Pakistan

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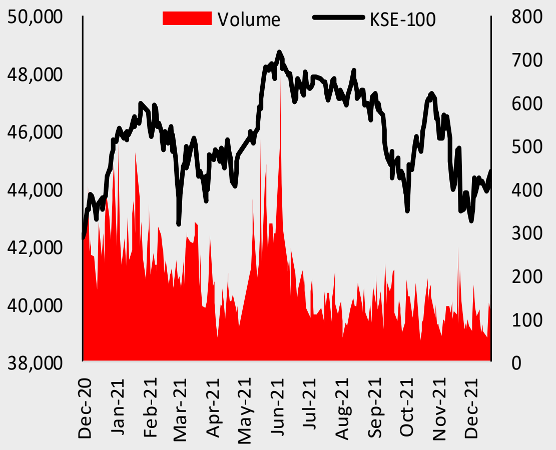
Historical Trend of KSE100



Source: PSX, Foundation Research, January 2022

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Pakistan Strategy

KSE-100 – Returning to normal with abnormal returns

Market to reach 57,750 by Dec-22

Pakistan equities are set to post positive returns in CY22, on the back of reducing commodity prices. We expect the KSE100 index to reach 57,750 (29.5% return and 21.7% in US$ term) by December 2022 as weakening commodity prices would help continuation of economic growth. Moreover, economic and structural reforms with the resumption of IMF program along with improvement in investment climate would help the market to rally. The benchmark KSE100 is trading at 5.2x PE, which is at a 68% discount to MSCI EM index and accompanied by dividend yield of ~7.4%.

KSE100 in CY21 – Remain muted

Reclassification of Pakistan from MSCI EM to FM with growing concerns over CAD amid heightened political noise and US withdrawal from Afghanistan has kept the Index under pressure. Moreover, external account pressures on escalating trade deficit during the latter part of the year continued to keep Index under pressure. Domestic robust demand due to fiscal incentive and lax monetary policy along with construction package amid higher commodity prices had caused economic overheating. Thus, SBP adopted aggressive monetary tightening and Gov't tried to cool down the economy with imposition of taxes through Mini Budget. Hence, KSE-100 ended CY21 with a return of 1.6% (~-8.2% in US$ terms) with ADTO at all time high of 464mn shares.

Commodity boom cycle coming to an end

We expect commodity cycle to cool off as demand eases and supply restores due to opening of economies given increasing vaccination drive. This would cause the trade deficit to shrink and inflation pressures to ease off. Thus would allow the central bank to start monetary easing and create fiscal space for the government to spend on development projects.

Resumption of IMF program to restore foreigners' interest

Resumption of IMF program would help the country in achieving sustainable economic growth through focus on economic reforms. Adoption of market based exchange rate with building international reserves provides exchange rate sustainability. However, ending of stimulus by FED and uncertainty over fate of Afghanistan would keep foreign investors at bay but industry or sector specific response could not be ruled out.

Model portfolio

We look for stock that are beneficiary of currency depreciation and decrease in commodity prices. We are 'Overweight' on Banks, E&P, Fertilizer, Cement, Autos, OMCs, Consumers and Textile. We are 'Market Weight' on Power. While we are 'Under Weight' on Technology as we expect multiple to re-adjust according to sectors earning despite forecasting 26% earnings growth.

Top-picks

Large Cap: OGDC, MARI, LUCK, PPL, MCB and HBL

Mid Cap: ENGRO, FFC, INDU and PSO

Small Cap: ILP, FABL, FFBL, APL, ISL and FCCL

Table 1: Pakistan Top Conviction Ideas

Stock	Sector	M-cap US$ mn	Reason for liking
Large Cap			
OGDC	E&P	2,083	Largest oil (55%) and gas (32%) reserves in Pakistan Maintain its gas volumes of over 1bcfd through various discoveries Beneficiary of circular debt resolution and energy sector reforms Better pricing regime on new gas finds
MARI	E&P	1,240	Induction of 280mmcfd into SNGPL system in one year Laying of gas pipeline to reduces variability of flows from MARI HRL Exploration activities in Block 28 and Bannu West
LUCK	Cement	1,234	Largest cement player with 16% market share Lower cost/ton ratio compare to peers 660MW coal based power plant & diversification into Autos
PPL	E&P	1,208	Beneficiary of circular debt resolution and energy sector reforms Working interest in Gambat Block along with Nashpa and Tal blocks Better pricing regime on new gas finds
MCB	Banks	1,021	Higher dividend yield Low cost deposits (CASA at ~88%) which would result in NII growth Flexible investment book to better capture interest rate cycles
HBL	Banks	961	Translation of Policy Rate in core margins Improvement in cost/income and stability in currency/equity market. Buildup of CAR would be a key upside trigger that will also help to restore higher payouts
Mid Cap			
ENGRO	Fertilizer	882	Diversification into Tower sharing business Project completion of EPTL Materialization of Petrochemical and Renewable projects
FFC	Fertilizer	717	Pricing power given strong agronomics Expansion into 1.3mn ton fertilizer complex in Tanzania COD of TEL 330MW coal mine mouth power plant
INDU	Autos	543	Brand equity High localization Rich cash position
PSO	OMC	480	Circular debt resolution is key IMF reform agenda to reduce balance sheet stress Robust white oil and HSD growth CPI linked margins to provide cash earnings
Small Cap			
ILP	Textile	367	Beneficiary of government friendly policies Continuation of subsidized energy tariffs Diversification into apparels and US$300mn expansion plan in five years
FABL	Banks	196	Conversion into Islamic Increase in coverage along with dilution of NPL Strong CAR of 19% resuming dividend
FFBL	Fertilizer	180	Improved pricing power in DAP market due to international prices rebound Enhanced utilization of urea plant amid higher retention prices Foot print in power, banks and food businesses
APL	OMC	176	Decent performance in white oil segment and future growth from CPI linked margins. Investment in storage facilities and retail network expansion Balance sheet strength amid high cash availability and debt free
ISL	Engineering	162	Beneficiary of government regulatory policies Higher HRC-CRC margins Lower working capital requirement given strong cash flows
FCCL	Cement	142	Amalgamation with Askari Cement to make it 2nd Largest player in North Lower risk of increase in policy rate due to debt free balance sheet Higher reliance on internal power generation

Source: Foundation Research, January 2022

KSE-100 – Returning to normal with abnormal returns

Politics – Political noise to remain heightened

- Government is feeling the heat of economic adjustments which has been driven by elevated commodity cycle.
- Government remained engaged in enhancing geo-economics with foreign policy tools, as their utmost priority. Their stance remained focused on enticing investment and enhancing export activities.
- Improvement of 39 points in Ease of Doing Business, 59 points in Pakistan's Business Confidence Ranking, flows of US$2.9bn in Roshan Digital Account (RDA), an increase of over US$2bn in the export of information technology and information technology-enabled sector and notable increase in flow of remittances through official channel were the result of business friendly policies of this government during the year 2021.
- Supportive and conducive role of institutions would help the government with implementation of its consolidation policies.

Economic growth to continue amid macro slippages

The return to economic growth witnessed in 2021 would continue in 2022 as the agricultural and services sector are expected to make up for lagging industrial activity.

- Resumption of the stalled IMF program (5th one since 2000), hopefully in Jan'22, would restore macroeconomic stability and help sustain growth.
- Stark deterioration of current account is driven by higher commodity prices and robust domestic demand. During CY22, we expect (1) some normalisation of commodity prices given resolution of supply chain snarls and (2) slowdown in domestic economic activity supported by flexible exchange rate and monetary tightening.
- The fiscal side would continue on the delining trend of last 3 years and come in at 5.8% of GDP in FY22. We believe resumption of IMF program would result in increased tax revenue post mini budget and impose fiscal discipline on Gov't.

Macro Picture

- ✓ Pakistan GDP growth is likely to grow by 4.3% in FY22 vs 3.9% in FY21 given gov't focus on food security and expansionary policies.
- ✓ CAD is likely to increase to US$14.6bn in FY22 (4.7% of GDP) vs US$1.9bn in FY21 (0.6% of GDP), on the back of higher imports of goods. We expect CAD to decrease to US$9.8bn in FY23 due to cooling-off of commodity prices.
- ✓ Resumption of IMF program along with assistance from friendly nations has resulted in increase of FX reserves and we estimate SBP FX reserves would remain constant at ~US$17.5bn by Jun'22.
- ✓ Increase in trade deficit, recorded at US$25bn, during the 1HFY22 has depreciated the Rupee by ~10.7% and US$-parity to touch 182.9 mark by June-22.
- ✓ Budget deficit to stand at around 5.8% of GDP in FY22 and 5.0% in FY23.
- ✓ Inflation would remain high given lagged affects of currency depreciation and rationalization of gas and electricity prices to average around 10.6% in FY22 against 8.9% in FY21.
- ✓ Central bank is expected to continue with the monetary tightening in 1HCY22 but this is expected to be graduated with only 100bps increase while we expect monetary easing to start by Sep'22 on lowering of inflation.

COVID – Omicron reemerging threat

Omicron, the new COVID variant is spreading much faster than previous variants. Global restrictions are tightening and daily cases are rising sharply. Health care costs and hospitalizations could rise due to highly contagious nature of new variant resulting in far higher number of cases than previous variants. Government of Pakistan is expected to impose smart lockdowns and partial closures along with boosting vaccination drive to fight the upcoming wave.

Commodities – Boom cycle coming to an end

- In the after math of COVID lockdown, the stimulus injection in economic system has caused excess demand of commodities which remains unmatched with the supply side. Supply constrains remain due to low production and under investment. We expect commodity cycle to cool off as demand eases and supply restores.
- Low inventory levels and under construction gas infrastructure remains key to inflated global RLNG prices. However Pakistan's long term contract with Qatar would hedge risk from shortage of supplies
- Food inflation on its 50-yr high, mainly driven from high prices of edible oils are expected to come down as well given lockdown situation diffusing in Malaysia, largest producer of palm oil.

- Freight charges have followed a similar trend, as shortage of space have created exponential high rates. Port clearing in LA and availability of containers in China has contributed to correction in freight charges.

CPEC – Development activity on Phase II starts picking up

- The development on CPEC is underway, being the pioneer of belt-and-road initiative, enabling 46 different projects to attract US$25bn have established projects in (1) infrastructure projects, (2) Gwadar development, and (3) Energy projects. The projects are fast on track to development and enabling investing avenues.
- Infrastructure projects is on roads with completion of Multan-Sukkur (M-5) motorway, similarly Hazara Motorway and Western alignment has been completed. SEZ development of Allama Iqbal Industrial city has attracted various international manufactures to avail tax holiday and duty-free machinery import. Meanwhile Rashkai SEZ and Dhabeji SEZ are fast on track as well. CPEC power projects have completed 1320MW of Power Plant in Sahiwal, Port Qasim (Karachi), and Hub Balochistan, and Thar Coal Block Power Plant has been 75% completed.

Across the board support to earnings growth

- Using FSL universe as a proxy (~65% of FF Mcap), we forecast an average earnings growth of ~10.5% in CY22.
- Cement sector would be the primary contributor to earnings growth, followed by Banks, E&Ps, Technology and Power.
- Fertilizer sector is expected to benefit from government policies to ensure food security.
- Textile sector is likely to remain beneficiary of govt's supportive policies and subsidized energy availability.

Approaching the stock market

- **Bottom-up:** Based on Dec-22 TP of stocks under our coverage, we see the benchmark KSE100 to reach **57,750pts** by Dec-22, implying an upside of 29.5% (~21.7% in US$ terms) along with dividend yield of 7.7%. This translates into market return of 36.9% (~28.7% in US$ term).
- Major theme to play on would be monetary easing on the back of ease in commodity prices amid continuation of economic growth.

Sector Position

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

Table 02: Valuations of stocks in the portfolio

Stocks	Reco	CMP	TP	Mkt Cap	PE (X)		PB (X)		DY (%)	
				US$ mn	22E	23E	22E	23E	22E	23E
OGDC	O-PR	86.2	149.6	2,100	3.1	2.9	0.4	0.4	8.1	7.0
MARI	O-PR	1,654.2	2,039.2	1,250	5.9	4.5	1.3	1.1	8.5	8.5
LUCK	O-PR	679.3	918.0	1,244	7.4	5.4	1.1	0.9	0.4	1.2
PPL	O-PR	79.0	151.9	1,218	3.2	3.0	0.5	0.4	2.5	3.8
MCB	O-PR	153.4	212.0	1,030	5.8	5.0	0.1	0.1	13.4	13.0
HBL	O-PR	116.6	176.0	969	4.6	4.3	0.6	0.6	6.9	8.6
ENGRO	O-PR	272.4	321.9	889	5.3	5.9	0.5	0.5	8.4	11.0
FFC	O-PR	100.3	141.9	723	5.2	4.8	2.5	2.3	16.4	17.8
INDU	O-PR	1,229.0	1,570.0	547	5.7	6.1	1.7	1.6	8.8	11.5
PSO	O-PR	181.9	288.8	484	3.1	3.5	0.5	0.5	7.7	9.3
ILP	O-PR	72.7	104.8	370	8.1	6.0	2.5	1.9	4.3	9.3
FABL	O-PR	23.0	35.6	198	4.1	3.5	0.5	0.4	8.7	8.7
FFBL	O-PR	24.8	39.8	181	3.7	3.2	0.8	0.7	12.1	12.1
APL	O-PR	314.0	413.6	177	5.8	8.5	1.3	1.2	11.9	8.8
ISL	O-PR	66.1	123.1	163	3.3	3.9	1.2	1.1	15.1	15.1
FCCL	O-PR	18.4	30.5	144	5.0	3.8	0.9	0.7	-	-

Source: Foundation Research, January 2022

Public centric approach to remain at helm of affairs

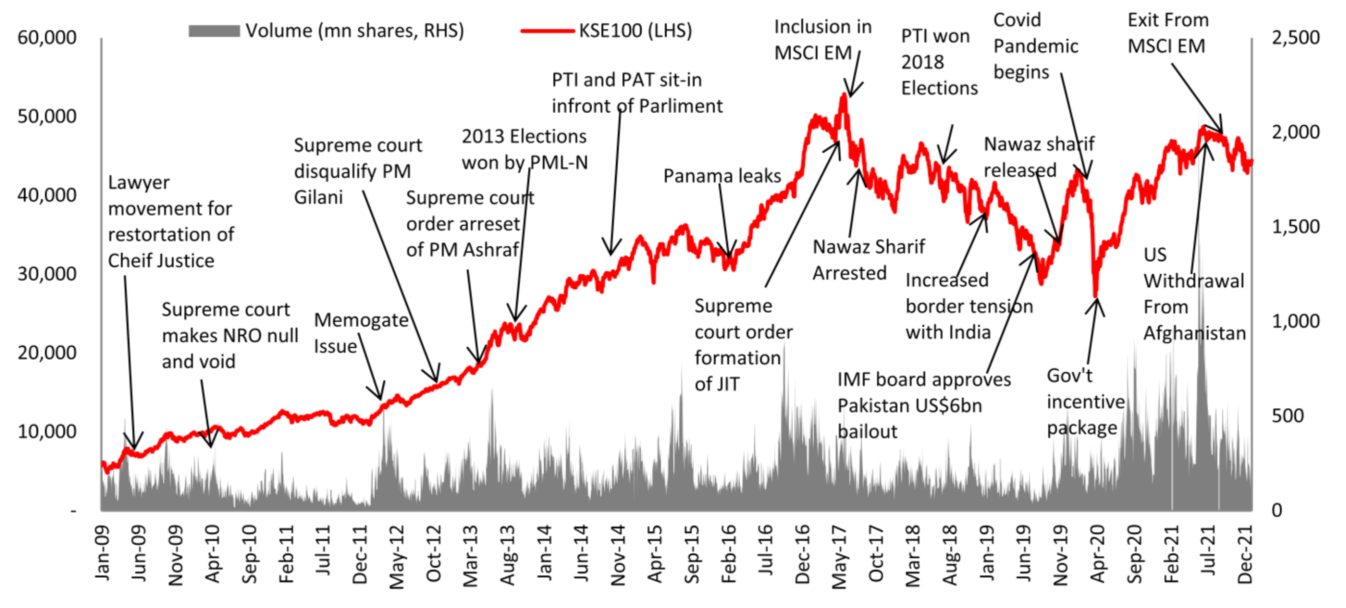
Focus of policies to remain election centric

Government is feeling the pressure of economic adjustments which has been driven by elevated commodity cycle. The inflationary pressures become more daunting in comparison to peers as impact of higher commodity prices become more prominent due to significant rupee depreciation.

This compels government to take austerity measures as inflationary pressure eroded the gains made through successful handling of COVID and economic recovery. Thereafter interest rates were dropped to 7 percent with combined fiscal and monetary stimulus of more than 6 percent of GDP. The situation could be challenging when government implements the reforms needed to resume the upheld IMF program required for external account sustainability.

However, efforts for gaining public support to win the upcoming elections would slow down the reform process even under the IMF program, in our view. It would slow down the legislation process which was already facing hurdles as sixty two percent of the bills passed by National Assembly were brought through Presidential ordinance.

Fig 01: Regional and internal political noises kept the index under pressure throughout the year



Source: PSX, Foundation Research, January 2022

However, the institutions have taken on a supportive and conducive role, to help the government with implementation of its consolidation policies. Despite the additional requirements placed on the department function, they have demonstrated ownership and resourcefulness by accepting a lower than inflationary increase in its budget allocation in comparison to that of previous years.

Encouraging pivotal role of Foreign office in the evacuation of 80 thousand individuals across 42 nationalities, consisting of Diplomats, NGOs and media post withdrawal of US forces from Afghanistan is one of the many examples where Pakistan proved to be a responsible nation. These efforts are acknowledged and appreciated by the international community as well as local Afghan community.

Pakistan geared its diplomacy in advocating regional and international countries for maintaining constructive and sustained engagement with the interim authorities in Afghanistan to avert humanitarian and economic crisis. Pakistan's efforts include formation of six countries body of Afghanistan's immediate neighbors on Pakistan's initiative along with participation in Moscow format. The extended Troika plus meeting including Pakistan, China, Russia and US along with members of Afghanistan interim setup held in Islamabad is also another success of Pakistan diplomacy. The highest point was the hosting of Extraordinary Session of the OIC Council of Foreign Ministers in Islamabad to focus on the humanitarian situation of Afghanistan. The session was attended by over 70 delegations, including 30 at the Ministerial/Deputy Ministerial level.

We believe ease in commodity cycle would create room for extra collection of taxes and structural reforms along with providing relief to the masses. However, we expect political environment to remain challenging till elections while resolution of Afghanistan governance issue would ease investor's concerns.

FATF compliance to attract foreign investment

Acknowledgement of Pakistan's swift steps towards improving its progress on all action plan items by Financial Action Task Force (FATF) and Asia Pacific Group (APG) is the result of government's work on strengthening of Anti Money Laundering and Countering Financial Terrorism (AML/CFT) policies in order to resolve pitfalls related to strategic terrorist financing. Out of 27 action plan items, encouragingly Pakistan has now largely addressed 26 action items against 21 in its previous assessment.

Moreover, acknowledgment of APG for Pakistan's significant progress in addressing the technical compliance deficiencies identified in Mutual Evaluation Report (MER) in the form of Rerating on four points. Subsequently Pakistan has 35 Recommendations rated Compliant (C) / Largely Compliant (LC). APG kept Pakistan on enhanced follow-up and continues to assess Pakistan's progress on strengthening its implementation of AML/CFT measures. Pakistan's next progress report, which is fourth assessment, is due in February 2022.

Recent improvement introduced in law by removing deficiencies highlighted by FATF and APG gives us confidence about the removal of Pakistan from the FATF grey list. The country is currently being monitored by three different but interlinked bodies: APG, FATF and the US.

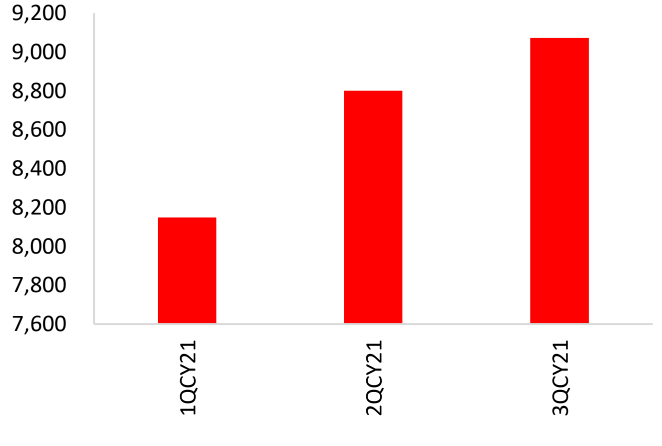
FATF in its recent assessment of Pakistan observed that country has shown significant progress on making legislative amendments to enhance its international cooperation framework, demonstrating designated non-financial businesses and professions (DNFBP) monitoring for Proliferation Financing (PF) Targeted Financial Sanctions (TFS) and DNFBP supervision commensurate with the risks; and applying sanctions for non-compliance with beneficial ownership requirements.

Government continues to work on other strategically important AML/CFT deficiencies that comprises of providing evidence that it actively seeks to enhance the impact of sanctions beyond its jurisdiction by nominating additional individuals and entities for designation at the UN and demonstrating an increase in ML investigations and prosecutions; and that proceeds of crime continue to be restrained and confiscated in line with Pakistan's risk profile, including working with international bodies and foreign counterparts to trace, freeze and confiscate assets.

In order to comply with the FATF targets and make up for deficiencies, National Assembly has passed around 17 pieces of legislation along with relevant rules and regulations in last three years. Government is committed to further amendments or improvements in case any legal deficiency arises in passed legislations that is not in line with the FATF requirements. The laws not only strengthen the systems in Pakistan but also brought in system sustainability.

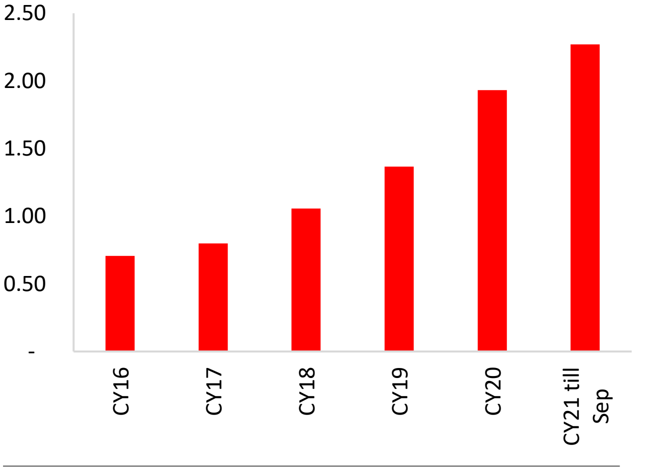
The GoP's policy in relation to tackling ML and TF is to ensure there is a whole of government approach to ''follow the money'' as a matter of priority during investigations, prosecutions, and subsequent confiscation in all money laundering, terrorism financing and high risk predicate crimes. To comply with FATF conditions reporting of Suspicious Transaction Report (STRs) and Cash/Currency Transaction Report (CTRs) has drastically increased during the last year.

Fig 02: STR on a rising trend



Source: FMU, Foundation Research, January 2022

Fig 03: CTR increased as well (mn transaction)



Source: FMU, Foundation Research, January 2022

International bodies continuous supportive role in improving Pakistan's ability to consistently provide and timely seek Mutual Legal Assistance (MLA) further supports our conviction of Pakistan getting out of the FATF grey list. This includes removing hurdles in MLA that fall under the umbrella of Anti-Terrorism Act (ATA), National Accountability Ordinance (NAO) and Anti Money Laundering Act (AMLA) or enacting a separate MLA law. Absence of hurdles could assist in enhancing capacities of Law Enforcement Agencies (LEAs) to consider international elements. Financial Monitoring Unit of Pakistan (FMU) is sharing information of financial intelligence with Foreign Intelligence Unit (FIUs) provided by LEAs.

Table 03: FATF/APG effectiveness and technical compliance ratings as of the reporting date (July 2021)

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**	

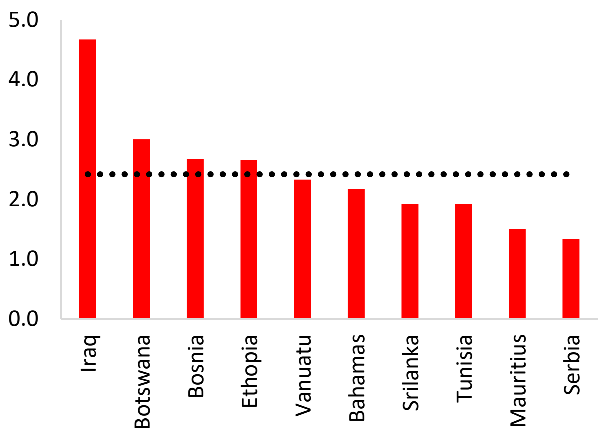
Technical compliance ratings (C – compliant, LC – largely compliant, PC – partially compliant, NC – non-compliant)

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**	**PC**	**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		
PC	**NC**	**LC**	**PC**		

Source: APG, Foundation Securities, January 2022

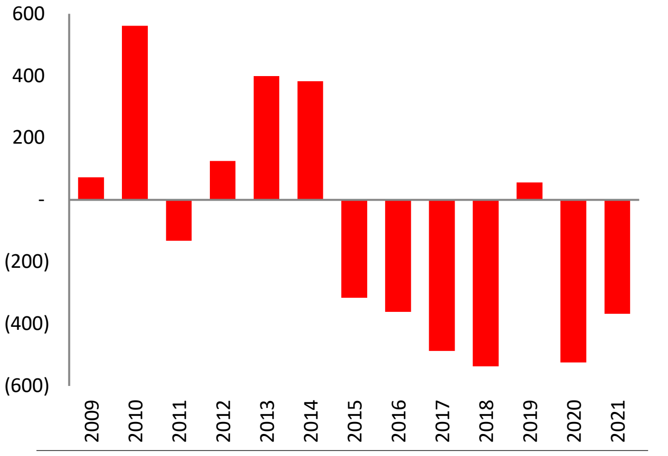
Revised upward

Fig 04: No. of years taken to get out of FATF



Source: FATF, Foundation Research, January 2022

Fig 05: …causes FIIs to shy from equities (US$ mn)



Source: Mufap, Foundation Research, January 2022

National Security Policy to consolidate improved security situation

Approval of National Security Policy (2022-26), that aims to cover both traditional and non-traditional security challenges to guide the gov't foreign, defence and economic policies, would cement the gains of National Action Plan.

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.

