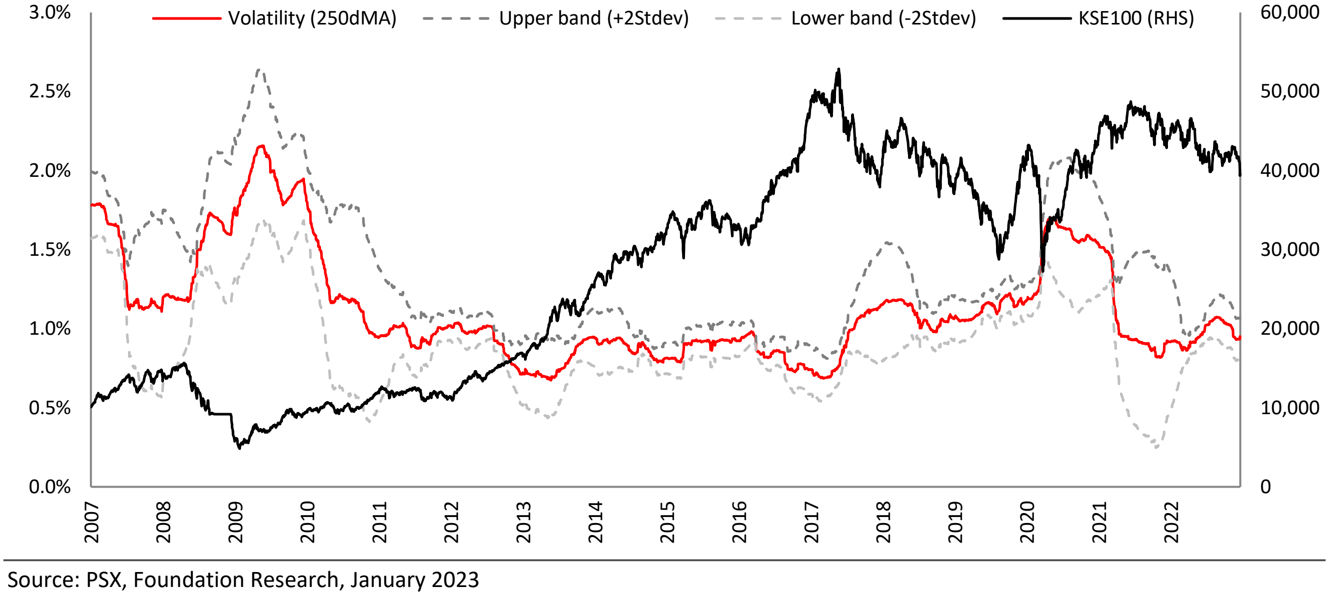
Fig 89: Political uncertainty drops Mkt cap to GDP



Source: PSX, SBP, FSL Research, January 2023

The general perception of policy and security uncertainty in Pakistan has tainted the investment climate of the country. However, market volatility remains one of the lowest in the region. We attribute this to relatively lower correlation with other EM and FM markets and more reliance on the domestic base.

Fig 90: Volatility increased in comparison to recent past



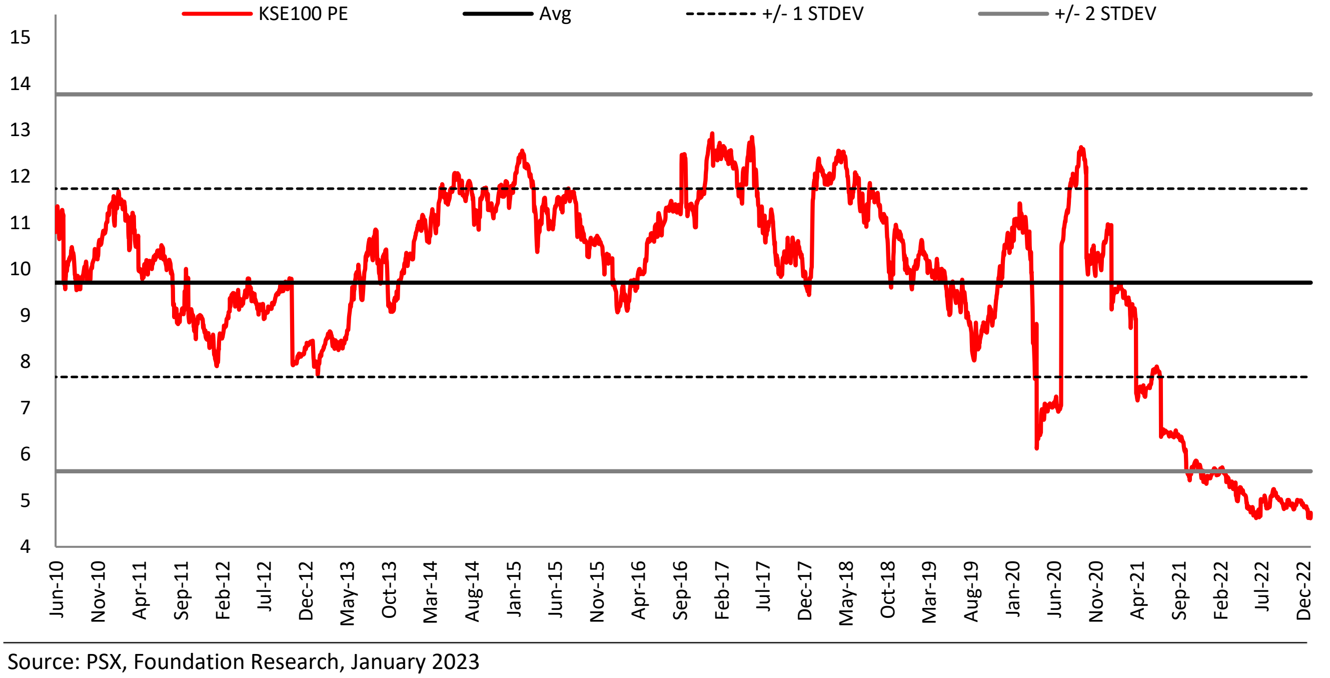
Source: PSX, Foundation Research, January 2023

Approaching the stock market

Earning growth approach yielding an index target of 47,308 by Dec-2023

We have adopted an earnings growth approach for Pakistan equities in CY23 and have arrived at a modest KSE100 index target of 47,308 by December 2023, implying a return of ~17.0% (~11.5% in US$ terms) along with an impressive dividend yield of ~8.9%. This translates into total market return of ~28.4% (~22.3% in US$ term). Our Index target is a function of an average FSL universe 17.0% earnings growth for the next year. Moreover, we do not foresee rerating in market current PE multiple given elevated external debt repayments amid political uncertainty. However, we could not rule out rerating in the current PE multiple if the new government comes with a strong mandate, from its current value of 4.88x to 6.07x, which is still lower than one negative standard deviation of average market multiple since 2010.

Fig 91: KSE-100 trading way below -2STDEV



Source: PSX, Foundation Research, January 2023

Key sectors driving this return include the Banks that should benefit from an interest rate hike and which are available at a steep discount in relation to their sustained ROEs. We prefer top-tier banks including UBL PA and MCB PA. We believe E&P sector would be another sector that should benefit from higher commodity prices and rupee depreciation along with energy sector reforms in particular resolution of circular debt through hike in electricity and gas prices. We prefer OGDC PA, PPL PA and MARI PA.

Fertilizers are expected to benefit from and will remain in investor's radars in CY23 on the back of improving farmer's economics post floods and government focus towards lowering perishable prices and ensuring food supply chain. The Power sector will remain out of fashion given lack of higher dividend payouts due to lower utilization of furnace oil plants however project completion of CPHGC could generate interest in HUBC PA. OMCs are expected to benefit from circular debt resolution along with higher CPI linked margins on white oil products. Circular debt reforms and a reduction in past overdue power payments of PSO would help to reduce the sector's finance cost.

Cements are expected to take a toll of deterioration in retention prices given economic slowdown and lower exports amid substantial increase in capacity. However, we like LUCK PA due to its diversified exposure and expected COD of Lucky Electric Power Company. Similarly, steel sector is also expected to take brunt of economic slowdown and elevated interest rates.

The auto sector would continue to remain suppressed given import issues and economic slowdown amid elevated interest rates. On the other hand, Textile sectors will benefit from government export friendly policies and declining cotton prices amid declining freight charges. Technology is likely to take correction given rerating of multiples in line with 24% profitability growth. Chemicals are likely to remain under pressure due to normalization of margins as trade normalizes.

Bottom-up approach yielding an index target of 56,635 by Dec-2023

Based on the bottom-up approach, our index target comes at 56,635 pts, implying an upside of ~40.1% (~33.4% in US$ terms) along with dividend yield of 8.9%. This translates into a total return of ~53.8% (~46.4% in US$ term). Our index target is primarily a function of our FSL's universe Dec-23 TP based on Rf of 14.5% and market risk premium of 6.5%.

Risks to our call

Though we remain optimistic about Pakistan's potential and believe that there is enough space in the market to accommodate incoming growth, we believe there are some stress factors in the system that can adversely impact our conviction call.

- ✓ Intensifying political headwinds that may cause a change in the political set-up. PTI gaining substantial support or taking a drastic measure such as dissolution of Punjab and KP assemblies could create challenges for the government.
- ✓ Prolongation of Russia-Ukraine war would dim prospects of post-pandemic economic recovery for emerging markets and developing countries due to significant disruption in trade and food and fuel price shocks, all of which are contributing to higher inflation and subsequent tightening in global and local financing conditions.
- ✓ Failure to meet external debt obligations as country Central Bank reserves are at low of 8 years and enough to cover imports of one month.
- ✓ Hung parliament as a result of upcoming elections would weaken the reform process and amplify the challenges for the government amid constraining fiscal affordability and mounting external account pressure.
- ✓ New Supervariant and spike in cases or another new alien strain could lead to new waves of virus outbreak which would result in lockdowns, reduced economic activity and lower GDP. A similar case in international markets would curb Pakistan's exports and result in constrained commodity supply and higher prices.
- ✓ Slowdown in global growth, with further slowing could cause countries fall into recession. If these trends persist, with long-lasting consequences that are devastating for people in emerging market and developing economies.
- ✓ Tougher rhetoric from the US administration in regards to changes in policy towards region after change in Government in Afghanistan could increase geopolitical uncertainty.
- ✓ Escalation of tension with India and increase in local insurgency would demand a shift of resources towards defense expenditures subsequently hurting the public development spending and government expenditure on health and education.
- ✓ Deterioration in law and order situation along the Durand line.
- ✓ Escalation of trade war between US and China. This would cause further economic distress in both domestic and foreign markets and will keep commodity prices on higher side, increasing the cost of raw material and ultimately resulting in higher inflation.
- ✓ Higher than expected FED rate hike that causes funds to move away from emerging markets.
- ✓ Exit from IMF program before its completion. Failure to comply with the demands set forth by the program would halt the flow of much needed funds into the economy, destabilize the currency and could lead to another economic crisis especially in light of upcoming debt servicing payments.
- ✓ Drastic increase in international oil prices. Given struggling financial account situation, a hike in international oil prices would lead to higher utility tariffs which would further worsen the upcoming increase under the IMF program, a higher current account deficit and more than anticipated rupee devaluation and inflation.
- ✓ Higher than expected monetary tightening would lead to flight of liquidity from equity markets and slow down the much needed economic growth.
- ✓ Regulatory changes or more onerous KYC conditions which make investment in stock market more difficult.
- ✓ Climate change causing floods or droughts would adversely impact the agriculture sector which stands as a major contributor to the country's GDP. This would lead to high food inflation, lower exports of agricultural goods and a significant hit to Pakistan's GDP.
- ✓ Pakistan equity risk premium remaining high could deter foreign investors from taking a large stake in the country's equity markets.

Table 30: Sector positioning in Model portfolio

Sector	Portfolio Stance	KSE-100 weight	Comments
Banks	Overweight	20%	Banks are expected to post sharp recovery in profitability on the back of (i) surge in NIIs amid higher NIMs, (ii) reduction in cost to income and (iii) reduction in rate of super tax to 4%. This will be sufficient to address the concern of provisioning risk. This would help to maintain payout in addition to recovery in ROEs that justifies higher PBV.
Fertilizers	Overweight	14%	Pricing power would remain with the base players due to (i) rebound in agriculture output after floods, (ii) elevated DAP prices that compelled higher demand for Urea, (iii) reduced fiscal space for government to provide imported Urea on subsidized rates amid elevated Int'l prices and lower inventory levels. However, we expect full payment of GIDC this year given fiscal constraints in light of court judgment which is incorporated in our valuations.
E&P	Overweight	12%	Resolution of circular debt and energy sector reforms would significantly improve the cash flows of E&P sector. Elevated oil prices due to disruption in global supply chain on Russia Ukraine war along with higher dollar indexation would provide significant growth in profitability. Subsequently, accelerate exploration and production activities that would yield volumetric growth. Expansion in to overseas offshore block would dilute geographical risk for OGDC PA, PPL PA and MARI PA while stake in Reko Diq lowers business risk for OGDC PA and PPL PA.
Technology	Under weight	9%	Sector is trading at a significant premium to market given embedded risks. Slowdown in high margin markets (US and Europe) owing to the increase in interest rates amid sector's aggressive investment in human capital to sustain growth would pose challenge for the sector. Moreover, continuation of trend of recent increase in receivables from overseas business would significantly reduce cash flows. However, GCC region is going to provide sustainable growth given elevated oil prices.
Cement	Market weight	7%	Cement industry is expected to face tough year in FY23/FY24 as we expect cement players would not be able to retain pricing discipline in the short run due to capacity additions of 9.7mn tons in current fiscal year and decline in export amid slowdown in demand. Moreover, monetary tightening would increase finance cost for the companies. However, decline in coal prices would provide support to profitability margins.
Power	Market weight	5%	Higher position in the merit list due to elevated furnace oil prices amid economic slowdown would reduce reliance on RFO based plants. Moreover, change in tariff structure from "Take or Pay" to "Take and Pay" would substantially dent sectors profitability. However, project completion of CPHGC and TEL would provide impetus to HUBC PA.
OMCs	Overweight	4%	We expect volumes to remain suppressed due to slowdown in demand and elevated oil prices. However, CPI indexation for margins would have positive impact on increase in white oil margins going forward. Furthermore, circular debt resolution and energy sector reforms would reduce finance cost and increase payouts of the sector.
Chemical	Under weight	4%	Suppressed margins and increase in gas prices would dampen sector profitability. Moreover, economic slowdown would diminish prospects as demand is expected to remain subdued.
Autos	Market weight	3%	Economic slowdown coupled with sky-high prices amid lower prioritization in opening of LCs for the sector imports would continue to pressure the overall sales of the sector, with some recovery expected due to stabilized rupee and improving macro factors.
Consumers	Under weight	3%	Profitability will take a toll due to (i) reduced consumer purchasing power due to economic slowdown, (ii) increasing competition and (iii) margins squeezing due to inflation and rupee devaluation.
Textiles	Moderate Overweight	2%	Currency depreciation along with government support to encourage exports would bode well for the sector. Energy at subsidized rates and reduction in cotton prices during the procurement season for imported cotton would provide further support to sectors profitability. However slowdown in export destinations would be a concern for growth.
Engineering	Market weight	1%	Domestic steel demand of Pakistan in both flat/long steel sector is expected to remain under pressure in FY23/24 due to (i) slowdown in public sector spending given limited fiscal space as evident by decline in PSDP, (ii) lackluster private sector construction activity amid high borrowing costs and flooding, (iii) restrictions on subsidized loans for house construction on NPHP scheme and (iv) significant increase in construction cost due to record high cement/steel prices. However, steel players are expected to regain pricing power due to limited import of finished goods by trader given difficulties in LC opening and higher working capital cost amid volatile international prices and duty protection provided to domestic players.

Source: Foundation Research, January 2023

Table 1: Valuation Summary

Stocks	Mkt Cap	Mkt Price	TP	Upside	EPS			DPS			PE			PB		
	(US$ mn)	(Rs/sh)	Rs/sh		2022	2023	2024	2022	2023	2024	2022	2023	2024	2022	2023	2024
Commercial Banks																
HBL	414	64	146	128%	23.1	35.2	36.7	7.7	11.0	13.0	2.8	1.8	1.7	0.3	0.3	0.3
MCB	598	114	154	35%	24.9	38.6	33.2	19.0	24.0	24.0	4.6	3.0	3.4	0.8	0.7	0.7
BAFL	241	31	47	52%	10.1	13.6	15.6	4.5	3.8	3.5	3.0	2.3	2.0	0.5	0.5	0.4
UBL	545	101	143	42%	22.6	34.8	36.8	17.0	16.0	16.0	4.5	2.9	2.7	0.6	0.5	0.5
AKBL	111	20	35	73%	11.2	16.7	19.3	2.0	4.0	4.0	1.8	1.2	1.0	0.4	0.3	0.3
MEBL	761	96	123	27%	22.5	30.3	28.8	6.8	8.2	7.8	4.3	3.2	3.4	1.6	1.2	1.0
FABL	169	25	30	20%	7.6	12.2	9.4	6.0	1.5	2.0	3.3	2.1	2.7	0.6	0.5	0.4
Oil and Gas Companies																
OGDC	1,562	82	138	67%	31.1	43.5	41.3	7.3	8.0	9.0	2.6	1.9	2.0	0.4	0.3	0.3
POL	519	414	515	24%	91.4	104.3	101.6	49.9	85.0	80.0	4.5	4.0	4.1	2.3	1.8	1.6
PPL	913	76	139	82%	19.7	35.1	37.9	2.0	2.0	2.0	3.9	2.2	2.0	0.5	0.4	0.3
MARI	900	1,528	2,097	37%	247.8	388.1	474.8	124.0	140.0	150.0	6.2	3.9	3.2	1.2	1.0	0.8
PSO	300	145	228	57%	183.7	65.2	119.0	10.0	12.0	24.0	0.8	2.2	1.2	0.3	0.3	0.2
APL	168	305	371	22%	149.0	71.6	53.1	45.0	40.0	30.0	2.0	4.3	5.8	1.0	0.9	0.9
FERTILIZER																
ENGRO	724	285	322	13%	41.0	43.9	47.0	34.0	15.0	20.0	6.9	6.5	6.1	0.6	0.5	0.5
FFBL	84	15	40	172%	5.6	11.0	8.7	-	1.0	3.0	2.6	1.3	1.7	0.4	0.3	0.3
FFC	574	102	133	30%	16.8	17.3	21.5	13.0	14.1	18.2	6.1	5.9	4.8	2.5	2.3	2.1
EFERT*	472	80	60	-26%	10.7	12.4	9.9	10.7	5.2	4.0	7.5	6.5	8.1	2.3	5.8	4.0
POWER GENERATION																
HUBC	351	61	82	33%	21.9	30.2	39.3	6.5	15.5	5.0	2.8	2.0	1.6	0.6	0.5	0.4
KAPCO	106	27	50	83%	11.2	8.9	10.5	8.0	6.0	6.0	2.4	3.1	2.6	0.3	0.3	0.3
NPL	27	18	34	91%	9.4	9.5	5.5	4.5	3.0	3.0	1.9	1.8	3.2	0.2	0.2	0.2
NCPL	23	14	18	29%	6.8	9.2	3.8	10.0	-	1.0	2.1	1.5	3.7	0.2	0.2	0.2
CEMENT																
ACPL	34	56	69	23%	8.1	7.7	2.7	1.2	-	-	6.9	7.3	21.1	0.4	0.3	0.3
DGKC	92	48	83	74%	6.8	3.4	1.8	1.0	-	-	7.1	14.2	27.2	0.3	0.3	0.3
CHCC	86	100	134	34%	22.9	27.3	15.9	3.0	2.0	1.0	4.4	3.7	6.3	1.1	0.9	0.8
LUCK	618	433	595	37%	91.2	91.2	110.5	-	-	-	4.7	4.7	3.9	0.7	0.6	0.5
KOHC	122	137	179	31%	25.0	29.5	18.1	-	-	-	5.5	4.7	7.6	1.0	0.8	0.7
FCCL	123	11	18	60%	3.4	3.1	1.9	-	-	-	3.3	3.7	6.1	0.7	0.6	0.5
PIOC	50	50	69	38%	4.1	7.1	2.6	-	0.5	-	12.2	7.1	19.6	0.4	0.4	0.4
AUTOMOBILE ASSEMBLER																
INDU	341	983	1,107	13%	225.4	80.0	120.0	112.5	40.0	60.0	4.4	12.3	8.2	1.4	1.3	1.2
PSMC	51	141	182	29%	(34.0)	3.0	11.3	-	-	-	(4.1)	47.0	12.5	0.5	0.5	0.5
HCAR	88	139	167	20%	(1.4)	1.5	9.0	-	-	-	(99.3)	92.7	15.5	1.1	1.1	1.0
FOOD & PERSONAL CARE PRODUCT																
FCEPL	225	67	58	-13%	2.6	1.6	3.1	-	-	-	25.9	42.2	21.8	4.2	3.8	3.2
CHEMICAL																
LOTCHEM	174	26	20	-22%	7.7	4.3	4.5	5.5	2.7	2.7	3.4	6.0	5.8	1.4	1.5	1.3
EPCL	179	45	36	-20%	13.0	9.7	10.7	11.5	2.5	4.0	3.4	4.6	4.2	1.5	1.2	1.0
TEXTILE COMPOSITE																
NML	80	52	91	76%	29.3	24.0	28.2	7.0	6.5	7.7	1.8	2.2	1.8	0.2	0.2	0.2
ILP	233	57	101	79%	13.2	16.7	18.3	3.8	1.9	6.7	4.3	3.4	3.1	1.8	1.3	0.9
TECHNOLOGY & COMMUNICATION																
SYS	636	497	369	-26%	25.1	31.1	38.5	6.3	7.8	7.7	19.8	16.0	12.9	6.1	4.7	3.6
ENGINEERING																
MUGHAL	69	47	73	56%	16.1	8.2	12.1	3.0	1.0	3.0	2.9	5.7	3.8	0.7	0.7	0.6
ASTL	25	19	30	59%	4.5	3.8	5.6	-	-	-	4.3	5.0	3.4	0.4	0.3	0.3
AGHA	35	13	19	45%	3.1	2.4	3.8	-	-	-	4.2	5.4	3.4	0.5	0.5	0.4
ISL	85	44	80	81%	12.4	5.4	7.2	4.5	-	2.0	3.5	8.2	6.1	0.9	0.9	0.8

Source: Foundation Research, January 2023

* Adjusted equity for payment of GIDC on new plant

**All prices are of December 30'2022

CY23 Major Events Timeline

January

- MPC meeting
- MTB Auction with a target of Rs650bn
- PIB Auction with a target of Rs175bn
- US Fed Meeting
- IMF Ninth review

February

- MTB Auction with a target of Rs800bn
- PIB Auction with a target of Rs175bn
- MSCI Quarterly Index Review
- IMF Tenth review

March

- MPC meeting
- US Fed Meeting

April

- MPC meeting
- COD of BWCL 2.3mn tons cement plant

May

- MSCI Semi-Annual Index Review
- US Fed Meeting
- IMF Eleventh review

June

- MPC meeting
- FY24 Budget
- US Fed Meeting
- COD of ACPL 1.2mn tons cement plant

July

- US Fed Meeting
- COD of AGHA 400,000 MT billet capacity

August

- MSCI Quarterly Index Review
- Dissolution of the Assembly

September

- US Fed Meeting

October

- US Fed Meeting

November

- MSCI Semi-Annual Index Review
- General Elections

December

- US Fed Meeting
- Ending of GSP+ Status


TOP PICKS
2023


LARGE CAP

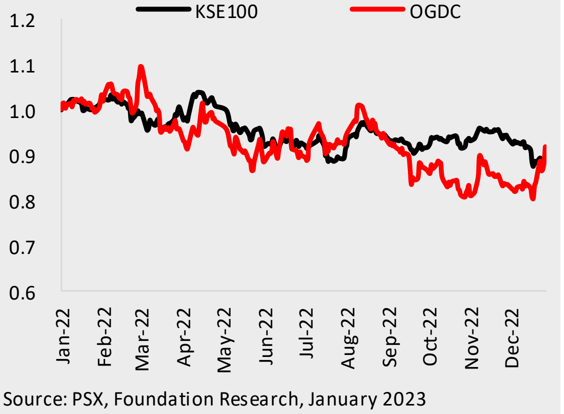
OGDC PA **Outperform**

Price (31 Dec 22 CP)	Rs	82.3
Dec-23 Target Price	Rs	137.8
Upside/Downside	%	67.4
12M Target Price	Rs	137.8
- Reserve Based Methodology		
Sector		E&P
Market cap	Rs bn	354.0
30-day avg turnover	$ m	1.0
Market cap	$ m	1,561.9
Freet float	%	15.0
Shares issued	m	4,300.9

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	335,464	416,717	400,992	384,673
EBITDA	m	239,141	308,358	283,357	266,322
EBITDA Growth	%	38.3	89.5	18.5	(13.6)
PBT	m	232,521	287,589	264,906	251,479
Recurring Profit	m	133,784	186,888	177,487	168,491
Net Profit	m	133,784	186,888	177,487	168,491
EPS reported	Rs	31.1	43.5	41.3	39.2
Rev growth	%	40.3	24.2	(3.8)	(4.1)
EPS growth	%	46.2	39.7	(5.0)	(5.1)
PE	x	2.6	1.9	2.0	2.1
DPS	Rs	7.3	8.0	9.0	10.0
Div. Yield	%	8.8	9.7	10.9	12.1
ROA	%	12.8	15.6	13.2	11.4
ROE	%	16.3	19.6	16.2	13.7
EV/EBITDA	x	0.6	0.4	0.3	(0.2)
Net D/E	x	(0.2)	(0.2)	(0.2)	(0.3)
Price to Book	x	0.4	0.3	0.3	0.3
Price to Sales	x	1.1	0.8	0.9	0.9

OGDC KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Oil and Gas Development Company

Circular debt resolution to improve cash flows

Event

- Higher oil prices, dollar hedged revenue, debt free balance sheet and improving cash flows amid resolution of gas sector circular debt along with energy sector reforms make a strong investment case for the stock. Expansion into mining business and pricing of newer finds on lucrative rates would further strengthen our conviction.