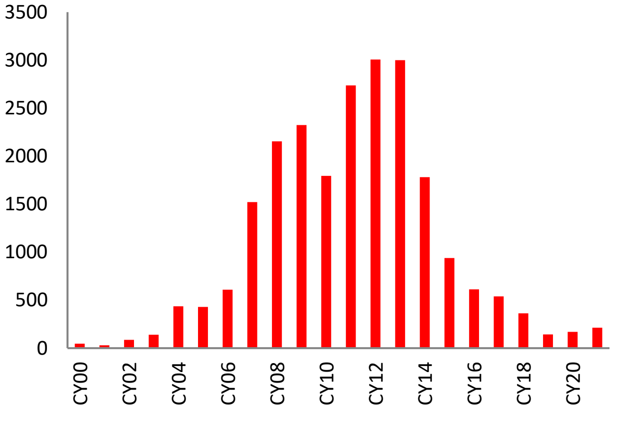
Government's continuous efforts to implement the Anti-Terrorism Act of 1997, the National Counter Terrorism Authority (NACTA) Act, the 2014 investigation for the Fair trial Act, and 2014 amendments to the Antiterrorism Act (ATA) have given law enforcement agencies, prosecutors and courts enhanced powers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

Under the auspices of the military and local law enforcement, "Operation Radd-ul-Fasaad" has propped up domestic security, materializing the gains of "Operation Zarb-e-Azb". These efforts have resulted in a sharply declining terrorism death toll, reduced significantly in last six years, according to the South Asia Terrorism Portal. The main factor behind recent improvements is a continued decline in the Tehreek-e-Taliban Pakistan (TTP) and its associated factions' activities.

However, TTP being an ideological brothers of Taliban may continue to create problems for Pakistan. The TTP swear allegiance to Mullah Haibtullah Akhund means the latter is bound to protect the TTP and its interests. However, the Taliban assurance to its neighbours not to allow insurgents to use Afghan soil amid lower TTP connectivity with its facilitators would keep the threat of escalation in terrorist attacks at bay.

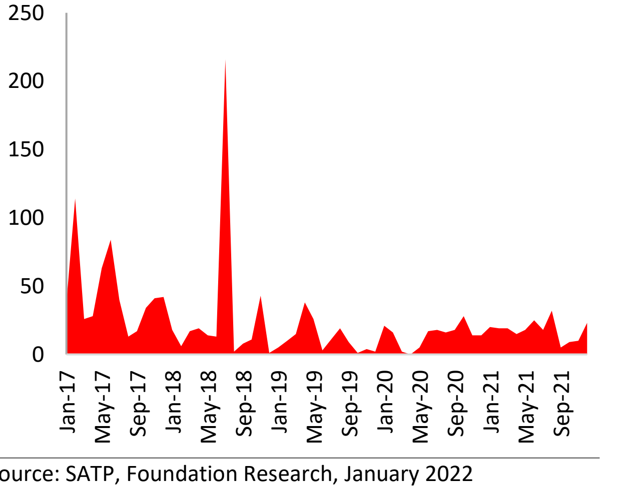
Besides, government operated five de-radicalization camps offering "corrective religious education", vocational training, counselling and therapy to eliminate hatred from the society. Pakistan is also working with United Nations Office on Drugs and crime (UNODC) under the umbrella of Pakistan Action to Counter Terrorism (PACT) with an aim to curb terrorism.

Fig 06: Counter terrorism efforts yielding results….



Source: SATP, Foundation Research, January 2022

Fig 07: Incidents drop during later part of the year



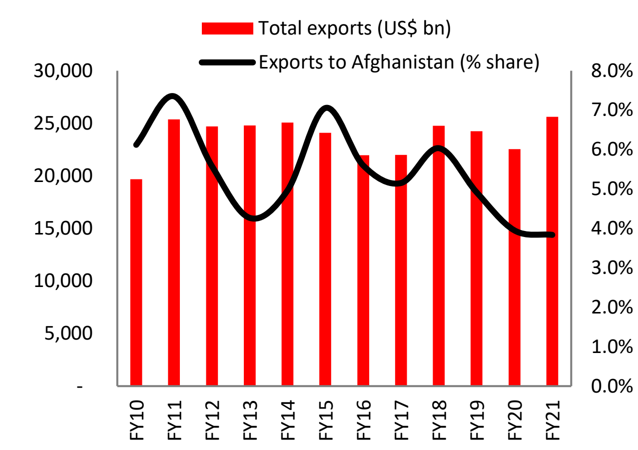
Source: SATP, Foundation Research, January 2022

Pakistan-US relations have seen many swings, but for the last ten years these relations have been deteriorating. Once a blooming partnership now suffers from mistrust and neglect, ignoring Pakistan's contribution in facilitating dialogue between US and the Taliban. In 2020, Special Representative for Afghanistan Reconciliation at the State Department thanked Pakistan for releasing Baradar from custody and for facilitating the travel of Taliban leaders to talks in Doha. The same has been acknowledged by the then US President as he sought Pakistan's assistance in US talks with Taliban.

Pakistan's acceptance to build regional consensus about the recognition of the Taliban in the Shanghai Cooperation Organization (SCO)'s Summit indicates that Pakistan has lowered its expectation of a "friendly government" for a peaceful and stable Afghanistan in comparison to "friendly but Chaotic" Afghanistan. A resolution of the Afghan issue would also reduce terrorist attacks carried out from hideouts in Afghanistan and would lower the burden of refugees hosted by Pakistan. Evolving role of Taliban in Afghanistan politics, viewed as Pakistan friendly and Anti Indian in Afghanistan, would lower the threat of strategic encirclement by India. Funds previously allocated to this issue could be freed and used on education, health and other development.

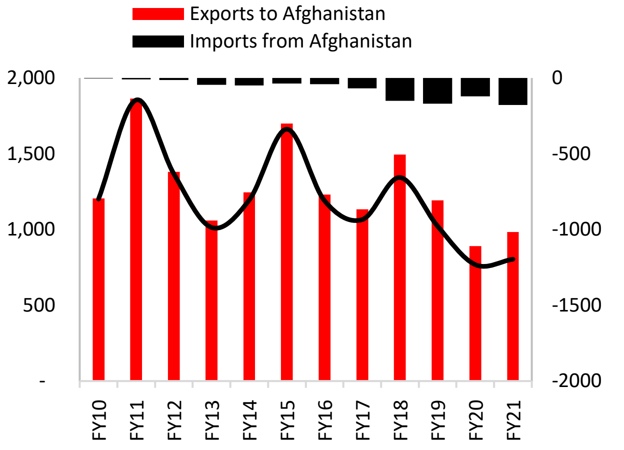
Pakistan's approach to solving disputes through talks should prevent unnecessary military escalation with India. PM decision to allow movement of 50k tons of wheat from India to Afghanistan through Pakistan territory is also a signal from Pakistan that it is serious for establishing peace in the region. Moreover, the country's peaceful intent is clear by the government's decision to reach out to the UN for the resolution of Kashmir dispute.

Fig 08: Exports to Afghanistan forms a minor portion



Source: WB, Foundation Research, January 2022

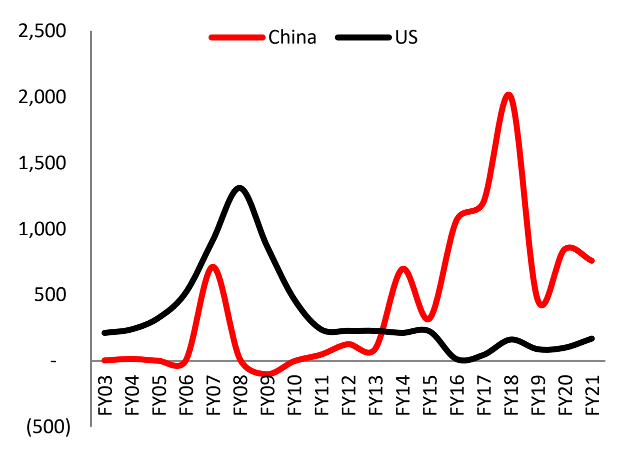
Fig 09: but could loose that too (US$ bn)



Source: PBS, Foundation Research, January 2022

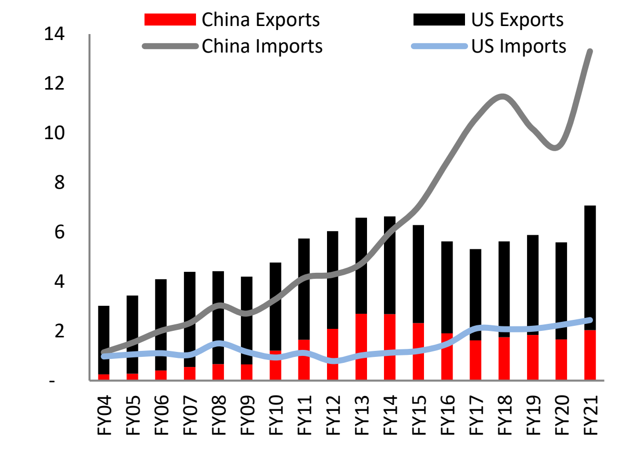
Pakistan's position in the region became more valuable given increased reliance of US and China for securing of their vested interest, in our view. President Biden made it clear, while giving the withdrawal plan that, "the US pull out did not abandoned Afghanistan and that the US would now enter into competition with an increasingly assertive China". 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 10: China became major source of FDI (US$ mn)



Source: SBP, Foundation Research, January 2022

Fig 11: US is still imp from trade perspective (US$ bn)



Source: SBP, Foundation Research, January 2022

Table 4: Economic Indicators of Islamic Republic of Afghanistan

	2018	**2019**	**2020**	**2021**
GDP	18,395	18,907	19,779	20,117
External debt stock, official	1,212	1,147	1,482	1,699
Gross international reserves, central bank	8,273	8,573	9,763	9,470
Fiscal				
Revenues and Grants	406	396	398	419
Domestic Revenue (Afghani bn)	190	207	173	200
Tax Revenue (Afghani bn)	122	123	115	140
Non-Tax Revenue (Afghani bn)	68	84	59	60
Total Expenditures (Afghani bn)	384	412	489	432
Operating (Afghani bn)	258	273	285	308
Salaries	*184*	*198*	*197*	*201*
Pension	*27*	*26*	*22*	*20*
Development (Afghani bn)	126	139	147	151
Deficit				
External Account				
Current account	2,022	2,209	2,246	2,136
Excluding official grants	(5,776)	(5,102)	(4,809)	(5,064)
Trade balance of goods	(5,721)	(5,294)	(5,103)	(5,351)
Exports of goods and services	1,609	1,509	1,476	1,587
Goods	875	864	777	864
Services	734	645	700	722
Imports of goods and services	7,984	7,371	6,983	7,388
Goods	6,596	6,158	5,880	6,215
Services	1,388	1,213	1,103	1,173
Income, net	212	307	189	172
Of which: Interest on official loans	5	7	8	9
Current transfers, net	8,399	7,764	7,564	7,766
Of which: Official	8,013	7,311	7,055	7,201
Capital account	-	-	-	-
Financial account, net	(393)	139	(2,314)	(2,651)
Foreign direct investment	79	(3)	(24)	48
Portfolio investment	(141)	15	(70)	43
Information memorandum				
Import coverage of reserves	14	15	16	15
in percent of GDP	7	6	8	9
Current account, in % of GDP	12	12	14	11
Trade balance, in % of GDP	(31)	(28)	(26)	(27)
Export of goods and services, in % of GDP	9	8	8	8
Import of goods and services, in % of GDP	43	39	35	37
Official grants, in % of GDP	44	39	39	36

Source: IMF, WB, Foundation Research, January 2022

Economic growth to continue amid macro slippages

The return to economic growth witnessed in 2021 would continue in 2022 as the agricultural and services sector are expected to make up for lagging industrial activity. Omicron, the new variant of COVID, is not expected to result in mass scale disruptions given effective Gov't startegy of micro-lockdowns. Long term growth potential remains robust given the large economy and population size.

Resumption of the stalled IMF program (5th one since 2000), hopefully in Jan'22, would restore macroeconomic stability and help sustain growth. Last stumbling blocks of mini budget and SBP Autonomy Bill have been tabled in the parliament, the approval of which would pave the way for completion of 6th review and release of funds held up for last 7 months. Going forward, the IMF program is expected to revolve around removal of structural impediments and facilitating the structural transformation of the economy by increased focus on economic productivity, investment, and private sector development.

Stark deterioration of current account is driven by higher commodity prices and robust domestic demand. During CY22, we expect (1) some normalisation of commodity prices given resolution of supply chain snarls and (2) slowdown in domestic economic activity supported by flexible exchange rate and monetary tightening. Thus, full year deficit is expected to be US$14.6bn (4.7% of GDP). Financial account is expected to remain strained given high CAD and elevated debt servicing.

The fiscal side would continue on the declining trend of last 3 years and come in at 5.8% of GDP in FY22. We believe resumption of IMF program would result in increased tax revenue post mini budget and impose fiscal discipline on Gov't. A steep decline is also expected in non-tax collection mostly in profit from SBP. Expenditures are unlikely to decrease as they consist of mostly current expenditiures which are fixed. We expect that development spending would be axed.

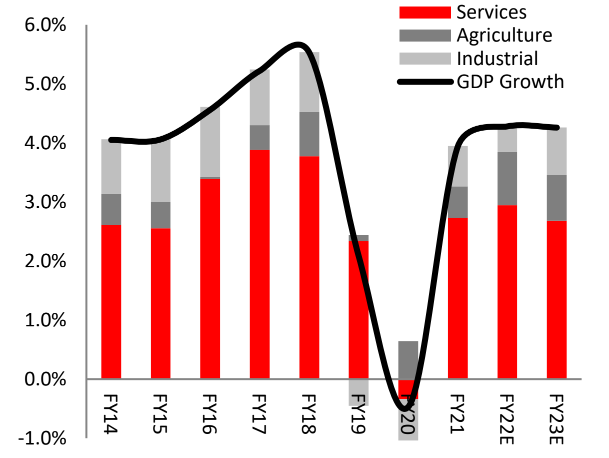
Robust growth to continue

The return to economic growth witnessed in 2021 would continue in 2022 as the agricultural and services sector are expected to make up for lagging industrial activity. Strong domestic demand had caused some overheating in 2021 given (1) fiscal and monetary stimulus, and (2) extension of construciton package. This has been curtailed by timely Gov't action of monetary tightening, regressive mini budget and macro prudential tightening. Omicron, the new variant of COVID, is not expected to result in mass scale disruptions given effective Gov't startegy of micro-lockdowns. Thus, we forecast GDP growth of 4.3% in FY22 vs 3.9% observed in FY21.

Large Scale Manufacturing (LSM) has seen recent downward trend with growth falling to 3.2% YoY in 4MFY22 (from 14.9% YoY in FY21) attributable to rising input prices and supply chain disruptions. Segments exhibiting declines were cement (↓2.7% YoY), fertilizer (↓7.2% YoY), electronics (↓10.9% YoY) and rubber products (↓32.2% YoY). However, other high frequency indicators like electricity generation (↑9.0% YoY in 5MFY22) and sales of petroleum product and fast moving commercial goods remain upbeat. Balancing these contrasting trends, we project that LSM would remain flat YoY in FY22 amid Gov't actions to curtail runaway demand. Business Confidence Index of the central bank has also seen recent sharp downward trend recently.

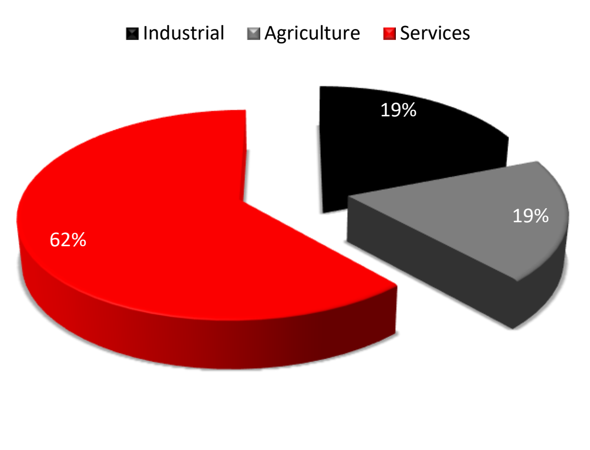
Major crops would be boosted by (1) a sharp rebound of ~25% YoY in cotton harvest and (2) higher production of other crops. The onus of growth would once again rest with the services sector (62% weight in GDP). In the medium to long term, we believe earnest focus on enhancing exports (textile and mobile policies have been approved by Gov't) and structural reforms could return growth levels to Pakistan's true potential of ~6% (previously seen in FY03-07).

Fig 12: GDP projected to grow



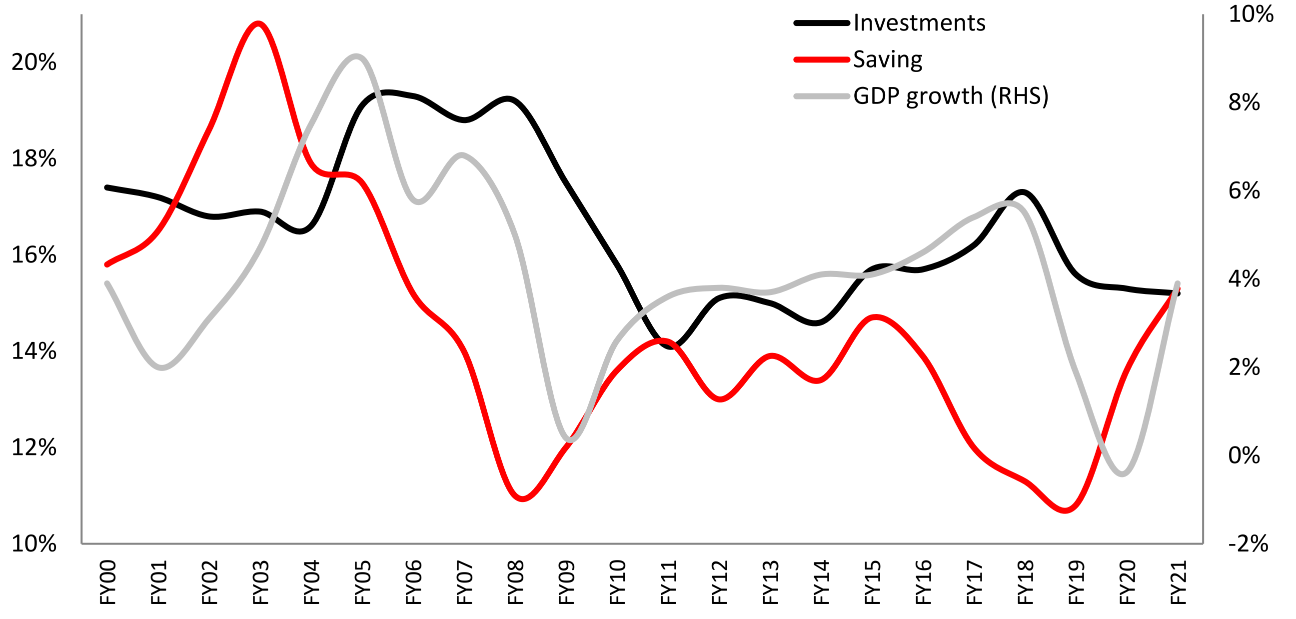
Source: MoF, Foundation Research, January 2022

Fig 13: Sectoral weights in GDP



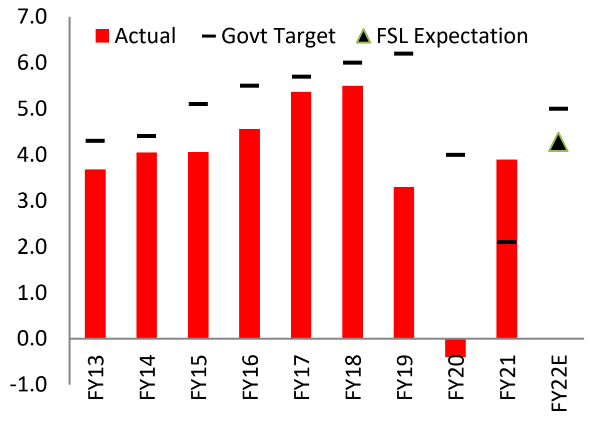
Source: MoF, Foundation Research, January 2022

Fig 14: Saving and investments remained low (% of GDP)



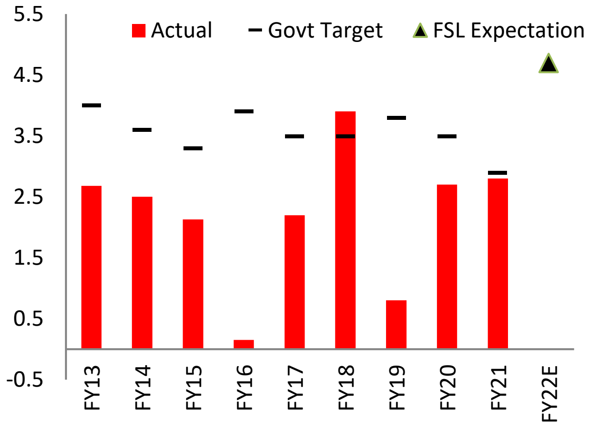
Source: PBS, Foundation Research, January 2022

Fig 15: Projected GDP to grow by 4.3% in FY22



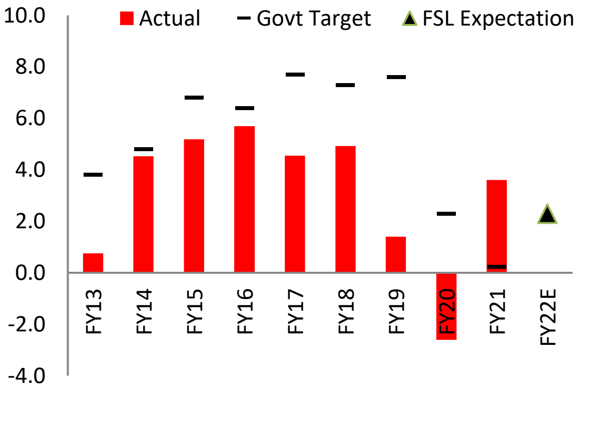
Source: MoF, Foundation Research, January 2022

Fig 16: as agri to outperform given recovery in cotton



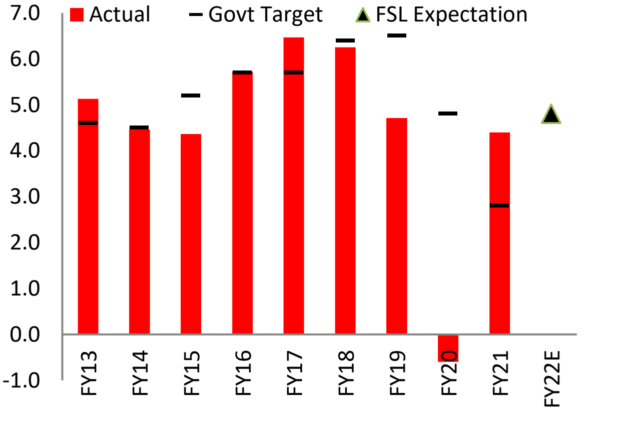
Source: MoF, Foundation Research, January 2022

Fig 17: Muted industrial growth as LSM to remain subdued



Source: MoF, Foundation Research, January 2022

Fig 18: Services to drive with 4.8% YoY growth



Source: MoF, Foundation Research, January 2022

External account slippages

Current account has started FY22 on a dour note with a deficit of US$7.1bn in 5MFY22 compared to surplus of US$1.9bn in 5MFY21. This stark deterioration is driven by higher commodity prices and robust domestic demand. During CY22, we expect (1) some normalisation of commodity prices given resolution of supply chain bottlenecks and (2) slowdown in domestic economic activity given Gov't policy tightening. Thus, full year deficit is expected to be US$14.6bn (4.7% of GDP).

The thrust behind worsening CAD is higher imports which is a symptom of runaway domestic demand. The stimulus provided by lax monetary policy (low interest rates and high Gov't borrowing) and fiscal incentives (pro growth FY22 budget and construciton package) has caused economic activity to increase to a level where it sucks in ever increasing imports to sustain itself. However, monetary tightening has gathered pace over last 2 months (policy rate up by 250bps) which coupled with falling Rs-US$ parity (down 0.5/3.3/10.7% in last 1/3/6months) would help to rein in domestic domand and curtail imports. We believe these policy actions will take time to bear fruit as their effect works their way through the economy and project that it will be atleast another 3 months before CAD starts witnessing substantial decline.

Our FY22 projections for exports show a 17% YoY incline propelled by increase in textiles (up 20% YoY), food (up 15% YoY) and services (up 20% YoY). Textiles exports would smash records whereas food would be up owing mostly to a rise in rice. Higher commodity prices will drive up imports which are expected to increase by 30% YoY in FY22 due to surge in oil imports, palm oil, textile machinery, automobiles, iron & steel and services.

Remittances are sustaining well above the US$2.0bn per month mark for last 20 months despite showing sequential downward trajectory in Oct/Nov'21. It is important to note that remittances have continued to grow by 10% YoY in 5MFY22 on an already high base of FY21 which had been higher than pre-COVID level mostly due to rising use of formal channels amid limited cross border travelling curtailing money couriers. We believe this increase is primarily driven by uptick in global economy. As cross border travel gradually returns to normalcy, we expect that remittances through official channels would start normalizing. Thus, we assume only 5% YoY increase in FY22 remittances. It is worth noting that in 5MFY22 remittances have declined by 2% YoY from Saudi Arabia and remained flat YoY from UAE despite higher oil prices. Whereas witnessed increase of 9% YoY from Other GCC. Remittances from Middle East have a 56% market share. On the contrary, remittances from EU/USA/UK have increased by 41/30/14% YoY during 5MFY22 (market share of 12/10/14%).

Table 5: Current Account position to improve as commodity prices cool down

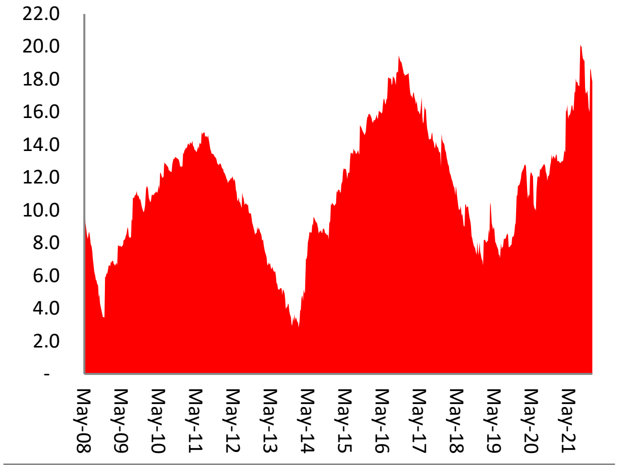
	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Current Account Balance	**(12,270)**	**(19,195)**	**(13,434)**	**(4,449)**	**(1,916)**	**(14,591)**	**(9,781)**
Exports of Goods FOB	22,003	24,768	24,257	22,536	25,630	29,829	31,321
Imports of Goods FOB	48,001	55,671	51,869	43,645	53,818	69,662	67,560
Balance on Trade in Goods	**(25,998)**	**(30,903)**	**(27,612)**	**(21,109)**	**(28,188)**	**(39,832)**	**(36,239)**
Exports of Services	5,915	5,851	5,966	5,437	5,882	7,059	7,412
Imports of Services	10,576	12,277	10,936	8,753	7,839	10,192	10,701
Balance on Trade in Services	**(4,661)**	**(6,426)**	**(4,970)**	**(3,316)**	**(1,957)**	**(3,133)**	**(3,289)**
Balance on Primary Income	**(5,014)**	**(5,437)**	**(5,610)**	**(5,459)**	**(4,613)**	**(4,388)**	**(4,738)**
Balance on Secondary Income	**23,403**	**23,571**	**24,758**	**25,435**	**32,842**	**32,762**	**34,486**
Workers' Remittances	19,351	19,914	21,740	23,131	29,370	30,839	32,381

Source: SBP, Foundation Research January 2022

Elevated current account and debt servicing would strain the financial account during FY22. External debt repayments total US$18.7bn in FY22 (of which principal/interest are US$16.9/1.8bn). Some relief would come from extension of the G20 Debt Servicing Suspension Initiative (DSSI) which was announced in October 2021. Whereas, support would also come from Roshan Digital Account inflows (avg. US$270mn per month in 5MFY22).

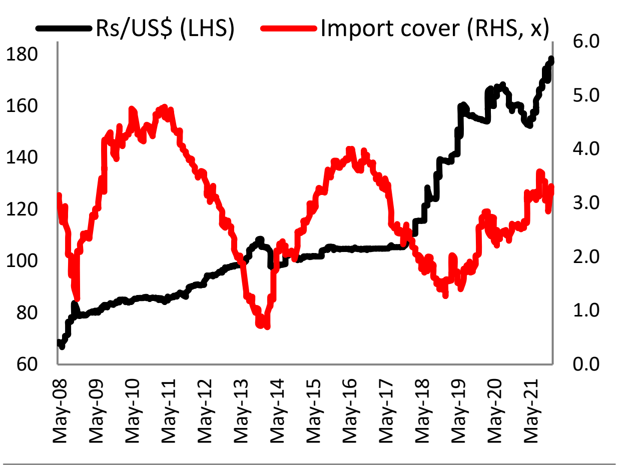
Pakistan has recently received US$3.0bn deposit and US$1.5bn per year deferred oil payment facility from Saudi Arabia. Resumption of IMF program, hopefully in Jan'22, would result in release of US$1.1bn tranche with further releases of US$700mn every quarter thereafter subject to meeting IMF conditionality. Restart of IMF program would also ease the path to reissuance of eurobonds/sukuk in internationl markets. FDI would remian lacklusture despite the country recently attracting significant VC funding. Resultantly, FX reserves build up is likely to remain tepid.

Fig 19: FX reserves near record high (US$ bn)



Source: SBP, Foundation Research, January 2022

Fig 20: Import cover hovering around the 3M mark



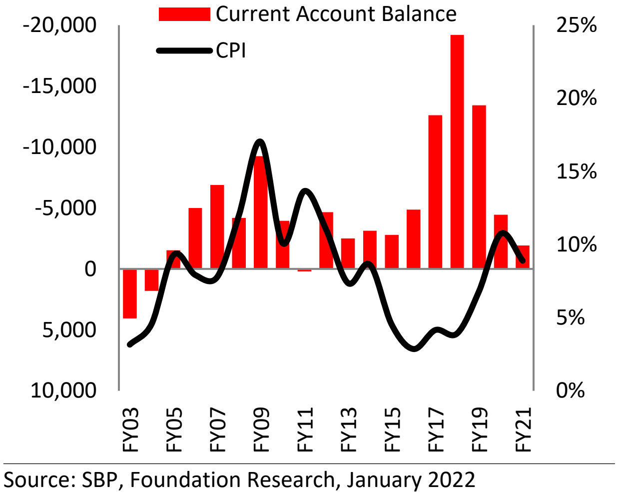
Source: SBP, Foundation Research, January 2022

Exchange rate to remain volatile till further policy rate hikes and IMF resumption

Exchange rate volatility is projected to continue into CY22 given runaway CAD and spiralling inflation effecting sentiment in FX markets. It is pertinent to note that despite increase of 250bps in policy rate during last 2 months, stability has not returned to the FX market. We project further hike of 100bps in interest rates during 2HFY22 to rein in CAD which alongwith resumption of IMF program would bring back stability to Rs-US$ parity.

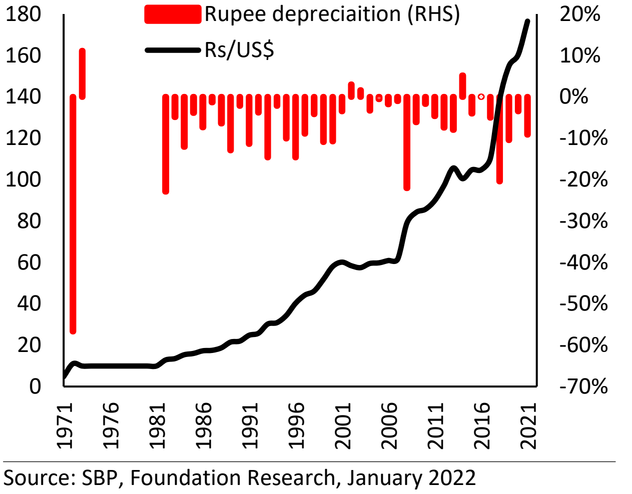
We expect that the Rupee is likely to see 6% depreciation annually (10 year average annual depreciation is 6.5%) from now onwards. We forsee the US$ to be Rs182.9 by Jun-22 while around Rs190.4 at the end of CY22.

Fig 21: Current account balance (US$ bn) and Rs-US$ (RHS)



Source: SBP, Foundation Research, January 2022

Fig 22: Currency depreciated by ~9% YoY in 2021



Source: SBP, Foundation Research, January 2022

Fiscal deficit to decline amid IMF program discipline

Fiscal deficit is projected to continue on a declining path to 5.8% of GDP in FY22 from 7.1/8.1/8.9% of GDP in FY21/20/19 (down 9% YoY in 1QFY22) given higher FBR tax revenue despite higher expenditures (mostly current). Debt servicing is projected to increase given higher interest rates. On the revenue side, direct taxes, sales tax, customs duty and excise duty are all projected to post strong growth given 32/43/43/27% YoY growth observed respectively in 1QFY22.

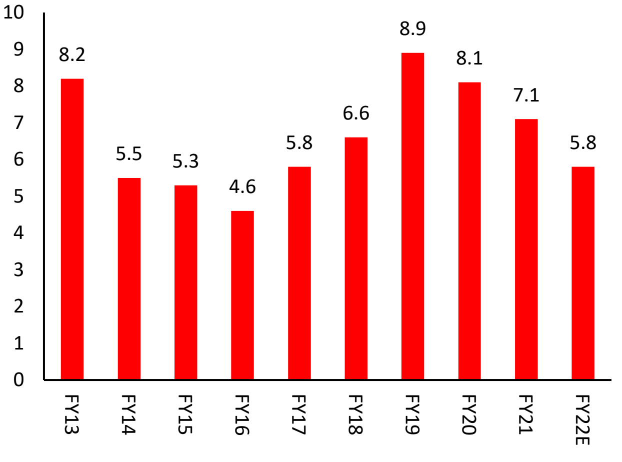
Mini budget tabled recently in parliament as a pre condition to release of IMF tranche would result in additional revenue of Rs375bn. We believe resumption of IMF program would impose fiscal discipline on Gov't and force it to run primary surpluses (fiscal balance which excludes debt servicing) during the program duration. Gas Infrastructure Developmet Cess (GIDC) collection in FY22 would remain muted given stay order obtained by industry against Supreme Court verdict to pay GIDC in installments. Gov't has decided to increase Petroleum Levy by Rs4/liter every month till it reaches Rs30/liter as required by IMF. However, collection under this head is projected to decline 19% YoY in FY22 to Rs345b.

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 FY21 are debt servicing 27%, defence 12% and development 12%).

In the budget, the main culprits of spiralling expenditures are (1) debt servicing which is projected to increase by 22% YoY (but is down 16% YoY in 1QFY22) and (2) federal development spending which is set to increase by 43% YoY (up 53% YoY in 1QFY22). However, we feel that development spending would be curtailed at both the federal and provincial levels during this fiscal year to comply with IMF conditionality.

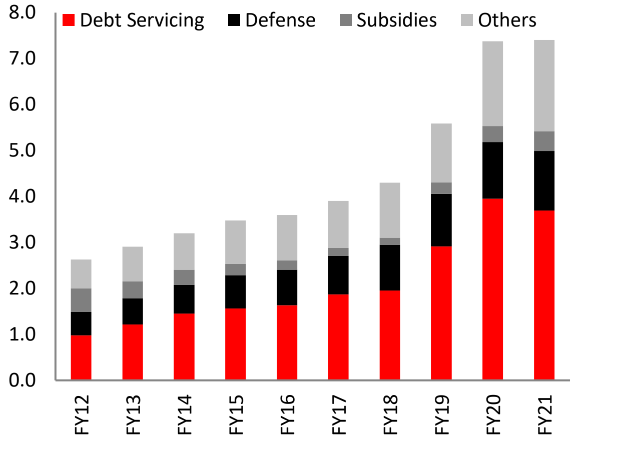
We expect that revenues would post strong growth in FY22 given robust economic growth. However, the Gov't would not be able to curtail current expenditures given their fixed nature but anticipate that the axe would fall on development spending. A steep decline is also expected in non-tax collection with Profit from SBP likely to fall by 25% YoY. Resultantly, we expect FY22 fiscal deficit to be 5.8% of GDP (vs govt target of 6.3%).

Fig 23: Fiscal roadmap (% of GDP)



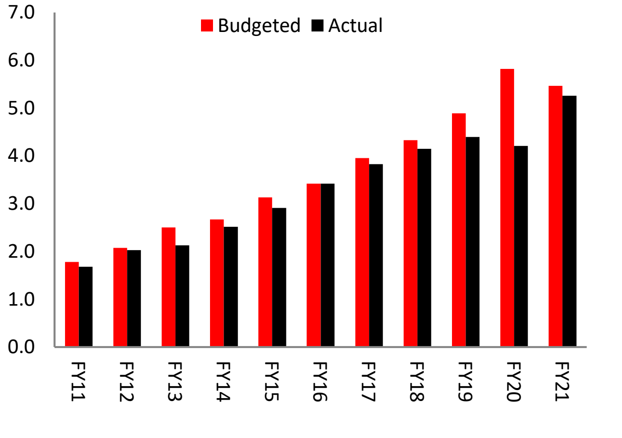
Source: MoF, Foundation Research, January 2022

Fig 24: Debt servicing remains major chunk of current exp.



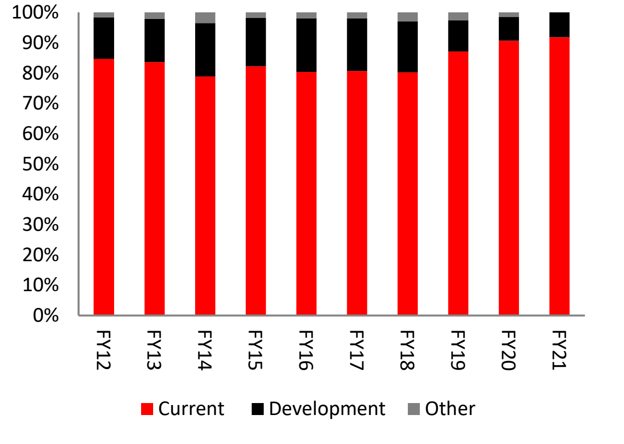
Source: MoF, Foundation Research, January 2022

Fig 25: Tax revenue nearly meets target in FY21



Source: MoF, Foundation Research, January 2022

Fig 26: Current exp. eating into development exp.



Source: MoF, Foundation Research, January 2022

Inflation spiraling out of control

Higher international oil prices being passed onto domestic consumers, electricity/gas tariff increase as required by IMF and elevated food inflation tracking higher international food prices amid supply chain disruptions coupled with sharp Rupeedepreciation over last 6 months would keep FY22 inflation on the higher side. Thus, we see avg. inflation rising to 10.6% in FY22 compared to 8.9% YoY in FY21.

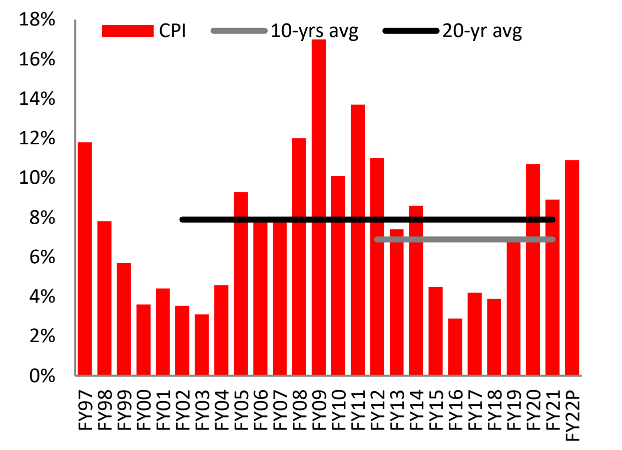
Recent upsurge in Core inflation (a relatively stable gauge of underlying inflationary pressures which excludes food and energy) shows a broad based increase in price levels (housing and clothing/footwear showing the largest rise) pointing to demand pull factors in play. We feel this would require further policy action to moderate.

Food inflation has been on the higher side over the last nearly 3 years which can be partly explained by the run up in global food prices, untimely/torrential rains and pest attacks. However, we believe commodity management problems are also responsible for the surge. Thus, we foresee higher food inflation in the remainder of FY22.

Further monetary tightening likely

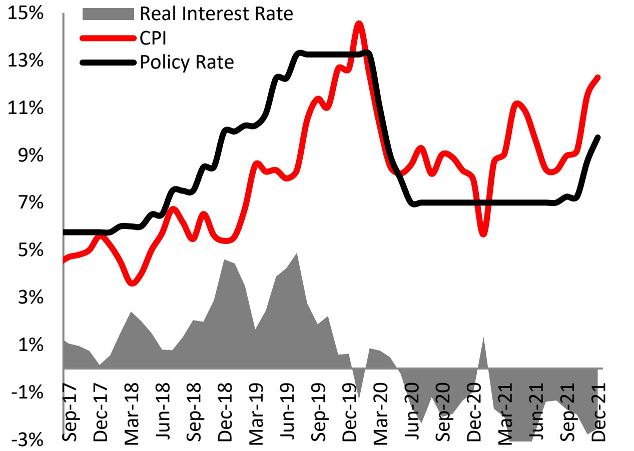
The monetary tightening cycle which started in Sept'22 and has resulted in 275bps increase in the policy rate is likely to continue in CY22 given (1) runaway CAD, (2) spiraling inflation and (3) falling Rs-US$ parity. Coupled with mildly negative 1-year projected real interest rate, we feel the central bank would be compelled to hike interest rates by a further 100bps before Jun'22 to curtail demand and provide monetary stability.

Fig 27: Food inflation to keep CPI high



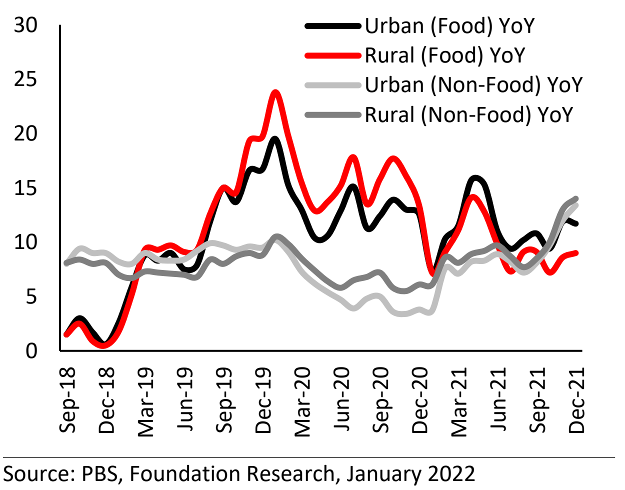
Source: SBP, Foundation Research, January 2022

Fig 28: Tightening to continue in 2022 amid CAD concerns



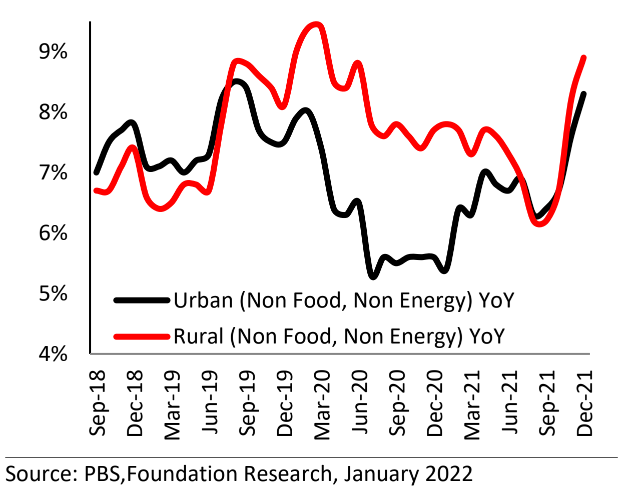
Source: PBS, SBP, Foundation Research, January 2022

Fig 29: Non-Food inflation on an upwards trajectory



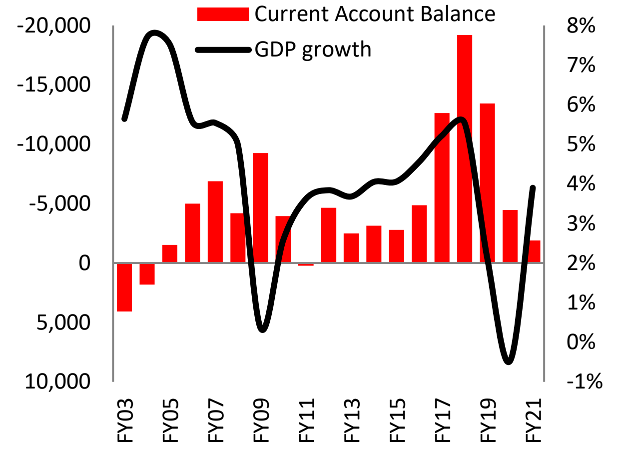
Source: PBS, Foundation Research, January 2022

Fig 30: Core inflation rising sharply



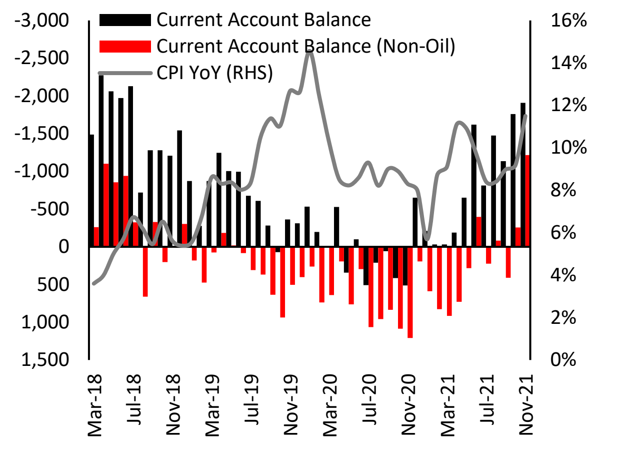
Source: PBS,Foundation Research, January 2022

Fig 31: Inflation (RHS) and CAB in the long turn…



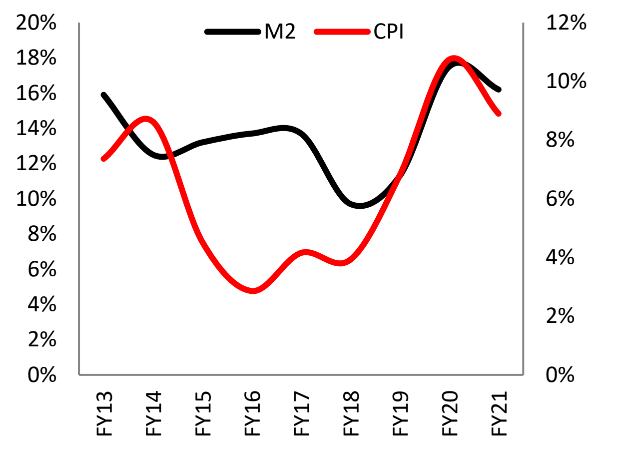
Source: SBP, PBS, Foundation Research, January 2022

Fig 32: … and in the short term



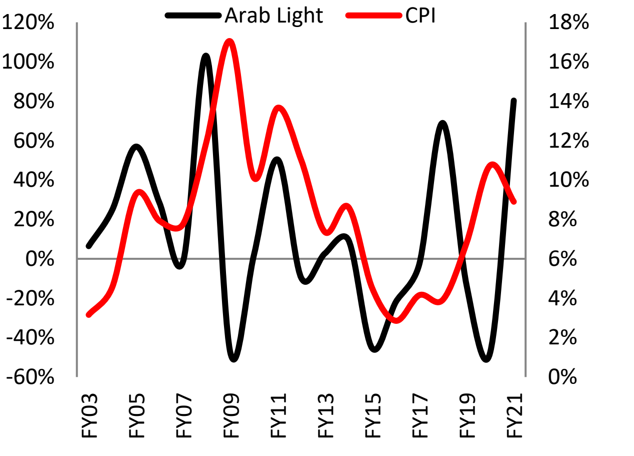
Source: SBP, PBS, Foundation Research, January 2022

Fig 33: Inflation (RHS) and Broad Money in tandem



Source: SBP, PBS, Foundation Research, January 2022

Fig 34: Inflation (RHS) and oil prices



Source: Bloomberg, PBS, FSL Research, Jan 2022

Table 6: Economic Indicators

	Unit	FY17	FY18	FY19	FY20	FY21	FY22F	FY23F
GDP growth	%	5.2%	5.5%	2.1%	-0.5%	3.9%	4.3%	4.3%
Agriculture	%	2.2%	4.0%	0.6%	3.3%	2.8%	4.7%	4.0%
Industrial	%	4.6%	4.6%	-1.6%	-3.8%	3.6%	2.3%	4.3%
Services	%	6.5%	6.4%	3.8%	-0.6%	4.4%	4.8%	4.3%
GDP (Mkt Price)	US$ bn	305	313	278	263	299	312	329
Per Capita (US$)	US$	1,630	1,652	1,455	1,361	1,543	1,632	1,615
US$ parity - Period End	Rs	104.9	121.5	162.0	167.8	157.3	182.9	194.6
Depreciation	%	-0.1%	-13.7%	-25.0%	-3%	6.7%	-14.0%	-6.0%
CAD	US$ bn	(12.6)	(19.2)	(13.4)	(4.4)	(1.9)	(14.6)	(9.8)
CAD	% of GDP	-4.1%	-6.1%	-4.8%	-1.7%	-0.6%	-4.7%	-3.0%
Trade & Services Gap	US$ bn	(31.7)	(36.2)	(33.2)	(24.4)	(30.1)	(43.0)	(39.5)
Exports	US$ bn	27.6	30.1	29.6	28.0	31.5	36.9	38.7
Import	US$ bn	59.3	66.2	62.8	52.4	61.7	79.9	78.3
Remittance	US$ bn	19.4	19.9	21.7	23.1	29.4	30.8	32.4
FX - Period end	US$ bn	16.1	9.8	7.3	11.2	16.1	17.5	18.0
Import Cover	Months	3.3	1.8	1.4	2.6	3.1	2.6	2.8
Fiscal Deficit	% of GDP	5.8%	6.6%	8.9%	8.1%	7.1%	5.8%	5.0%
Policy Rate (period-end)	%	5.8%	6.5%	12.3%	12.8%	7.0%	10.8%	9.3%
CPI (Avg)	%	4.2%	3.9%	7.4%	10.7%	8.9%	10.6%	7.7%

Source: MoF, SBP, Foundation Research, January 2022

IMF program to focus on structural reforms

Resumption of IMF program to support structural transformation

The US$6bn IMF program restarted in Apr'21 but stalled again in Jun'21 as Pakistan was unable to reach an agreement with IMF on the 6th review. Gov't has increased electricity tariff under circular debt management plan, passed NEPRA Act Amendments, renegotiated Power Purchase Agreement with IPPs, and presented mini budget and SBP Autonomy Bill in parliament to meet conditionality for release of US$1.1bn tranche before IMF Executive Board meeting in mid-Jan'21. As a strong macroeconomic recovery has gained hold in Pakistan, and monetary (SBP Bill) and fiscal (additional revenue measures) reforms would be in place before next tranche, going forward, the IMF program is expected to focus on removal of structural impediments and facilitating the structural transformation of the economy by increased focus on economic productivity, investment, and private sector development.

1. Improving the governance, transparency and efficiency of the state-owned enterprises

IMF program to focus on putting Pakistan's public finances on a sustainable path which would require the (1) creation of a modern legal framework, (2) better sectoral oversight by the state, especially of the largest SOEs, and (3) reduction of the footprint of the state in the economy by continuing privatization drive.

2. Fostering the business environment, governance and the control of corruption

New benchmarks would include simplifying procedures for starting a business, approving FDI, preparing trade documentation, and paying taxes; and the empowerment of people and production of more complex goods from investing more in education and human capital. Ensuring a level playing field and the rule of law also remains essential, mainly by bolstering the effectiveness of existing anti-corruption institutions and accountability of high-level public officials and by completing the much-advanced action plan on AML/CFT.

3. Boosting competitiveness and exports

Key objectives would include (1) implementing the approved national tariff policy, (2) negotiating new free trade agreements, and (3) facilitating the integration in global supply chains by improving firms' reliability and product quality, and registering firms with all necessary entities for tax and business purposes.