Impact

- **Circular debt resolution to enhance liquidity:** Resolution of circular debt, a key reform agenda of the IMF program, would improve company's cash flow position in the medium term. While, energy sector reforms would help to arrest rise in these receivables in the longer run. To highlight, company has receivables of Rs490bn at Sep'30. Moreover, conversion of Rs142bn TFCs to PIBs or T-bill would provide immediate breather to the company. In our base case, we have assumed receivables to grow by 80% and 60% of gas revenue in FY23 and FY24.

- **Diversification to mining business to lower business risk:** OGDC and PPL PA together with Government Holdings (Private) Limited, jointly named as State Owned Enterprises (SOEs) have signed the Definitive Agreements with respect to the SOEs' participation in the reconstituted Reko Diq Project, that ultimately acquired 25% stake. So far company has invested an amount of US$187.5mn. Barrick Gold Corporation would be the operator of the project, which will be granted a mining lease, exploration license, surface rights, and a mineral agreement for a period of 30 years. Actual path of project progress would be contingent upon the results of feasibility study, however operator is optimistic to start commercial production by 2028.

- **Production plateau expected to sustain:** OGDCL exploratory efforts yielded 7 discoveries of 47mmcfd of gas and 4,250bpd of oil during FY22 along with injection of 10 wells into the system. These discoveries includes flows from Wali-1 (Kawagarh), Wali-1 (Hangu), Wali-1 (Lockhart), Jandran West-1, Umair South, Nim and Kalerishum.

- Moreover, resolution of circular debt amid elevated oil prices would expedite exploration and development activities at multiple locations including Dakhni, KPD-TAY, Uch, Nashpa etc. These efforts would help company to maintain its' production profile along with pricing of newer flows at higher rates.

Earnings Revision

- We revise up our earnings by 48/40% for FY23/FY24 as we tweak assumption of dollar, volumetric, Arab Light and exploration expense.

Price Catalyst

- Dec-23 TP: Rs137.8/sh based on Reserve Based Methodology.

- Catalyst: (1) Energy sector reforms in particular resolution of circular debt, (2) commencement of KPD-Tay and Uch compression facility, (3) subdued electricity demand and (4) diversification into gold and copper mining.

- Risk: (1) Aging of fields, (2) change in behavior of Nashpa wells, and (3) Dry wells.

Outlook

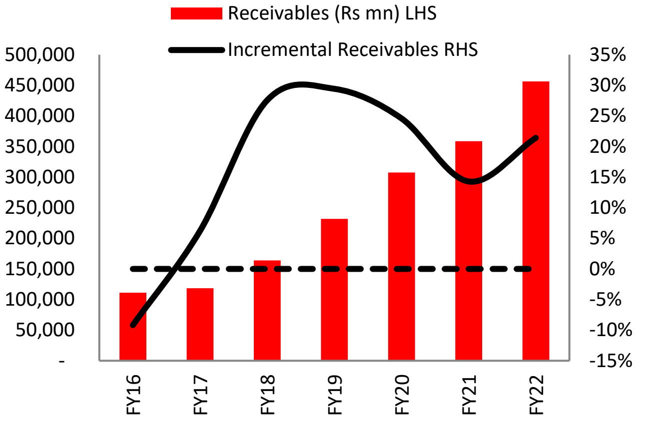
- We have an 'Outperform' rating on the stock that is trading at FY23/24 PE of 1.9/2.0x.

Table 32: Development projects of OGDC

Name of Project	Location of Project	Working Interest Owners	Completion Date	Current Status
Qadirpur Compression	Ghotki, Sindh	75%	Apr'22	Operational
Maru-Reti Compression	Ghotki, Sindh	57.76%	Sep'22	Installation of compressor has been completed, while commissioning and startup operations are in progress
Daru-Mangrio Central Facility LPG Extraction	Hyderabad, Sindh	77.5%	Apr'23	Technical and financial evaluation of bids for hiring of PCC contractor have been completed.
Dakhni Compression	Attock, Punjab	100%	Nov'23	Technical and financial evaluation of the bids for hiring of the EPCC contractor have been completed.
KPD-TAY Compression	Hyderabad, Sindh	KPD: 100% TAY: 77.50%	Mar-24	Technical evaluation of the bids for hiring of the EPCC contractor has been completed, while financial bids are under evaluation.
Uch Compression	Dera Bugti, Balochistan	100%	May'24	Technical and financial evaluation of the bids for hiring of the EPCC contractor have been completed.

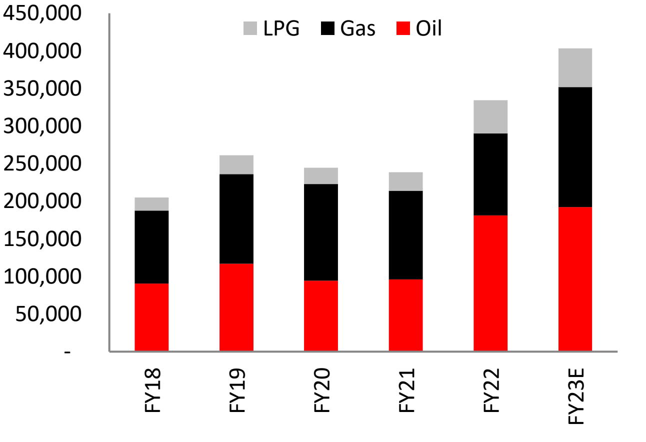
Source: Company Accounts, Foundation Research, January 2023

Fig 92: CD resolution plan to slow increase in receivables…



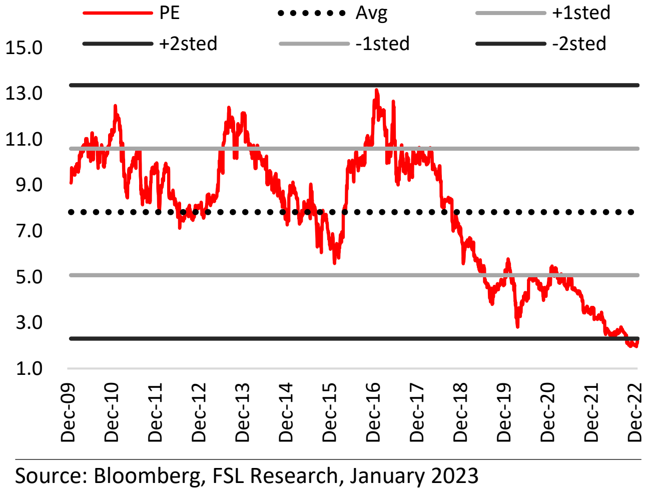
Source: Company reports, FSL Research, January 2023

Fig 93: LPG % increase significantly in recent times (Rs m)



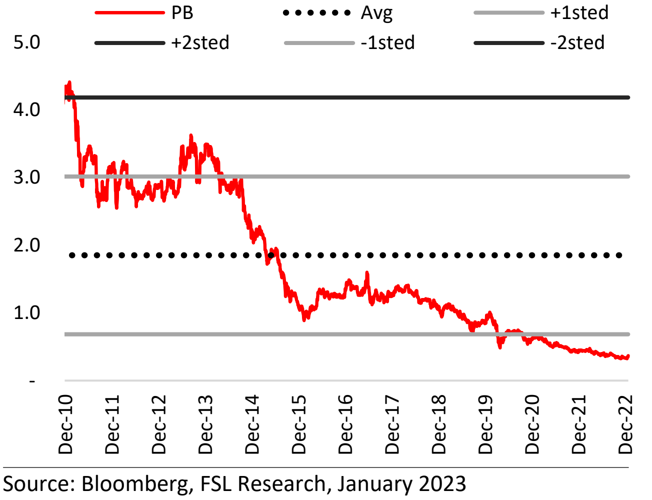
Source: PPIS, FSL Research, January 2023

Fig 94: Trading at -2Sted on PE basis



Source: Bloomberg, FSL Research, January 2023

Fig 95: … down on P/B as well



Source: Bloomberg, FSL Research, January 2023

Table 33: Oil and Gas Development Company Limited (OGDC PA, 'Outperform', Dec-23 TP Rs137.8)

Balance Sheet		**FY22A**	**FY23E**	**FY24E**	**FY25E**
PP&E	m	224,209	226,229	220,028	200,716
Cash & ST invest	m	218,577	238,576	280,358	412,607
LT invest	m	76,401	76,401	76,401	76,401
Inventory	m	20,519	30,826	29,653	28,445
Acct. Receivable	m	456,595	601,885	711,357	729,301
Other Assets	m	133,682	98,526	99,855	101,248
Total Assets	**m**	**1,129,983**	**1,272,443**	**1,417,652**	**1,548,718**
Acct. payable	m	105,121	119,877	120,807	126,423
Deferred tax	m	39,364	37,850	36,395	34,995
Dism. Allow	m	43,122	43,122	43,122	43,122
Others	m	66,983	43,721	50,676	52,045
Total Liabilities	**m**	**254,590**	**244,570**	**251,000**	**256,584**
Paid-up Capital	m	43,009	43,009	43,009	43,009
Reserves	m	832,383	984,864	1,123,643	1,249,125
SH' Equity	**m**	**875,393**	**1,027,873**	**1,166,652**	**1,292,134**
L+E	**m**	**1,129,983**	**1,272,443**	**1,417,652**	**1,548,718**

Profit & Loss		**FY22A**	**FY23E**	**FY24E**	**FY25E**
Net Sales	m	335,464	416,717	400,992	384,673
Op. Cost	m	78,593	82,126	101,563	105,024
Royalty	m	37,958	52,180	46,099	44,222
Gross Profit	**m**	**218,913**	**282,411**	**253,330**	**235,427**
S&A	m	6,908	7,781	6,824	7,072
Exp. Write off	m	15,586	16,645	6,074	7,087
Other Income	**m**	50,680	47,683	39,438	44,216
Other Charges	m	12,238	15,136	12,022	11,063
EBIT	**m**	**234,862**	**290,531**	**267,849**	**254,422**
Finance cost	m	2,340	2,942	2,942	2,942
PBT	**m**	**232,521**	**287,589**	**264,906**	**251,479**
Taxation	m	98,738	100,701	87,419	82,988
PAT	**m**	**133,784**	**186,888**	**177,487**	**168,491**
EPS	Rs	31.1	43.5	41.3	39.2
EPS growth	%	46%	40%	-5%	-5%
DPS	Rs	7.3	8.0	9.0	10.0

Q performance		**1Q'23A**	**2Q'23E**	**3Q'23E**	**4Q'23E**
Net Sales	m	106,012	102,529	103,628	104,547
Op. Cost	m	18,175	20,031	20,390	23,531
Royalty	**m**	12,177	13,201	13,342	13,460
Gross Profit	m	**75,661**	**69,298**	**69,896**	**67,556**
S&A	m	1,463	2,006	2,147	2,166
Exp. Write off	m	1,545	4,600	4,700	5,800
Other Income	m	21,015	7,049	9,830	9,789
Other Charges	**m**	4,642	3,452	3,609	3,434
EBIT	**m**	**89,026**	**66,290**	**69,270**	**65,945**
Fin Cost	m	818	708	708	708
PBT	**m**	**88,207**	**65,582**	**68,562**	**65,237**
Tax	m	34,905	21,642	22,626	21,528
PAT	**m**	**53,303**	**43,940**	**45,937**	**43,709**
EPS (rep)	Rs	12.4	10.2	10.7	10.2
DPS (rep)	Rs	1.8	2.0	1.8	2.5

Key ratios		**FY22A**	**FY23E**	**FY24E**	**FY25E**
BVPS	Rs	203.5	239.0	271.3	300.4
EPS	Rs	31.1	43.5	41.3	39.2
PE	X	2.6	1.9	2.0	2.1
PBv	x	0.4	0.3	0.3	0.3
GP margins	%	65%	68%	63%	61%
EBITDA margin	%	71%	74%	71%	69%
EBIT margin	%	70%	70%	67%	66%
Net margin	%	40%	45%	44%	44%
ROE	%	16%	20%	16%	14%
ROA	%	13%	16%	13%	11%
Earnings yield	%	37%	52%	50%	47%
Payout Ratio	%	23%	18%	22%	26%
Dividend Yield	%	9%	10%	11%	12%
EV/EBITDA	x	0.6	0.4	0.3	0.2

All figures in Rs unless noted
Source: Company data, Foundation Research, January 2023

About the company

Oil and Gas Development Company (OGDCL), the largest Exploration and Production Company of Pakistan, was established in 1961 to prospect, refine and sell oil and gas in Pakistan. The company is listed on Pakistan stock exchange, as well as on London Stock Exchange. Government of Pakistan (GoP) divested 4.98% of its shareholding in the company in October 2003 through an IPO. GoP further divested 9.5% of its shareholding through SPO in the form of Global Depository Shares to international/local institutional investors in Dec 2006 and 0.5% to general public in Feb 2007. GoP now own 85.02% of shares of the company. OGDCL's share in country's total oil and gas production stands at 51% and 28% respectively.

Auditors: M/s KPMG Taseer Hadi & Co., Chartered Accountants and M/s A.F. Ferguson & Co., Chartered Accountants

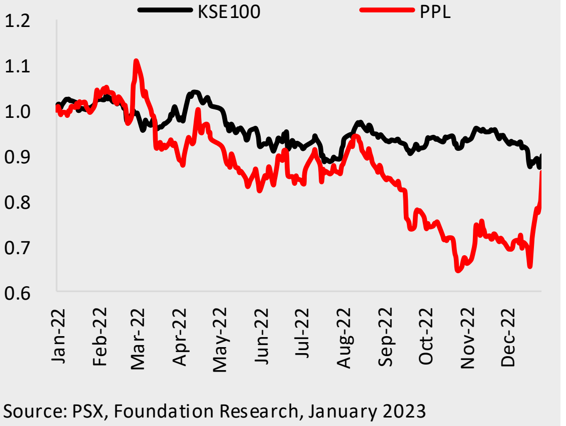
PPL PA **Outperform**

Price (31 Dec 22 CP)	Rs	76.1
Dec-23 Target Price	Rs	138.6
Upside/Downside	%	82.2
12M Target Price	Rs	138.6
- Reserve Based Methodology		
Sector		E&P
Market cap	Rs bn	206.9
30-day avg turnover	$ m	1.0
Market cap	$ m	913.0
Freet float	%	24.5
Shares issued	m	2,721.0

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	202,199	283,557	282,838	282,900
EBITDA	m	142,227	198,859	199,895	198,102
EBITDA Growth	%	30.7	94.1	40.5	(0.4)
PBT	m	98,131	148,636	153,974	150,696
Recurring Profit	m	53,546	95,467	103,162	100,967
Net Profit	m	53,546	95,467	103,162	100,967
EPS reported	Rs	19.7	35.1	37.9	37.1
Rev growth	%	36.2	40.2	(0.3)	0.0
EPS growth	%	2.1	78.3	8.1	(2.1)
PE	x	3.9	2.2	2.0	2.0
DPS	Rs	2.0	2.0	2.0	2.0
Div. Yield	%	2.6	2.6	2.6	2.6
ROA	%	9.1	14.1	13.6	12.0
ROE	%	12.9	19.7	17.9	15.0
EV/EBITDA	x	0.9	0.8	0.8	0.7
Net D/E	x	(0.2)	(0.1)	(0.1)	(0.1)
Price to Book	x	0.5	0.4	0.3	0.3
Price to Sales	x	1.0	0.7	0.7	0.7

PPL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Pakistan Petroleum Ltd

Liquidity to unlock true potential

Event

▪ Clearance of receivables given resolution of circular debt would improve cash flow of the company, subsequently expedite exploration activities. This along with elevated oil prices, debt free balance sheet, dollar denominated topline and potential fields to add flows in a short period of time would strengthen our conviction on stock.

Impact

▪ **Circular debt resolution to enhance exploration & development activities:** Rationalization of gas prices and energy sector reforms would enhance liquidity position of the company. OGRA decision to increase gas prices up to 74% and constitution of committee for resolution of circular debt by Prime Minister has brightened the prospects of clearance of company's receivables. However, we have assumed an average 60% of gas revenue to be stuck in receivables for FY23 and FY24.

▪ **Number of avenues to trigger volumetric growth:** Rejuvenation of flows from Kandhkot, installation of facilities at Gambat South, discoveries at Dhok Sultan and exploration activities at Margand field would provide volumetric growth to the company. In first quarter, Kandhkot field produced 164 mmcfd against 103 mmcfd in FY22 and potential capacity of 200 mmcfd. Moreover, installation of compression facilities at Gambat South would enhance flows from existing production of 142 mmcfd against proven discoveries of 256 mmcfd.

▪ **Reko Diq to provide diversification:** Company along with OGDC and GHPL, together named as SOEs, owned 25% stake in Reko Diq. PPL has invested an amount of US$187.5mn against 8.3% stake. Currently, Barrick, the operator of the field, is in the process of updating its feasibility, which would determine the fate of the project with an expected life of 40 years. Moreover, historical resource for five porphyry deposits of ~3bn tons grading 0.48% copper and 0.26g/t gold in measured and indicated category, and 2.9bn tons at 0.35% copper and 0.18g/t gold in inferred category.

▪ **Overseas Offshore success to significantly change the course:** Company has received approval of ADNOC for detailed appraisal plan built for Block 5 in Abu Dhabi. Subsequently, company plans to drill 3 wells in 2023 for which preparations are underway, whereas contract has been awarded for critical lead. We await further clarity before incorporating any inflows of the said in our valuation.

Earnings Revision

▪ We revise our FY23/24 estimates by 35.5/46.9% as we tweak our dollar, volumetric, Arab Light and exploration expense assumptions.

Price Catalyst

▪ Dec- 23 TP: Rs138.6/sh based on Reserve based DCF methodology.

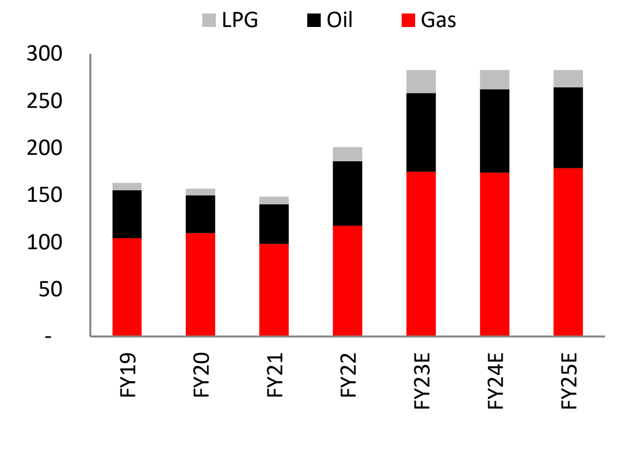
▪ Catalyst: (1) resolution of circular debt (2) production enhancement from Gambat South, Dhok Sultan & Nashpa, (3) development of Margand Field, (4) commencement of work on Lead and Zinc Mining, (5) discoveries at Offshore Block 5 Abu Dhabi, (6) rejuvenation of gas flows from kandhkot field and (7) success of Reko Diq.

▪ Risks: (1) unfavorable TAL block verdict, (2) unsuccessful result of Iraq block, (3) earlier than expected ageing of Sui field (4) continuation of unexpected water production from Adhi field and (4) delay in Gambat South production.

Outlook

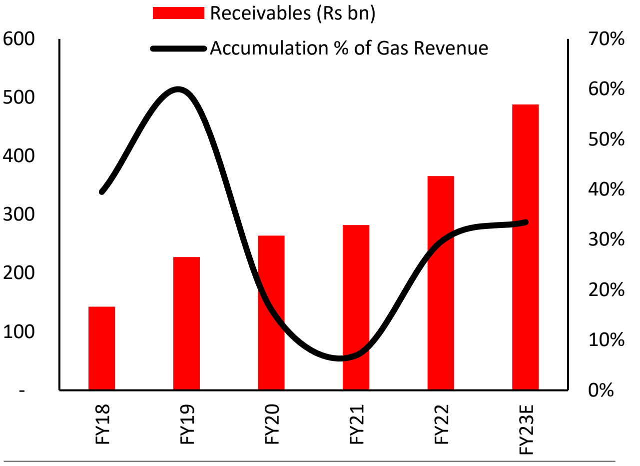
▪ We assign an "Outperform" rating to PPL given resolution of circular debt, expansion into offshore blocks and diversification into mining business.

Fig 96: Gas to remain dominant in revenue (Rs bn)....