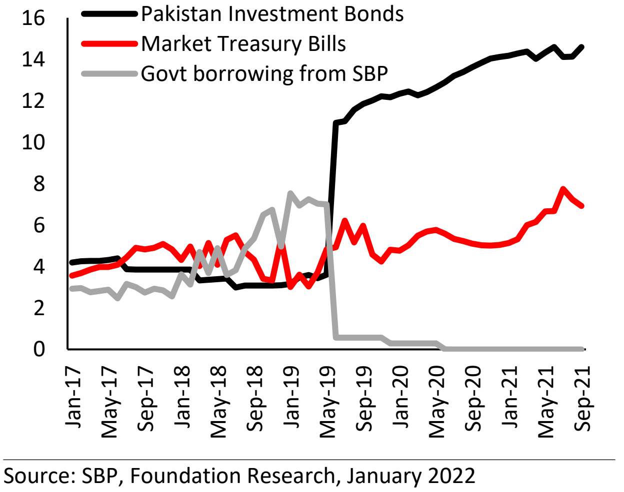
4. Promoting financial deepening and inclusion

To better channel savings toward productive investment, key policies are expected to include (1) entrenching macroeconomic stability, (2) strengthening institutional and regulatory frameworks, (3) creating conditions that allow for a greater role of private credit, and (4) boosting financial coverage of underserved segments of the population and SMEs.

5. Stepping up to climate change

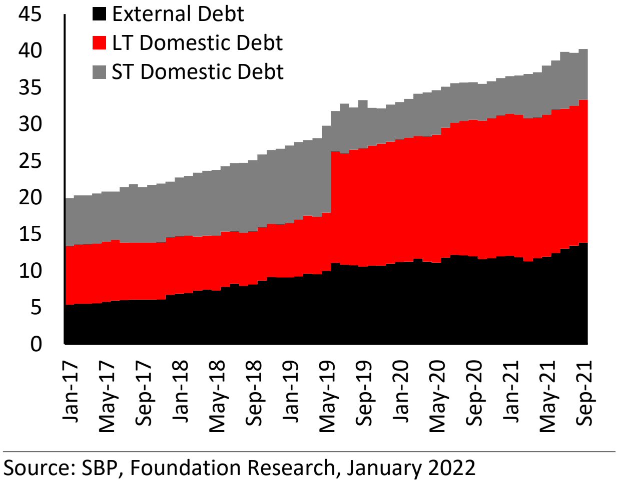
As Pakistan ranks both among the top 10 countries with the largest damages from climate-related disasters and top 20 countries with the largest greenhouse gas (GHG) emissions, IMF program to promote (1) accelerating the finalization of the authorities' National Adaptation Plan (NAP), and (2) implementing an adequate set of measures to meet the COP26 Nationally Determined Contribution (NDC) targets and securing sufficient financing, including from international partners.

Fig 35: Increasing reliance on longer tenor PIB (Rs tn)



Source: SBP, Foundation Research, January 2022

Fig 36: Domestic debt still dominates the mix (Rs tn)



Source: SBP, Foundation Research, January 2022

Privatization process underway at slow pace

Privatization of SOEs is another tool that the government is currently pursuing to not only improve the efficiency of these companies but also generate non-tax revenue for the government and reduce/eliminate the grants and loans provided to them. A total of 19 SOEs are currently on the active privatization list with some of them nearing completion within FY22. However, the government's track record is not encouraging with only privatization of some properties having been completed in since 2016. We believe privatization process would remain lukewarm during the current year given lack of investors' interest amid deteriorating macroeconomic scenario and uncertain environment due to resurgence of pandemic.

The long overdue privatization of Pakistan Steel Mill seems to be finally set in motion as the Privatization Commission recently asked for Expression of Interest for sale of 51 to 74% shares of Steel Corp (a subsidiary of PSM consisting of core operating assets).

Table 07: Privatization Active List

Company name	Industry
1,223 MW Balloki Power Plant	Power
1,230 MW Haveli Bahadur Power Plant	Power
SME Bank Limited	Banks
First Women Bank Limited	Banks
Pakistan Re-Insurance Co. Ltd. (PakRe)	Insurance
Jinnah Convention Centre, Islamabad	Property and Construction
House Building Finance Corporation (HBFC)	Property and Construction
Pakistan Steel Mills	Steel
Heavy Electrical Complex (HEC)	Power
Sindh Engineering Limited (SEL)	Engineering
Faisalabad Electric Supply Company Limited (FESCO)	Power
Islamabad Electric Supply Company Limited (IESCO)	Power
Lahore Electric Supply Company Limited (LESCO)	Power
Gujranwala Electric Power Company Limited (GEPCO)	Power
Multan Electric Power Company Limited (MEPCO)	Power
Peshawar Electric Supply Company Limited (PESCO)	Power
Hyderabad Electric Supply Company Limited (HESCO)	Power
Quetta Electric Supply Company Limited (QESCO)	Power
Sukkur Electric Power Company (SEPCO)	Power

Source: Privatization commission, Foundation Research, January 2022

COVID – Does new variant pose a significant threat?

Omicron: The New Variant

Omicron, the new COVID variant is spreading much faster than previous variants. Global restrictions are tightening and daily cases are rising sharply. Highly contagious Omicron variant has displaced the earlier Delta strain much faster, representing 95% of new cases in US. Meanwhile, France and United States reported historic high cases of 1.38M and 2.8M last week, respectively. A study from Hong Kong, found that chances of getting lung infection is much lower than parent strain suggesting that chances of getting severe illness are much less. UK Health Security Agency has confirmed that booster vaccine is 88% effective against new variant and prevents hospitalization. Meanwhile, World health Organization is repeatedly raising concerns over far reaching consequences of the Omicron spread and urging relevant authorities to initiate mass vaccination programs to contain the spread of new variant.

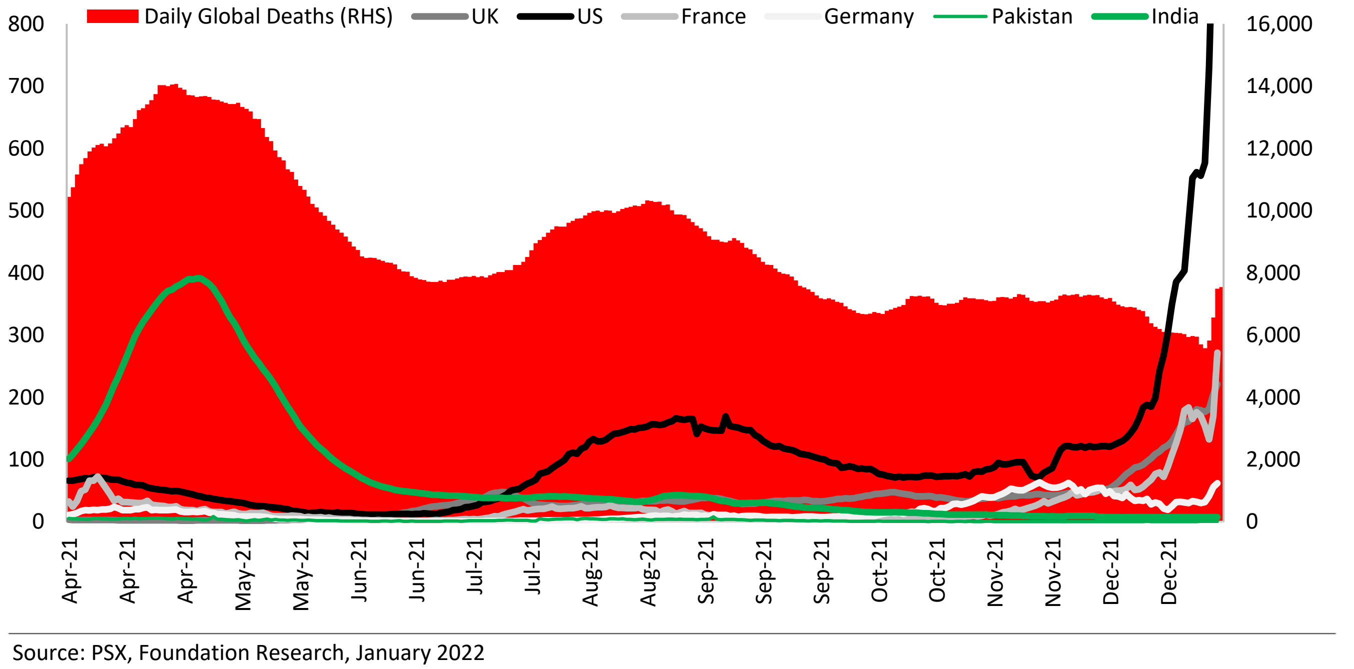
Implications for Pakistan

Government is expected to take affirmative steps to fight the upcoming wave. Smart lockdowns and partial closures are expected in Pakistan. But the chances of full lockdown are remote. Health care costs and patient inflow to hospitals could rise due to highly contagious nature of new variant resulting in far higher number of cases than previous variants.

The way forward - Large Scale Vaccination Drive

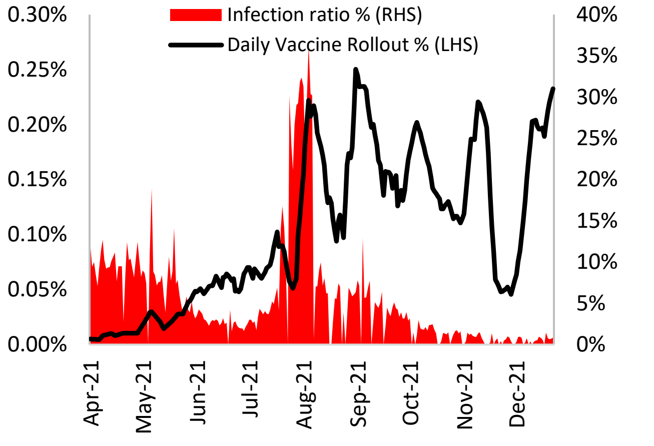
Pakistan is still lagging in vaccination drive as compared to regional players. Although, infection ratio and death rate are low but vaccination rate also remains below par and only 33% of total population is fully vaccinated. The government has been proactive and is constantly focusing on handling variety of Covid-19 infection waves by initiating mass vaccination campaign and economic policy actions, when required.

Fig 37: COVID Cases (LHS) (000') rising rapidly across Europe & US



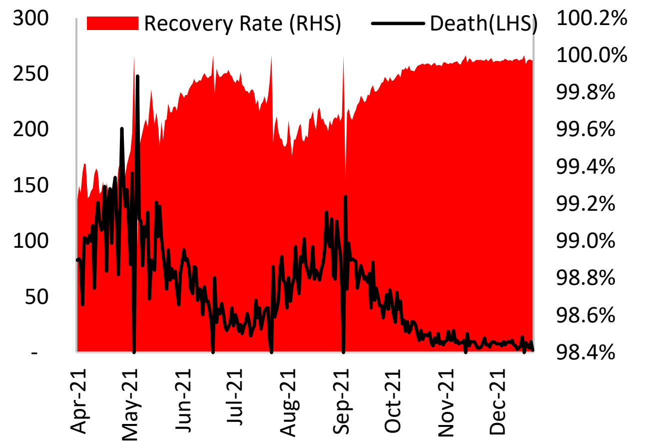
Source: PSX, Foundation Research, January 2022

Fig 38: Vaccine rollout effectively decreases Infection



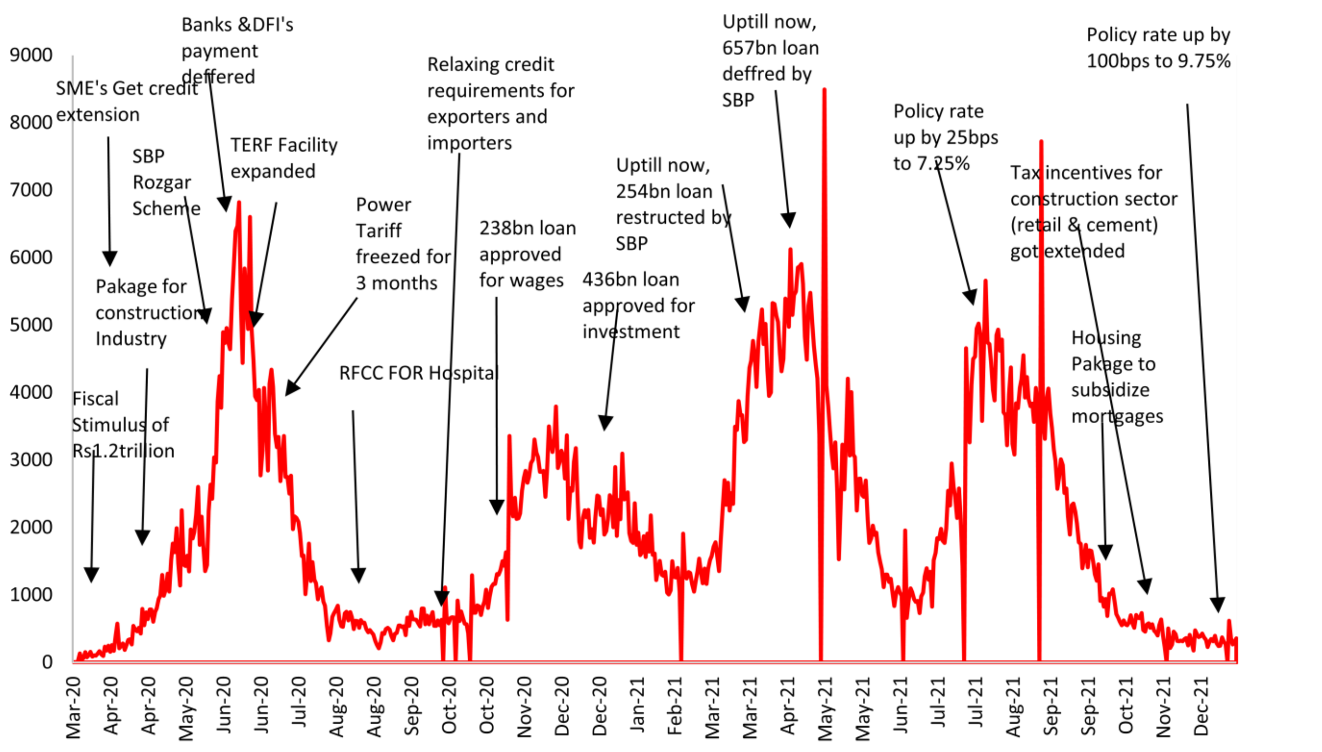
Source: GoP, Foundation Research, January 2022

Fig 39: Recovery Rate vs # of Deaths



Source: GoP, Foundation Research, January 2022

Fig 40: SBP's initiatives during Covid-19 period



Source: SBP, Foundation Research, January 2022

GCI Recovery Index ratings: Method approved by World Health Organization

The GCI is driven fully by big data, and the index scores 184 WHO Member States on how well they are coping with the COVID-19 pandemic. The intent of the GCI Index is to enable countries to compare their relative performance against other countries which then enables the identification of appropriate best practices from the successful nations. This statistical method assigns a score between 0-100. Higher score in Recovery Index and lower score in Severity index depicts more effective measures taken by respective governments.

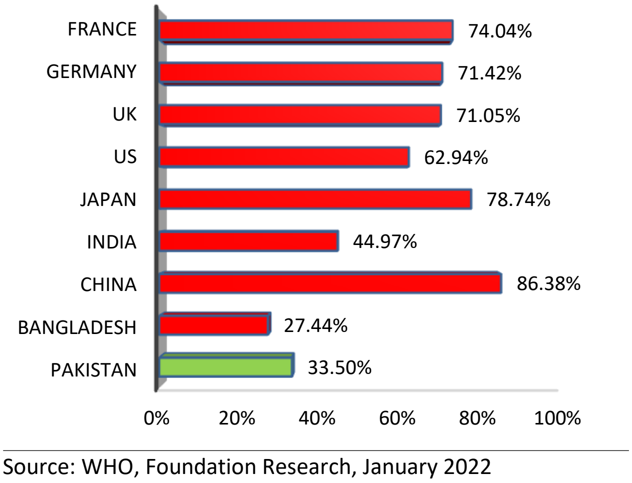
Currently Pakistan's stands at 44 out 184 countries with score of 68 and 19 in recovery and severity index, respectively.

Table 08: Global Covid-19 Recovery Index

Country	Overall Rank	Recovery Rating	Recovery Index	Recovery Index+/-	Severity Rating	Severity Index
Singapore	8	4	84.26	0.004	2	22.08
China	1	5	91.09	-0.0008	2	13.79
UAE	2	5	90.57	-0.0025	2	16.1
Saudi Arabia	10	4	83.58	-0.06%	2	17.55
Japan	4	5	86.14	-0.07%	1	9.13
Malaysia	25	4	74.89	-0.03%	2	27.2
India	20	4	76.55	0.06%	2	16.5
Turkey	86	3	56.56	-0.43%	3	41.6
Pakistan	44	3	68.7	0.04%	2	19.45
UK	141	2	48.1	0.04%	3	46.79
Thailand	29	4	72.22	0.09%	2	18.75
Germany	109	3	52.23	-1.13%	4	60.28
Bangladesh	37	4	70.22	0.76%	2	20.05
France	145	2	47.33	0.03%	4	63.27
Russia	101	3	53.35	-0.60%	3	42.23
Vietnam	64	3	61.56	-0.85%	3	45.12

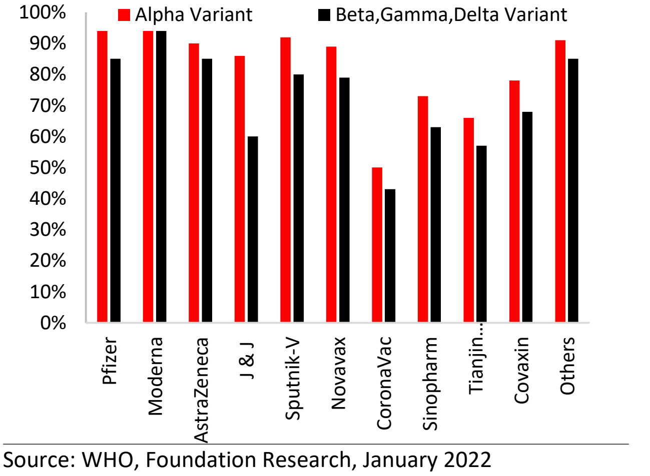
Source: WHO, Foundation Research, January 2022

Fig 41: People fully Vaccinated out of Total Population



Source: WHO, Foundation Research, January 2022

Fig 42: Efficacy in Preventing Covid Disease



Source: WHO, Foundation Research, January 2022

Stringency Index

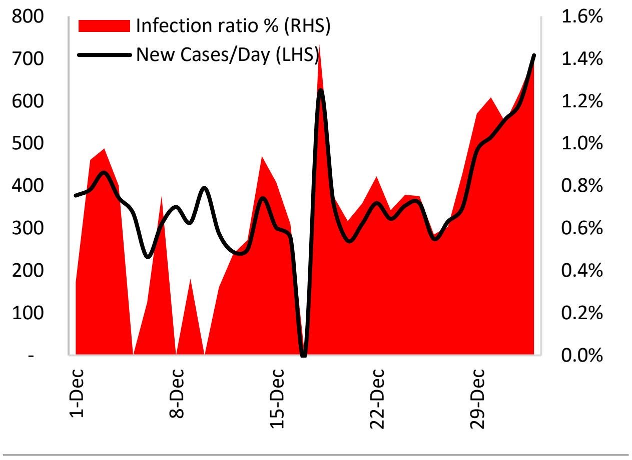
It is composite measure based on nine response indicators including school closures, travel bans, workplace closures rescaled to a value from 0 to 100 (100 = Strictest). This index trend shows the level of government restrictions imposed as a defensive measure against Covid spread aiming to compare policy reactions across the world. Pakistan has the lowest score of 36 showing least restrictions imposed among all others with only 33.3% people fully vaccinated. But China, Germany, France and United States have higher scores of 84, 78, 72 and 65 with 86.38%, 71%, 74% and 62.94% respectively.

Table 09: Stringency Index

	China	UK	US	France	Germany	Pakistan	India
Apr-21	75	65	57	74	75	66	71
May-21	68	61	52	61	75	69	80
Jun-21	73	53	55	52	68	60	82
Jul-21	76	48	52	44	68	68	80
Aug-21	76	44	54	60	60	65	73
Sep-21	76	42	55	67	56	59	67
Oct-21	76	44	56	67	42	35	54
Nov-21	74	47	52	67	54	34	43
Dec-21	71	49	50	72	84	33	51
Jan-22	78	51	65	72	84	36	60

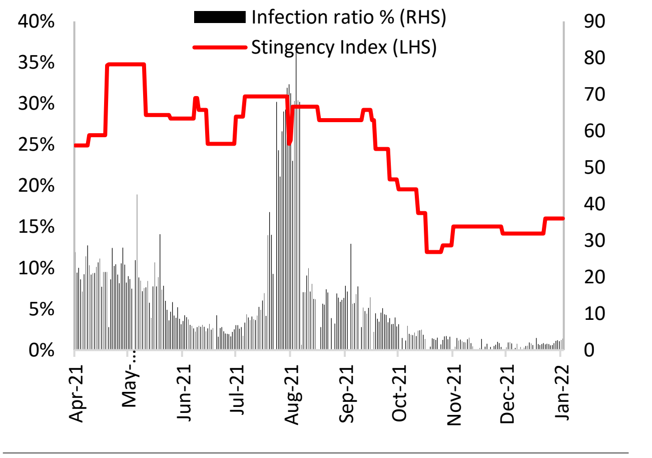
Source: OWID, Foundation Research, January 2022

Fig 43: Omicron trend for Dec, 21. Signals threat!



Source: WHO, Foundation Research, January 2022

Fig 44: Stringency Index Vs Infection Ratio



Source: WHO, Foundation Research, January 2022

Commodities: Boom cycle coming to an end

Oil: Black gold disruption

International oscillation of oil prices has caused pressure on petroleum imports of Pakistan. Pakistan imports account for around 24% of import bill. Easing off of oil prices as supply constraints and political instability decreases, would create breather for oil import bill for Pakistan. However the breather wouldn't be effectively transferred to consumer as gov't would revise PDL/GST to increase revenue collection. We expect oil price to clock in at US$74/64bn for FY22/23, whereas the domestic oil prices would also absorb rupee depreciation and keep MS/HSD range bound between Rs140-150/ltr.

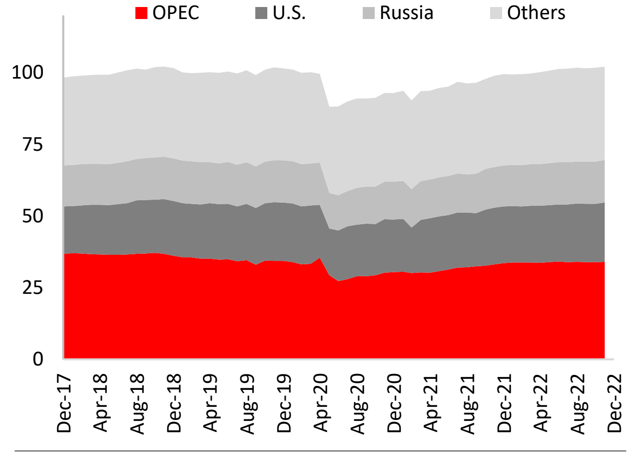
International oil prices to ease off as OPEC+ would meet targets

Oil (Arab light) averaged US$70.7/bbl in CY21 (up by 68% YoY) as demand rebounded amid constrained supply. Future Oil prices are in contango, with 1yr contract trading at discount. In addition to the macroeconomic factors, the increase in energy consumption behavior in winter season and restoration of oil production would keep prices lower bound.

US Energy Information Administration (EIA) estimates that the global consumption of petroleum and liquid fuels will increase by 3.5mn b/d in 2022 to averaging 100.5mn b/d, which is 100k b/d lower than the previous expectations due to lower air travel. Majority of the demand increase would be driven from India and China, and a surge of 30,000 b/d in demand from Japan as global economic activity gathers pace.

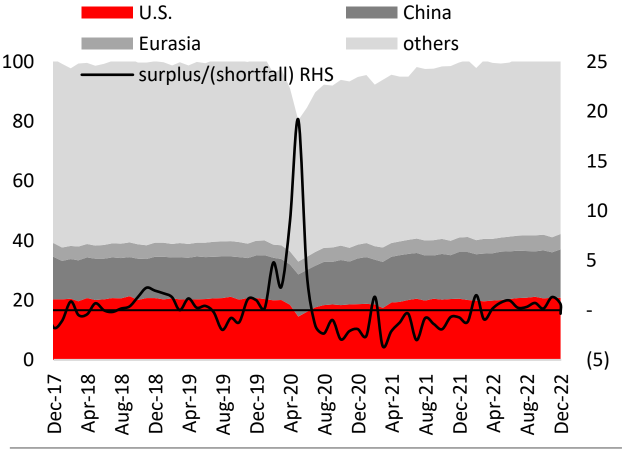
Meanwhile the increasing demand is yet to be met by supply side from OPEC+, as due to underinvestment and over-compliance, the output remained below target. OPEC plans to boost output by 400k b/d. However, OPEC+ has missed its production target by 650k b/d in Nov-21, as African oil exporters, Nigeria and Angola, struggle to boost output. The two countries failed to meet targets due to underinvestment and persistent maintenance issues. The restoration of supply lines and OPEC increasing its output would ease off pressure from the price. Further, oil prices would also stabilize given political turmoil easing in Kazakhstan and other oil producing countries.

Fig 45: OPEC keeps supply steady (supply mn b/d)



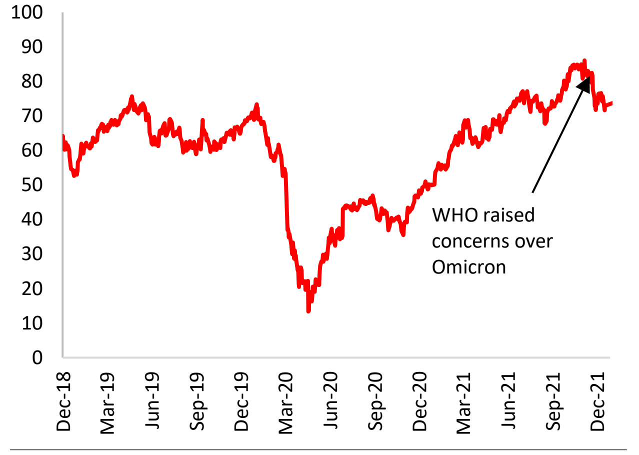
Source: EIA, Foundation Research, Jan 2022

Fig 46: High demand to induce shortfall (mn b/d)



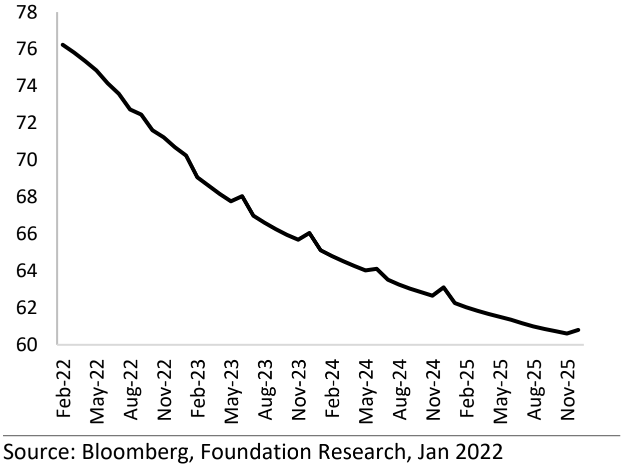
Source: EIA, Foundation Research, Jan 2022

Fig 47: Arab light (US$/bbl) easing off due to omicron



Source: Bloomberg, Foundation Research, Jan 2022

Fig 48: Arab light future prices in contango (US$/bbl)



Source: Bloomberg, Foundation Research, Jan 2022

Breather for oil import bill as prices ease off

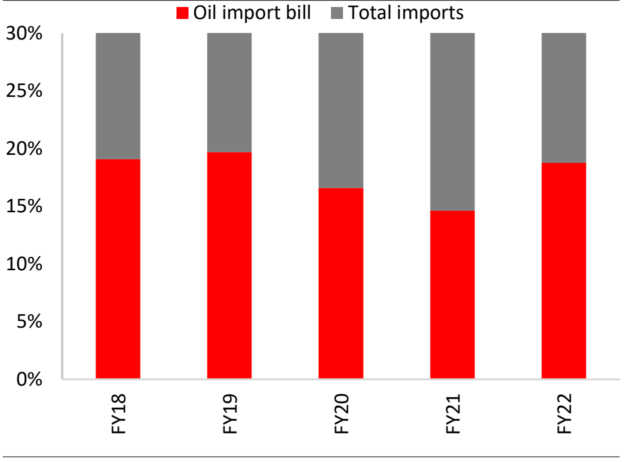
Pakistan's total demand for oil is around ~27mn tons, which remained steady as demand from transport increased to counteract with the decline from power as electricity generation shifts to coal. The increase in demand from transport sector has induced appetite for motor spirit, whereas need for furnace oil declined. Pakistan imports 85% of total oil consumption. We expect oil import bill to ease of at US$13/12bn for FY22/23, as international oil supplies would allow prices to come down that would counteract with increasing demand.

Petroleum imports counts for 24% of import bill of Pakistan. The revival of economic activity created pressure on demand of petroleum products. Currently, Pakistan imports more than 500k b/d, up by 20% YoY. This has accumulated into 11.44mn tons in 5MFY22. Oil imports rose by 114% YoY to US$6.2bn in 5MFY22, as prices increased by 53/49% for crude/petroleum products. Moreover, skew towards refined petroleum products has increased in recent years, by gaining 12ppt against crude oil since FY19.

Going forward, easing global demand as winter passes and increase in supply from OPEC, prices would ease to an average of US$74.5/64.0 b/d (Arab-light) for FY22/23. The decrease in prices would be set off by increase in quantity demanded. As economy continues with its momentum of 4.3/4.3% GDP growth in FY22/23, the demand for oil would increase to 30mn tons by FY23. We expect domestic demand to continue and imports for oil to clock in at 25/26.2mn tons in FY22/23, which would take import bill for to US$13.4/12.0bn for FY22/23.

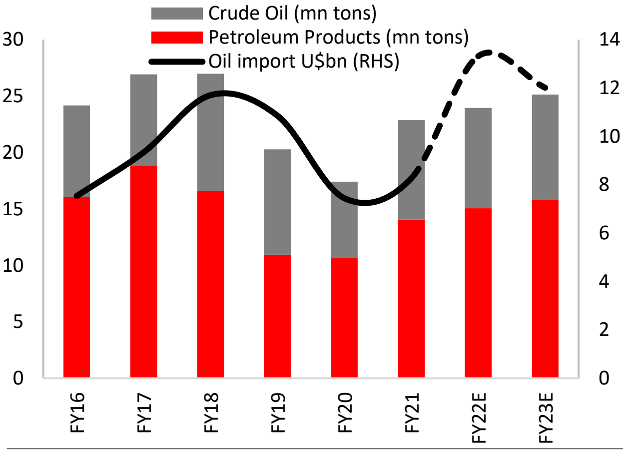
Domestic production for oil would remain stagnant at 3.75mn tons/yr as bottleneck problems from local refineries prevails in the industry. Currently, refineries have temporarily halted their production due to excess inventory on lack of buying from IPPs. Refinery industry is expecting refinery policy to provide them incentives for upgradation of their facility by setting up new deep conversion refineries. Refinery policy would also allow industry to import crude with no duties and sales tax. Upgradation facility would allow the refineries to achieve target of Euro-V specification.

Fig 49: Petroleum products as % of total imports↑



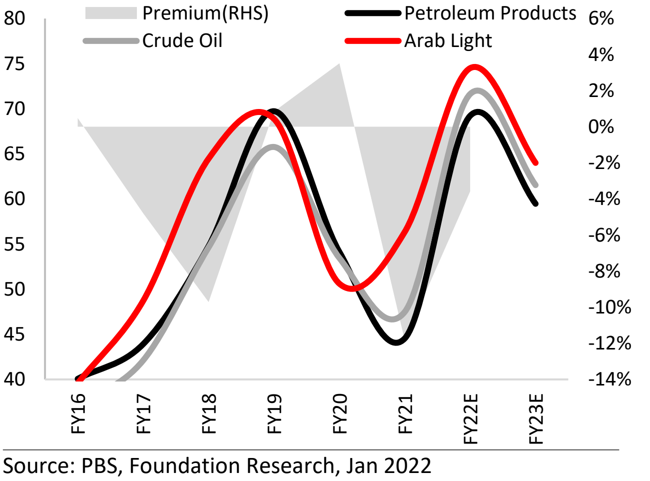
Source: PBS, Foundation Research, Jan 2022

Fig 50: Oil import bill to ease off as prices ↓(mn tons)



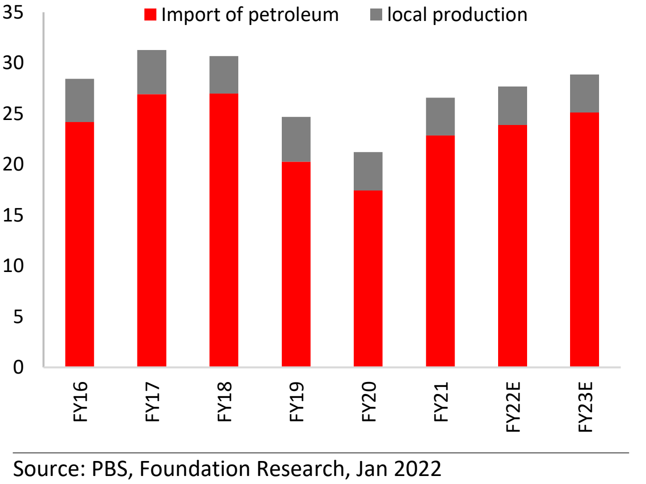
Source: PBS, Foundation Research, Jan 2022

Fig 51: Effective oil procurement at discount



Source: PBS, Foundation Research, Jan 2022

Fig 52: Imports cont to dominate supply (mn tons)



Source: PBS, Foundation Research, Jan 2022

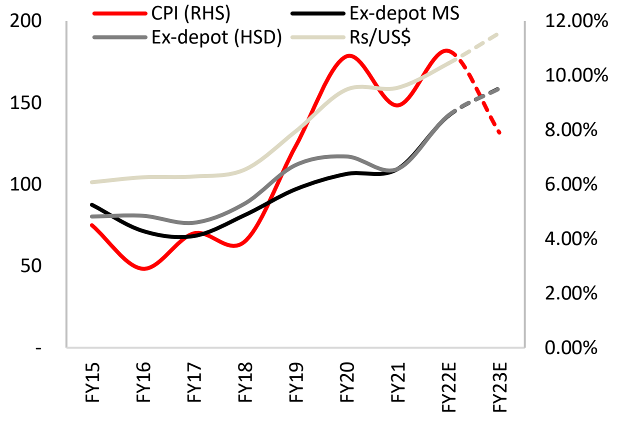
Breather not transferred to consumers as gov't would increase its revenue base

The increasing greenback against the local currency has fueled up prices for MS/HSD to all time high. Gov't has provided revenue collection cuts by reducing sales tax and petroleum levy (PDL) to ease of pressure to retail consumers. As prices are expected to come down, gov't would have breather to increase its tax collection. Initial target for FY22 was Rs600bn, which was revised down to Rs300bn due to duty withdrawals. Currently petroleum levy is set to Rs17.62/13.14 for MS/HSD. This, alongside with rupee depreciation would keep retail petroleum prices range bound between Rs150-160/ltr.

Initial target of gov't in FY22 budget to collect petroleum levy was Rs610bn, of which gov't has collected Rs13.3bn in 1QFY22. It was because PDL was set to zero for 2 months (July-Aug), and increasing thereon as international oil prices declines due to Omicron variant. To compare, Gov't collected petroleum levy of Rs136.35bn in 1QFY21 which accumulated to Rs424.65bn in FY21. Gov't is expected to collect Rs350bn in FY22, as PDL will increase by Rs4 in every month price review to Rs30 by mid Feb'22. Similarly Gov't would revise sales tax to 17% on petroleum under the harmonized tax regime that would increase the petrol prices as well.

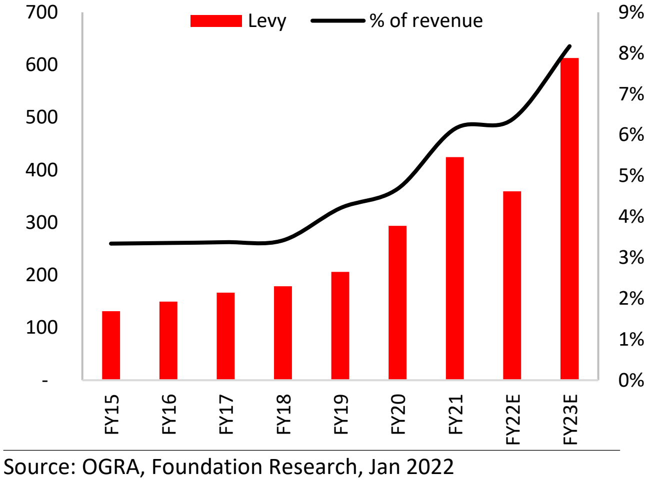
Transport constitutes 2.9% weight in CPI index, which has increased 40.8% YoY, due to the recent price hikes in MS. As inflationary pressure persist, the prices for oil would linger range bound and thereon would keep inflation sticky. To highlight Pakistan's per capita income has been stagnant, whereas proportion of income per capita used for transportation has accumulated given low infrastructure to facilitate transportation and provide boost to disposable income.

Fig 53: Prices to stay stagnant as PDL increases



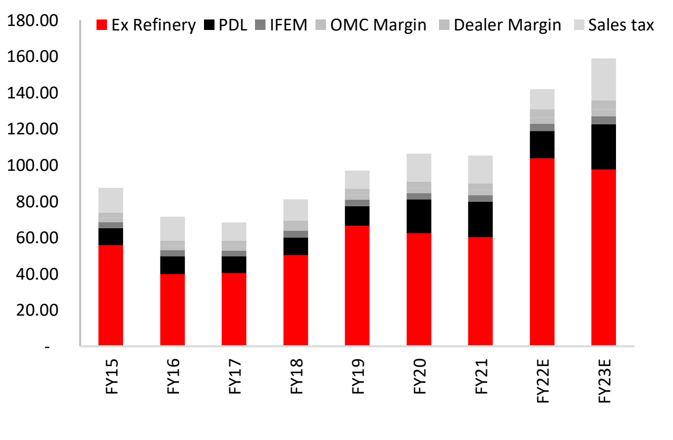
Source: OGRA, Foundation Research, Jan 2022

Fig 54: PDL collection drops in FY22, recovers in FY23



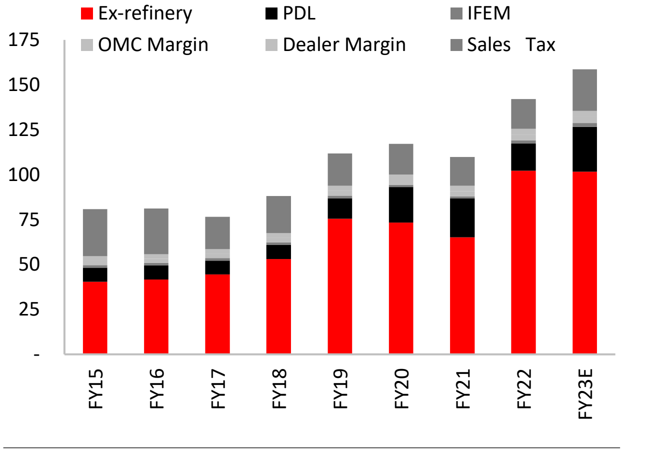
Source: OGRA, Foundation Research, Jan 2022

Fig 55: MS ex-depot price to avg at Rs158ltr in FY23



Source: OGRA, Foundation Research, Jan 2022

Fig 56: HSD ex-depot price to avg at Rs158ltr in FY23



Source: OGRA, Foundation Research, Jan 2022

Gas: Increasing demand to shift towards renewables

The increasing trend of energy transition to renewable energy sources for net-zero emissions target has put gas in ideal situation as it provides a reliable support to the transition. The demand increase, as consumption in winter rises and inventories dry out, has been mismatched by the supply constraints. Supplies would be matched as infrastructure buildup to increase flows and demand easing would likely slowdown prices. Pakistan has hedged global cycle by securing 10yr contract with Qatar and increase in infrastructure buildup by Russia pipeline that would keep import bill of petroleum gas at US$4.4bn in FY22.

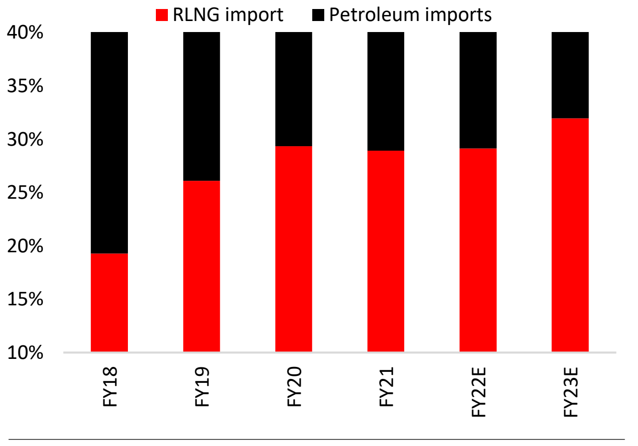
Increasing demand racing with under construction supplies

EIA expects demand to be 104.14 bcf/d (↑3 bcf/d YoY) for 2022, which is revised downwards by 730 mmcfd and majority of demand is expected to come from north East Asia. LNG is procured at discount in Asian market due to long term supply contracts, this inflated price due to disparity from European market and cargos are redirecting to highest price market (Europe) amid their low storage levels. Currently Australia and MENA are leading supplier of global LNG. US and Russia are expected to increase their supplies by 94/57% by 2025 to counter declining production from ageing facilities. Moreover Qatar's expansion plans in north field east project would make Qatar the top LNG exporter.

Locked in LNG cargos to secure domestic supplies

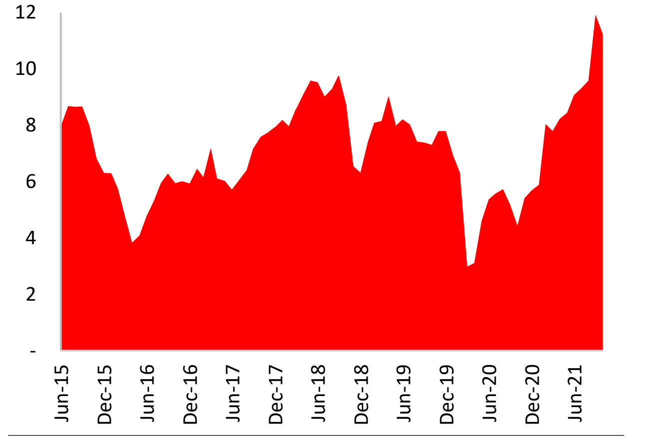
Pakistan currently houses two LNG terminals (1) the Engro Elengy Terminal and (2) Pakistan Gasport, which have a combined capacity of 1,200mmcfd. Furthermore, Gov't is also investing ~US$2.3bn for north-south pipeline (Karachi to Kasur) with strategic partnership with Russia which can transport about 1,200mmcfd, 10-yr contract with Qatar that would ensure 6 fixed cargos at 13.37% of Brent and additional 2 cargos for winters at 10.2% of Brent. Pakistan has LNG import requirement of around 1,100 mmcfd. The inflated global prices have increased import bill for LNG by 65% YoY at US$4.3bn, as weighted average cost would increase to US$13.6/mmbtu for FY22. Meanwhile increase in demand of LNG would increase requirement by 300 mmcfd, however normalizing of gas prices would tune it down to US$11.5/mmbtu which would keep import bill for petroleum gas stagnant at US$4.4bn in FY23.

Fig 57: RLNG as %of petroleum imports↑



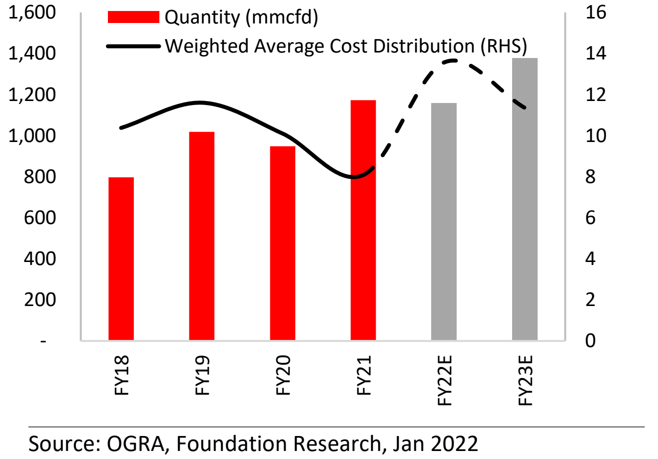
Source: OGRA, Foundation Research, Jan 2022

Fig 58: …due to pressure from price (US$/mmbtu)



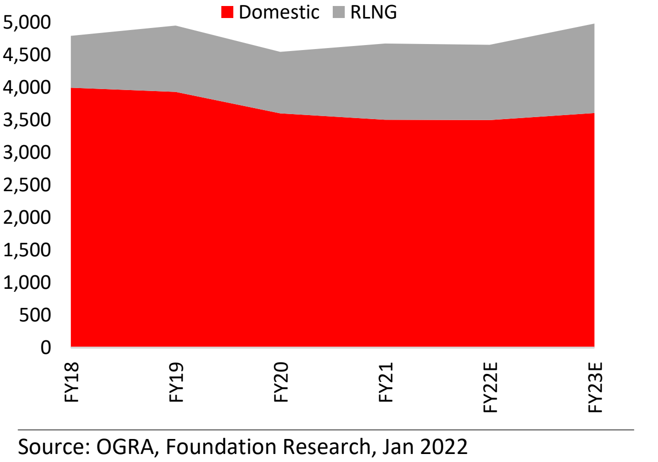
Source: OGRA, Foundation Research, Jan 2022

Fig 59: Prices to come down to keep imports stagnant



Source: OGRA, Foundation Research, Jan 2022

Fig 60: High RLNG demand as gas supply falls



Source: OGRA, Foundation Research, Jan 2022

Coal: Maintains its positions as largest source of energy

Demand for coal to remain high

Coal is one of the largest source of energy, with global power mix of ~36% in 2021, and largest source of CO2 as well. Apart from industrial usage growth, demand for coal is receptive to alternative movement in gas prices and increasing shift towards renewable energy. China accounts for ~one-third of the global consumption, being the largest producer and importer of coal, any demand shifts in China has an immediate impact on international markets. Coal demand for 2021 increased by 6% YoY, reaching record levels seen in 2013/14. Although the rebound in demand in 2021, outpaced the supply side which resulted in significant run-up in prices. For 2022, resumption of coal mines and higher gas prices would create new highs for coal demand to satisfy the increasing demand from China, India and other developing countries. EIA expects the demand shift to renewable and gas to trim growth for Coal by 2024, until then coal would remain in higher demand.

Domestic demand for coal increase on Power and Cement outlook

Pakistan's annual consumption of coal is about ~23mn tons, of which import/domestic production is about 70/30%. Around 70% of the imported coal is procured from the South Africa. Sector-wise, power sector consumes the most with 49% as electricity generation has skewed towards coal based power plants in recent years, followed by cement sector with 26% share. With expected coal consumption in cement sector/power sector of 7/13mn tons in FY22, total coal consumption accumulate to 27mn tons, increasing by 8% YoY. We expect effective coal price to average at US$140, for FY22.

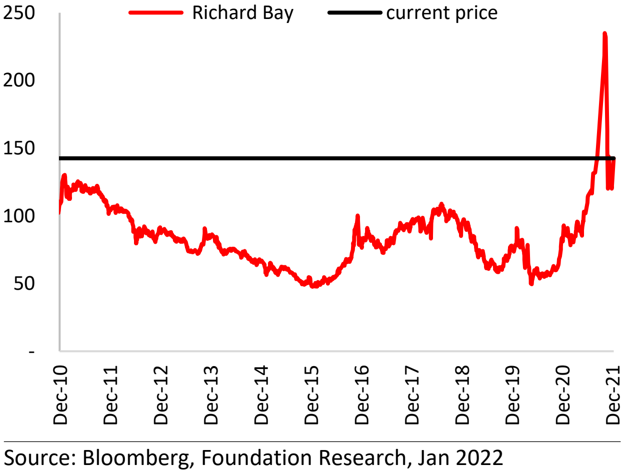
Pakistan cement sector is the most sensitive to change in coal prices given its dual use as fuel/energy component during cement manufacturing process. Cement companies have already passed on the majority impact of surge in input cost due to higher coal prices by multiple hike in retail prices (↑~Rs125/120/bag in north/south region) since May'21. However, as a result of increase in cement prices to all time high dispatches declined by 4.1% YoY to 27.5mn tons in 6MFY22. To highlight, as we move forward with winter season coal prices have started to decline (down 42% from Oct'21 high) and currently stand at US$135/ton. Cement prices are also expected to follow the suit and will decline by ~Rs30/bag in Feb'21 if coal prices remain at current levels in order to revive monthly dispatches above 5.0mn tons level.

Table 10: Impact of US$10 increase in coal price on FSL cement universe

Company	FY22E EPS	Impact of US$10 increase in coal price	Impact as a %age of EPS
LUCK	91.8	3.9	4%
FCCL	3.7	0.3	9%
DGKC	6.2	2.1	34%
PIOC	9.1	1.9	21%
CHCC	18.7	2.6	14%
KOHC	19.6	2.3	12%
ACPL	5.8	3.1	53%

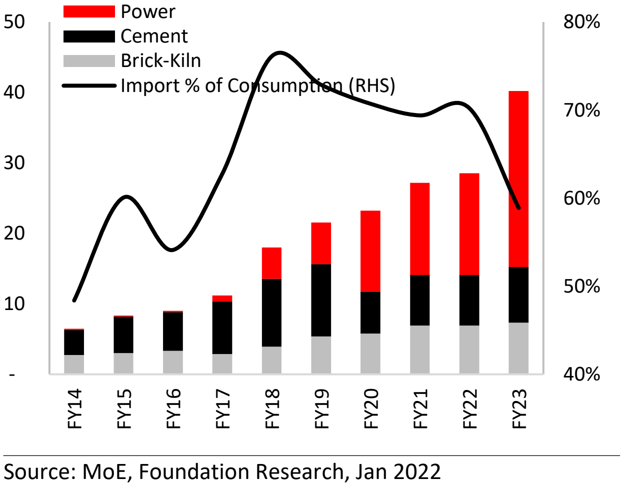
Source: Foundation Research, January 2022

Fig 61: Winter demand takes coal prices to new high



Source: Bloomberg, Foundation Research, Jan 2022

Fig 62: Industry-wise usage of coal (mn tons)



Source: MoE, Foundation Research, Jan 2022

Non-energy: Significantly contributed in inflation uptick

Food inflation to ease as food prices come down

Global food inflation due to high edible oil prices

Global economies still in recovery phase, food inflation have increased to all time high. This food inflation is served in Pakistan's net import bill of food. With food prices up by 25%, majorly due to increase in price of Palm oil, would clock food import bill at US$10.58/8.5bn for FY22/23.

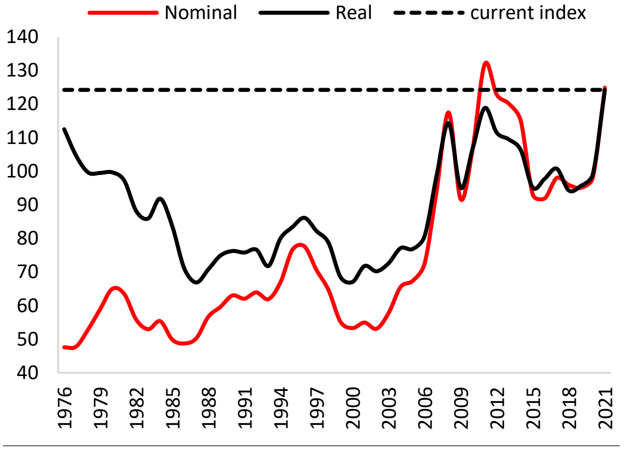
The global mismatch of supply and demand has eaten up food segment, which has caused spiral effect of escalation of prices in real terms. As per FAO food price index, the prices are at 50 year high of 124.2 increasing by 25% YoY. The price index is mainly driven from surging edible oil prices which surged by 40% in 2021. Palm oil is a main constituent of vegetable oil basket, which caused the prices to escalate due to supply constraints. Supply constraints for supply chain persists due to shortage of labor in Malaysia because of their COVID related travel restrictions.

Domestic food imports to decline

Due to (1) recent procurement of wheat and sugar this season, and (2) and increased prices of palm oil, Pakistan's import bill is expected to pile up to all time high. Palm oil constituents 38% of total domestic food imports, which has increased by 6ppt of total food imports due to price increase, however quantity imported has been stagnant at 8.7k ton/d, due to which total food imports have increased by 33% YoY in 5MFY22. Going forward, as food prices remain on higher side in near term, we expect food import bill to clock in at US$10.6bn in FY22 and, as prices tame down next year, US$8.5bn in FY23.