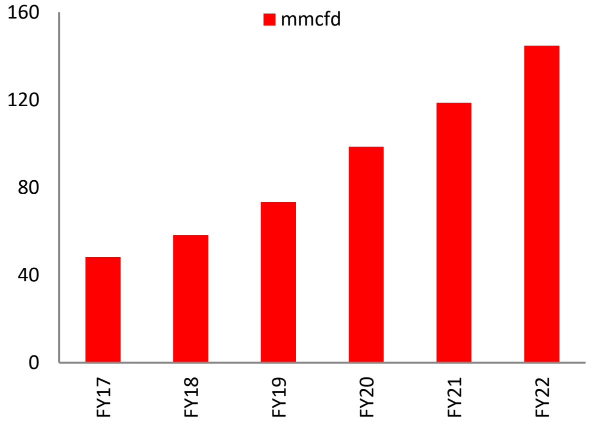
Source: Company reports, FSL Research, January 2023

Fig 97: ... CD resolution to reduce receivables



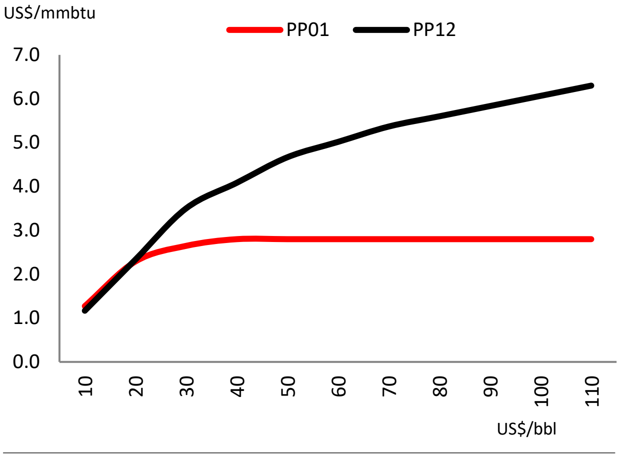
Source: Company reports, FSL Research, January 2023

Fig 98: Gambat South field production is increasing



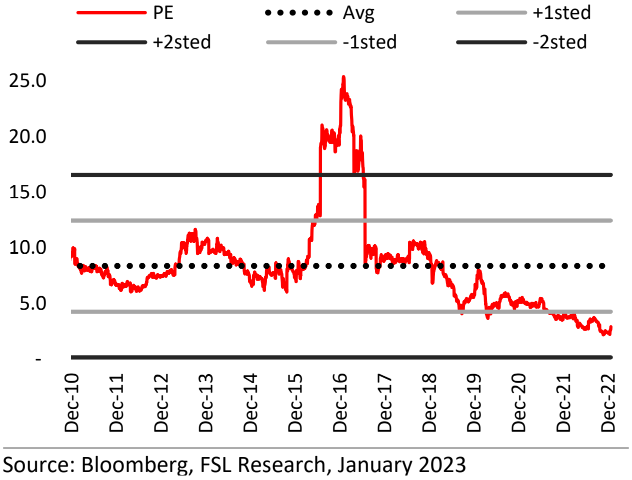
Source: Company reports, FSL Research, January 2023

Fig 99:...fetch better pricing regime



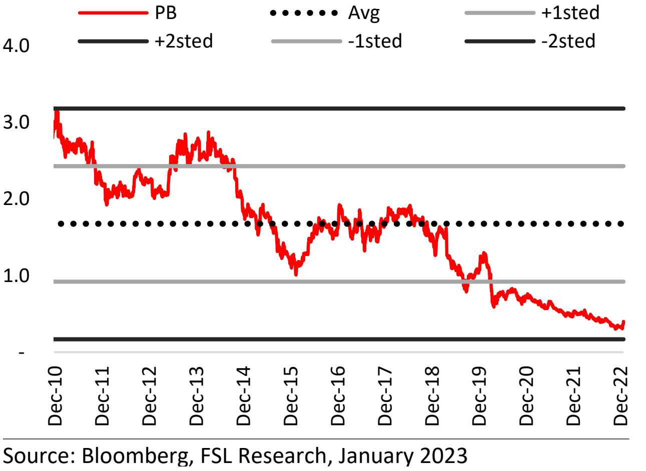
Source: PPIS, FSL Research, January 2023

Fig 100: Trading at -2stdev of historical PE average



Source: Bloomberg, FSL Research, January 2023

Fig 101: Also trading low on PB



Source: Bloomberg, FSL Research, January 2023

Table 34: Pakistan Petroleum Limited (PPL PA, 'Outperform', Target price: 138.6)

Balance Sheet		**FY22A**	**FY23E**	**FY24E**	**FY25E**
PP&E	m	133,539	122,049	117,850	120,096
Cash & ST invest	m	80,728	41,968	40,044	67,227
Receivables	m	365,792	488,302	575,251	628,853
Other Assets	m	55,484	62,844	65,053	67,463
Total Assets	**m**	**635,543**	**715,163**	**798,199**	**883,639**
Acct. payable	m	122,876	113,445	99,701	90,525
Deferred tax	m	28,780	27,807	26,867	25,958
Dism. Allow	m	32,650	32,650	32,650	32,650
Others	m	5,763	5,763	5,763	5,763
Total Liabilities	**m**	**190,070**	**179,666**	**164,981**	**154,897**
Paid-up Capital	m	27,210	27,210	27,210	27,210
Others	m	411,422	501,447	599,167	694,692
SH' Equity	**m**	**438,632**	**528,657**	**626,377**	**721,902**
L+E	**m**	**628,702**	**708,323**	**791,358**	**876,799**

Profit & Loss		**FY22A**	**FY23E**	**FY24E**	**FY25E**
Net Sales	m	202,199	283,557	282,838	282,900
Op. Cost	m	48,404	55,081	48,786	57,401
Royalty	m	30,500	48,943	47,375	47,181
Gross Profit	**m**	**123,295**	**179,533**	**186,677**	**178,318**
Exp. Write off	m	23,735	17,680	16,859	17,245
EBIT	**m**	103,273	159,324	153,242	149,671
Other Income	**m**	14,144	10,796	9,511	9,626
Other Expense	m	19,286	21,485	8,779	8,601
PBT	**m**	**98,131**	**148,636**	**153,974**	**150,696**
Tax	m	44,585	53,170	50,811	49,730
PAT	**m**	**53,546**	**95,467**	**103,162**	**100,967**
EPS (rep)	Rs	19.7	35.1	37.9	37.1
EPS growth	%	2%	78%	8%	-2%
DPS	Rs	2.0	2.0	2.0	2.0

Q performance		**1Q'23A**	**2Q'23E**	**3Q'23E**	**4Q'23E**
Net Sales	m	72,611	67,163	71,489	72,294
Op. Cost	m	12,667	12,228	16,287	16,428
Royalty	m	12,533	11,593	12,339	12,478
Gross Profit	**m**	**47,411**	**43,342**	**42,862**	**43,388**
Exp. Write off	m	1,480	4,200	5,500	6,500
EBIT	m	45,931	39,142	37,362	36,888
Other Income	m	4,843	1,610	2,176	2,168
Other Expense	m	4,904	5,714	5,466	5,400
PBT	**m**	**45,871**	**35,038**	**34,072**	**33,656**
Tax	m	19,257	11,563	11,244	11,106
PAT	**m**	**26,614**	**23,475**	**22,828**	**22,549**
EPS (rep)	Rs	9.8	8.6	8.4	8.3
DPS (rep)	Rs	-	-	-	2.0

Key ratios		**FY22A**	**FY23E**	**FY24E**	**FY25E**
BVPS		161.2	194.3	230.2	265.3
EPS		19.7	35.1	37.9	37.1
PE	x	3.9	2.2	2.0	2.0
PBv	x	0.5	0.4	0.3	0.3
GP margins	%	61%	63%	66%	63%
EBITDA margin	%	70%	70%	71%	70%
Net margin	%	26%	34%	36%	36%
ROE	%	13%	20%	18%	15%
ROA	%	9%	14%	14%	12%
Earnings yield	%	26%	46%	50%	49%
Payout Ratio	%	10%	6%	5%	5%
Dividend Yield	%	3%	3%	3%	3%
EV/EBITDA	x	0.9	0.8	0.8	0.7
Debt/Equity	x	-0.2	-0.1	-0.1	0.1

All figures in Rs unless noted
Source: Company data, Foundation Research, January 2023

About the company

Pakistan Petroleum Ltd is the oldest exploration and production company in the country. It was incorporated on 5th June, 1950 subsequent to the promulgation of the Pakistan Petroleum Production Rules, 1949 with the main objective of conducting exploration, development and production of Pakistan's oil and natural gas resources.

PPL inherited all the assets and liabilities of the Burmah Oil Company (Pakistan Concessions) Limited and commenced business on 1st July 1952. At present, the Company's portfolio, together with its subsidiaries, consists of forty-five exploratory blocks, out of which twenty-six are PPL operated (including Block-8 in Iraq being operated by PPL Asia) and remaining nineteen, including three offshore blocks in Pakistan and two onshore blocks in Yemen, are partner operated.

Auditors: KPMG Taseer Hadi & Co Chartered Accountants

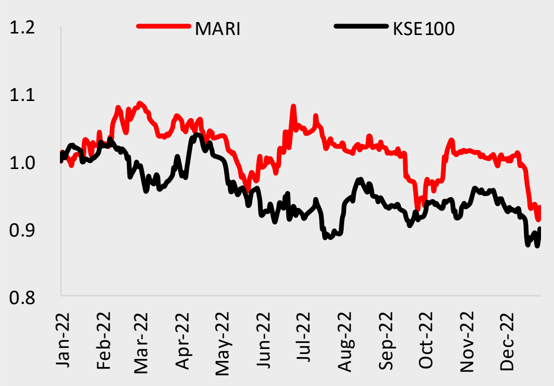
MARI PA **Outperform**

Price (31 Dec 22 CP)	Rs	1,528.3
Dec-23 Target Price	Rs	2,096.6
Upside/Downside	%	37.2
12M Target Price	Rs	2,096.6
- DCF methodology		
Sector		E&P
Market cap	Rs bn	203.9
30-day avg turnover	$ m	0.2
Market cap	$ m	764.6
Freet float	%	20.0
Shares issued	m	133.4

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	95,134	134,744	161,206	167,475
EBITDA	m	69,510	99,263	116,557	119,150
EBITDA Growth	%	31.2	90.2	67.7	20.0
PBT	m	52,116	77,627	94,538	98,488
Recurring Profit	m	33,063	51,777	63,340	65,987
Net Profit	m	33,063	51,777	63,340	65,987
EPS reported	Rs	247.8	388.1	474.8	494.6
Rev growth	%	30.3	41.6	19.6	3.9
EPS growth	%	5.1	56.6	22.3	4.2
PE	x	6.2	3.9	3.2	3.1
DPS	Rs	124.0	140.0	150.0	165.0
Div. Yield	%	8.1	9.2	9.8	10.8
ROA	%	19.7	25.1	25.5	22.6
ROE	%	22.4	27.9	27.6	24.4
EV/EBITDA	x	2.3	1.5	1.2	1.0
Net D/E	x	(0.2)	(0.3)	(0.3)	(0.3)
Price to Book	x	1.2	1.0	0.8	0.7
Price to Sales	x	2.1	1.5	1.3	1.2

ASTL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Mari Petroleum Company Ltd

Gaining diversification through aggressive exploration

Event

- We have an "Outperform" stance on the stock given expected flows of lower Goru-B reserves, enhanced probability of continuation of flows on incremental pricing from HRL, immunity to circular debt, dollar hedged topline, aggressive exploration drive in hydrocarbon rich areas and offshore expansion in overseas block.

Impact

- **SGPC to enhance production capacity to 900 mmcfd:** Completion of Phase-II of Sachal Gas Processing Complex (SGPC) would enable the company to process 200mmcfd of gas. Phase-I and Phase-III has already been completed and allowed the company to inject 80 mmcfd of gas into the national network. The work on Phase-II is in advanced stages of construction and likely to be completed in FY23. Phase-II of SGPC would add ~Rs61/96 per share to company's profitability of FY24/FY25.
- **…also helps to prolong plateau of HRL:** Aforementioned processing facility along with installation of processing and compression equipment at CMF-II under Swing Gas project has helped to sell 60 mmcfd of Habib Rahi Limestone (HRL) incremental flows to SNGPL. This project has provided the company greater flexibility to divert undrawn HRL flows of power and fertilizer sector to SNGPL network.
- Simultaneously, company is working to maintain Mari HRL plateau for which application of new technology has resulted in first-ever successful horizontal well drilling. Debottlenecking measures at HRL along with drilling of wells would enable the company to sustain and prolong period of 650mmcfd plateau, in our view.
- **Bannu West discovery open new area of exploration:** Discovery of 50 mmcfd gas and 300 bpd of oil at Bannu West block has opened new area of expansion and diversification for the company. Company is currently developing production facility and working along with SNGPL that is laying pipeline for connectivity with national grid to bring the production online on priority basis. This discovery would have an annualized EPS impact of Rs 37.2.
- **Peripheral exploration may yield significant results:** Company has also started seismic and exploration activities in Block-28 and Taung, the latter has the potential for discoveries equivalent to Sui and Mari. The company also plans 9 exploratory/appraisal wells for this year.

Earnings Revision

- We have revised our earnings forecast up by 5.0%/28.8% for FY23/FY24 given change in assumption of flows from lower Goru B and addition of Bannu west along with change in dollar appreciation and Arab Light. Subsequently, revised our TP upward for Dec-23 by 1.9%.

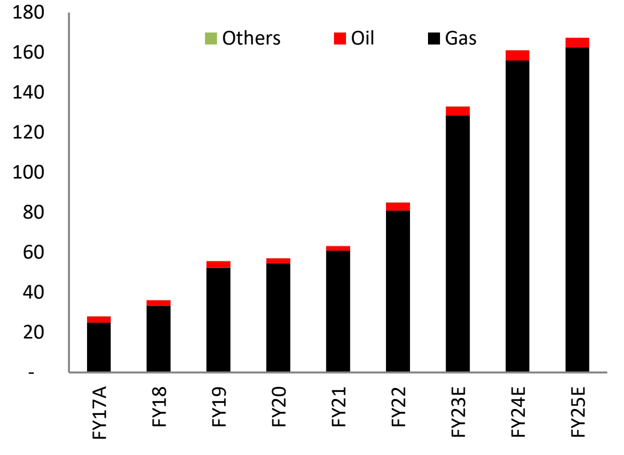
Price Catalyst

- Dec-23 TP: Rs2,096.6/sh based on Reserve based methodology
- Catalyst: (1) materialization of potential flows from Lower Goru B, (2) sustainability of MARI HRL flows at these levels, (3) further development of Bannu West Block and (4) positive result of seismic activity and exploratory well in Block-28.
- Risks: (1) major reliance of revenue on MARI field, (2) higher dry well cost and (3) delay in SGPC phase II.

Outlook

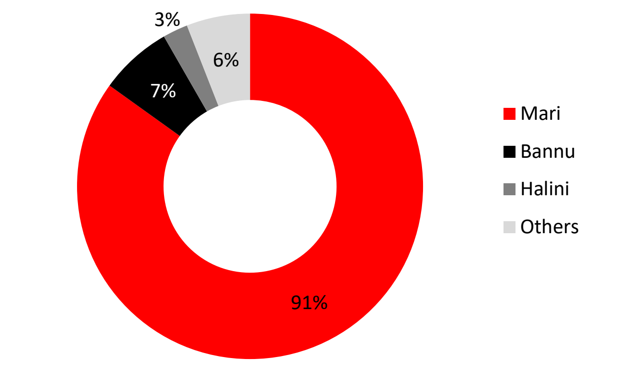
- We have an "Outperform" stance on the scrip with TP of Rs2,096.6/sh.

Fig 102: Gas to remain dominant in revenue (Rs bn)



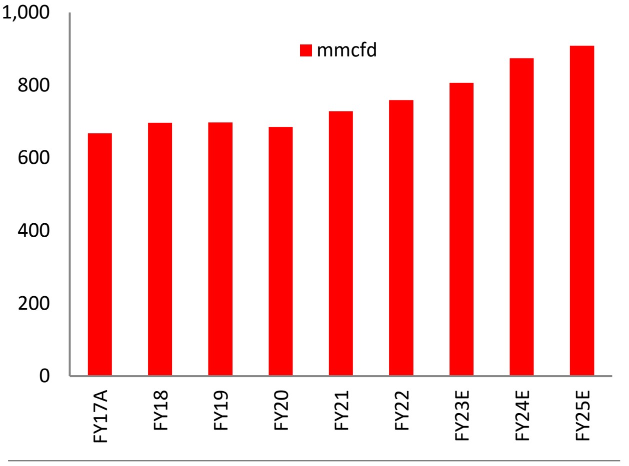
Source: PPIS, Foundation Research, January 2023

Fig 103: Bannu to provide diversification in gas flows



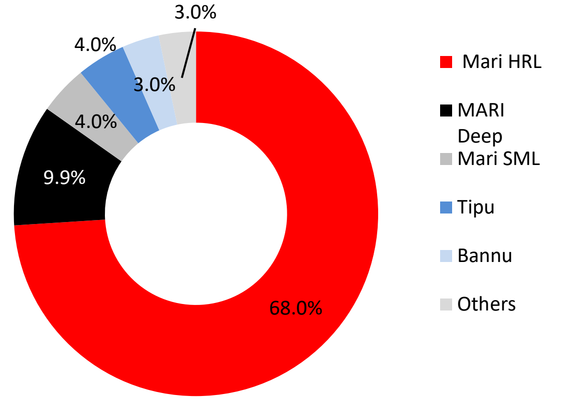
Source: PPIS, Foundation Research, January 2023

Fig 104: Gas flows to cross 900 mmcfd by FY25



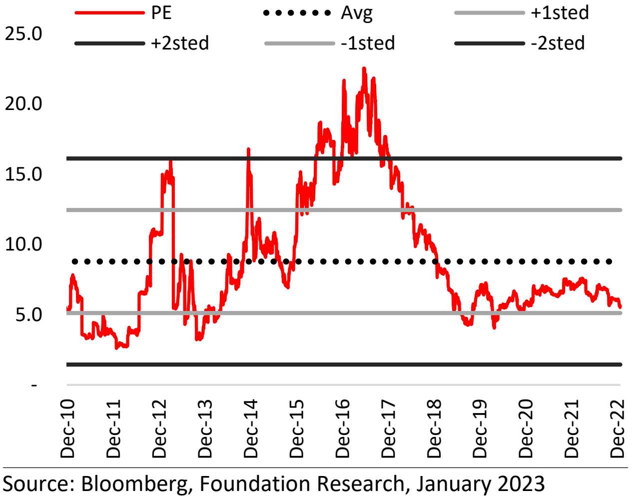
Source: PPIS, Foundation Research, January 2023

Fig 105: with reduction in reliance on MARI HRL by FY25



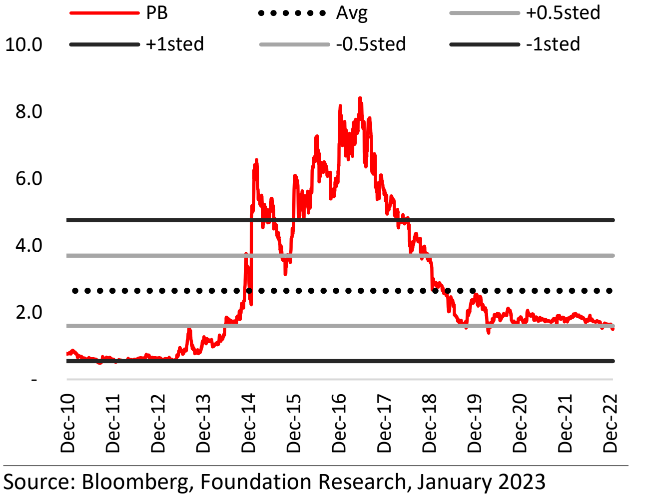
Source: PPIS, Foundation Research, January 2023

Fig 106: Trading below historical average on PE...



Source: Bloomberg, Foundation Research, January 2023

Fig 107: ...lower on PB as well



Source: Bloomberg, Foundation Research, January 2023

Table 35: MARI Petroleum Limited (MARI PA, Outperform, Target price Rs2,096.6)

Balance Sheet		FY22A	FY23E	FY24E	FY25E
Fixed Assets	m	91,019	111,534	132,334	148,462
Other long term assets	m	6,412	6,412	6,412	6,412
Long term Assets	m	**99,125**	**119,639**	**140,440**	**156,568**
Inventories	m	3,424	5,325	6,371	6,619
Accounts receivable	m	32,359	38,155	47,147	59,068
Cash & equivalents	m	41,794	55,725	65,733	82,690
Current Asset	m	**86,253**	**108,315**	**128,816**	**158,419**
Reserves	m	**129,525**	**162,625**	**205,953**	**249,928**
Shareholders' equity	m	**130,859**	**163,959**	**207,287**	**251,262**
Long term financing	m	**724**	**724**	**724**	**724**
Non-current Liability	m	**16,268**	**16,731**	**17,284**	**17,902**
Trade payables	m	23,299	31,845	29,265	30,404
Others	m	14,951	15,420	15,420	15,420
Current Liability	m	**38,251**	**47,264**	**44,685**	**45,823**
SH. Equity + Liabilities	m	**185,378**	**227,954**	**269,256**	**314,987**

Profit & Loss		FY22A	FY23E	FY24E	FY25E
Revenue	**m**	**95,134**	**134,744**	**161,206**	**167,475**
Operating cost	m	13,624	18,925	21,882	24,672
Royalty	m	12,000	16,555	22,767	23,652
EBITDAX	m	**69,510**	**99,263**	**116,557**	**119,150**
D&A	m	3,778	3,677	6,666	7,516
Dismantling cost	m	311	412	499	562
Exp & Devel		10,932	13,680	13,248	11,808
EBIT	**m**	**54,800**	**81,907**	**96,643**	**99,826**
Interest income	m	1,918	2,714	5,851	6,902
Financial cost	m	980	1,760	1,167	1,167
Other charges	m	3,623	5,234	6,789	7,073
PBT	m	**52,116**	**77,627**	**94,538**	**98,488**
Tax expense	m	19,053	25,850	31,197	32,501
PAT	m	**33,063**	**51,777**	**63,340**	**65,987**
EPS	**Rs**	**247.8**	**388.1**	**474.8**	**494.6**
DPS	**Rs**	**124.0**	**140.0**	**150.0**	**165.0**

Q' Profit and Loss		1QFY23	2QFY23	3QFY23	4QFY23
Revenue	m	31,825	29,815	35,086	38,018
Operating & D&A	m	5,854	4,816	5,529	6,403
Royalty	m	4,004	3,636	4,279	4,636
Exp. write-offs	m	**1,380**	**2,800**	**3,600**	**5,900**
EBIT	m	20,588	18,562	21,678	21,078
Interest income	**m**	**496**	**726**	**776**	**716**
Financial cost	m	440	440	440	440
Other charges	m	1,319	1,134	1,335	1,446
PBT	**m**	**19,325**	**17,714**	**20,679**	**19,908**
Tax expense	m	6,610	5,846	6,824	6,570
PAT	**m**	**12,715**	**11,869**	**13,855**	**13,339**
EPS	**Rs**	**95.3**	**89.0**	**103.9**	**100.0**
DPS	**Rs**	**-**	**65.0**	**-**	**75.0**

Key Ratios		FY22A	FY23E	FY24E	FY25E
EPS rep	Rs	247.8	388.1	474.8	494.6
EPS Growth	%	5.1	56.6	22.3	4.2
EBITDAX margins	%	73.1	73.7	72.3	71.1
EBIT margins	%	57.6	60.8	59.9	59.6
Net margins	%	34.8	38.4	39.3	39.4
BVPS	Rs	981	1,229	1,554	1,883
P/BV	x	1.2	1.0	0.8	0.7
P/E	x	6.2	3.9	3.2	3.2
DPS	Rs	124.0	140.0	150.0	165.0
DY	%	8.1%	9.2%	9.8%	10.8%
Payout	**%**	50.0	36.1	31.6	33.4
ROA	**%**	19.7	25.1	25.5	22.6
ROE	%	22.4	27.9	27.6	24.4

All figures are in Rs unless noted

Source: Company data, Foundation Research, January 2023

About the Company

Mari Petroleum Limited is one of the largest gas production company, having approximately 16.2% of gas reserves of Pakistan. MGCL was incorporated on December 04, 1984 as an unlisted public limited company with its IPO taking place in 1994. Fauji Foundation, Oil & Gas Development Company Limited and Government of Pakistan are its major shareholders with 40%, 20% and 18.2% shareholding respectively. The Company is the owner of the production lease and operator of Pakistan's second largest natural gas reservoir, Mari Gas Field in Sindh, which has been earmarked for provision of natural gas to the fertilizer and power sectors. Recoverable reserves of Mari field including Goru-B reservoir stands at 8.2TCF out of which cumulative production has been 3.82TCF till June 2010. The distributable dividend of MGCL is determined by the GPA made with GOP that guarantees a minimum return of 30% on its shareholder's fund, plus an additional return of 1% for every additional 20MMCFD over and above 425MMCFD of gas in any period. The company is an associate of FSL.