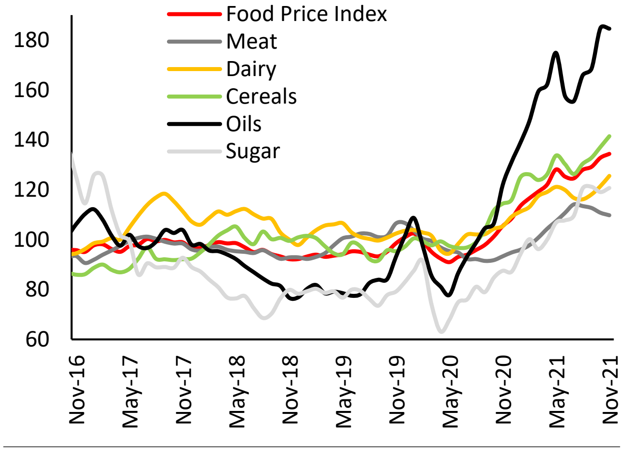
Furthermore, the prevailing high headline inflation is due to increase in food prices, which has caused domino's effect in overall economy. As palm oil prices would normalize, it would lubricate the inflation down stream which would break the spiraling hike of the demand-supply imbalance.

Fig 63: Food prices up in real terms



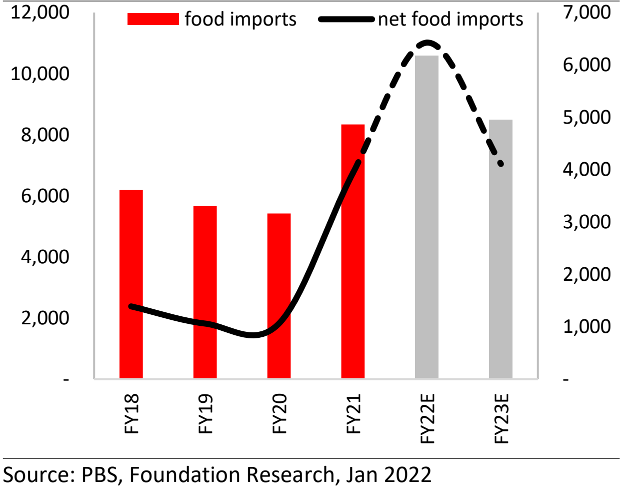
Source: FAO, Foundation Research, Jan 2022

Fig 64: ...due to high edible oil prices



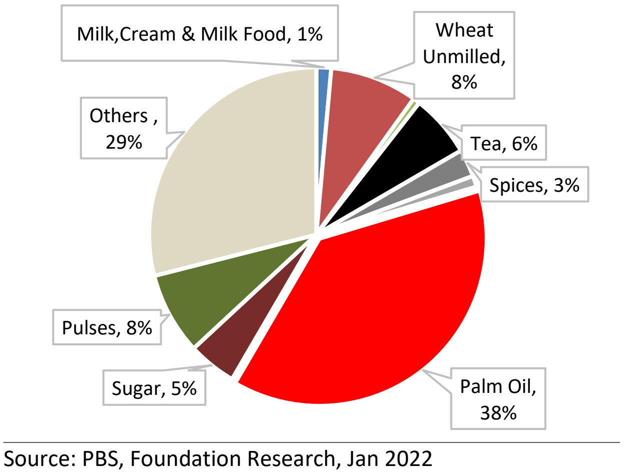
Source: FAO, Foundation Research, Jan 2022

Fig 65: Food imports to come down as prices tame



Source: PBS, Foundation Research, Jan 2022

Fig 66: Palm oil highest constituent of food imports



Source: PBS, Foundation Research, Jan 2022

Bridging supply constraints and excess demand for Steel

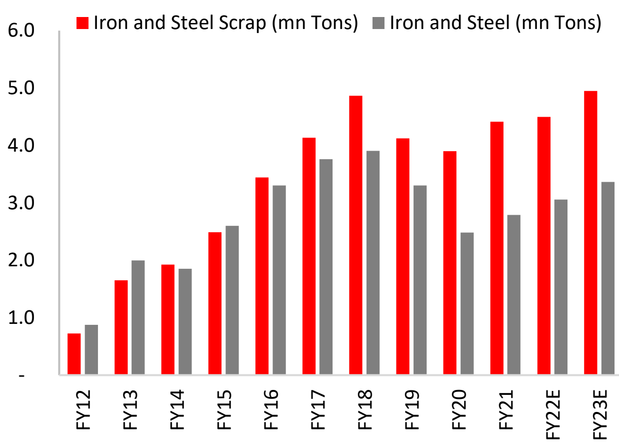
The resumption of global economic activity after easing COVID induced lockdown restrictions resulted in higher demand for steel. However production cuts due to lackluster activity in 2020 and lower inventory availability at ports couldn't rebound its supply lines. Moreover China, being the largest producer of crude steel (45%) cut down its exports due to (1) high domestic demand, (2) increasing export tariffs on ferrochrome and high-purity pig iron to 40/20% and (3) cutting carbon emissions as steel sector accounts for 10-20% of carbon footprint, due to which demand for steel outpaced the supply. Inventories are at all-time low, as input prices (energy and iron ore) also rises making it marginally inefficient to raise supply.

Pakistan imports 85% of its Iron-steel scrap to satisfy the local demand of 5.0/1.3mn tons for rebar/flat steel. Even though demand for scrap increased by 9%, as construction activity remains steady in FY22, the uptick in prices increasing by 39% YoY, would drive up import bill for metal group. Furthermore, spread for scrap and finished products would decrease as supply side normalized. We expect the metal imports to clock in at US$6.5bn for FY22, and as prices would normalize, upbeat demand would keep imports at US$6.1bn for FY23.

Auto vehicle manufactures also shared the burden of high steel prices. As steel prices escalated effective (average) cost of completely knocked down (CKD) unit also increased. Auto manufactures have been able to pass on the cost to the consumers, however subsequent high prices have suppressed volumetric growth for the industry.

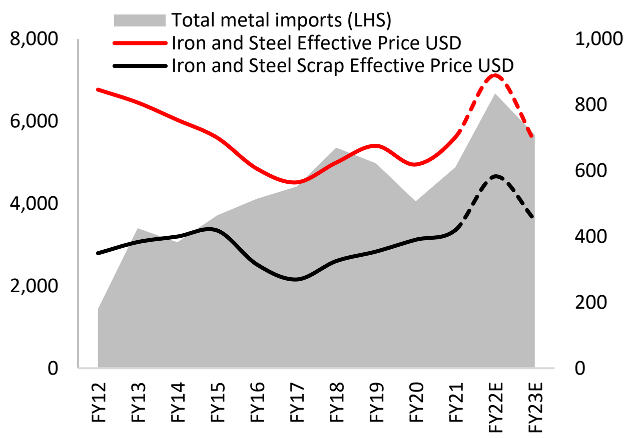
FSL estimates steel companies to pass on the impact of higher scrap prices in a timely manner due to pricing power in rebar market as market demand shifts ungraded to graded products. Rebar prices in domestic market increased by 68% since start of price increase cycle in Nov'20. To highlight, increase in pricing power of steel companies has also resulted in decline in operating cycle of the companies' hence lower working capital requirement.

Fig 67: Quantity to remain upbeat however…



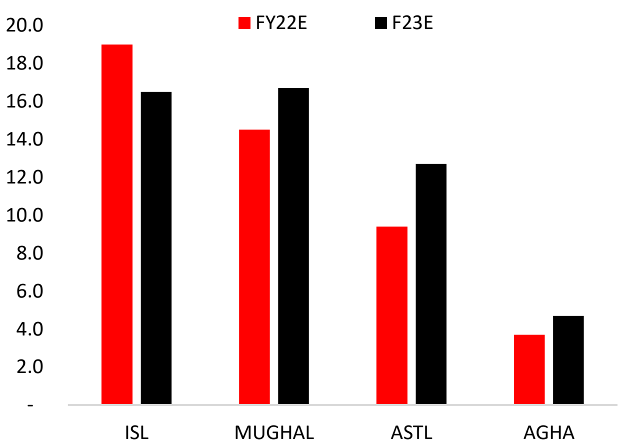
Source: PBS, Foundation Research, Jan 2022

Fig 68: …Total metal imports would come down



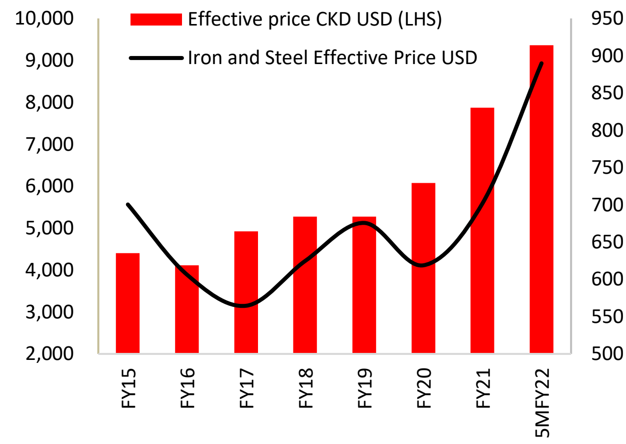
Source: PBS, Foundation Research, Jan 2022

Fig 69: EPS of FSL steel universe



Source: Company Accounts, FSL Research, Jan2022

Fig 70: Effective price of CKD vehicle moves with steel



Source: PBS, Foundation Research, Jan 2022

Industrial conducive government policies to promote localization and Exports

The increasing import bill has been a major concern for the macro economics. To counteract with the following concern, Gov't has deviced various policies that would promote localization. This would channel influx of investments and endorse industrialization. The policies are coherent with export facilitation and industrialization that would increase employment.

Textiles and Apparel Policy, 2020-25

Textile industry has been fundamental economic driver for local and export orientation as well. The industry is well verse with vertical and horizontal integration from agriculture of cotton to ginning, spinning, waving, knitting, processing, and finishing to Apparel and Home textile. In recent years, as multi fiber agreement was abolished due to agreement on textiles and clothing (ATC), Pakistan textile export growth was competitively lesser than the peers. Textile and Apparel Policy (2020-25) addresses these concerns and aims to boost value added exports. The policy's objective is to leveraging complete textile sector to value added products, increasing yield for cotton farmers, and to provide level playing field by prioritizing SMEs.

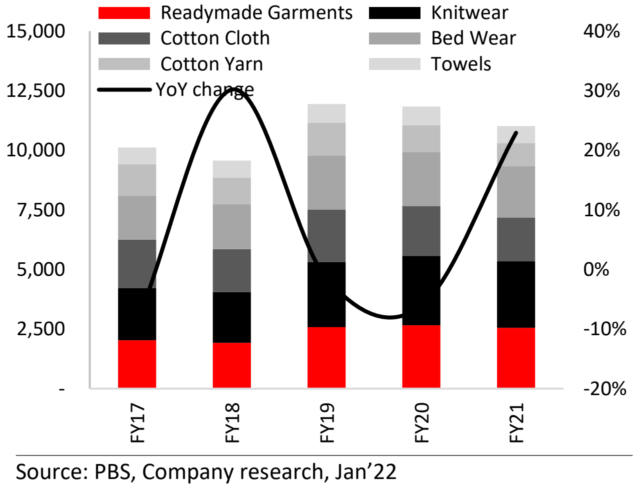
Currently textile exports for Pakistan accounts for US$7.8bn in 5MFY22, and US$15bn in FY21. The policy aims to target exports of US$20/25/31/40 in FY22/23/24/25, these export targets would be achieved given the relaxation measures given by the gov't. The policy also includes measures to achieve by the manufacturers that include (1) Technology upgradation by providing financing for machinery, (2) Infrastructure development by reducing cost of manufacturing and establishing new garment cities (3) developing SMEs and integration in global value chain. Moreover the policy aims to reduce cost of doing business by (1) providing level playing field with global competition, (2) ease of doing business by uninterrupted energy supply and DLTL.

The Incentives provided to textile industry by the textile and apparel policy (2020-25) would facilitate industry by:

- ✓ Uninterrupted supply of energy (electricity and gas/RLNG) to export-oriented units at regionally competitive rates. This would allow industry to procure electricity at 9c/kwh and RLNG at US$6.5/mmbtu.
- ✓ Establishing state of the art infrastructure, having electricity and steam generation system.
- ✓ Long term financing facility and Export financing rates to continue at 5/3% respectively. Financing would include branding and acquisition fund, and inclusion of spare parts, accessories, dyes and chemicals in LTFF schemes of SBP. This would further include SMEs, and other indirect exporters.
- ✓ Continuation of Duty drawback scheme (DLTL) for technical textile, apparel & made ups and duty-free import of machinery. Furthermore zero custom duty on import of spare parts.
- ✓ Establishment of Expo centers and new garment cities for SMEs having plug and play facility.
- ✓ Training and development of work force especially women to promote inclusion in the work form.

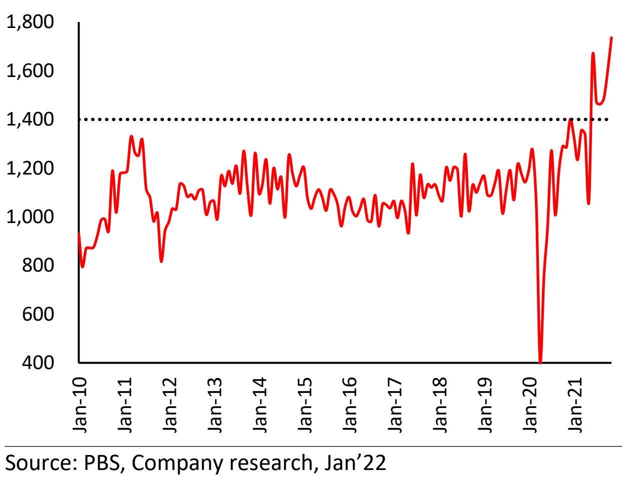
Biggest challenge remains to be addressed is improvement in farmer profitability by increasing yield by introducing seed technology and Product diversification by improvement in fiber mix and concentration that would improve competiveness.

Fig 71: Value added product mix increases



Source: PBS, Company research, Jan'22

Fig 72: Monthly textile exports (US$ mn)



Source: PBS, Company research, Jan'22

Mobile Device Manufacturing Policy

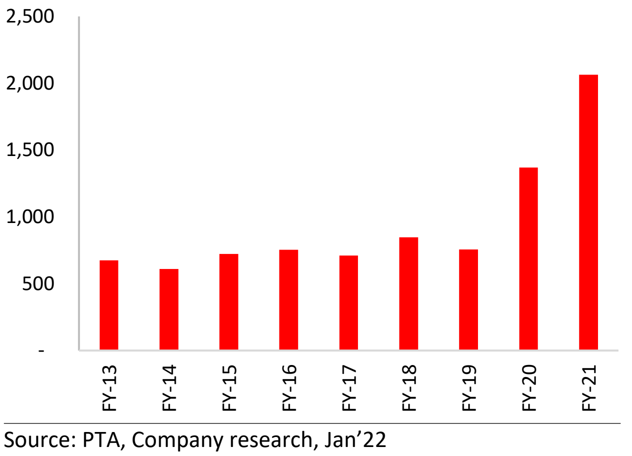
Pakistan currently have demand of around 36mn units per annum. This has translated into mobile phone imports of US$2.1bn in FY21. The rising trend of cellular is increasing and demand is channeled through Mobile Device Manufacturing Policy which envisions made in Pakistan strategy of gov't. The policy aims to provide tariff free environment for the mobile phone manufactures over the policy period. This is set to increase employment opportunities and nourish industry technical manpower leading to economic growth.

The implantation of Device Identification, registration and blocking system (DIRBS) by PTA has been instrumental in controlling smuggling of mobile phone devices in addition to providing safeguards against security hazards. This has allowed proper documentation, accountability and imports through legal channels. This was essential to address to gauge the rising adoption towards latest technology, as internet transforms from 2G/3G to 4G in couple of years. Internationally this practice have been proven to be fruitful as countries like Indonesia, India, and Bangladesh have not only adopted the technological transformation but also resulted in exports.

Under the policy, regulatory duty on completely knocked down (CKD) and semi knocked down (SKD) units have been removed. Furthermore, fixed income tax on CKD/SKD manufacturing (up to $350) have also been removed, however for US$350-500/500+ have been set to Rs2000/6,300. The policy also includes removal of sales tax on CKD and SKD manufacturing. To promote localization and export, research and development expense allowance have been set to 3% for exports and 4% exception on withholding tax on domestic sales.

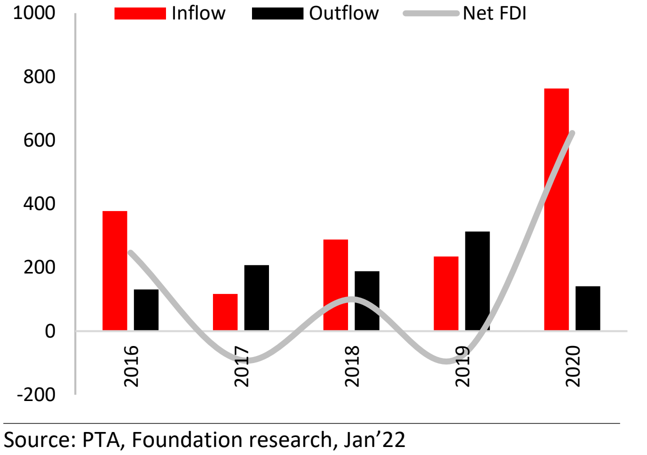
The recent major facilitation was capitalized by LUCK, by setting up a manufacturing-cum-assembly plant for import of CKD of Samsung which had become operational. Other flagship manufactures that have started their local production include Oppo and Vivo.

Fig 73: Total mobile imports



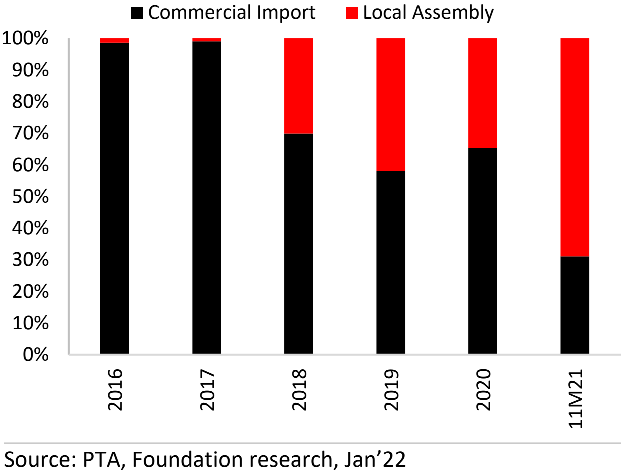
Source: PTA, Company research, Jan'22

Fig 74: Net FDI in telecom (US$ mn)



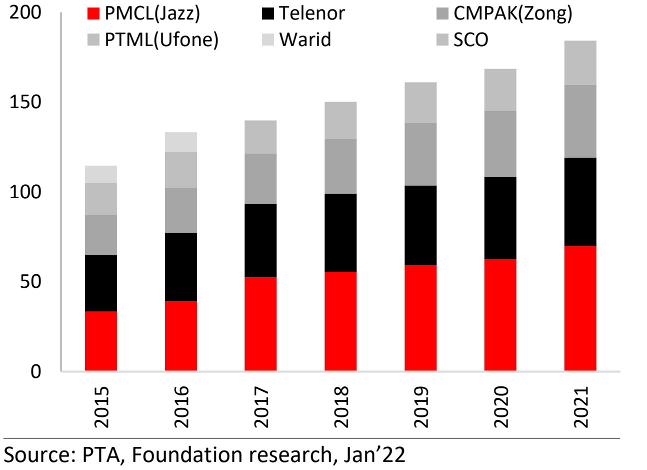
Source: PTA, Foundation research, Jan'22

Fig 75: local manufacturing surpasses imports



Source: PTA, Foundation research, Jan'22

Fig 76: total subscribers increasing constantly



Source: PTA, Foundation research, Jan'22

Government Policies to gear up Automotive

Post Auto development Policy (2016-21), which allowed new entrants to minimize the three decades old oligopoly by allowing new entrants to enter the market and stablish their manufacturing plant tariff free. Existing player have been offering limited number of vehicles and capitalizing the market with their oligopoly. Industry dynamics transformed for good, as new player entered into the market increasing the number of product offering and reviving the competition of the industry. ADP (2016-21) attracted Greenfield projects and attracted ~USD1bn within the duration of the policy.

Table 11: New Makes under ADP 2016-21

Company	Product Line	Investments (USD mn)
Kia Lucky Motors Pakistan, Karachi	LCVs and SUVs	190.0
Hyundai Nishat Motor, Faisalabad	LCVs and SUVs	163.0
Foton JW Auto Park, Lahore	LCVs, HCVs, and SUVs	150.0
Master Motors, Karachi	SUVs, HCVs, Jeeps	101.0
Sazgar Engineering Works, Lahore	PCs, SUVs, and Jeeps	40.0
United Motors, Lahore	800cc/1000cc LCVs	19.5
Regal Automobile Industries, Lahore	LCVs, Vans, and SUVs	10.7

Source: EDB, Foundation research, January 2022

Automotive Industry Development and Export Plan (AIDEP 2021-26)

Now the Auto development and Export Plan is under way which would be focused on increasing localization and enhancing product quality to create competitive manufacturing for local and export market. The policy includes target exports for automobile manufacturers especially 2/3 wheelers, which would allow to earn valuable foreign exchange and provide utility to trade bill. Pakistan has currently imported USD1.9bn worth of transport in 5MFY21.

- ✓ AIDEP promotes affordability for consumers by abolishing FED and reducing sales tax to 12.5% on vehicles up to 850cc and 1000cc, to highlight this segment remains uncontended and only vehicle offering is by PSMC (Suzuki Alto). Moreover custom duty would also be reduced to 15/30% for localized/non-localized parts.
- ✓ Moreover for consumer protection, the policy addresses the issue of 'on-money' given that the person would bear tax amounting to 50/100/200k depending on the engine capacity of the vehicle, if the booking is made by person A and registration is made in name of person B. Furthermore, the compulsory payment of KIBOR+3% interest by manufacturers on delivery beyond 60 days on initial deposited amount.
- ✓ New product policy also covers Agricultural tractors, motorcycles, and auto rickshaws. For Agricultural tractors, new models as certified by EDB would allow manufacturers tax advantage of 20% on localized parts, as custom duty would be reduced to 15%, for three years. Similarly for motorcycles exceeding 125cc and auto rickshaw exceeding 200cc, custom duty would be reduced to 30/15% on localized/non-localized parts.
- ✓ For reducing carbon footprint and oil import by transport, gov't has allowed incentives for EV/Hybrid manufacturing as well. Gov't has set custom duty of 1% on specific parts for electric vehicle and reduction of sales tax on locally manufactured EV (below 50kWH) to 1% from 17%. Consumers can also import EV CBU at 10% CD for one year instead of 25%. Similarly for HEV, custom duty for import of specific parts have been set to 4% and sales tax reduced to 8.5%. To note, INDU has decided to benefit from this incentive and have disclosed plans to invest US$100mn for establishing first locally manufactured HEV. The policy also aims to include duty free import of plant and machinery for setting up EV manufacturing.
- ✓ AIDEP also fixes target exports for OEM manufacturers that is to aim for 10% export as a % of imports by FY26. This would be achieved by stepping by exports by 2/4/7% in FY23/24/25.
- ✓ Formulation of Auto sector monitoring committee and auto industry development and export committee to ensure consumer concerns about late deliveries, On-money and WP-29 safety regulations, and minimum initial payment not exceeding 20% of the final price.

The following policies would encourage local manufacturers to increase localization which would make them less receptive to the adverse changes in exchange rate. Increasing localization would promote local OEM industry and encourage R&D to create more competitive market dynamics. Furthermore consumer protection incentives would keep market forces in check to trim dominance from supplier. Furthermore the interim budget is expected to increase excise duty on CBU imports, because of their no utility in the industry.

Strategic Trade Policy Framework (STPF) 2020-25

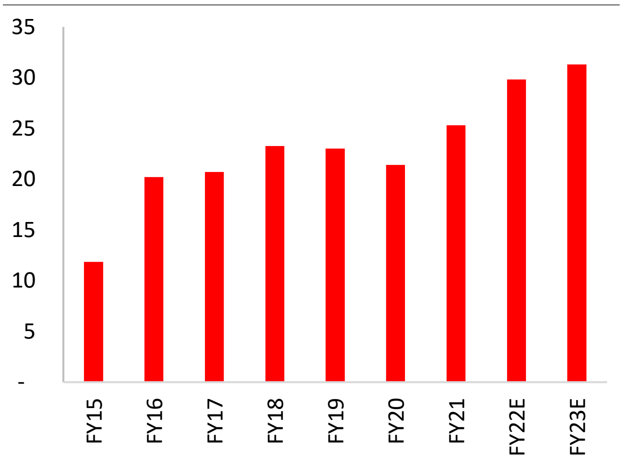
To address the long term sustainability growth of exports, STPF has been essential to address the export orientated industries. Policy aims to provide competitive environment to provide trade facilitation and export enhancement by increasing its competitiveness of Pakistan's exports to the global account. It further focuses on product diversification, cost reduction through tariff rationalization and pursuit of regional connectivity.

Previous trade policy failed to address the supply constraints due to weak thrust and structural reforms, with limited implantation and weak monitoring and evaluation mechanism. Another major reason for continuous decline and stagnation of exports was the unrealistic exchange rate. Non-implementation of policy initiatives included inadequate disbursement of funds, out of Rs20bn only Rs1bn was disbursed. Furthermore policy was also disconnected with global production and value chains and lacked comprehension of Pakistan's exports into global dynamics. Furthermore Pakistan's export for FY21 clocked in at US$25bn, which was an increase of 18% YoY, this was translated to 5Y-CAGR of 5%.