Auditors: A.F. Ferguson & Company Chartered Accountants

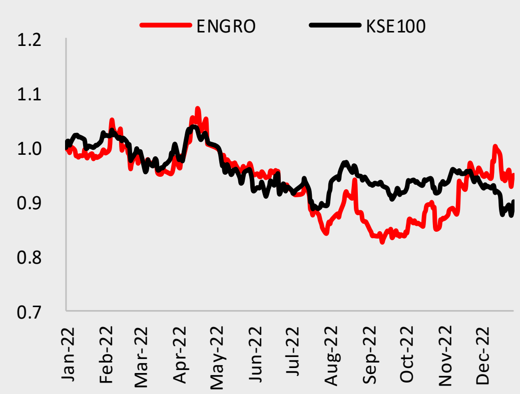
ENGRO PA **Outperform**

Price (31 Dec 22 CP)	Rs	284.7
Dec-23 Target Price	Rs	322.1
Upside/Downside	%	13.1
12M Target Price	Rs	322.1
- Sum-of-Parts		
Sector		Fertilizer
Market cap	Rs bn	164.0
30-day avg turnover	$ m	0.9
Market cap	$ m	723.6
Free float	%	55.0
Shares issued	m	576.2

Investment fundamentals

Year end Jun		2021A	2022E	2023F	2024F
Net Revenues	mn	311,587	397,797	458,651	456,361
EBITDA	m	88,874	98,495	117,116	118,553
EBITDA Growth	%	54.2	39.2	31.8	20.4
PBT	m	71,240	75,698	72,226	74,553
Recurring Profit	m	27,942	23,625	25,304	27,092
Net Profit	m	27,942	23,625	25,304	27,092
EPS reported	Rs	48.5	41.0	43.9	47.0
Rev growth	%	25.2	27.7	15.3	(0.5)
EPS growth	%	11.3	(15.5)	7.1	7.1
PE	x	5.9	6.9	6.5	6.1
DPS	Rs	25.0	34.0	15.0	20.0
Div. Yield	%	8.8	11.9	5.3	7.0
ROA	%	4.6	3.5	3.5	3.6
ROE	%	12.1	9.2	8.7	8.1
EV/EBITDA	x	2.6	3.0	2.7	2.2
Net D/E	x	0.3	0.5	0.5	0.3
Price to Book	x	0.7	0.6	0.5	0.5
Price to Sales	x	0.5	0.4	0.4	0.4

ENGRO KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Engro Corporation Limited

Securing returns with future in mind

Event

- Commencement of dividend income from Thar coal power plants and potential for inorganic growth in telecom business along with utilization of cash through venturing into Petrochemical complex and renewable projects makes a strong investment case for the scrip. Moreover, materialization of buyback equivalent to 12.1% of shares at market price would provide further impetus to stock price.

Impact

- **EPTL dividend to overshadow decline in fertilizer and polymer payouts:** We expect project completion of Engro Powergen Thar Limited (EPTL) would commence dividend income from the project that would substitute declining dividend stream of fertilizer and chemical business. The availability of the plant remained 17% YoY lower in CY22 due to issue in conveyer belt, however both units of the plant successfully came back online. We expect decline in dividend stream of fertilizer business due to payment of GIDC over dues and polymer segment on the back of normalization of margins as PVC-Ethylene margins and higher gas prices.

- **Inorganic growth to change the landscape of Enfrashare:** Acquisition of a tower portfolio from existing telecom companies would provide significant jump to company's Telecom segment. Currently, Enfrashare is eyeing a potential investment opportunity in the tower infrastructure sector in Pakistan, however the deal is contingent upon due diligence, finalization and execution of definitive documents as well as regulatory approvals.

- At present it has portfolio of 3,132 towers with a tenancy ratio of 1.14x. The segment captured a market share of 61% in Built to Suit (B2S) towers rollout and captured 139% increase in colocation tenants in 9MCY22. Enfrashare has secured orders of 3,900+ towers and is well on track to become a 5,000+ company by 2024, well ahead of earlier set target of 2025.

- **PDH & PP big ticker approaching decisive point:** Front End Engineering Design (FEED) study for the US$1.3-1.7bn PDH & PP complex being developed by the company is on track. Conclusion of feed and assessment of other key factors would enable value accretive decision making for the project. Any positive development on this project would provide substantial upside to our valuation as we have not incorporated this being in infancy stage.

Earnings Revision

- We revise our earnings forecast downward by 20.4%/5.6% for CY22/CY23 on imposition of Super tax and increase in interest rates while adjusted our earnings upward for CY24 by 13.6% on change in our dollar assumption.

Price Catalyst

- Dec- 23 TP: Rs322.1/sh based on Sum of the part methodology.

- Catalyst: (1) delay in payment of GIDC, (2) project completion of EPTL, (3) success of Enfrashare, (4) positive outcome of PDH & PP complex feasibility study, and (5) materialization of MoU signed for setting up of wind power project.

- Risks: (1) increase in gas prices, (2) ending of dollar indexation for EPTL, (3) shifting of EPCL to RLNG and (4) discouraging results of Enfrashare.

Outlook

- We have an "Outperform" rating on the stock given company's aggressive plan of diversification and expected commencement of dividend stream from EPTL.

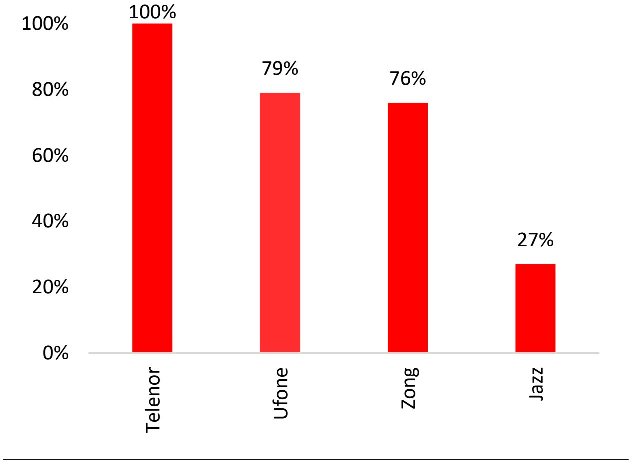
Table 36: Engro sum of the parts valuation (Rs/sh)

Companies	EV December-23	Valuation	Shares held (%)	Portfolio Discount	Engro's share in EV	Rs/share	% Contt in TP
Engro Fertilizer Limited	79,627	59.6	56.5%	20%	35,960	62.4	19%
EPTL	78,527	136.3	50.1%	25%	29,507	51.2	16%
Engro Polymer & Chemicals Limited*	43,303	35.8	42.2%	20%	14,635	25.4	8%
Engro Connect	19,446	33.8	100.0%	25%	14,584	25.3	8%
Engro Foods Limited	44,302	57.8	39.9%	25%	13,257	23.0	7%
SECMC	94,081	163.3	11.9%	30%	7,843	13.6	4%
Engro Elengy	12,784	22.2	42.0%	25%	4,027	7.0	2%
Engro Vopak Terminal Limited	10,517	20.1	50.0%	30%	3,681	6.4	2%
Engro PowerGen Qadirpur Limited	6,533	20.2	68.8%	20%	3,596	6.2	2%
Engro Eximp (Private) Limited	4,541	8.7	100.0%	30%	3,178	5.5	2%
Add: Cash & ST Investments	55,312				55,312	96.0	30%
No. of shares outstanding (mn)					576		
Dec-23 TP (Rs)						322.1	100%

Source: Company Accounts, Foundation Research, January 2023

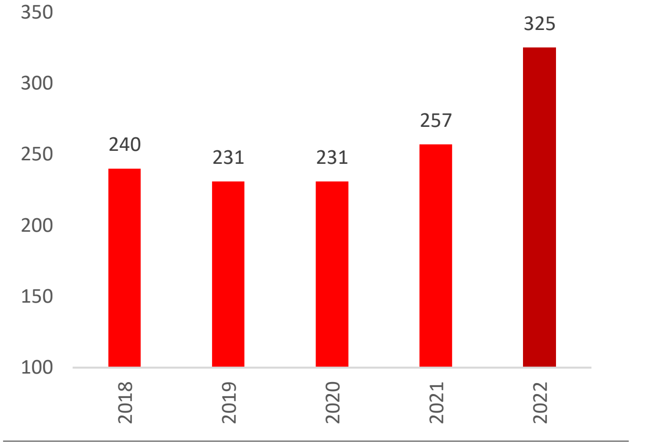
* Adjusted for preference shares

Fig 108: B2S market share preferred TowerCo by MNOs



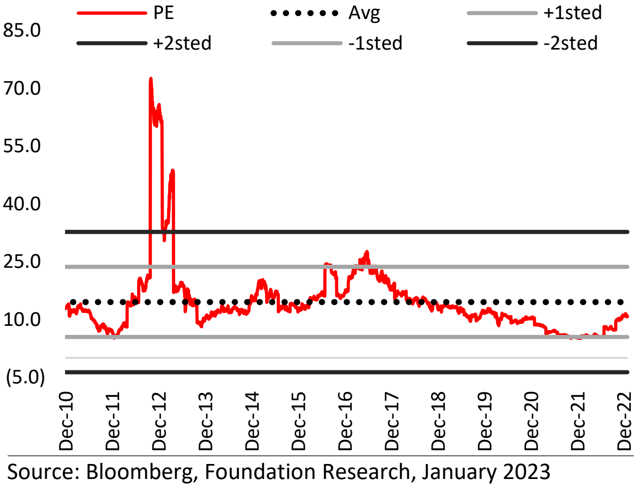
Source: PSX, Foundation Research, January 2023

Fig 109: Local PP market remained strong in 1H (000 tons)



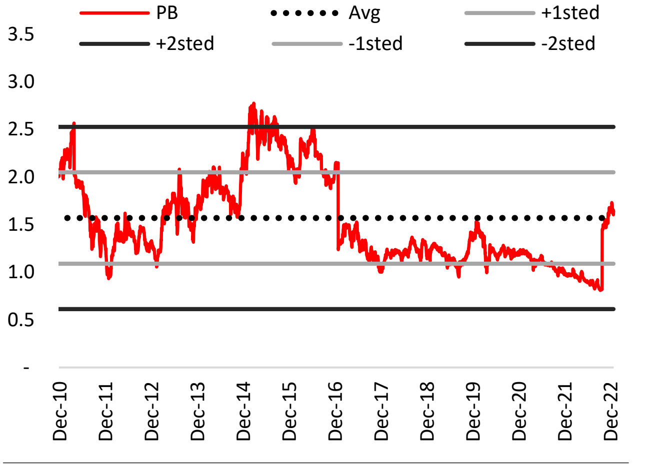
Source: PSX, Foundation Research, January 2023

Fig 110: Returning to normalization on buyback



Source: Bloomberg, Foundation Research, January 2023

Fig 111: …on PB too



Source: Bloomberg, Foundation Research, January 2023

Table 37: Engro Corporation Limited (ENGRO PA, 'Outperform', Target price: 322.1)

Balance Sheet		**CY21A**	**CY22E**	**CY23E**	**CY24E**
PP&E	m	282,155	323,184	320,048	316,556
Cash & ST invest	m	123,384	80,873	65,866	93,486
LT invest	m	34,217	35,856	36,142	36,484
Other Assets	m	204,773	280,041	314,400	313,245
Total Assets	**m**	**644,528**	**719,954**	**736,456**	**759,771**
LT Loan	m	139,818	157,822	132,912	110,704
Ot Liabilities	m	261,911	289,767	291,783	289,522
Total Liabilities	**m**	**401,729**	**447,589**	**424,695**	**400,226**
Paid-up Capital	m	5,762	5,762	5,762	5,762
Premium	m	13,068	13,068	13,068	13,068
Minority	m	81,061	103,798	131,718	159,324
Others	m	142,909	149,738	161,214	181,391
SH' Equity	**m**	**242,800**	**272,365**	**311,761**	**359,545**
L+E	**m**	**644,528**	**719,954**	**736,456**	**759,771**

Profit & Loss		**CY21A**	**CY22E**	**CY23E**	**CY24E**
Net Sales	m	311,587	397,797	458,651	456,361
Cost of Sales	m	212,133	287,447	330,444	328,564
Gross Profit	**m**	**99,455**	**110,350**	**128,208**	**127,797**
S&A	m	15,478	16,696	19,336	20,009
Other Income	m	12,222	18,300	11,403	9,339
Share JV		3,227	2,845	4,679	6,162
Other Exp	m	10,354	11,517	11,326	11,079
EBIT	**m**	**89,071**	**103,282**	**113,629**	**112,210**
Finance cost	m	17,832	27,584	41,403	37,656
PBT	m	71,240	75,698	72,226	74,553
Taxation	m	18,657	29,336	19,002	19,856
PAT	**m**	**52,582**	**46,361**	**53,224**	**54,698**
Attibt. PAT	**m**	**27,942**	**23,625**	**25,304**	**27,092**
EPS (rep)		48.5	41.0	43.9	47.0
EPS growth YoY (rep)	%	11%	-15%	7%	7%
DPS		25.0	34.0	15.0	20.0

Q performance		**1Q'22A**	**2Q'22A**	**3Q'22A**	**4Q'22E**
Net Sales	m	88,333	89,122	91,285	129,057
Cost of Sales	m	61,116	62,166	64,642	99,523
Gross Profit	**m**	**27,218**	**26,955**	**26,643**	**29,534**
S&A	m	3,559	4,596	4,709	3,831
Other Charges	m	2,700	5,122	1,712	1,984
Other income	m	3,986	5,637	4,130	4,547
Share JV	m	988	284	818	755
Finance cost	m	5,128	6,874	7,112	8,470
PBT	**m**	**20,805**	**16,285**	**18,057**	**20,550**
Taxation	m	5,908	14,370	4,160	4,899
PAT	**m**	**14,897**	**1,915**	**13,898**	**15,651**
Attribt. PAT	m	**7,972**	**(558)**	**8,017**	**8,194**
EPS (rep)		13.8	(1.0)	13.9	14.2

Key ratios		**CY21A**	**CY22E**	**CY23E**	**CY24E**
BVPS		280.7	292.6	312.5	347.5
EPS		48.5	41.0	43.9	47.0
PE	x	5.9	6.9	6.5	6.1
PBv	x	0.7	0.6	0.5	0.5
GP margins	%	32%	28%	28%	28%
EBITDA margin	%	29%	25%	26%	26%
Net margin	%	9%	6%	6%	6%
ROE	%	12.1	9.2	8.7	8.1
ROA	%	4.6	3.5	3.5	3.6
Earnings yield	%	0.2	0.2	0.2	0.2
Payout Ratio	%	52	83	34	43
Dividend Yield	%	8.8	11.9	5.3	7.0
EV/EBITDA	x	2.6	3.0	2.7	2.2

All figures in Rs unless noted
Source: Company data, Foundation Research, January 2023

About the Company

Currently, Engro's portfolio consists of a varied business portfolio, which include fertilizers, foods, chemical storage & handling, trading, energy, telecom and petrochemicals. Integrated in the agricultural sector and reaching out to over 1.5 million farmers, Engro provides PKR 77 billion of farm inputs and procures PKR 19 billion of farm produce, converting it to consumer food products which provide convenience, hygiene and nutrition to over 12 million consumers each day, every day. Producing low cost electricity from flared gas for millions of Pakistanis, developing indigenous power production from Thar Coal and LNG facilities, Engro well placed to help Pakistan overcome the energy crisis.

Auditors: A.F. Ferguson & Co., Chartered Accountants

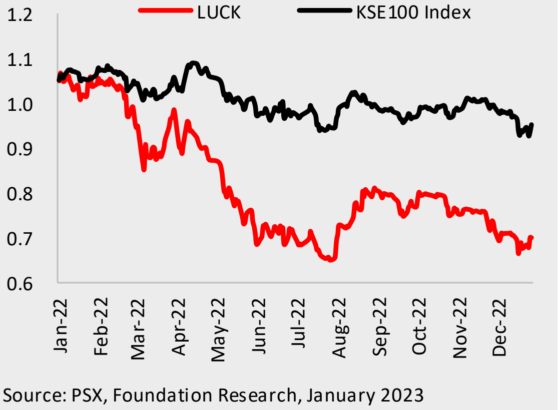
LUCK PA **Outperform**

Price (31 Dec 22 CP)	Rs	433.1
Dec-23 Target Price	Rs	595.4
Upside/Downside	%	37.5
12M Target Price	Rs	595.4
- Sum-of-Parts		
Sector		Cements
Market cap	Rs bn	140.1
30-day avg turnover	$ m	0.5
Market cap	$ m	617.9
Freet float	%	40.0
Shares issued	m	323.4

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	331,462	387,016	423,051	452,527
EBITDA	m	50,722	71,571	70,120	70,912
EBITDA Growth	%	347.6	90.7	38.2	(0.9)
PBT	m	47,036	43,168	49,644	57,736
Recurring Profit	m	29,497	29,490	35,739	41,432
Net Profit	m	29,497	29,490	35,739	41,432
EPS reported	Rs	91.2	91.2	110.5	128.1
Rev growth	%	60.0	16.8	9.3	7.0
EPS growth	%	29.0	(0.0)	21.2	15.9
PE	x	4.7	4.7	3.9	3.4
DPS	Rs	-	-	-	4.0
Div. Yield	%	-	-	-	0.9
ROA	%	6.8	5.7	6.6	7.5
ROE	%	16.5	13.6	14.1	14.0
EV/EBITDA	x	5.9	4.3	4.2	4.0
Net D/E	x	0.8	0.7	0.6	0.4
Price to Book	x	0.7	0.6	0.5	0.4
Price to Sales	x	0.4	0.4	0.3	0.3

LUCK KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Lucky Cement Limited

Lucky Electric all set to uplift earnings amid inclusive slowdown

Event

- Company maintained its dominant position as largest domestic cement player in ongoing expansion cycle of FY22-24 and will post 5 years earnings CAGR of 21%. Moreover, LUCK will witness growth in profitability due to (1) better cement retention prices in domestic market, (2) COD of 660MW LEPCL coal fired power plant, (3) improved profitability of ICI and (4) higher share of profit from Iraq/Congo cement operations. However, company is facing challenges with regard to local cement dispatches amid lackluster construction activity and decline in automobile sales due to monetary tightening and record high inflation.

Impact

- **LEPCL to overshadow decline in cyclical businesses:** Commissioning of LEPCL 660MW coal fired power plant would contribute more than 50% in company's profitability during the period of next three years. Moreover, the profitability of the power business is dollar hedged. The project is expected to contribute Rs69.9/67.6/64.6/sh in FY23/24/25 profitability.

- **LUCK timely expansion will preserve its position as the largest cement player in the country:** After the expansion of 3.1mn tons capacity at its Pezu site LUCK total capacity has increased to 15.3mn tons with current market share of 18.4% (15.4/29% in north/south regions). The company core business is facing headwinds as industry dispatches in north region declined by 18.1% YoY in 1HFY23. We expect domestic industry dispatches in North to ↓/↑ by 13.1/8.1% in FY23/FY24. Whereas, in south industry will see slight growth in domestic dispatches (↑ 1.1/8.2/10.4% in FY23/24/25) due to post flood rehabilitation spending, which would be funded by foreign donors. But, export dispatches will remain subdued due to demand contraction in export markets amid global recession.

- **Expansions to put pricing discipline to the test**: On pricing front we expect domestic players in north would not be able retain pricing discipline in the short run due to capacity additions of ~9.7mn tons in current fiscal year amid declining utilization levels. Whereas, in south region decline in export dispatches would force the companies to sell the residual stock at greater discounts amid tempered domestic demand. To highlight, recent decline in coal prices is expected to provide support to profitability margins in 2HFY23 as winter demand eases. However, this would be greatly offset by depreciation of Pak rupee against greenback. Furthermore, LUCK relatively greater portion of subsidized financing facilities and $ hedged earnings from Iraq-Congo operations would provide support to bottom line.

Earnings Revision

- We have revised down our FY23/24 EPS by 27/7.6% due to revised assumption of cement demand and energy prices.

Price Catalyst

- Dec-23 TP: Rs595.4/sh based on sum of the Parts (SOTP) methodology.

- Catalyst: (1) better cement retention prices, (2) declining coal prices and (3) project completion of 660MW LEPCL power plant.

- Risk: (1) lower than expected offtakes, (2) price war, and (3) revision of LEPCL tariff.

Outlook

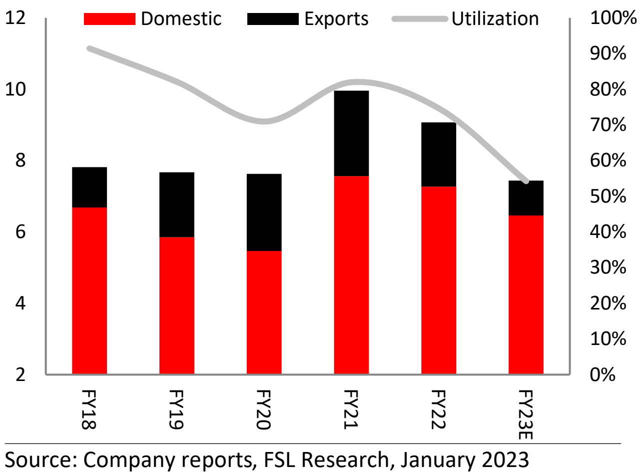
- We have an 'Outperform' stance on the stock with Dec-23 TP of Rs595.4/sh.

Table 38: LUCK sum of the parts valuation (Rs/sh)

Company	Valuation (Rs mn)	Shares held (%)	Portfolio Discount	LUCK share in valuation	Rs/sh TP contribution	% Contt in TP
Cement standalone	59,317			59,317	183.4	31%
LEPCL (Power)	76,135	100%	25%	57,101	176.6	30%
LMC (KIA)	20,962	71%	25%	11,184	34.6	6%
ICI	58,187	55%	20%	25,602	79.2	13%
Iraq	59,544	50%	25%	22,329	69.0	12%
Congo	40,487	50%	25%	15,182	47.0	8%
Yunus Energy	13,042	20%	30%	1,826	5.6	1%
No of shares outstanding (mn)				323		
Dec-23 TP (PKR)					**595.4**	**100%**

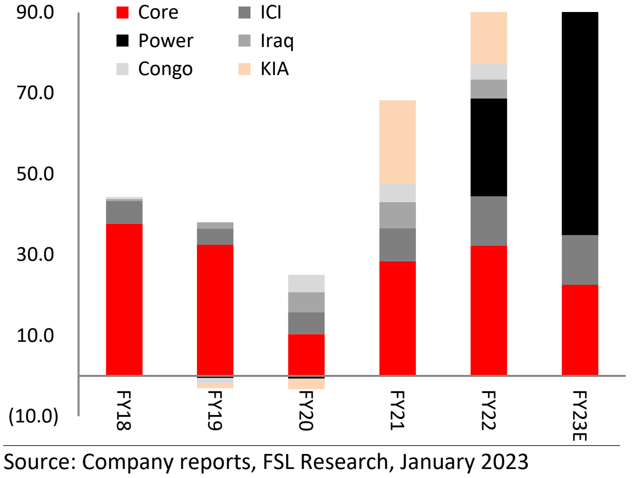
Source: Company Accounts, Foundation Research, January 2023

Fig 112: Dispatches declined with the industry avg (mn tons)



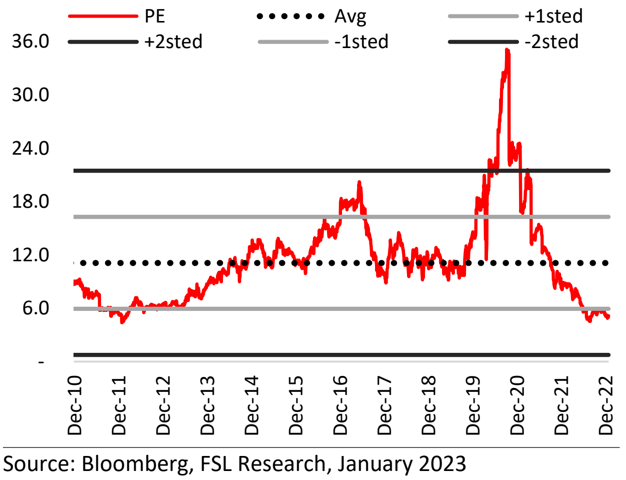
Source: Company reports, FSL Research, January 2023

Fig 113: LEPCL will constitute 56% of the earnings in FY23



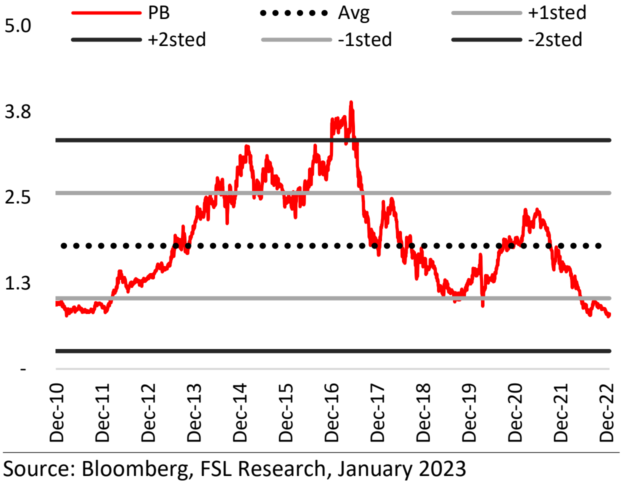
Source: Company reports, FSL Research, January 2023

Fig 114: Trading below historical average on PE



Source: Bloomberg, FSL Research, January 2023

Fig 115: Trading below historical average on PB



Source: Bloomberg, FSL Research, January 2023

Table 39: Lucky Cement Company Limited (LUCK PA, 'Outperform', Dec 23 TP: 595.4/sh)

Balance Sheet		FY22A	FY23E	FY24E	FY25E	Profit & Loss		FY22A	FY23E	FY24E	FY25E
PP&E	m	276,030	286,030	279,030	279,030	Net Sales	m	331,462	387,016	423,051	452,527
Trade Debt	m	36,355	51,947	66,370	86,281	COGS	m	268,291	304,694	337,347	362,446
Cash & ST	m	29,877	32,056	29,764	26,397	**Gross Profit**	**m**	**63,171**	**82,322**	**85,704**	**90,081**
Other Assets	m	161,426	168,628	172,589	172,589	S&A expenses	m	17,585	17,730	23,088	26,433
Total Assets	**m**	**503,687**	**538,661**	**547,753**	**564,297**	Other Charges	m	4,466	4,378	2,149	2,514
						Other Income	m	13,011	13,659	15,850	17,036
Total debt	m	191,205	197,072	182,128	166,941	**EBIT**	m	**54,131**	**73,873**	**76,317**	**78,169**
Trade Payable	m	78,407	79,035	73,735	68,535	Finance cost	m	7,095	30,705	26,673	20,433
Oth Liabilities	m	34,317	34,317	34,317	34,317	**PBT**	**m**	**47,036**	**43,168**	**49,644**	**57,736**
Total Liabilities	**m**	**303,929**	**310,424**	**290,180**	**269,792**	Taxation	m	10,613	9,701	10,059	11,847
						PAT	**m**	**36,423**	**33,467**	**39,585**	**45,889**
Paid-up Capital	m	3,234	3,239	3,243	3,247	Att to company	m	**29,497**	**29,490**	**35,739**	**41,432**
Others	m	196,525	224,998	254,330	291,258	EPS(rep)	Rs	91.2	91.2	110.5	128.1
SH' Equity	**m**	**199,758**	**228,237**	**257,573**	**294,505**	EPS growth YoY	%	29%	0%	21%	16%
Liab + Equity	**m**	**503,687**	**538,661**	**547,753**	**564,297**	DPS	Rs	-	-	-	4.0
Q performance		**2QFY22A**	**3QFY22A**	**4QFY22A**	**1QFY23**	**Key ratios**		**FY22A**	**FY23E**	**FY24E**	**FY25E**
Net Sales	m	68,398	93,197	114,885	90,633	BVPS	Rs	617.7	705.8	796.5	910.7
COGS	m	54,671	78,730	91,569	72,501	EPS	Rs	91.2	90.3	110.5	128.1
Gross Profit	**m**	**13,727**	**14,467**	**23,316**	**18,131**	PE	x	4.9	4.9	4.0	3.5
S &A expenses	m	4,764	4,914	4,065	4,190	P/Bv	x	0.7	0.6	0.6	0.5
Other Charges	m	868	972	1,851	1,173	P/S	x	0.4	0.4	0.3	0.3
Other Income	m	719	976	3,005	1,453	GP margins	%	19.1%	21.3%	20.3%	19.9%
EBIT	**m**	**8,814**	**9,557**	**20,406**	**14,221**	EBIT margin	%	14.6%	17.9%	16.9%	16.2%
Finance cost	m	574	1,257	4,924	6,485	Net margin	%	9.3%	7.4%	8.2%	9.1%
PBT	m	8,240	8,300	15,482	7,736	ROE	%	17%	13%	14%	14%
Taxation	m	1,627	1,802	5,448	2,270	ROA	%	7%	6%	6%	7%
PAT	**m**	**6,612**	**6,498**	**10,033**	**5,466**	EY	%	20%	20%	25%	29%
At to company	m	6,496	7,572	8,779	5,449	Payout Ratio	%	-	-	-	3.1
EPS(rep)	**Rs**	**20.1**	**23.4**	**27.1**	**16.9**	Dividend Yield	%	0%	0%	0%	1%

Source: Company Accounts, Foundation Research, January 2023

About the company

Lucky Cement Limited (the Company) was incorporated in Pakistan on September 18, 1993 and is listed on the Pakistan Stock Exchange. The Company has also issued Global Depository Receipts (GDRs) which are listed and traded on the Professional Securities Market of the London Stock Exchange. The principal activity of the Company is manufacturing and marketing of cement. The Company has two production facilities at Pezu, District Lakki Marwat in Khyber Pakhtunkhwa and at Main Super Highway in Karachi, Sindh. The company has also diversified its businesses in cement plants in Congo and Iraq, power generation, automobile and chemicals.

Auditors: M/s A.F. Ferguson & Co. Chartered Accountants

MID CAP

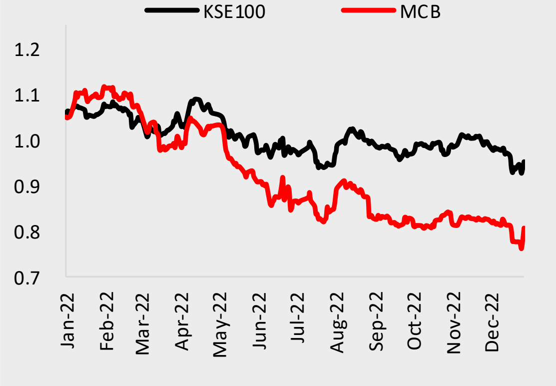
MCB PA **Outperform**

Price (31 Dec 22 CP)	Rs	114.5
Dec-23 Target Price	Rs	154.0
Upside/Downside	%	34.5
12M Target Price	Rs	154.0
- Two stage Gordon Growth Model		
Sector		Banks
Market cap	Rs bn	135.7
30-day avg turnover	$ m	0.2
Market cap	$ m	598.5
Freet float	%	35.0
Shares issued	m	1,185.1

Investment fundamentals

Year end Dec		2021A	2022E	2023F	2024F
Net interest Income	mn	68,378	94,188	123,482	115,421
Non interest inc	m	20,655	29,251	26,474	25,038
U/L Profit	m	17.9	51.8	28.2	(14.4)
PBT	m	53,275	74,054	88,588	76,501
PBT Growth	%	31,180	29,540	45,794	39,386
Net Profit	m	31,180	29,540	45,794	39,386
EPS reported	Rs	26.3	24.9	38.6	33.2
NII growth	%	(9.8)	37.7	31.1	(6.5)
EPS growth	%	6.0	(5.3)	55.0	(14.0)
PE	x	4.4	4.6	3.0	3.4
DPS	Rs	19.0	19.0	24.0	24.0
DY	%	16.6	16.6	21.0	21.0
ROA	%	1.6	1.3	1.9	1.5
ROE	%	16.8	16.8	24.9	19.8
NIMs	%	4.0	4.9	5.8	4.9
Coverage	%	90.0	84.2	84.2	84.3
Price/Book	x	0.8	0.8	0.7	0.7
		2.0	1.4	1.1	1.2

MCB KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

MCB Bank Limited

Well positioned to weather economic slowdown

Event

- Prudent asset deployment with lower ADR concentrated corporate book along with higher CASA would provide cushion to the Bank to pass through this tough economic environment. Moreover, lower cost of deposits and operating cost along with adequate CAR would further strengthen our conviction for the bank to reflect asset repricing in its profitability.

Impact

- **Profitability to remain strong:** To ride the cycle of rising interest rates in economic slowdown with prudent lending, MCB is expected to maintain its profitability growth. Profitability would be driven from increase in NII as asset repricing comes into play along with lower operating and provisioning expense given low risk profile and adequate coverage ratio. NIM for the bank is expected to improve to 5.8% while we expect deposit base to grow by ~10% given bank focused on low cost deposits. Bank is expected to post EPS of Rs38.6/33.2 in CY23/24, which would be followed by DPS of Rs24/24, respectively.
- **Prudent asset deployment:** Bank's asset deployment remains optimally prudent in economic slowdown amid monetary tightening, with IDR/ADR clocking in at 67/42%. IDR remains in line with peers, however ADR is on lower side in the industry with industry averaging at 51%. Bank would maintain its prudent nature with low ADR and capitalize on investment. Meanwhile, Bank's infection ratio is at 7.3% which is expected to decrease as bank becomes more discreet in minimizing NPLs.
- **Efficient on deposit cost and operations:** MCB's CASA is highest amongst peers, clocking in at 89.5%, with CA contribution of 39.2%. CASA translates to cost of deposit to lower side at 6.0/7.0% (10.3/12.3% excluding CA) for CY23/24. Similarly Cost/income ratio for the bank has declined to 38.8% which is expected to improve as total income improves going forward.
- **Investment book geared to adopt changing scenario:** Investment book is parked in repricing assets with concentration in floating PIBs and T-bills (27% of repricing assets) constituting 73% of the portfolio. However, Bank has started building fixed income PIB portfolio closing at Rs284bn on Sep'30. Bank is well versed to ride the increasing yield curve ahead as well equally geared to change its position as interest rate peaks.
- **Sufficient CAR to uphold dividend stream:** The bank's CAR is currently at 17.6%, which is well above the regulatory requirement. Bank's ROE generation is expected to improve to 25% in CY23, as repricing occurs and interest rates peak. Sufficient CAR provides buffer to maintain its dividend stream, which is currently at 80% payout.

Earnings Revision

- We revise down our CY22 earnings by 5% given higher taxation, while revised upward estimate for CY23 earnings by 27% as a result of aggressive monetary tightening.

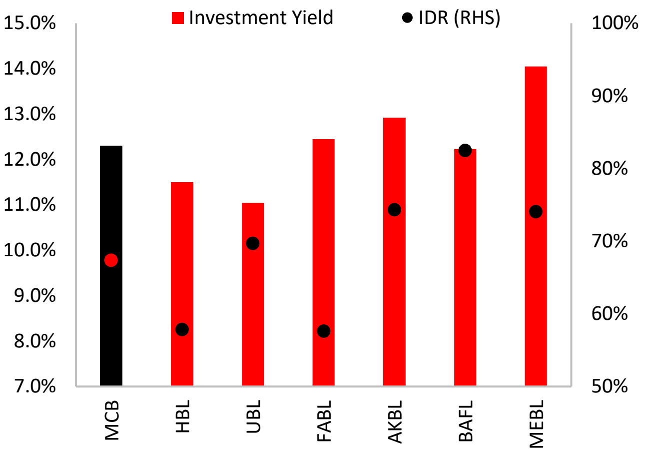
Price Catalyst

- Dec- 23 TP: Rs154.0/sh based on 2-stage Gordon growth model.
- Catalyst: (1) sufficient capital buffer, (2) lower provisioning and (3) higher CASA.
- Risks: (1) high IDR, (2) sensitive treasury book and (3) lower spread.

Outlook

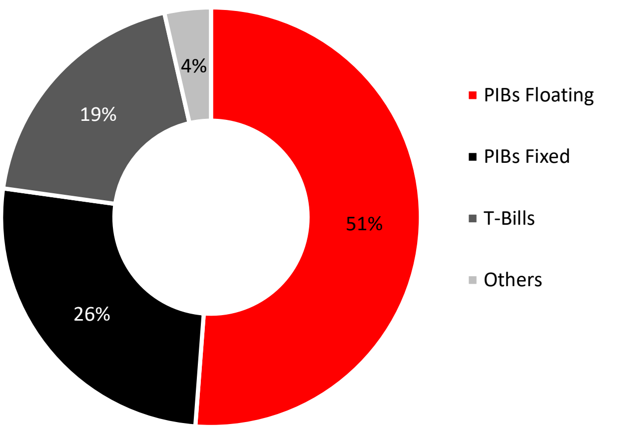
- We have an "Outperform" stance on the scrip with Dec-23 TP of Rs154.0/sh.

Fig 116: Prudent asset deployment to keep IDR high



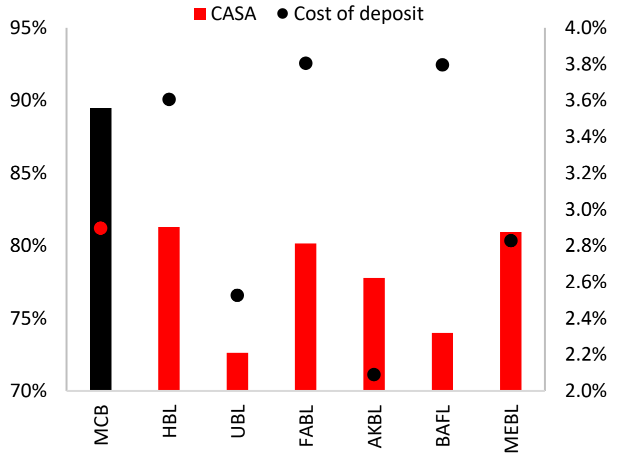
Source: Company Acc, Foundation Research, Jan 2023

Fig 117: ..... focused on building flexible investment book



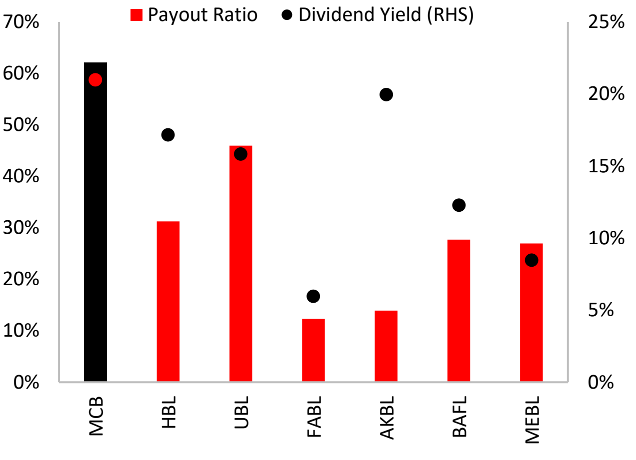
Source: Company Acc, Foundation Research, Jan 2023

Fig 118: CASA highest amongst peers



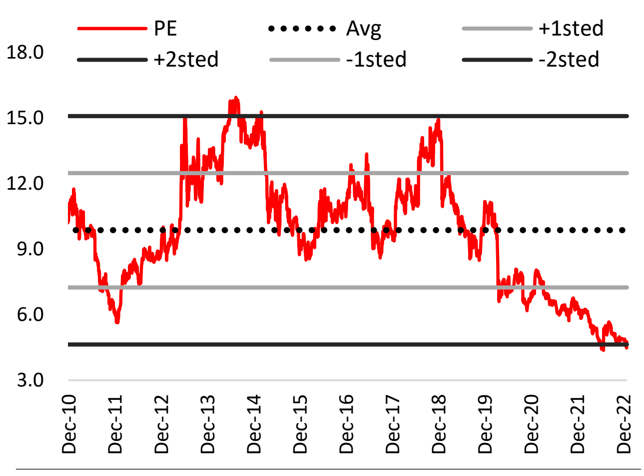
Source: Company Acc, Foundation Research, Jan 2023

Fig 119: Highest payout and dividend yield in industry



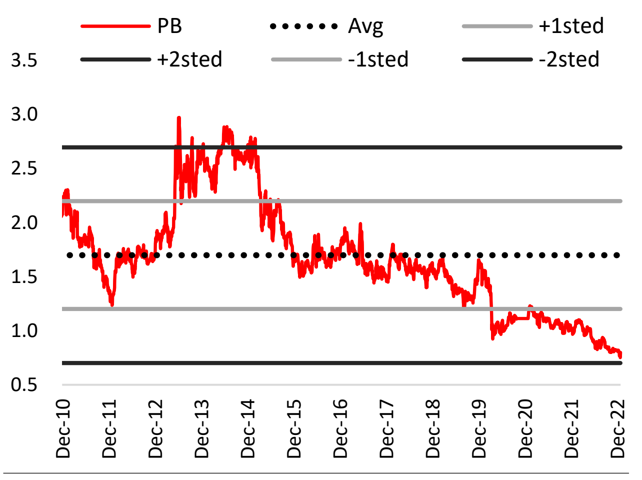
Source: Company Acc, Foundation Research, Jan 2023

Fig 120: Trading below lowest level in last 12 years…



Source: Bloomberg, Foundation Research, January 2023

Fig 121: …lower on PB as well



Source: Bloomberg, Foundation Research, January 2023

Table 40: MCB Bank limited (MCB PA, Outperform, Target Price Rs154.0)

Balance Sheet		**CY21A**	**CY22E**	**CY23E**	**CY24E**
Cash	m	175,922	169,415	186,757	205,875
Investments	m	1,062,569	1,196,567	1,333,706	1,458,877
Advances	m	686,389	700,415	780,673	872,315
Fixed Assets	m	62,352	62,757	62,645	62,600
Total Assets	**m**	**2,122,121**	**2,336,703**	**2,581,728**	**2,829,076**
Deposits	m	1,534,587	1,776,739	1,958,618	2,159,115
Borrowings	m	282,899	237,241	266,486	284,379
Other Liabilities	m	127,067	148,476	163,675	180,430
Total Liabilities	**m**	**1,944,553**	**2,162,455**	**2,388,778**	**2,623,923**
Net Assets	**m**	**177,569**	**174,248**	**192,950**	**205,152**
Share Capital	m	11,851	11,851	11,851	11,851
Unapp. Profits	m	64,697	70,490	88,789	100,883
Total Equity	**m**	**177,569**	**174,248**	**192,950**	**205,152**

Profit & Loss		**CY21A**	**CY22E**	**CY23E**	**CY24E**
NII	m	68,378	94,188	123,482	115,421
NFI	m	20,655	29,251	26,474	25,038
Fee Income	m	13,961	15,150	16,221	16,804
Total Income	**m**	**89,976**	**123,439**	**149,957**	**140,460**
Opex Exp	m	42,173	49,713	56,059	60,226
Admin Exp	m	40,590	47,946	53,844	58,282
Provisions	m	(5,473)	(327)	5,310	3,733
PBT	m	53,275	74,054	88,588	76,501
PAT	m	31,180	29,540	45,794	39,386
EPS		**26.3**	**24.9**	**38.6**	**33.2**
DPS		**19.0**	**19.0**	**24.0**	**24.0**
EPS Growth	%	6	(5.3)	55.0	(14)
Payout	%	72.2	74.5	60.9	70.2

Quarterly P&L		**1QCY22**	**2QCY22**	**3QCY22**	**4QCY22E**
NII	m	19,358	22,892	24,990	26,948
NFI	m	3,459	6,937	4,705	4,975
Fee Income	m	2,533	3,134	3,180	3,637
Total Income	**m**	**22,817**	**29,829**	**29,695**	**31,923**
Opex Expenses	m	11,083	12,231	13,066	13,332
Admin Expenses	m	10,754	11,828	12,557	12,808
Provisions	m	(992)	71	(377)	971
PBT	m	11,731	16,587	9,884	11,674
PAT	m	9,083	2,286	9,246	9,612
EPS		**7.66**	**1.93**	**7.80**	**8.11**
DPS		**5.00**	**4.00**	**5.00**	**5.00**

Key Ratios		**CY21A**	**CY22E**	**CY23E**	**CY24E**
NIMs	%	4.0	4.9	5.8	4.9
ADR	%	44.3	42.0	42.5	43.0
Infection	%	7.5	7.3	7.3	7.1
Coverage	%	90.0	84.2	84.2	84.3
IDR	%	69.2	67.3	68.1	67.6
Deposit growth	%	10.5	15.8	10.2	10.2
CASA	%	89.2	89.5	88.6	-
Cost/Income	%	45.1	38.8	35.9	41.5
CAR	%	16.0	16.5	18.3	18.0
ROE	%	17.0	17.0	25.0	20.0
BV	x	149.8	147.0	162.8	173.1

All figures are in Rs unless noted
Source: Company Accounts, Foundation Research, January 2023

About the Company

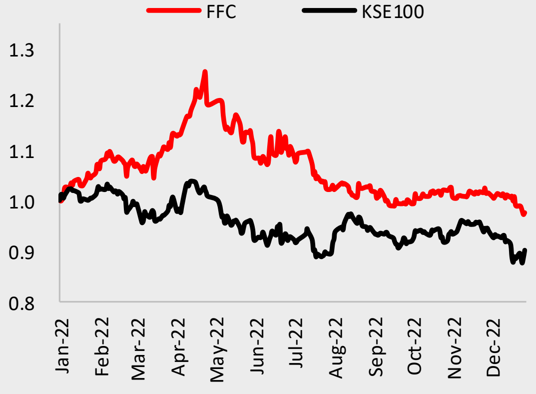
Established in 1947, MCB Bank Limited is one of the largest Banks in Pakistan with a total customer base exceeding 7 million. Renowned for its consumer-centric approach, the Bank has a vast branch network of over 1,400+ branches in Pakistan and abroad, in countries such as Sri Lanka, Bahrain and Dubai. Through remote banking services, consumers can access real time banking from the Bank’s 1350+ ATMs across Pakistan and via Internet Banking and Mobile Banking.