STPF (2020-25) targets export of US$57bn by FY25, with FY22/23/24 exports to reach US$31/38/46bn respectively. The target is aim to achieved by expanding into opportunities that have high demand vacuum and larger return, over and above the sector oriented policies to increase exports such as automobile, textile, food processing and services. To ensure the implementation of the policy, The Ministry of Commerce will serve as a secretariat of the National Export Development Board (NEDB) and at least bimonthly meetings of the Board will be held, to ensure alignment and progress of the policy. The framework includes:

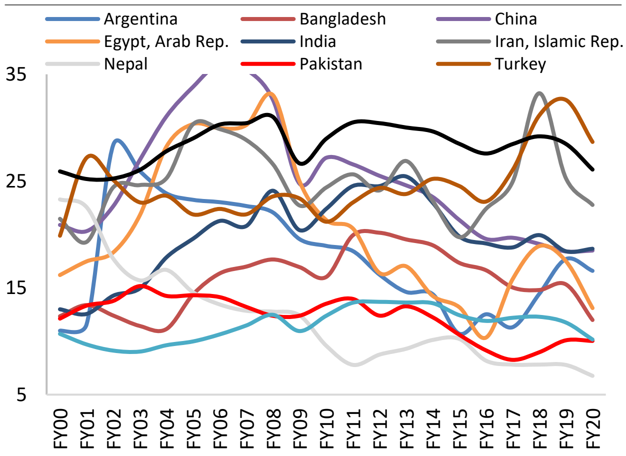
- ✓ Competiveness enhancement: ● Reduction in cost of doing business ● Tariff rationalization ● Productivity enhancement
- ✓ Trade related investment: ● Transformation of Production base ● technology up-gradation ● removal of bottlenecks
- ✓ Integration into Value chain: ● Enhanced Market Access ● Export Diversification ● Innovation Driven Exports
- ✓ Export Ecosystem: ● Trade Facilitation ● Economic Infrastructure Development ● Transshipment/Economic Corridor

Fig 77: Total Exports yearly



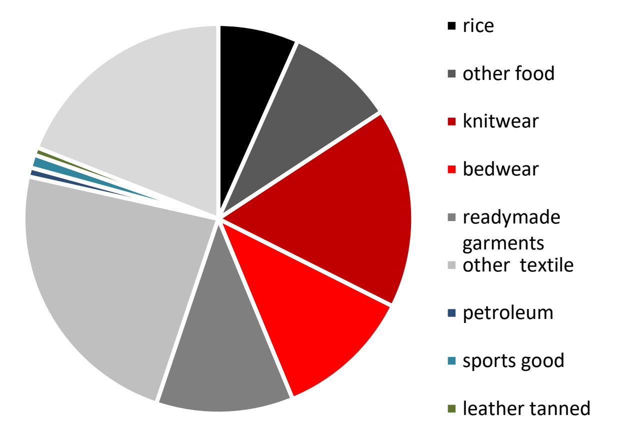
Source: PBS, Company research, Jan'22

Fig 78: Exports as a % of GDP: Pakistan in lower region



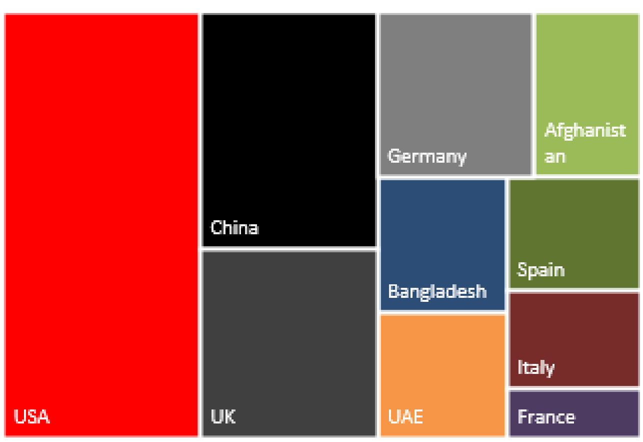
Source: WB, Foundation research, Jan'22

Fig 79: Exports by Commodity



Source: PBS, Company research, Jan'22

Fig 80: Exports by country



Source: PBS, Foundation research, Jan'22

CPEC – Development activity on Phase II starts picking up

The geographical advantage of Pakistan, unlocking gateway to landlocked regions has been key advantage to the neighbors. CPEC transforming this mythical fact into reality, has proven to be strategically advantageous to attract investments to develop infrastructure. This would attract US$25.4bn under 46 different projects which are under construction and completed. CPEC, being the pioneer project of belt-and-road initiative, is in full gear encompassing (1) infrastructure projects, (2) Gwadar development, and (3) Energy projects. CPEC Phase 2 has successfully resumed after COVID and back on track to fulfil the upgradation of ML-1 and development of SEZs.

Transport Infrastructure Projects under CPEC

Road connectivity and infrastructure development has been essential to the network laid out by CPEC. The ML-1, route from Peshawar to Karachi, has been accelerated as upgradation regarding doubling the track, increase line capacity and increase share of domestic freight is underway. Multan-Sukkur highway (M-15) has been completed and opened for traffic, similarly Hazara Motorway and Western alignment has been completed. M-15 and M-5 were financed with

US$4.2 with China State Construction Engineering Corporation. Meanwhile in progress projects that include Khuzdar-Basima (N-30) would be financed through PSDP with estimated cost of Rs19bn.

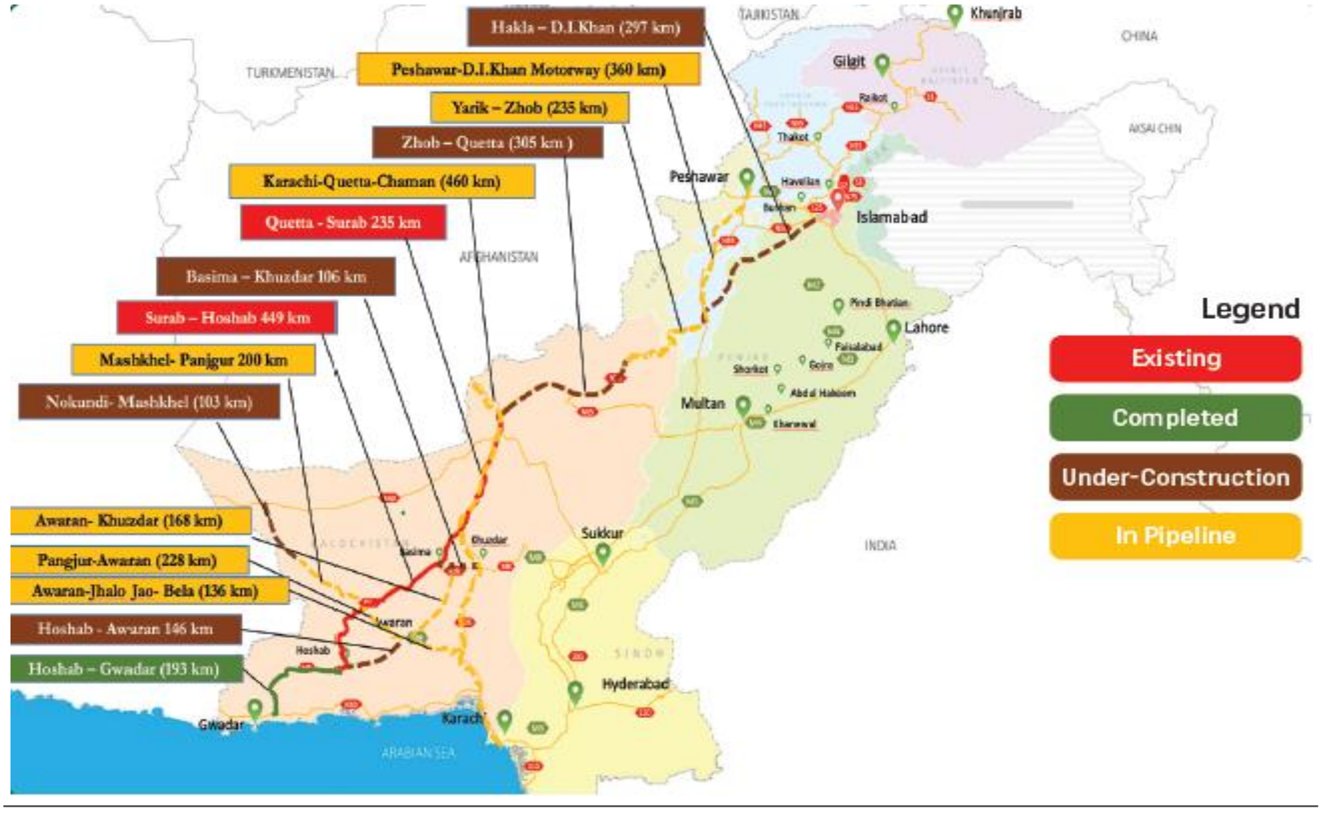
Other projects are also in pipeline which include 1,733km track for upgradation and dualization of and establishment of Dry Port near Havelian.

Table 12: Infrastructure projects

	Length (km)	Progress	Financing (US$ mn)
Hazara Motorway (Havelian-Thakot) M-15	120	✓	1,315
Motorway (Multan-Sukkur) M-5	392	✓	2,889
Western Alignment (Hakla-D.I.Khan) M-14	297	✓	Rs122bn *(PSDP)*
National highway (Khuzdar-Basima) N-30	110	74%	Rs19.9bn *(PSDP)*
Eastway Expressway N-10	19	94%	Interest free loan

Source: CPEC, Foundation research, Jan 2022

Fig 81: Transport infrastructure for CPEC



Source: Senate, Foundation Research, January 2022

Special Economic Zones under CPEC

The road map would be a route to connectivity with industrialization along the way. Gov't is heads on to provide incentives to set up special economic zones enticing investment packages. The country's improving metrics and China's stance towards CPEC would soon enable an industrial revolution in which SEZs would play a critical role. SEZs magnets international investors by offering attractive incentives for investments including 10 year tax holiday, zero import duty on plant and machinery and facility of 100% profit repatriation. A total of 9 SEZs have been planned under CPEC with major progress made in (1) Rashakai Special Economic Zone and (2) Dhabeji Special Economic Zone.

Table 13: special economic zone development under CPEC

Economic Zone	area (acre)	location
Rashakai Special Economic Zone	1,000	Nowshera, Khyber Pakhtunkhwa(KP)
Dhabeji Special Economic Zone	1,530	Thatta, Sindh
Allama Iqbal Industrial City	3,217	Faisalabad, Punjab
Bostan Special Economic Zone	1,000	District Pishin bordered with Quetta, Baluchistan

Source: CPEC, Foundation research, January 2022

Rashakai Special economic zone has started development work and one Chinese company (century steel) has started construction of steel factory. Similarly Zhangbang Agriculture, another Chinese company is establishing a unit to produce pesticide products, with an investment of US$ 8 million. Green crockery and warehouse is also setup the plant to produce crockery/sanitary products with an investment of US$12mn.

For, Allama Iqbal Industrial city, ~1,000 acres of plots have been assigned and few companies have started construction of factories. Many multinational companies have established their plant, availing incentives that SEZ offers. AkzoNobel, producer of paints and performance coating have entailed US$24mn investment in Allama Iqbal Industrial City, Faisalabad. Strong Stitch is also investing US$8.5mn to set up textile plant. Similarly, German company Alptak ltd have also entered into a joint venture to produce nitrile gloves with an investment of US$2mn.

Other SEZ projects that are in pipeline include ICT Model Industrial Zone, Industrial Park on Pakistan Steel Mill Land, Mirpur Industrial Zone, Mohmand Marble City, and Moqpondass Special Economic Zone, which are expected to attract further FDIs.

CPEC investments in Power:

The rising power demand from industries, and supply constraints have led to vacuum which has been addressed by the energy projects by CPEC. CPEC projects have added around 5'000 MW to the industry till now. Major investment included 1320MW Sahiwal Coal-fired Power Plant, 1320MW Coal-fired Power Plant at Port Qasim Karachi, and 1320MW China Hub Coal Power Project, Hub Baluchistan. In addition to the power plant, Matiari to Lahore ±660 KV HVDC Transmission Line Project has been completed.

Table 14: Under Construction Projects for Power

	MW	Progress
SSRL Thar Coal Block-I 7.8 mtpa & Power Plant (2×660MW) (Shanghai Electric)	1320	75%
HUBCO Thar Coal Power Project (Thar Energy)	330	73%
HUBCO Thal Nova Thar Coal Power Project	330	51%
Suki Kinari Hydropower Project, KP	884	70%
Karot Hydropower Project, AJK/Punjab	720	94%
Coal-Fired Power Project at Gwadar	300	3%

source: CPEC, Foundation research, Jan'21

Social and Economic Development under CPEC

CPEC project is also investing in development of socio-economic. So far the project has indulged in Poverty alleviation training, vocational and technical education capacity build-up project and Vaccine storage and transportation equipment facility. Currently the program encompasses Under Construction Projects which include Provision of Agricultural equipment and tools, Maintenance and renovation for 50 schools in newly merged districts, Gwadar hospital project, and Drinking water equipment. These projects are expected to raise standard of living and provide rise in income level to satisfy improving infrastructure.

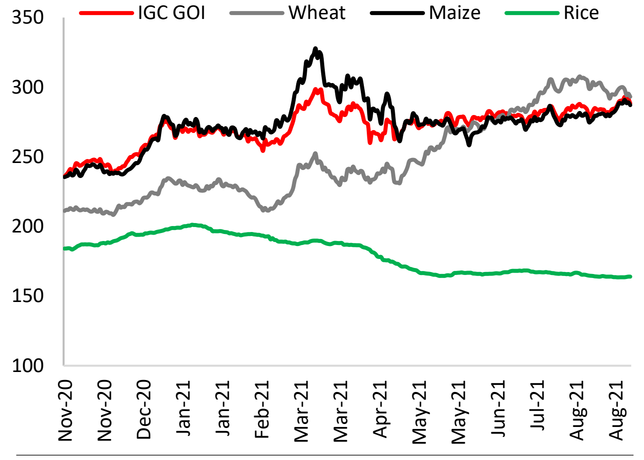
Agriculture output: key to achieve GDP growth target and control inflation

Global Food Outlook

According to the FAO, global food prices surged in Nov'21 to a 10-year high level. In Nov'21, the Food and Agriculture Organization's (FAO) food price index, which monitors international prices of the most widely traded food commodities, averaged 134.4 points, up from a 132.8 points in Oct'21. International wheat prices rose for the sixth month in a row in November, owing to robust demand and tighter supplies, particularly of higher quality wheat. In Nov'21, international maize prices rose as well, with the value of the benchmark US corn rising roughly 5% supported by strong import demand. In the next five years, global rice production is expected to increase. Gains will be mostly due to higher yields as well as potential for area growth in the major rice producing countries. Gains will be primarily due to higher yields, as area growth in Asia's major rice-producing regions appears to be limited. In Nov'21, the FAO All Rice Price Index (2014-2016=100) averaged 99.9 points, unchanged from October and 8% lower than a year before. Indica rice trading activity in Asian markets was slow in November, due to inconsistent demand and the persisting effects of high freight costs.

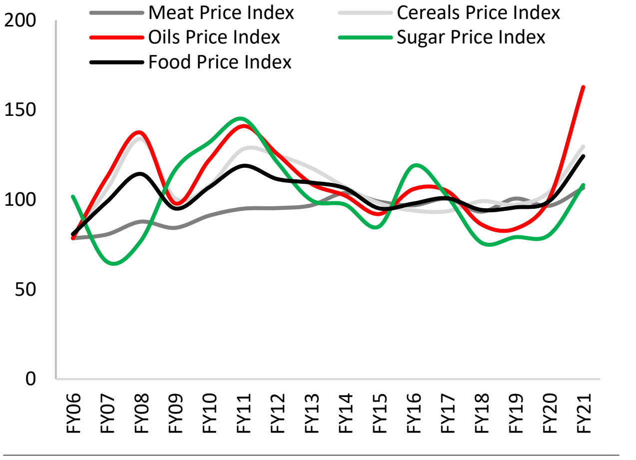
The recent increase in agricultural input prices has stirred up more concern about growing food production costs, which, in a free market economy, are typically passed on to the consumer through higher food prices. As per the report of Famine Early Warning System (FEWS) Network of the US States department, there are several notable concerns for global staple food markets in the near future. Agricultural commodities and fertilizer trade may be hampered by shipping container shortages and port delays. Fuel, fertilizer, and freight expenses have all increased since early 2020, putting upward pressure on agricultural production and transportation costs. Rice production is expected to rise, continuing to exceed consumption and prices are likely to stay below those of 2020. In FY22, maize and wheat production are expected to improve, while ending stocks are expected to be lower than average and prices are likely to continue above those of 2020.

Fig 82: IGC Index (GOI) & Sub-Indices (base-2000 = 100)



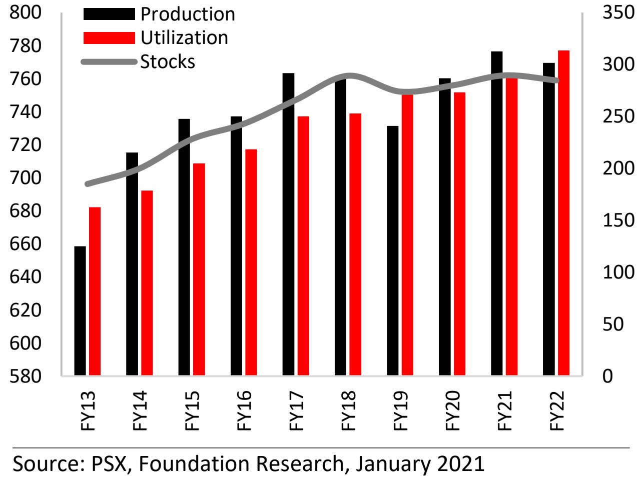
Source: IGC, Foundation Research, Jan 2022

Fig 83: UN FAO Food Price Index (base 2014-16=100)



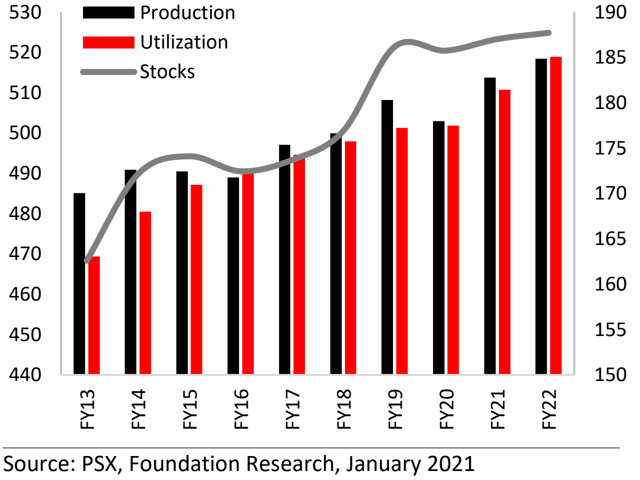
Source: UN FAO, Foundation Research, Jan 2022

Fig 84: Global Wheat Market (mn tonne)



Source: PSX, Foundation Research, January 2021

Fig 85: Global Rice Market (mn tonne)



Source: PSX, Foundation Research, January 2021

Agriculture and Pakistan: What to Know/Know-How

Agriculture is one of the largest sector of Pakistan's economy contributing 24% to GDP and employs ~50% of the labour force. Sector also plays its role in addressing Pakistan FX issue and generates US$4.4bn direct exports, imports substitution and indirect exports through provision of basic raw material (cotton) to the Textile sector which is Pakistan's largest manufacturer and exporter.

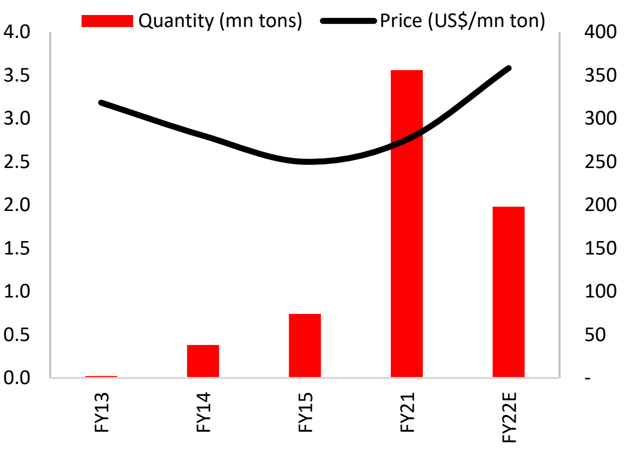
Pakistan has two cropping seasons, "Kharif" being the first sowing season starting from April-June and harvested during October-December while "Rabi", the second season, lasts from October to December. In Kharif season, rice, sugarcane, cotton, maize, pulses, bajra and jowar are planted while wheat, tobacco, rapseed, barley and mustard are largely planted In Rabi.

Important crops of Pakistan

1) **Wheat:** Wheat is a 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% percent of GDP. Wheat crop production reached to all-time high of 27.3mn tons in FY21 (up by 8.1% YoY) as compared to 25.2mn tons in FY20. This was mostly owing to an expansion in farmed land, as well as a shift in policy decisions to boost the wheat crop.

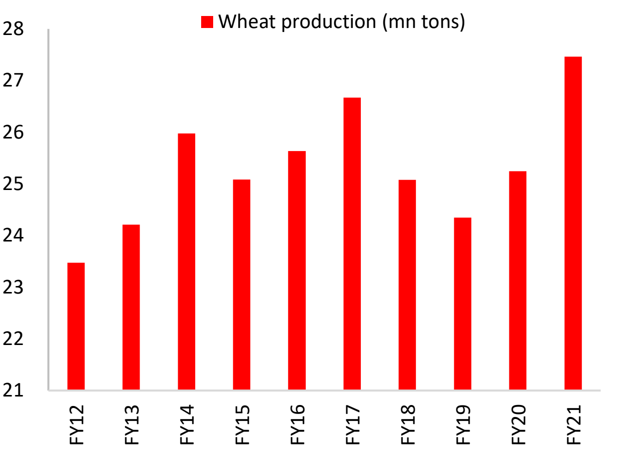
   Furthermore, Gov't has increased wheat support prices from Rs1,800/kg to Rs1,950/kg (up 8.3% YoY) for ongoing rabi season. Increase in support prices will help farmers earn more money to compensate higher input cost of fertilizer/pesticides and other increase in cost due to inflation. The global wheat market is anticipated to tighten further in FY22 as growth in production fails to balance growth in demand. To highlight, Gov't has set wheat sowing target of 30mn tons (9.9% YoY growth) for FY22 and import of additional 3mn tons during FY22 to build the strategic reserves. However due to constraint supply of key fertilizer (Urea/DAP) required for wheat sowing given higher prices, Gov't is unlikely to meet its wheat target for FY22, 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 Urea will result in higher food inflation and pressure on Fx reserves in 2HCY22.

Fig 86: Wheat Imports decline due to escalating prices



Source: PBS, Foundation Research, January 2022

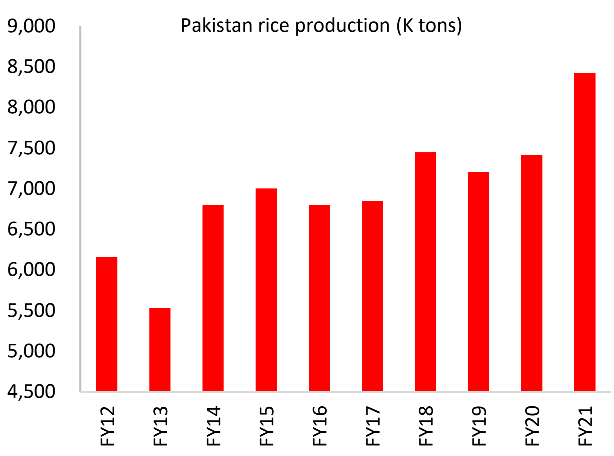
Fig 87: Wheat Production Surges as prices/yield increases



Source: MOF, Foundation Research, January 2022

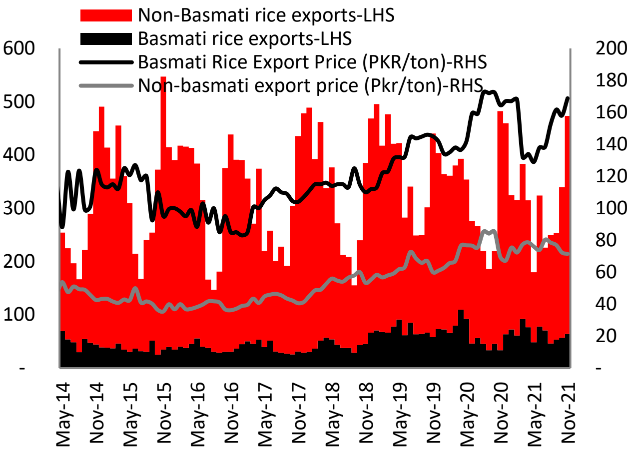
2) **Rice:** Pakistan is the world 11th largest producer of rice and generates ~US$2.0bn through its export. Pakistan's exports make up 8% of world's total rice trade. It contributes 3.5% of value added to agricultural sector and 0.7% to GDP. In FY21 Rice harvest of Pakistan made a record of 8.4mn tons as compared to 7.4mn tons FY20 (up by 13.6%). This increase can be accredited to rise in unit prices that attracted farmer's interest 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 FY21 at 3.3mnha rice crop was cultivated as compared to 3.0mnha in FY20 (up by 9.9%).

Fig 88: Pakistan rice production on continuous growth



Source: MOF, Foundation Research, January 2022

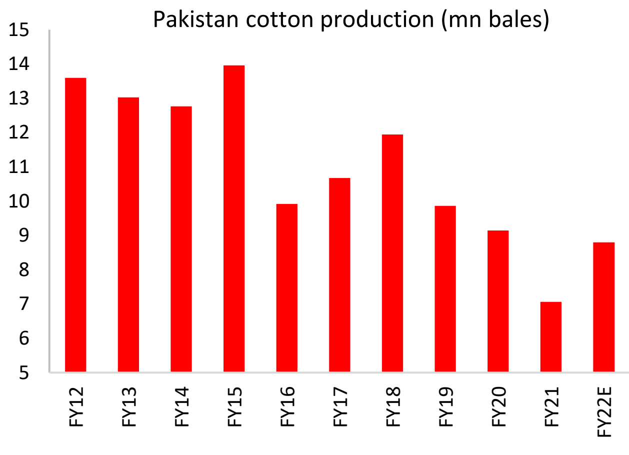
Fig 89: Basmati rice exports price towards new high



Source: PBS, Foundation Research, January 2022

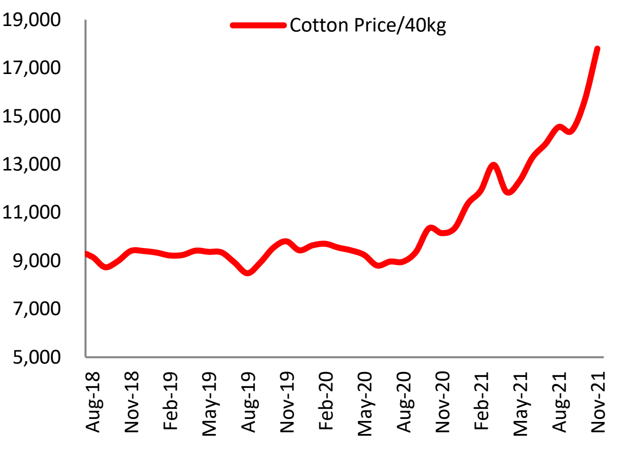
3) **Cotton:** With 0.6% contribution in GDP and 3.1% weight in agricultural sector's total value addition, cotton maintains important position among cash crops in Pakistan. Due to continuous Gov't efforts and ~30% YoY increase in domestic prices in May'21 tilted farmer's interest towards cotton again after continuous decline in production from last three years. Furthermore, in FY22 cotton production is estimated to increase by 25% YoY due to better yields and farmer's interest is expected to remain in cotton prices for a while as domestic prices increased by 56% in CY21 amid increasing textile exports. Cotton production in Pakistan was on continuous declining trend due to loss of its competitiveness in contrast to other crops in terms of profitability as acreage of cotton crop is shrinking due to non-profitability of the crop as matched to sugarcane, paddy and maize. Other factors contributing to the decline are, heat stresses and extreme rainfalls poor agricultural practices, abiotic stresses like climate change and excessive use of pesticides. Another area of concern is high input costs associated with fertilizer, pesticides and freight. To highlight, Pakistan will save US$1.5bn of Fx reserves in FY22 due to increased domestic cotton production.