Auditors: M/s A .F. Ferguson & Co., Chartered Accountants

FFC PA **Outperform**

Price (31 Dec 22 CP)	Rs				102.3
Dec-23 Target Price	Rs				132.9
Upside/Downside	%				29.9
12M Target Price	Rs				132.9
- Sum-of-Parts					
Sector					Fertilizer
Market cap	Rs bn				130.1
30-day avg turnover	$ m				0.2
Market cap	$ m				574.2
Freet float	%				55.0
Shares issued	m				1,272.2
Investment fundamentals					
Year end Dec		2021A	2022E	2023F	2024F
Net Revenues	mn	108,651	109,492	123,331	172,955
EBITDA	m	32,894	35,448	39,871	45,100
EBITDA Growth	%	33.0	36.1	21.2	27.2
PBT	m	30,339	36,007	32,346	39,993
Recurring Profit	m	21,896	21,369	22,044	27,292
Net Profit	m	21,896	21,369	22,044	27,292
EPS reported	Rs	17.2	16.8	17.3	21.5
Rev growth	%	11.3	0.8	12.6	40.2
EPS growth	%	5.2	(2.4)	3.2	23.8
PE	x	5.9	6.1	5.9	4.8
DPS	Rs	13.4	13.0	14.1	18.2
Div. Yield	%	13.1	12.7	13.7	17.8
ROA	%	11.7	10.5	13.0	19.5
ROE	%	48.6	42.6	40.1	46.0
EV/EBITDA	x	5.8	5.1	3.7	3.3
Net D/E	x	1.2	0.9	0.3	0.3
Price to Book	x	2.7	2.5	2.3	2.1
Price to Sales	x	1.2	1.2	1.1	0.8

FFC KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Fauji Fertilizer Company

Ideally placed to ride on rebound in agriculture sector

Event

- Rebound in agriculture productivity post floods along with significant difference of domestic and international prices amid lower Urea prices would keep pricing power with the company. Subsequently, providing ability to pass on the impact of probable increase in gas. Moreover, government support for farmers in order to ensure food security would help in lower hike in gas prices for fertilizer sector against general industry. We have an “Outperform” stance on the stock with Dec-23 TP of Rs132.9/sh. Furthermore, dividend resumptions by FFBL and AKBL along with expansion into new ventures would provide further support to the growth.

Impact

- **Rejuvenation of agriculture output to keep pricing power with Urea manufacturer:** We expect urea pricing power to remain with the manufacturer given (i) rebound in agriculture output after floods, (ii) elevated DAP prices that compelled higher demand for urea, (iii) reduced fiscal space with government to import Urea and provide it on subsidized rates, (iv) lower inventory levels and (v) elevated international prices (2.0x higher than domestic market) amid government support for agriculture sector.

- **..allow to pass on the impact of increase in gas prices:** Abovementioned factors would allow fertilizer manufacturer to pass on the impact of increase in gas prices. To highlight, OGRA has allowed gas distribution companies to increase gas prices up to 75%, however final consumer prices are yet to be determined. An increase of 75% in gas prices of both feed and fuel stock would require company to increase urea prices by 20% in CY23, in our view. Moreover, we have assumed 50%/60% increase in feed/fuel stock gas prices.

- **Balance sheet to remain strong after GIDC repayment due to prudent management:** FFC’s current ~Rs70bn cash position is sufficient to pay overdue Rs62.6bn GIDC. In our assumption, we have assumed full payment of GIDC after adjusted against receivables of Rs24bn from government in CY23. However, if receivables would not be adjusted against GIDC then it have an additional cash outflow of Rs18.9/sh.

- **Domestic and overseas expansion to provide further impetus:** Materialization of domestic expansion into DAP plant in order to substitute imports and fertilizer complex of 1.3mn tons in Tanzania would provide another leg of expansion. However, both of these projects are contingent upon regulatory approvals.

Earnings Revision

- We have revised downward our EPS for CY22/23 by 13/17% due to imposition of super tax, higher anticipated increase in gas prices and lower than expected dividend from investments.

Price Catalyst

- Dec 23 TP: Rs132.9/sh based on sum of the part methodology.

- Catalyst: (1) pricing power in UREA market, (2) revival of dividends from FFBL and AKBL, (3) commencement of dividend from TEL 330 MW, (4) development on domestic DAP plant, and (5) expansion into 1.3mn fertilizer complex in Tanzania.

- Risk: (1) continuation of volatility in commodity prices, (2) abrupt increase in gas prices and (3) payment of interest at GIDC amount withheld.

Outlook

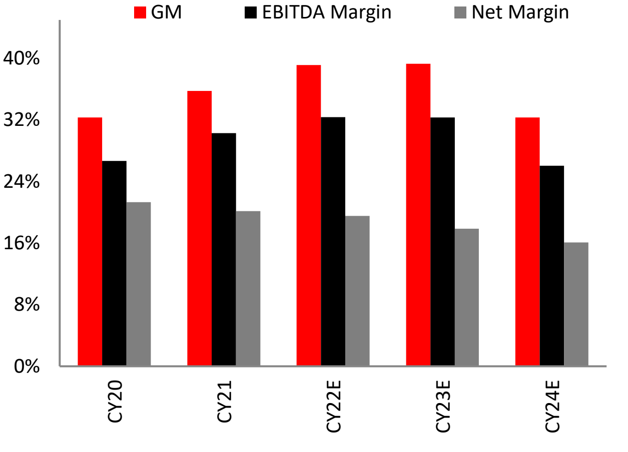
- We have an “Outperform” stance given attractive DY of 13.7/17.8% for CY23/24.

Table 41: FFC sum of the parts valuation detail

Company	Valuation Technique	Dec-23 TP	Share held (%)	Portfolio Discount	FFC Share	Contribution to value
Standalone	DDM				**73.9**	**56%**
FFBL	Sum of the part	40.1	49.9%	20%	16.2	**12%**
AKBL	Blended	34.7	43.2%	20%	11.9	**9%**
FCCEL	DDM	9.3	100.0%	25%	6.9	**5%**
TEL	DDM	31.7	30.0%	30%	6.7	**5%**
FWE I	DDM	7.5	100.0%	25%	5.6	**4%**
FWE II	DDM	7.4	80.0%	25%	4.4	**3%**
FFF	Investment Value	4.1	100.0%	25%	3.1	**2%**
PMP	DDM	25.2	12.5%	30%	2.2	**2%**
FCCL	FCFE	18.2	6.8%	20%	1.9	**1%**
Total					**132.9**	

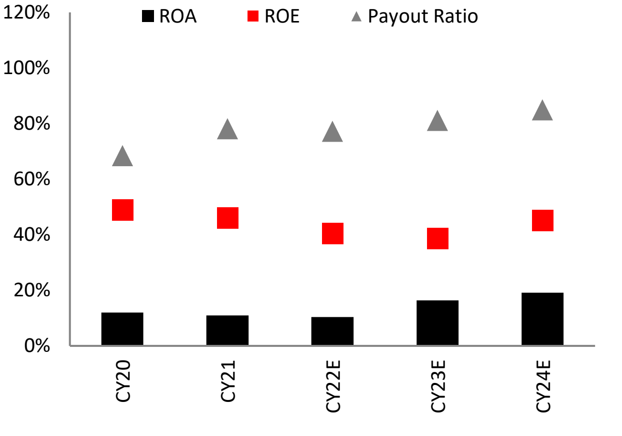
Source: Company accounts, Foundation Research, January 2023

Fig 122: Supportive government policies would allow FFC to retain pricing power



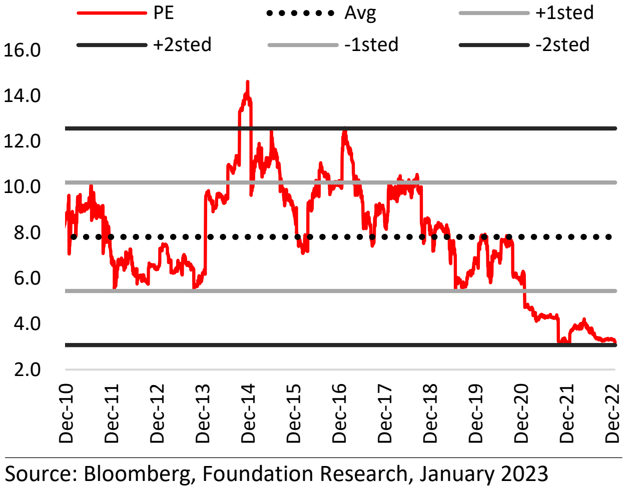
Source: Company Acc, Foundation Research, January 2023

Fig 123: Dividend payout to increase due to waiver of mark-up on GIDC amount withheld



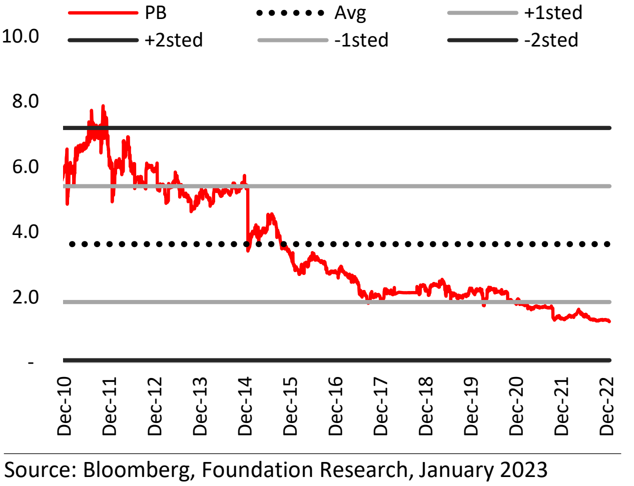
Source: Company Acc, Foundation Research, January 2023

Fig 124: Trading at below average PE



Source: Bloomberg, Foundation Research, January 2023

Fig 125: Trading low on PB as well



Source: Bloomberg, Foundation Research, January 2023

Table 42: Fauji Fertilizer Company Limited (FFC PA, 'Outperform', Target price: 132.9)

Balance Sheet		CY21A	CY22E	CY23E	CY24E
PP&E	m	23,987	24,360	25,254	26,211
Cash & ST invest	m	96,386	87,085	46,801	51,839
LT invest	m	46,115	46,115	46,115	46,115
Other Assets	m	34,519	47,745	16,739	21,040
Total Assets	**m**	**201,007**	**205,305**	**134,909**	**145,205**
LT+ST debt	m	55,694	50,259	40,251	42,975
Acct. payable	m	62,481	62,481	23,838	23,838
Deffered tax	m	24,583	29,083	4,583	4,583
Others	m	10,733	10,601	9,098	12,212
Total Liabilities	**m**	**153,492**	**152,425**	**77,771**	**83,608**
Paid-up Capital	m	12,722	12,722	12,722	12,722
Others	m	34,792	40,158	44,416	48,874
SH' Equity	**m**	**47,514**	**52,880**	**57,138**	**61,597**
L+E	**m**	**201,007**	**205,305**	**134,909**	**145,205**

Profit & Loss		CY21A	CY22E	CY23E	CY24E
Net Sales	m	108,651	109,492	123,331	172,955
Cost of Sales	m	69,772	66,619	74,833	117,066
Gross Profit	**m**	**38,879**	**42,873**	**48,498**	**55,888**
S&A	m	8,409	9,900	11,233	13,533
Other income	**m**	7,919	12,755	6,664	8,046
Other expenses	m	5,758	5,203	3,863	4,312
EBIT	**m**	**32,631**	**40,526**	**40,065**	**46,089**
Finance cost	m	2,292	4,519	7,719	6,096
PBT	**m**	**30,339**	**36,007**	**32,346**	**39,993**
Taxation	m	8,443	14,638	10,302	12,701
PAT	**m**	**21,896**	**21,369**	**22,044**	**27,292**
EPS		17.2	16.8	17.3	21.5
EPS growth yoy	%	5.2%	-2.4%	3.2%	23.8%
DPS		13.4	13.0	14.1	18.2

Q performance		3Q'22A	4Q'22E	1Q'23E	2Q'22E
Net Sales	m	24,474	30,312	25,437	29,166
Cost of Sales	m	15,034	17,779	15,562	17,682
Gross Profit	**m**	**9,440**	**12,533**	**9,875**	**11,484**
S&A	m	2,615	2,978	2,515	2,818
Other income	m	2,879	2,467	2,236	1,618
Other expenses	m	1,045	991	795	907
EBIT	m	**8,659**	**11,031**	**8,800**	**9,377**
Finance cost	**m**	1,210	1,291	1,930	1,930
PBT	m	**7,449**	**9,740**	**6,870**	**7,447**
Taxation	**m**	2,205	3,214	2,071	2,373
PAT	m	**5,244**	**6,526**	**4,799**	**5,074**
EPS		4.1	5.1	3.8	4.0
EPS growth yoy		56%	53%	-2%	10%
DPS		3.2	4.0	3.2	3.3

Key ratios		CY21A	CY22E	CY23E	CY24E
BVPS	x	37.3	41.6	44.9	48.4
EPS	x	17.2	16.8	17.3	21.5
PE	x	5.9	6.1	5.9	4.8
PBv	x	2.6	2.3	2.2	2.0
GP margins	%	36%	39%	39%	32%
EBITDA margin	%	30%	32%	32%	26%
Net margin	%	20%	20%	18%	16%
ROE	%	49%	43%	40%	46%
ROA	%	12%	11%	13%	19%
Earnings yield	%	18%	17%	18%	22%
Payout Ratio	%	78%	77%	81%	85%
DY	%	13%	13%	14%	18%
EV/EBITDA	x	5.8	5.1	3.7	3.3
Operat. cycle	x	(245.9)	(253.4)	(136.7)	(50.4)
Debt/Equity	x	1.2	0.9	0.3	0.3

All figures in Rs unless noted

Source: Company data, Foundation Research, January 2023

About the company

Fauji Fertilizer Company Limited (the Group) comprises of Fauji Fertilizer Company Limited (FFC I parent company) and its subsidiaries, FFC Energy Limited (FFCEL), Fauji Fresh n Freeze Limited (FFF), Foundation Wind Energy - I Limited (FWEL-I) and Foundation Wind Energy - II Limited (FWEL-II) incorporated in Pakistan as public limited companies, and OLIVE Technical Services (Private) Limited. The shares of FFC are quoted on Pakistan Stock Exchange.

The principal activity of FFC is manufacturing, purchasing and marketing of fertilizers and chemicals, including investment in other fertilizer, chemical, cement and banking operations. FFCEL has setup a 49.5 MW wind energy power project. FFF is principally engaged in the business of processing fresh, frozen fruit, vegetables, fresh meat, frozen cooked and semi cooked food. OLIVE technical services (Private) Limited is engaged in provision of Technical, Operations, Maintenance, Inspection and IT Services. FWEL-I & FWEL-II are each, 50 MW wind energy plants.

Auditors: A.F.Ferguson & Co Chartered Accountants

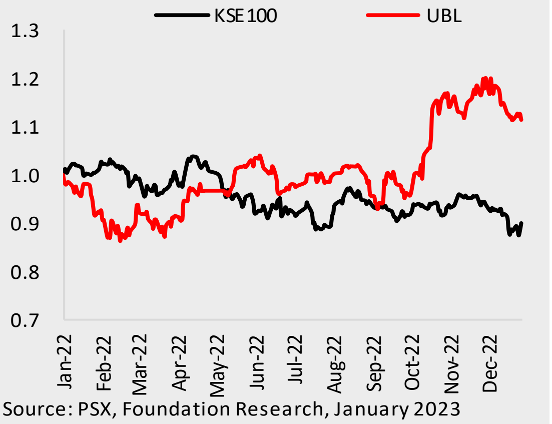
UBL PA **Outperform**

Price (31 Dec 22 CP)	Rs	101.0
Dec-23 Target Price	Rs	143.5
Upside/Downside	%	42.0
12M Target Price	Rs	143.5
- Sum-of-Parts		
Sector		Banks
Market cap	Rs bn	123.6
30-day avg turnover	$ m	0.3
Market cap	$ m	545.4
Freet float	%	40.0
Shares issued	m	1,224.2

Investment fundamentals

Year end Dec		2021A	2022E	2023F	2024F
Net interest Inco	m	74,736	105,220	136,189	140,541
Non interest inc	m	24,321	31,910	29,316	31,733
U/L Profit	m	3.2	69.3	20.5	(0.6)
PBT	m	52,167	71,426	89,864	95,607
PBT Growth	%	30,693	27,638	42,633	45,069
Net Profit	m	30,693	27,638	42,633	45,069
EPS reported	Rs	25.1	22.6	34.8	36.8
NII growth	%	(3.0)	40.8	29.4	3.2
EPS growth	%	47.5	(10.0)	54.3	5.7
PE	x	4.0	4.5	2.9	2.7
DPS	Rs	18.0	17.0	16.0	16.0
DY	%	17.8	16.8	15.8	15.8
ROA	%	1.2	0.9	1.3	1.2
ROE	%	14.1	12.4	18.7	17.8
NIMs	%	4.2	4.9	4.4	4.2
Coverage	%	97.5	97.6	97.6	97.6
Price/Book	x	0.5	0.6	0.5	0.5
		1.7	1.2	0.9	0.9

UBL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

UBL Bank Limited

Focusing on digitalization to outshine

Event

▪ Bank's focus on digitalization to achieve low cost deposits with controlled cost would bode positively. Besides, we foresee provisioning expense to normalize given lack of one offs, improving economic condition in Middle East due to elevated oil prices and focused on quality lending. Moreover, Bank's current investment portfolio provide it opportunity to ride the interest rate cycles along with agility to shift if things improve. Aforementioned factors along with comfortable buffer over regulatory requirements would enhance our conviction for continuation of strong dividend payout and thus compel us to have an "Outperform" stance on the stock.

Impact

▪ **Focus on digitalization to increase current deposits:** UBL digitalization along with expansion of Islamic branches laying the foundation for deposit growth as it enabled Bank to open 450k accounts in 9MCY22 against 413k accounts in 9MCY21. In 9MCY22, UBL App registration posted increase of 30% YoY to 2.5mn with transacting customers up 33% YoY and payment throughput increased by 51% to 1.8tn.

▪ This led to average CA deposits recording a growth of 13% YoY to Rs706bn, subsequently current account to total deposits ratio improved to 44.3% from 42% in 9MCY21. This along with controlled cost on domestic saving account has helped to contain the average cost of deposit to 4.71% in CY22 despite sharp increase in policy rate to 16%.

▪ **Provisioning expense to remain in control going forward:** We expect Bank's provisioning to normalize going forward given lack of one offs along with improvement in Middle East portfolio on elevated oil prices. In 9MCY22, Bank booked provisioning expense of US$18.8mn to build coverage against investments in Pakistan Eurobonds, and the Sri Lankan sovereign Debt. Subsequently, Bank's coverage against Int'l loans was moved up 40bps to 80.8%. However, we have kept provisioning expense higher for CY23 that largely incorporates domestic book contamination amid economic slowdown.

▪ **Investment book well positioned to move both ways:** Bank's placement of 62% of the investment book in repricing assets (PIB floaters 61% and 39% in T-bills) would provide leverage to tilt the portfolio according to the changing scenario.

▪ **Comfortable CAR to continue dividend payouts:** We foresee UBL to maintain a strong dividend payout as Bank's CAR has a buffer of 6.9% over a minimum regulatory requirements of 11.5%. Moreover, the Bank has to maintain an additional buffer of a mere 0.5% against 1.5% for other two major banks.

Earnings Revision

▪ We revise down our CY22 earnings by 13% due to higher tax rate while increase our CY23 estimate by 15% given increase in interest rates.

Price Catalyst

▪ Dec- 23 TP: Rs143.5/sh based on 2-Stage Gordon growth model.

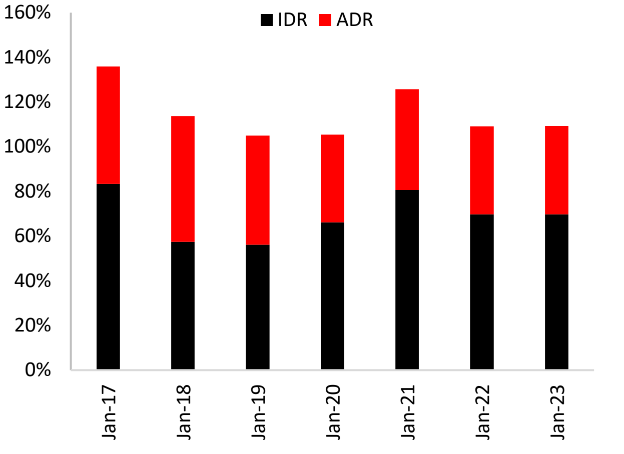
▪ Catalyst: (1) sufficient capital buffer, (2) lower ADR and (3) higher exposure in T-bills and PIB Floaters.

▪ Risks: (1) high NPLs, (2) breaching of CAR limit and (3) international exposure.

Outlook

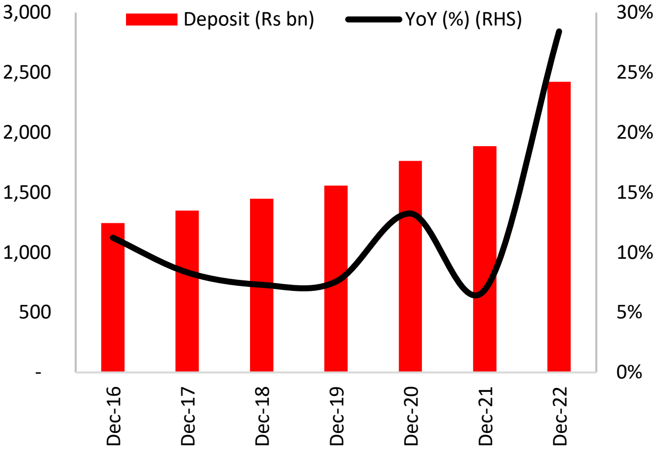
▪ We have an "Outperform" rating due to de-risking of int'l book and sufficient capital buffer to provide high dividend yield of 17% and recovery of NIMs.

Fig 126: Focus on building IDR



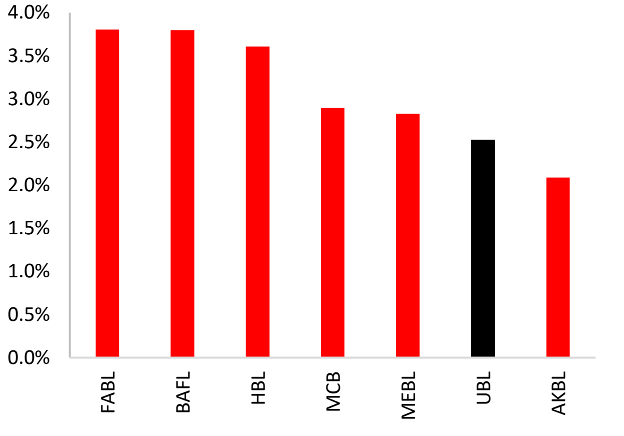
Source: Company Acc, Foundation Research, Jan 2023

Fig 127: Supported by robust deposit growth



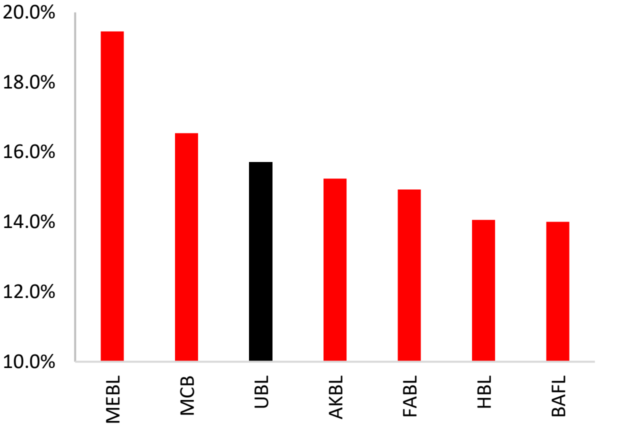
Source: Company Acc, Foundation Research, Jan 2023

Fig 128: ...with lower operating cost



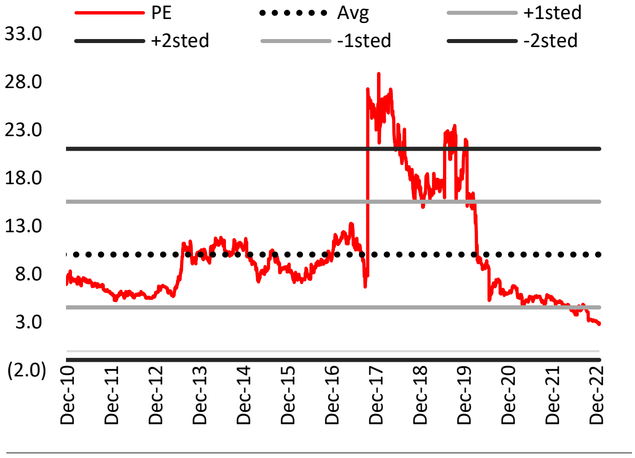
Source: Company Acc, Foundation Research, Jan 2023

Fig 129: ...comfortable in terms of regulatory requirements



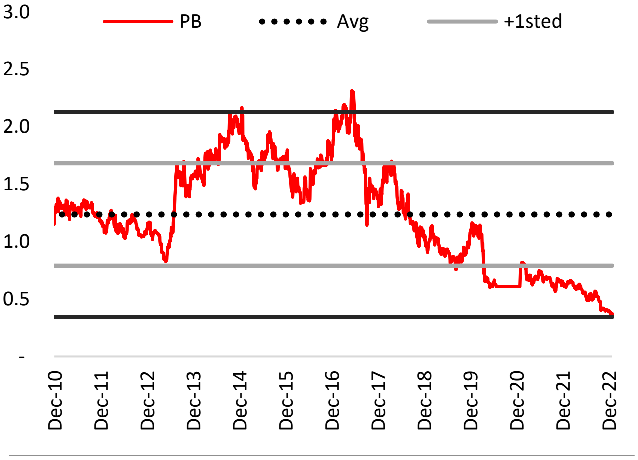
Source: Company Acc, Foundation Research, Jan 2023

Fig 130: Trading at below average PE



Source: Bloomberg, Foundation Research, January 2023

Fig 131: Trading low on PB as well



Source: Bloomberg, Foundation Research, January 2023

Table 43: United Bank Limited (UBL PA, Outperform, Target Price Rs143.5)

Balance Sheet		CY21A	CY22E	CY23E	CY24E
Cash	m	273,950	260,282	292,949	329,717
Investments	m	1,521,467	1,688,506	1,903,059	2,144,540
Advances	m	766,781	858,689	967,372	1,095,869
Fixed Assets	m	76,194	78,937	80,678	81,391
Total Assets	**m**	**2,781,228**	**3,084,479**	**3,453,684**	**3,874,152**
Deposits	m	1,885,772	2,421,935	2,725,910	3,068,035
Borrowings	m	565,173	306,238	329,870	363,134
Other Liabilities	m	101,970	150,081	168,918	190,118
Total Liabilities	**m**	**2,552,914**	**2,878,254**	**3,224,697**	**3,621,288**
Net Assets	**m**	**228,314**	**206,225**	**228,986**	**252,865**
Share Capital	m	12,242	12,242	12,242	12,242
Unapp. Profits	m	89,840	91,322	113,114	137,804
Total Equity	**m**	**228,314**	**216,525**	**240,579**	**265,912**

Income Statement		CY21A	CY22E	CY23E	CY24E
NII	m	74,736	105,220	136,189	140,541
NFI	m	24,321	31,910	29,316	31,733
Fee Income	m	14,717	17,079	18,449	19,956
Total Income	**m**	**99,057**	**137,130**	**165,505**	**172,274**
Op. Exp.	m	48,681	55,961	64,506	70,307
Admin Exp.	m	47,447	54,442	62,646	68,421
Provisions	m	(1,449)	9,743	11,135	6,361
PBT	m	52,167	71,426	89,864	95,607
PAT	m	30,693	27,638	42,633	45,069
EPS		**25.1**	**22.6**	**34.8**	**36.8**
DPS		**18.0**	**17.0**	**16.0**	**16.0**
EPS Growth	%	47.5	(10)	54	5.7
Payout	%	72.5	78.4	47.3	44.2

Quarterly I/S		1QCY22	2QCY22	3QCY22	4QCY22E
NII	m	22,363	24,627	28,923	29,306
NFI	m	6,776	8,859	8,182	8,094
Fee Income	m	4,217	4,155	4,286	4,421
Total Income	**m**	**29,139**	**33,486**	**37,105**	**37,400**
Op. Exp	m	13,021	13,691	14,777	14,473
Admin Exp.	m	12,687	13,304	14,437	14,015
Provisions	m	334	1,034	5,461	2,915
PBT	m	15,737	18,860	16,189	19,910
PAT	m	9,373	2,781	6,593	8,163
EPS		**7.60**	**2.17**	**5.32**	**6.59**
DPS		**5.00**	**4.00**	**4.00**	**4.00**

Key Ratios		CY21A	CY22E	CY23E	CY24E
NIMs	%	3.6	4.2	4.9	4.4
ADR	%	45.0	39.4	39.4	39.4
Infection	%	10.5	10.3	10.2	9.6
Coverage	%	92.6	97.5	97.6	97.6
IDR	%	80.7	69.7	69.8	69.9
Deposit growth	%	6.9	28.4	12.6	12.6
CASA	%	77.3	72.6	72.6	-
Cost/Income	%	47.9	39.7	37.9	39.7
CAR	%	19.5	15.7	14.9	14.1
ROE	%	14.0	12.0	19.0	18.0
BV	x	186.5	176.9	196.5	217.2

All figures are in Rs unless noted
Source: Company Accounts, FSL Research, January 2023

About the Bank

UBL was established in 1959 as a local private bank. However, it was nationalized in 1974 by the Government of Pakistan. After remaining under public ownership for over quarter century, the bank was sold off to a consortium of Abu Dhabi group of UAE and Bestway (Holdings) of UK in 2001 under privatization program. Currently, the bank is a subsidiary of Bestway Holding as Abu Dhabi group opted to exit the bank.

Post privatization, UBL has emerged as one of Pakistan's fastest growing and most aggressive financial institutions offering a complete range of corporate, SME and consumer products to its customers. Further, the bank also has a formidable international presence mainly concentrated in the Middle-East.

UBL is the one of the largest bank in Pakistan with of assets (Rs2.7tn), deposits (Rs2.2tn) and advances (Rs0.7tn). UBL's extensive branch network, comprises of 1,338 domestic including 150 Islamic branches and 2 in export processing zone. Besides, UBL is the largest Pakistani Bank based in the Middle East, branches in UAE, Bahrain and Qatar, outreach extended through fully licensed bank in UK.

Auditors: M/s. EY Ford Rhodes Chartered Accountants.

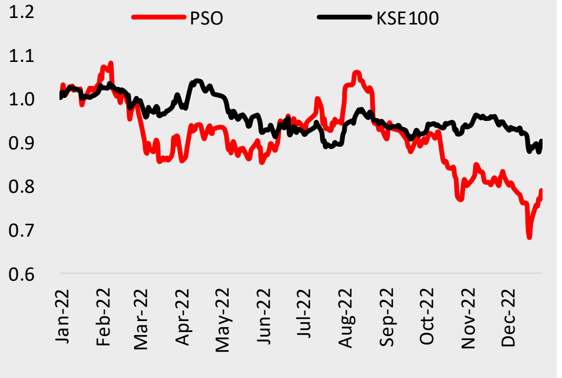
PSO PA **Outperform**

Price (31 Dec 22 CP)	Rs	145.0
Dec-23 Target Price	Rs	227.9
Upside/Downside	%	57.2
12M Target Price	Rs	227.9
- DCF Methodology		
Sector		OMCs
Market cap	Rs bn	68.1
30-day avg turnover	$ m	0.5
Market cap	$ m	300.4
Freet float	%	45.0
Shares issued	m	469.5

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	2,451,581	3,241,165	3,133,310	2,975,979
EBITDA	m	147,914	56,003	84,481	92,600
EBITDA Growth	%	5,629.3	21.3	(42.9)	65.3
PBT	m	147,855	54,929	83,366	92,322
Recurring Profit	m	86,223	30,620	55,855	61,855
Net Profit	m	86,223	30,620	55,855	61,855
EPS reported	Rs	183.7	65.2	119.0	131.8
Rev growth	%	103.6	32.2	(3.3)	(5.0)
EPS growth	%	NA	(64.5)	82.4	10.7
PE	x	0.8	2.2	1.2	1.1
DPS	Rs	10.0	12.0	24.0	27.0
Div. Yield	%	6.9	8.3	16.5	18.6
ROA	%	13.5	3.4	6.1	6.5
ROE	%	48.5	13.5	21.2	19.8
EV/EBITDA	x	1.4	4.0	2.9	2.2
Net D/E	x	0.7	0.6	0.6	0.4
Price to Book	x	0.3	0.3	0.2	0.2
Price to Sales	x	0.0	0.0	0.0	0.0

PSO KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Pakistan State Oil Company Limited

Resolution of circular debt to unlock potential

Event

▪Higher margins and steps to rein in circular debt would unleash the valuation upside of PSO. Being the largest OMC in Pakistan, it would also benefit from increasing market share despite steep decline in petroleum sales amid economic slowdown. Therefore, we have an outperform stance on the scrip with Dec'23 TP of Rs227.9/sh.

Impact

▪**Circular debt resolution to unclog balance sheet:** PSO's receivables from SNGPL on account of LNG sales have swelled to Rs306bn (~Rs651/sh) on Sept'30, 2022 from Rs116bn a year ago. To curtail the future build-up of circular debt as per IMF guidelines, OGRA has recently notified a 74% increase in SNGPL gas prices. This would improve the cash flow position of PSO, unclog its balance sheet and unleash valuation upside.

▪**OMC margin revision to improve earnings:** OMC margins were revised in Dec'22 after the Economic Coordination Committee of the Cabinet gave approval to increase to Rs6/ltr. Subsequently, margins on MS/HSD were increased to Rs6/5/ltr currently with EPS impact of ~Rs22.7.

▪**Improved market share on the back of infrastructure investment:** Amid a protracted decline in petroleum sales during 1HFY23 (MS/HSD/FO declined by 15/23/24% YoY), PSO was able to secure higher market share of 51.4% in 1HFY23 (up 1.2ppts YoY). Moreover, its market share of HSD increased by 5.7ppts to 55.0%. However, PSO's market share in MS/FO declined by 1.1/5.9ppts YoY to 43.4/55.4% during 1HFY23.

▪We believe that the higher market share is a result of (1) expansion of outlets, (2) investment in storage facilities, (3) lower competition, and (4) curb in smuggling of HSD due to better border controls. We believe that the company will be able to maintain its market share given continuous investment and expansion plans.

▪Furthermore, company has recently completed MS/HSD storage facilities of 112.5KT at Machike, Zulfiqarabad Oil Terminal and Juglot (GB), and rehabilitation of 44KT of storage capacity at Keamari. Company has also converted 180K tons of FO storage to MS/HSD storage. Besides PSO added 70 new retail outlets and 21 convenience stores across the country in FY22.

Earnings Revision

▪We revise up our FY23/24 EPS by 25/118% due to result update and higher than expected margin revision.

Price Catalyst

▪Dec-23 TP: Rs227.9/sh based on DCF methodology.

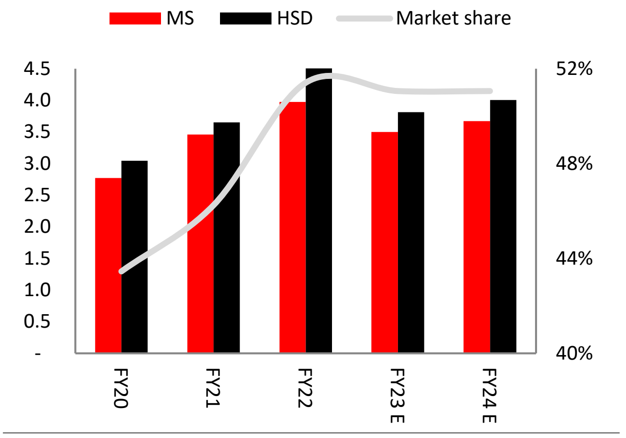
▪Catalyst: (1) margin revision and (2) increased payout.

▪Risk: (1) delay in circular debt resolution and (2) debt pile up.

Outlook

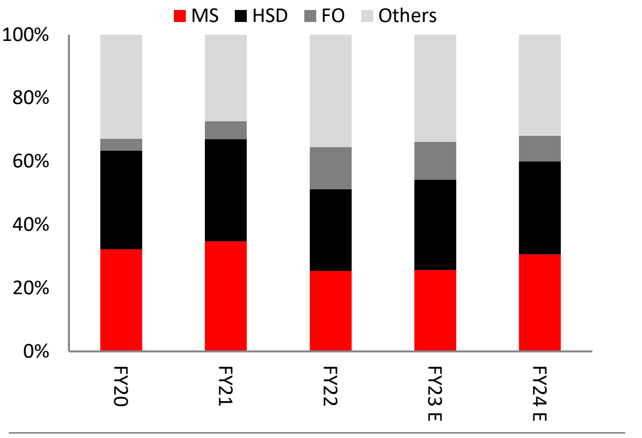
▪We have "Outperform" rating with Dec'22 TP of Rs227.9/sh owing to margin revision and resolution of circular debt.

Fig 132: Market share to remain stable



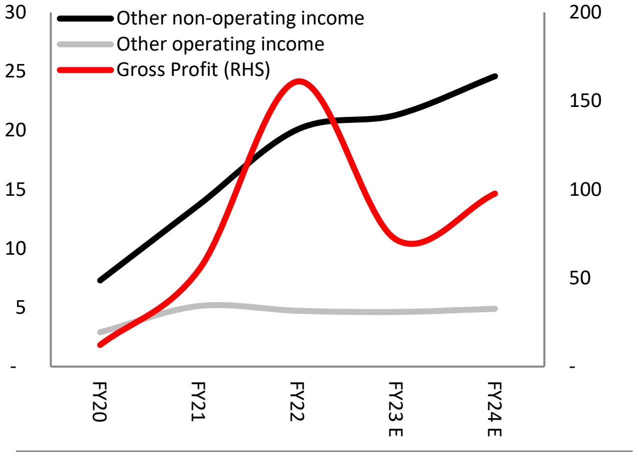
Source: OCAC, FSL Research, January 2023

Fig 133: MS/HSD gross profit mix continue expanding



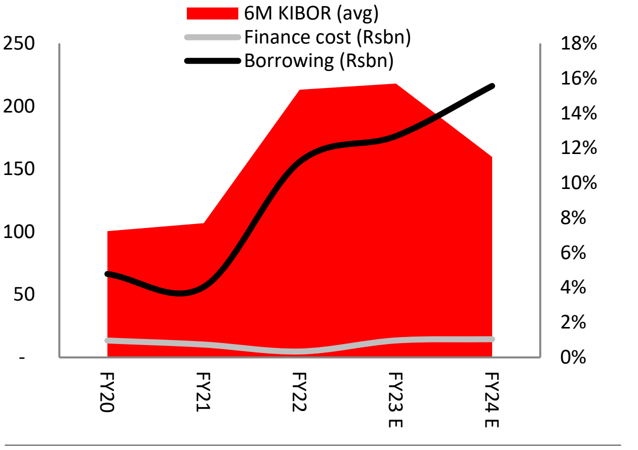
Source: OCAC, FSL Research, January 2023

Fig 134: GP to decline amid lack of inventory gain



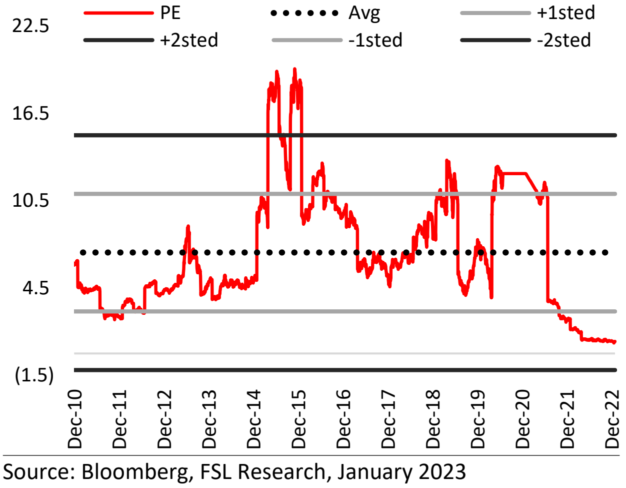
Source: Company reports, FSL Research, January 2023

Fig 135: Finance cost to drop



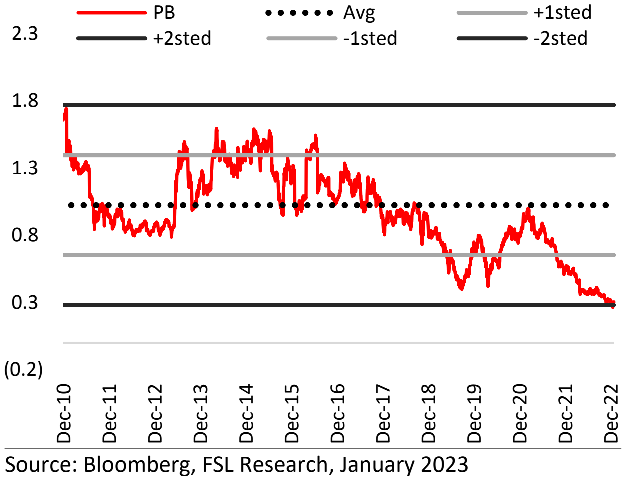
Source: PPIS, FSL Research, January 2023

Fig 136: Trading below -2sted



Source: Bloomberg, FSL Research, January 2023

Fig 137: …and lower on PB



Source: Bloomberg, FSL Research, January 2023

Table 44: PSO (PSO PA, 'Outperform', Dec 22 Target price: 227.9)

Balance Sheet		**FY22**	**FY23E**	**FY24E**	**FY25E**
PP&E	m	53,624	56,605	59,816	64,218
Trade Debt	m	430,942	539,558	590,281	581,563
Cash & ST	m	13,919	22,469	37,987	55,370
Others	m	400,969	263,010	267,804	249,757
Total Assets	**m**	**899,454**	**881,643**	**955,888**	**950,909**
ST Borrowing	m	155,846	176,205	216,131	187,459
Trade Payable	m	493,810	446,049	432,770	406,758
Others	m	34,149	20,067	19,698	19,379
Liabilities	**m**	**683,805**	**642,322**	**668,599**	**613,596**
Paid-up Capital	m	4,695	4,695	4,695	4,695
Others	m	210,954	234,626	282,595	332,619
SH' Equity	**m**	**215,649**	**239,321**	**287,289**	**337,313**

P&L		**FY22**	**FY23E**	**FY24E**	**FY25E**
Net Sales	m	2,451,581	3,241,165	3,133,310	2,975,979
Cost of Sales	m	2,290,586	3,169,506	3,035,620	2,871,617
Gross Profit	**m**	**160,995**	**71,659**	**97,690**	**104,362**
Dist exp	m	12,634	16,703	16,147	15,336
Admin Exp	m	4,178	5,212	5,727	6,168
O. Charges	m	17,114	8,721	9,051	9,447
O. Income	m	25,507	27,407	31,108	32,628
EBIT	**m**	**152,576**	**68,431**	**97,872**	**106,039**
Finance cost	m	4,721	13,501	14,506	13,717
PBT	**m**	**147,855**	**54,929**	**83,366**	**92,322**
Taxation	m	61,633	24,309	27,511	30,466
PAT	m	86,223	30,620	55,855	61,855
EPS (rep)	**Rs**	**183.7**	**65.2**	**119.0**	**131.8**
EPS growth	%	N/A	-64%	82%	11%
DPS	Rs	10.0	12.0	24.0	27.0

Q P&L		**2QFY22**	**3QFY22**	**4QFY22**	**1QFY23**
Net Sales	m	522,749	567,950	901,658	862,264
Cost of Sales	m	496,086	524,041	833,288	855,544
Gross Profit	**m**	**26,663**	**43,909**	**68,370**	**6,720**
D&A exp.	m	3,586	3,934	5,336	4,081
Other Charges	m	1,974	4,382	9,189	518
Other Income	m	9,068	11,920	2,620	6,681
EBIT	**m**	**30,171**	**47,513**	**56,465**	**8,803**
Finance cost	m	784	1,271	2,039	4,796
PBT	**m**	**29,386**	**46,242**	**54,425**	**4,008**
Taxation	m	9,191	13,661	32,972	2,810
PAT	**m**	20,195	32,580	21,454	1,198
EPS (rep)	Rs	43.0	69.4	45.7	2.6
DPS	Rs	-	-	10.0	-

Key ratios		**FY22**	**FY23E**	**FY24E**	**FY25E**
BVPS	Rs	459.3	509.8	611.9	718.5
EPS	Rs	183.7	65.2	119.0	131.8
PE	x	0.8	2.2	1.2	1.1
PBV	x	0.3	0.3	0.2	0.2
GP margins	%	6.6%	2.2%	3.1%	3.5%
EBIT margin	%	6.2%	2.1%	3.1%	3.6%
Net margin	%	3.5%	0.9%	1.8%	2.1%
ROE	%	48.5	13.5	21.2	19.8
ROA	%	13.5	3.4	6.1	6.5
EY	%	39.1%	13.9%	25.3%	28.1%
Payout	%	5.4	18.4	20.2	20.5
DY	%	5.6	6.8	13.5	15.2
EV/EBITDA	x	1.5	4.2	3.1	2.3

All figures in Rs unless noted
Source: Company data, Foundation Research, January 2023

About the Company

Pakistan State Oil (PSO) is the largest oil marketing company in Pakistan. The company is engaged in storage, distribution and marketing of POL products. PSO has a market share of ~51%. The company is also engaged in LNG supply business. Government of Pakistan owns 25.5% stake in PSO. The company is listed on PSX of the country.

Auditors: KPMG Taseer Hadi & Co. Chartered Accountants

SMALL CAP

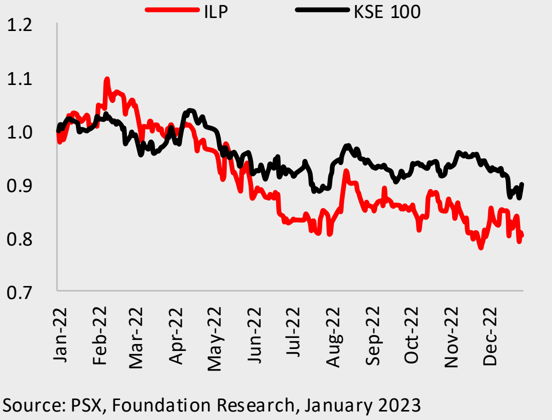
ILP PA **Outperform**

Price (31 Dec 22 CP)	Rs	56.5
Dec-23 Target Price	Rs	101.3
Upside/Downside	%	79.3
12M Target Price	Rs	101.3
- Sum-of-Parts		
Sector		Textile
Market cap	Rs bn	52.8
30-day avg turnover	$ m	0.1
Market cap	$ m	198.0
Freet float	%	14.0
Shares issued	m	934.3

Investment fundamentals

Year end Jun		2022A	2023E	2024E	2025E
Net Revenues	mn	90,894	122,809	118,894	131,996
EBITDA	m	18,691	25,478	24,473	26,986
EBITDA Growth	%	257.1	147.4	30.9	5.9
PBT	m	13,423	17,483	18,613	20,846
Recurring Profit	m	12,359	15,583	17,138	19,194
Net Profit	m	12,359	15,583	17,138	19,194
EPS reported	Rs	13.2	16.7	18.3	20.5
Rev growth	%	65.4	35.1	(3.2)	11.0
EPS growth	%	96.4	26.1	10.0	12.0
PE	x	4.3	3.4	3.1	2.8
DPS	Rs	3.8	1.9	6.7	15.4
Div. Yield	%	6.8	3.4	11.9	27.2
ROA	%	15.7	14.7	14.8	16.0
ROE	%	49.0	43.4	34.6	30.1
EV/EBITDA	x	5.5	4.2	3.8	3.1
Net D/E	x	1.7	1.3	0.7	0.5
Price to Book	x	1.8	1.3	0.9	0.8
Price to Sales	x	0.6	0.4	0.4	0.4

ILP KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2023
(all figures are in Rs unless noted)

Interloop Limited

Diversification and expansions to enhance prospects

Event

- Interloop's attractiveness is premised on it is leading global position in socks manufacturing, and diversification and expansion projects. It remains the most attractive textile company in Pakistan on account of (1) diversification into apparel and denim manufacturing, (2) US$300mn expansion and investment projects from 2021 to 2026, (3) superior margins and ROE generation compared to industry peers, (4) continuous efforts at innovation by running pilot projects, and (5) geographically diversified client base with a mix of designer and retail customers.
- Hence, we have an "Outperform" stance on the scrip with Dec-23 TP of Rs101.3/sh.

Impact

- **Diversification and Expansions:** To achieve its Vision 2025 ("Full family clothing partner of choice"), company has initiated a number of projects. ILP's US$100mn apparel expansion project would boost its annual capacity to 36mn garments from current 22mn garments per month and would come online in 4QFY23. Company is also increasing capacity of its recently added denim facility from 6mn pieces annually to 12mn pieces to cater to an ever expanding segment. Ramp up of these apparel and denim units is expected over the next few years which would add significantly to company's profitability.
- ILP also plans on adding a denim fabric mill, and enhancing its spinning and yarn dyeing capacity in the next couple of years. These expansions are a result of successful pilot projects of yesteryears. Company has also brought forward its 6th hosiery line expansion from FY25 to FY24 as company is unable to meet customer demand despite addition of 5th hosiery line which is already operating at full capacity.
- We believe that company's expansion plans are realistic given its recent stellar performance as evidenced by 3/5yr revenue CAGR of 28/34%. It is worth noting that Net Profit grew in tandem recording 3/5yr CAGR of 33/33%.
- **Higher profitability:** ILP's attractiveness is bolstered by its margins and ROE being superior to industry peers which exhibits management's commitment to transparency and the company's greater operational efficiencies (see graphs below). The sustainability of this feature of the company's profitability is confirmed by historical analysis. We believe management's commitment to achieving higher profitability bodes well for company's future outlook and shareholders returns.

Earnings Revision

- We revise up our FY23/24 EPS by 37/31% due to result update and higher profitability.

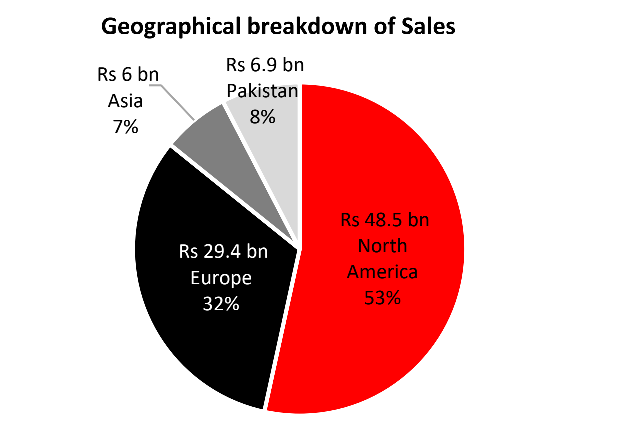
Price Catalyst

- Dec-23 TP: Rs101.3 /sh based on DCF methodology.
- Catalyst: (1) currency devaluation, (2) successful pilot projects of new products and (3) continuation of subsidized energy tariffs.
- Key Risks: (1) recession in export markets and (2) loss of a few key clients.

Outlook

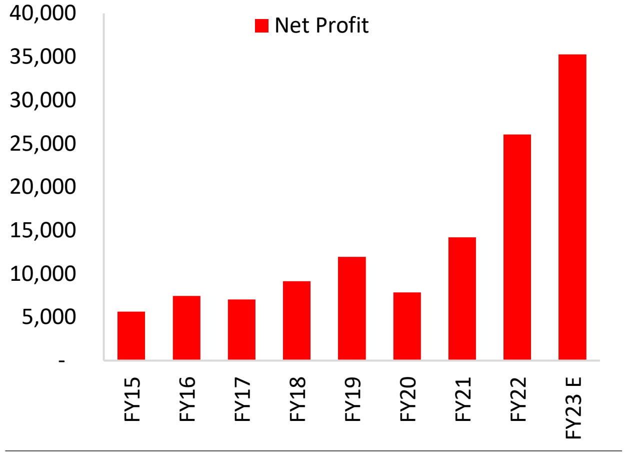
- With diversification into denim and apparel, and further hosiery and other expansion plans, we believe ILP is well positioned for further improvement in profitability. Thus, we have an "Outperform" stance on the scrip with Dec-23 TP of Rs101.3/sh.

Fig 138: Breakdown of topline…



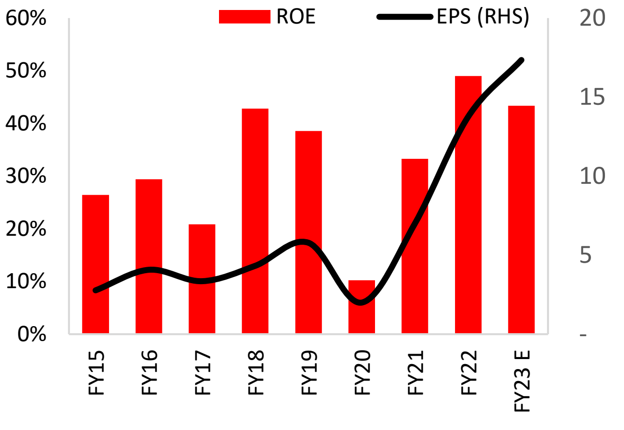
Source: Company accounts, FSL Research, Jan 2023

Fig 139: Profits pulling ahead…



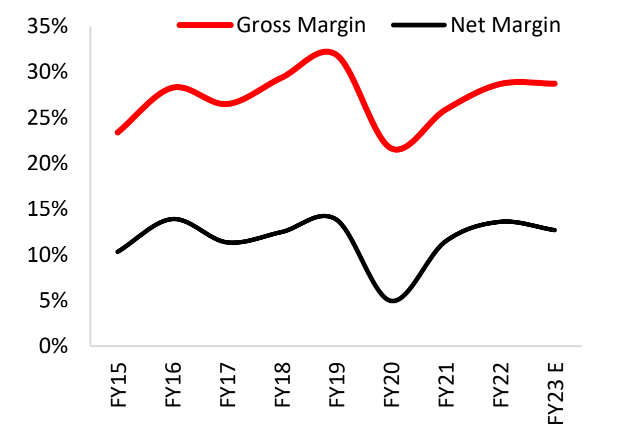
Source: Comp. acc, Bloomberg, FSL Research, Jan 2023

Fig 140: Profitability indicators improving



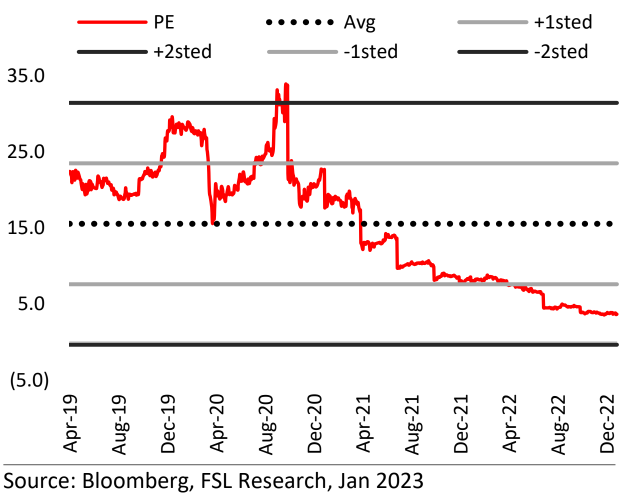
Source: Company acc., KCA, FSL Research, Jan 2023

Fig 141: Margins sustaining…



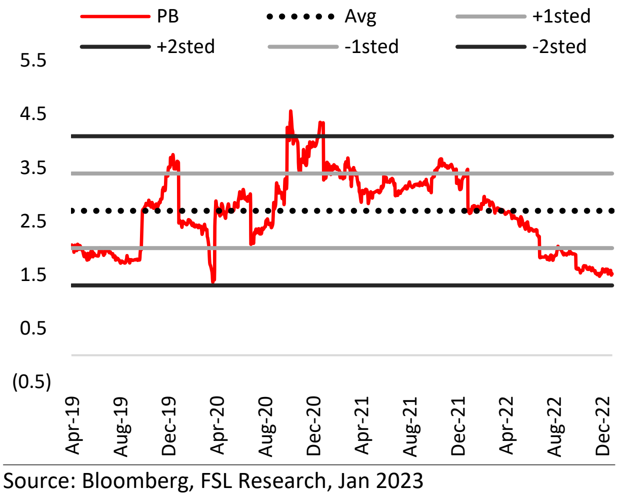
Source: Comp. acc, Bloomberg, FSL Research, Jan 2023

Fig 142: Trading at average PE



Source: Bloomberg, FSL Research, Jan 2023

Fig 143: Trading above average PB



Source: Bloomberg, FSL Research, Jan 2023

Table 45: Interloop Ltd (ILP PA, 'Outperform', Target price Rs101.3/sh.)

Balance Sheet		FY22	FY23E	FY24E	FY25E
PP&E	m	34,730	39,256	43,794	43,049
Cash & ST invest	m	617	258	431	38
Other Assets	m	60,968	75,770	72,695	79,702
Total Assets	**m**	**96,316**	**115,283**	**116,921**	**122,789**
Long terms Loan	m	14,396	14,858	12,901	10,031
Other Liabilities	m	51,979	58,496	46,749	42,583
Total Liabilities	**m**	**66,375**	**73,354**	**59,650**	**52,613**
Paid-up Capital	m	8,984	8,984	8,984	8,984
Reserves	m	20,957	32,946	48,287	61,192
SH' Equity	**m**	**29,940**	**41,929**	**57,271**	**70,176**
Liabilities + Equity	**m**	**96,316**	**115,283**	**116,921**	**122,789**

Profit & Loss		FY22	FY23E	FY24E	FY25E
Net Sales	m	90,894	122,809	118,894	131,996
Cost of Sales	m	64,828	87,534	84,958	95,243
Gross Profit	**m**	**26,066**	**35,275**	**33,936**	**36,754**
Dist expense	m	3,382	4,218	3,729	3,915
Admin. expenses	m	4,681	6,392	7,031	7,734
Other Charges	m	2,143	2,399	2,430	2,536
Other Income	m	57	87	13	19
EBIT	**m**	**15,916**	**22,352**	**20,760**	**22,588**
Finance cost	m	2,493	4,869	2,147	1,742
PBT	m	13,423	17,483	18,613	20,846
Taxation	m	1,064	1,901	1,475	1,652
PAT	**m**	**12,359**	**15,583**	**17,138**	**19,194**
EPS (rep)		13.2	16.7	18.3	20.5
EPS growth yoy	%	96%	26%	10%	12%
DPS		3.8	1.9	6.7	15.4

Q performance		2QFY22	3QFY22	4QFY22	1QFY23
Net Sales	m	20,017	21,259	30,288	30,463
Cost of Sales	m	15,106	15,711	20,218	20,347
Gross Profit	**m**	**4,911**	**5,548**	**10,070**	**10,116**
Dist expense	m	802	825	947	1,146
Admin expenses	m	1,013	1,237	1,493	1,571
Other Charges	m	395	304	864	899
Other Income	m	20	16	16	22
EBIT	**m**	**2,722**	**3,198**	**6,782**	**6,522**
Finance cost	m	512	719	902	1,217
PBT	**m**	**2,210**	**2,479**	**5,879**	**5,305**
Taxation	m	182	200	517	343
PAT	**m**	**2,028**	**2,279**	**5,363**	**4,961**
EPS (rep)		2.3	2.5	6.0	5.5

Key ratios		FY22	FY23E	FY24E	FY25E
BVPS	x	33.3	46.7	63.7	78.1
EPS	x	13.8	17.3	19.1	21.4
PE	x	4.3	3.4	3.1	2.8
PBv	x	1.8	1.3	0.9	0.8
GP margins	%	29%	29%	29%	28%
EBITDA margins	%	21%	21%	21%	20%
Net margin	%	14%	13%	14%	15%
Return on Equity	x	49%	43%	35%	30%
Return on Assets	x	16%	15%	15%	16%
Earnings yield	%	24%	30%	33%	37%
Payout Ratio	%	29%	12%	37%	75%
Dividend Yield	%	6.8%	3.4%	11.9%	27.2%
EV/EBITDA	x	5.5	4.2	3.8	3.1

All figures in Rs unless noted

Source: Company data, Foundation Research, January 2023

About the company

Interloop is the largest hosiery producer in Pakistan and among the largest global player. Interloop Limited was incorporated in Pakistan on April 25, 1992 as a private limited company and subsequently it was converted into public limited company on July 18, 2008 and was listed on Pakistan Stock Exchange on April 5, 2019. The Company is engaged in the business of manufacturing and selling of socks, leggies, denim and yarn, garments and allied products, providing yarn dyeing services and generating electricity for its own use. Interloop is Pakistan’s 2nd largest exporting firm and the largest listed Textile Company on PSX by Market Capitalization. The company has 25K+ employees and is located in Faisalabad, Pakistan with manufacturing facilities in Faisalabad and Lahore.

Auditors: Kreston Hyder Bhimji & Co.

Abbreviations

ADIP	Auto development Plan
AML/CFT	Anti Money Laundering and Countering the financing or Terrorism
AMLA	Anti Money Laundering Act 2010
APG	Asia/Pacific Group on Money Laundering
ATDO	Avg. Daily Turnover
avg	Average
bbl	barrel
bn	billion
bpd	thousand barrel per day
CAD	Current Account Deficit
CAGR	Compounded Annual Growth Rate
CAR	Capital Adequacy Ratio
CASA	Current Account Saving Account
CMP	Current Market Price
COD	Commercial Operations Date
CPEC	China Pakistan Economic Corridor
CPI	Consumer Price Inflation
CRC	Cold rolled coil
CY	Calendar Year
DAP	Diammonium Phosphate
dMA	daily Moving Average
DR	Discount Rate
DY	Dividend Yield
E&P	Exploration and Production
EFF	Extended Fund Facility
EM	Emerging Market
EPS	Earnings Per Share
FATF	Financial Action Task Force
FBR	Federal Board of Revenue
FED	Federal Excise duty
FESCO	Faisalabad Electric Supply Company
FF	Free Float
FI	Financial Institutions
FIA	Federal Investigation Agency
FII	Foreign Institutional Investor
FIU	Financial Intelligience Unit
FMCG	Fast-moving consumer goods
FMU	Financial Monitoring Unit of Pakistan
FO	Furnace oil
FSV	Forced Sale Value
FTA	Free Trade Agreements
FX	Forex reserves
FY	Fiscal Year
GC	Galvanized coil
GDP	Gross Domestic Product
GDPg	Gross Domestic Product growth
GEPCO	Gujranwala Electric Power Company
GST	General Sales Tax
HESCO	Hyderabad Electric Supply Company
HNWI	High Net worth Individuals
IDR	Investment Deposit Ratio
IESCO	Islamabad Electric Supply Company
IMF	International Monetary Fund
Insu	Insurances
IPO	Initial public offering
JIT	Joint Investigation Team
JUIF	Jamiat Ulema-e Islam (F)
KPK	Khyber Pakhtunkhwa
KSE	Karachi Stock Exchange
LESCO	Lahore Electric Supply Company Limited
LNG	Liquefied Natural Gas
LOC	Line of Control
LPS	Loss per share
LT	Long term
M	Month
Mcap	Market Capitalization
MEA	Middle East Africa
MEPCO	Multan Electric Power Company
ML	Money Laundering
MLA	Mutual Legal Assistance
mmcfd	million cubic feet per day
mn	Million
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
MPS	Monetary Policy Statement
MQM	Muttahida Quami Movement
MSCI	Morgan Stanley Composite Index
MW	Mega Watt
NA	National Assembly
NBFC	Non-banking financial companies
NEPRA	National Electric Power Regulatory Authority
NIMs	Net Interest Margins
NOPEC	Non-OPEC

NPL	Non-Performing Loan
NRO	National Reconciliation Ordinance
O&GMCs	Oil and Gas marketing Companies
O&M	Operational and Maintaince
OBOR	One belt one road
OGRA	Oil & Gas Regulatory Authority
OMC	Oil Marketing Company
OPEC	Oil Producing export countries
O-PR	Outperform
PB	Price to Book Value
PBS	Pakistan Bureau of Statistics
PE	Price to Earnings
PESCO	Peshawar Electric Power Company
PF	Proliferation Financing
PFS	Proliferation Financing Sanctions
PIB	Pakistan Investment Bond
PM	Prime Minister
PML-N	Pakistan Muslim League- Nawaz
PP12	Petroleum Policy 2012
PPA	Power Purchase agreement
PPP	Pakistan People's Party
PSEs	Public Sector Enterprises
PSX	Pakistan Stock Exchange
PTI	Pakistan Tehreek Insaf
PVC	Polyvinyl chloride
QESCO	Quetta Electric Supply Company
QTR	Quarter
RD	Regulatory Duty
REER	Real Effective Exchange Rate
RIR	Real Interest Rates
RLNG	Regasified Liquefied Natural Gas
ROE	Return on Equity
SBP	State Bank of Pakistan
SDR	Special Drawing rights
SDR	Special Drawing Rights
SECMC	Sindh Engro Coal Mining Company
SEPCO	Sukkur Electric Power Company
SEZs	Special Economic Zones
sh	Share
SME	Small and medium-sized enterprises
SNGPL	Sui Northern Gas Pipelines Limited
SOE	State Owned Enterprises
SPO	Secondary public offering
SSGC	Sui Southern Gas Company
STDEV	Standard Deviation
TF	Terrror Financing
TFS	Target Financial Sanctions
TP	Target Price
UFG	Unaccounted For Gas
UHT	Ultra-high temperature
UN	United Nations
VAT	Value added tax
WB	World Bank
WB	World Bank
WHR	Waste heat recovery
x	times
YoY	Year on Year
yr	Year

Important disclosures:

Research Dissemination Policy: Foundation Securities (Pvt.) Ltd. endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Target price risk disclosures: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

Analyst certification: The views expressed in this research accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this research. The analyst principally responsible for the preparation of this research receives compensation based on overall revenues of Foundation Securities and has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Recommendations definitions

If

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

Foundation Securities (Pvt) Ltd

URL: www.fs.com.pk

e-mail: info@fs.com.pk

Corporate Office:

Ground Floor, Bahria Complex II

M.T. Khan Road, Karachi

UAN: (92 21) 111 000 375

PABX: (92 21) 351 0380

Syed Ahmed Zaidi	Chief Executive Officer	+92 21 3561 2253	azaidi@fs.com.pk

Foundation Research

Analyst	Sector	PABX	E-mail:
Muhammad Awais Ashraf, CFA	Strategy, E&P, Fertilizer, Power	Dir: +92 21 3563 5012 +92 21 3561 2290 ext 338	m.awais@fs.com.pk
Zeeshan Azhar	Economy, OMC, Textile, Chemical,	+92 21 3561 2290 ext 331	zeeshan@fs.com.pk
Usman Arif	Fertilizer, Cement, Technology, FMCG	+92 21 3561 2290 ext 339	usman.arif@fs.com.pk
Ali Ahmad	Cement , Steel	+92 21 3561 2290 ext 311	ali@fs.com.pk
Malik Muhammad Taoseef	Database	+92 21 3561 2290 ext 312	taoseef@fs.com.pk

Foundation Sales

Trader	Designation	PABX	E-mail:
Karachi:			
Siraj Ebrahim Kazi	Head of Broking	+92 21 3561 2256	siraj@fs.com.pk
Muhammad Rameez	Head of Sales	+92 21 3561 0820	mrameez@fs.com.pk
Faisal Dhedhi	Deputy Head of Sales	+9221 3563 5011	faisal.dhedhi@fs.com.pk
Adnan Usmani	Trader Equities	+92 21 3561 0625	adnan@fs.com.pk
Sohail A. Sattar	Trader Equities	+92 21 3563 5134	abdul.sattar@fs.com.pk
Islamabad:			
Mohammad Irfan		+92 51 3289 5221	m.irfan@fs.com.pk
Lahore:			
Muhammad Usman	Branch Manager	+92 42 35776831	usman@fs.com.pk
Online Trading			
Najeeb Ahmed Khan	Head Online Business	+92 21 3561 2290 ext 351	najeeb.warsi@fs.com.pk