Fig 90: Pakistan cotton production increase after FY18….



Source: MOF, Foundation Research, January 2022

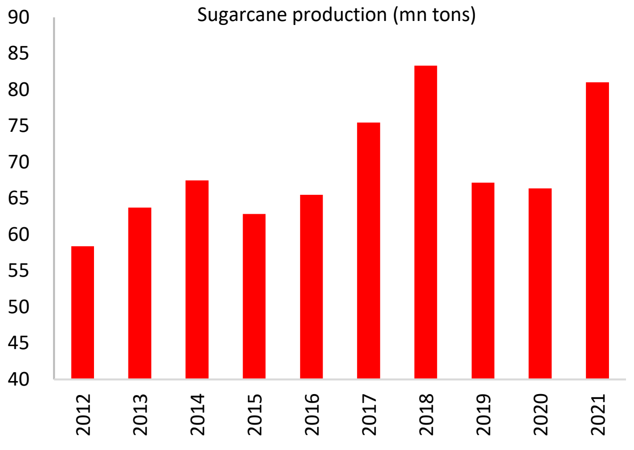
Fig 91: …domestic cotton prices also toward historic high



Source: PCCA, Foundation Research, January 2022

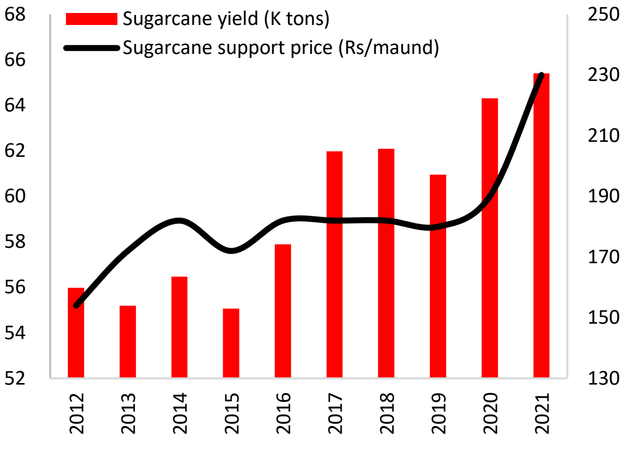
4) **Sugarcane:** With its end use in every household sugarcane is a high-value cash crop of Pakistan, and is also the second largest employer of labour in agriculture sector directly in fields and work force in manufacturing sector like sugar mills and FMCGs. Its output accounts for 3.4% of the value added in agriculture and 0.7 % of GDP. Furthermore, sugarcane crop's area under cultivation and yield both increased with time due to R&D in seeds by sugar mills and lucrative prices amid timely payments due to increase in prices of refined sugar. However, better weather conditions, improved management, timely availability of high-quality inputs, and increased economic rewards also provided support to the sector growth.

Fig 92: Pakistan sugarcane production jumps …



Source: MOF, Foundation Research, January 2022

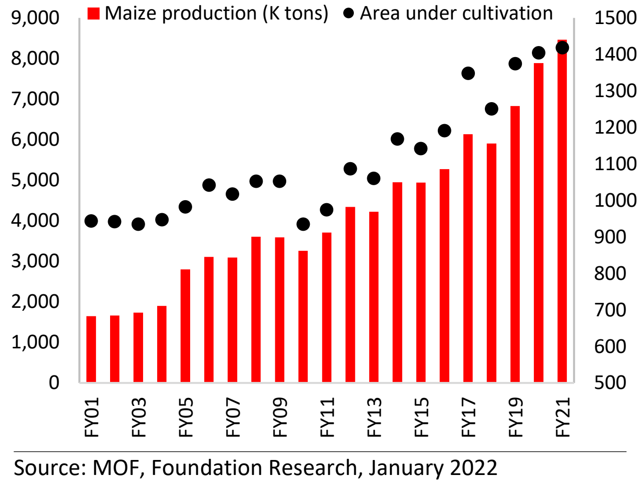
Fig 93: …due to deficit of refined sugar and higher prices



Source: PBS, Foundation Research, January 2022

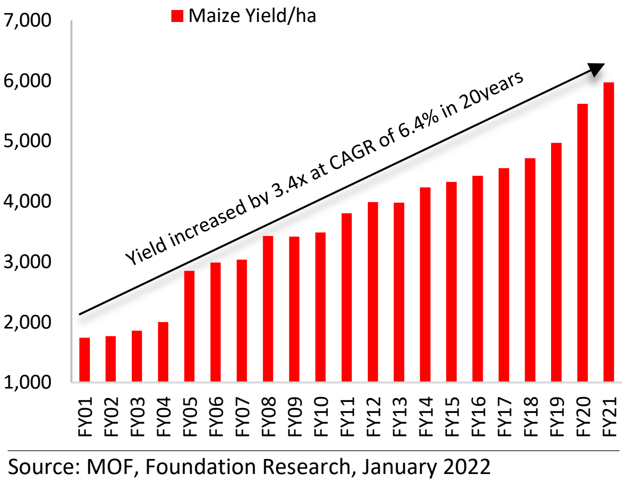
5) **Maize:** This is the third most important cereal crop of Pakistan after Wheat and Rice. Maize adds 3.4% to agricultural value added and 0.6% to GDP. Maize is a multifunctional crop that can be used for food, feed, and fodder. While human consumption is decreasing, its use in the feed and wet milling industries is rapidly increasing. Furthermore, Maize production in Pakistan is remain in continuous growth due to its prime use in poultry/animal feed and better yields. To highlight, rising cost of fertilizer's and higher freight costs is major concern for this sector.

Fig 94: Growth in Maize production is higher than area…



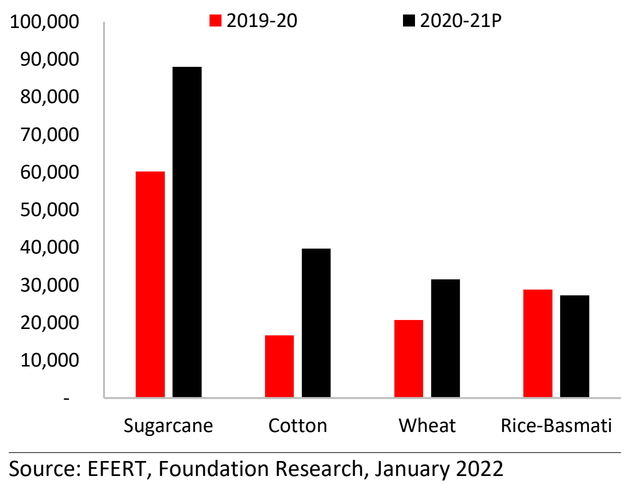
Source: MOF, Foundation Research, January 2022

Fig 95: …due to better yields given usage of hybrid seeds



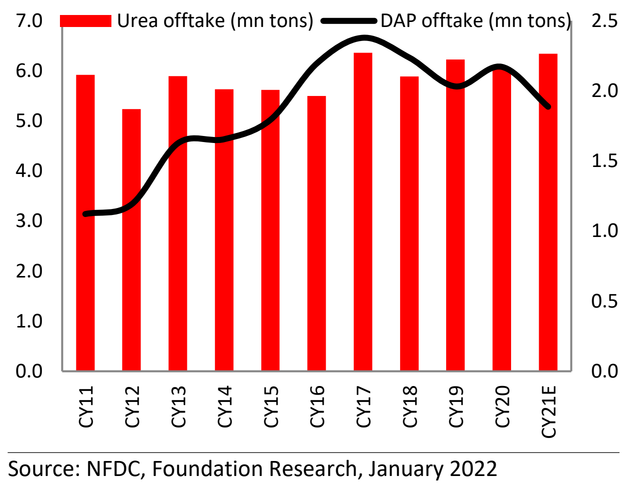
Source: MOF, Foundation Research, January 2022

Fig 96: Farmers income increase in major crops (Rs)



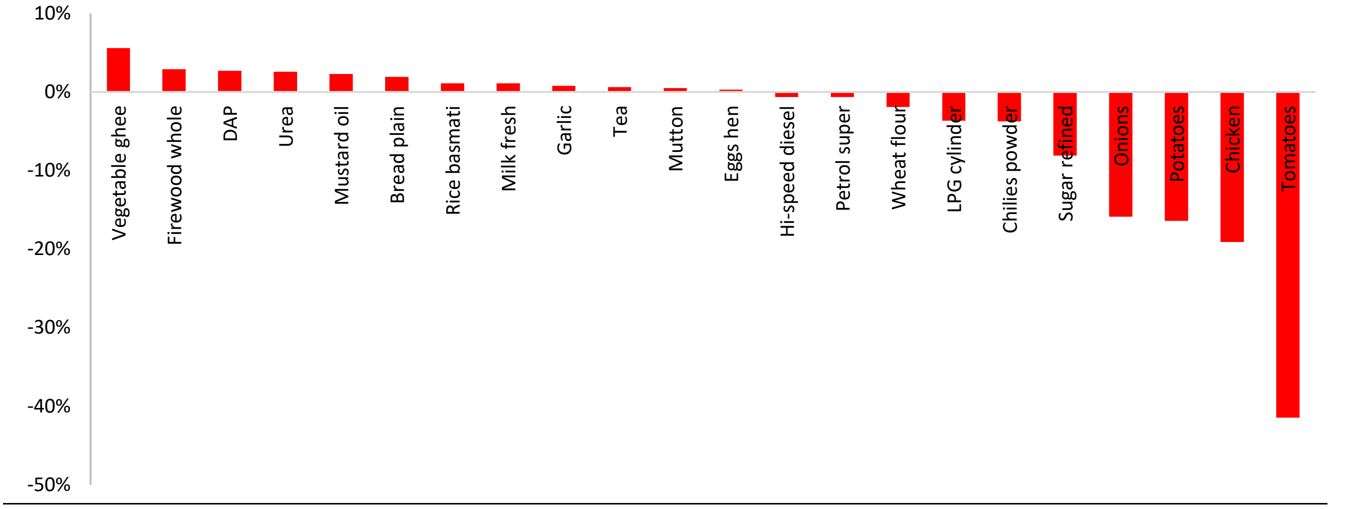
Source: EFERT, Foundation Research, January 2022

Fig 97: Highest ever Urea offtake to yield results in future



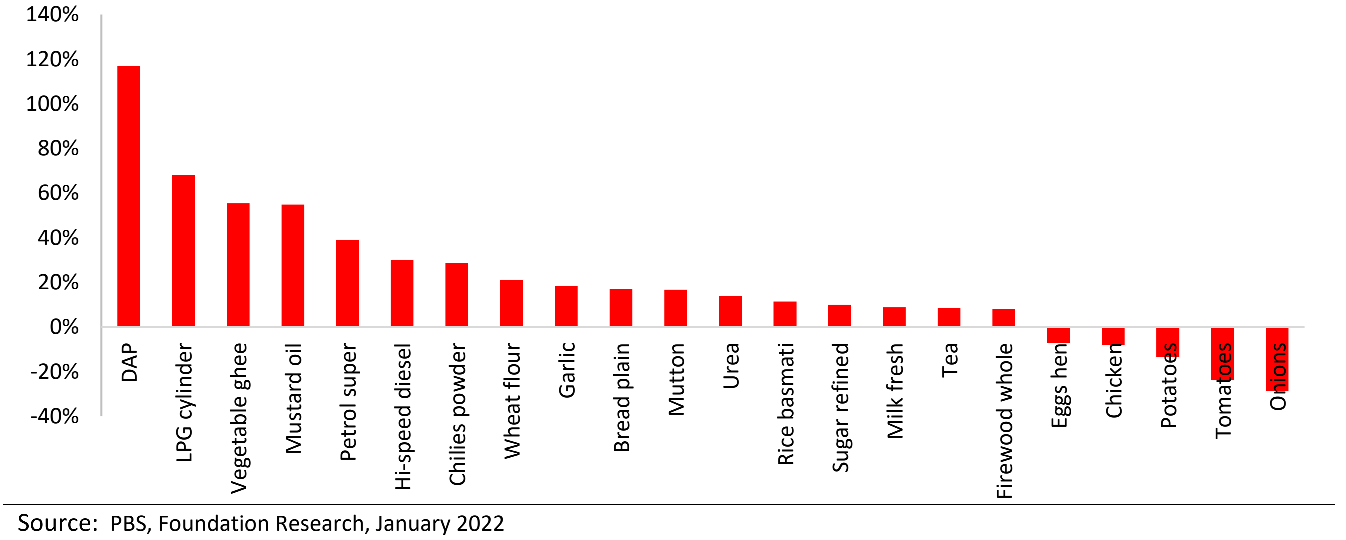
Source: NFDC, Foundation Research, January 2022

Fig 98: One month price change: Decline in vegetable prices negatively impacted farmers income



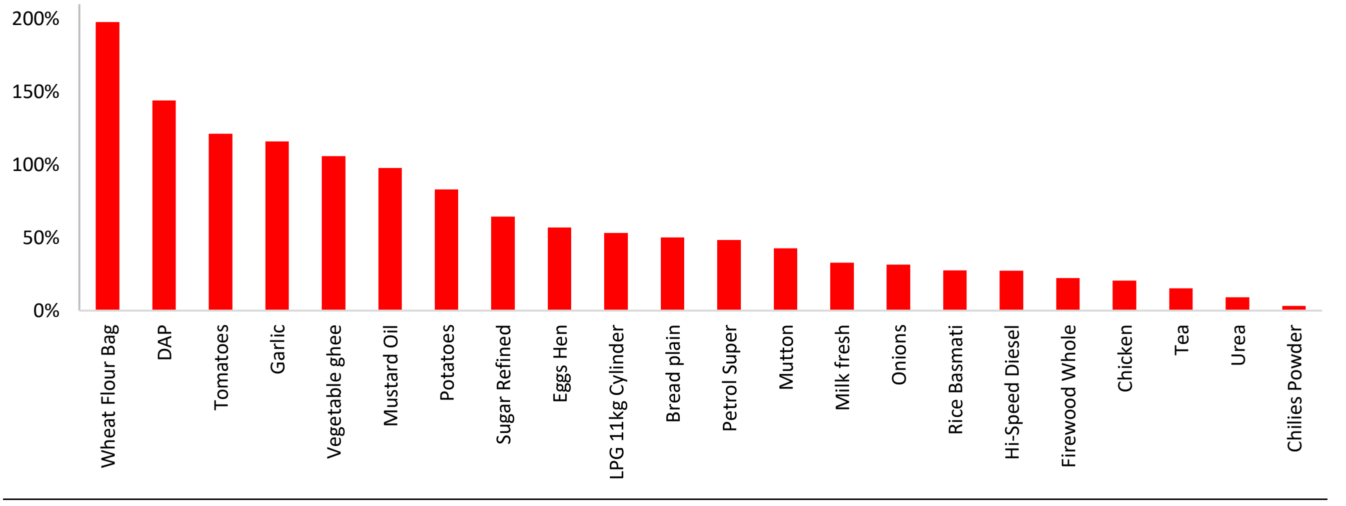
Source: PBS, Foundation Research, January 2022

Fig 99: One year price change: Impact of ↑ farmer input cost partially compensated by ↑ vegetable/crop prices



Source: PBS, Foundation Research, January 2022

Fig 100: Three year price change: Higher wheat, sugar and vegetable prices resulted in better farmers income



Source: PBS, Foundation Research, January 2022

Fig 101: Agriculture Sector of Pakistan

Pakistan's Agricultural Dilemma

Being an agrarian economy, Pakistan needs to revitalize this sector by addressing the major challenges of rising production costs, low quality produce, supply chain issues and low yield

11th Largest
Producer of Rice

22.04 Mn Hectares
Cultivated Area

38.5%
Labour Employed

19.2%
Contribution to GDP

2.77%
Real Growth rate

4.65%
Growth of Important Crops

1,005 Pkr bn
Export Earnings

1,332 Pkr bn
Food Import bill

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

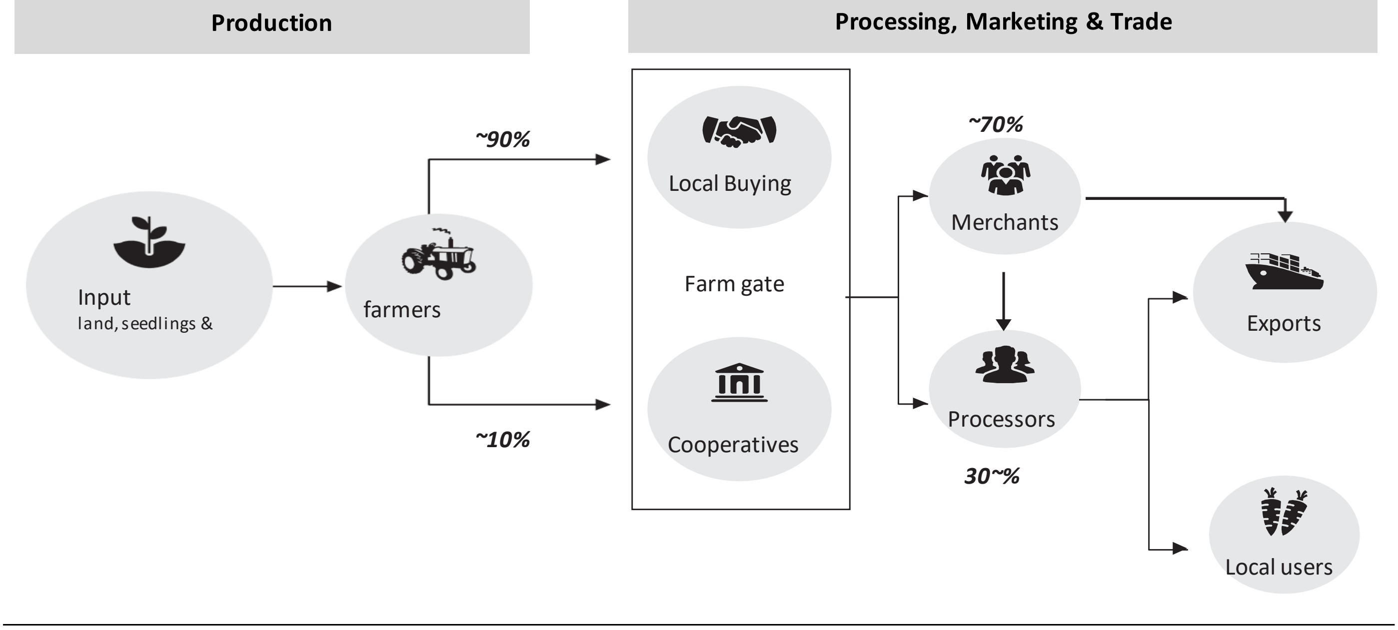
Sugar-cane	Wheat	Rice	Maize	Cotton
81,009	27,464	8,420	8,940	7,064

Top 5 Agriculture - Exports in (PKR bn)

Rice	Fruits, vegetables and nuts	Fish & Fish preparations	Meat & meat preparations	Spices
317	139	66	54	14

Top 5 Agriculture - Imports in (PKR bn)

Palm Oil	Wheat	Pulses	Tea	Spices
425	158	113	93	36



Source: MOF, MNSFR, Foundation research, January 2022

Capital Market developments to enhance Liquidity

PSX along with SECP and SBP has announced number of new platforms and systems to enrich capital markets with higher liquidity and further boost investor confidence.

SBP along with other regulatory bodies launched following new products:

- ✓ Successful launching of Roshan Digital Account (RDA)
- ✓ Launching (AMA) Assan Mobile Account to further ease account opening under branchless banking
- ✓ Exchange Traded Funds (ETF) to enhance liquidity in the market
- ✓ NCCPL initiated client onboarding through digitalized process

Roshan Digital Account (RDA)

Roshan Digital Account is a major initiative of State Bank of Pakistan, in collaboration with commercial banks operating in Pakistan. These accounts provide innovative banking solutions for millions of Non Resident Pakistanis (NRPs), including Non-Resident Pakistan Origin Card (POC) holders, and seeking to undertake banking, payment and investment activities in Pakistan. Some of the major benefits are listed below:

- ✓ Providing digital access to all conventional account services
- ✓ Enabling Non Resident Pakistanis to buy car through Roshan Apni Car
- ✓ Providing the facility to pay for charities via Roshan Samaaji Khidmat
- ✓ Investment in shares and units of funds in Pakistan Stock Market
- ✓ Investment in units of mutual funds
- ✓ Opening up investment opportunities in the Pakistani property market
- ✓ Enabling investment by non-resident Pakistanis in NPCs issued by the Government of Pakistan.

Table 15: RDA Inflows*

			Investments(USD million)		
	Accounts Opened	Funds received	NPC	Stock Exchange	Others
Sep-20	12,947	7	2	0	5
Oct-20	28,805	40	20	0	20
Nov-20	47,288	110	60	1	49
Dec-20	65,041	250	153	2	95
Jan-21	80,539	411	262	3	146
Feb-21	94,212	580	371	5	204
Mar-21	110,222	806	514	8	284
Apr-21	124,937	1,055	675	11	369
May-21	156,074	1,252	817	13	422
Jun-21	181,556	1,562	1,050	16	496
Jul-21	199,747	1,869	1,278	18	573
Aug-21	220,806	2,114	1,475	21	618
Sep-21	248,723	2,411	1,660	25	726
Oct-21	273,411	2,677	1,834	27	816
Nov-21	299,676	2,916	1,991	29	896
Dec-21	322,463	3,160	2,149	32	979

Source: PSX, Foundation Research, January 2022
*Numbers are on cumulative basis

Assan Mobile Account (AMA)

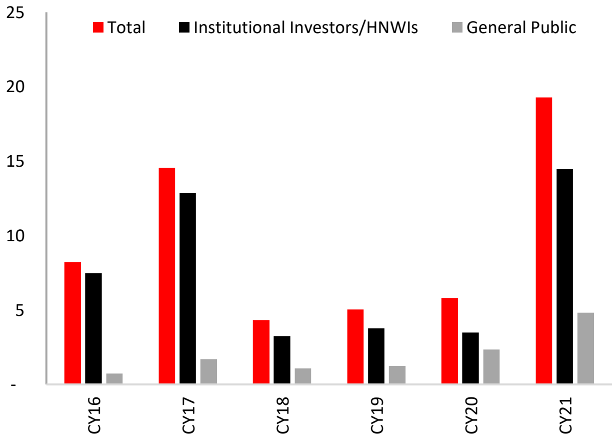
Asaan Mobile Account platform is a revolutionary initiative undertaken by branchless banking (BB) providers and telecom operators. The AMA platform has been launched under the National Financial Inclusion Strategy (NFIS) that aims to facilitate general masses, especially the low income segments, to digitally open their bank accounts and use the available financial services in a swift, easy and affordable manner. AMA will play a crucial role in reaching out to the low-income segments that do not have access to internet and is a perfect channel to onboard women customer segments as well.

Launching of PCM under new brokerage regime: leveling the playing field in the Stock market

Launch of Professional Clearing Member (PCM) (EClear Services ltd), an entity set up by CDC under SECP's new brokerage regime, is an independent third-party custodial, clearing and settlement service provider for the clearing and settlement of trades executed by trading only brokers. It would maintain transparent corporate structures and boost investor's confidence by ensuring planned development of the market. This will bring Pakistan's capital markets at PAR with international markets by addressing the very serious matter of misappropriation of customer's assets.

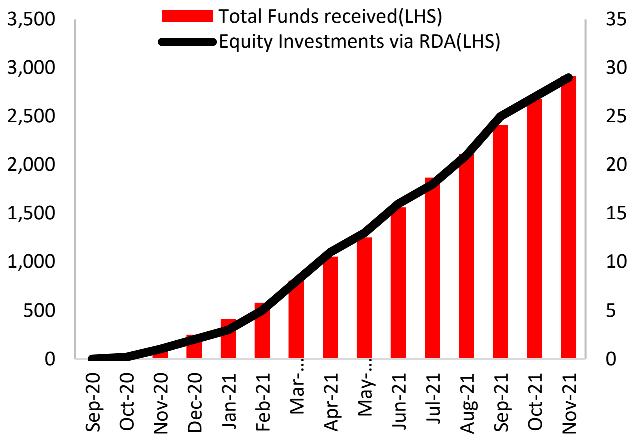
Historically, all brokerage houses retain custody of investor assets and are subject to the same compliance requirements regardless of their size or capacity, making it difficult for many brokers to comply with the law and ensure adequate investor protection. The practice was contrary to global benchmarks. Under the new regime, brokers would be categorized according to their net worth and governance requirements into three categories: trading and clearing broker (T&C), trading and self-clearing (TSC) and trading only (TO).

Fig 102: Liquidity Generated via IPO's over time (PKR Mn)



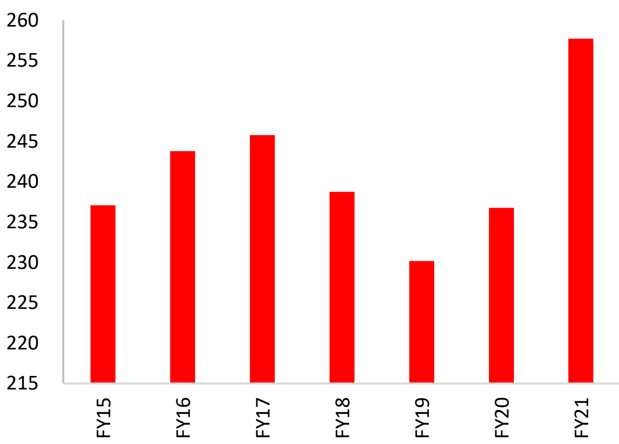
Source: PSX, Foundation Research, January 2022

Fig 103: Funds received via RDA trending upward (US Mn)



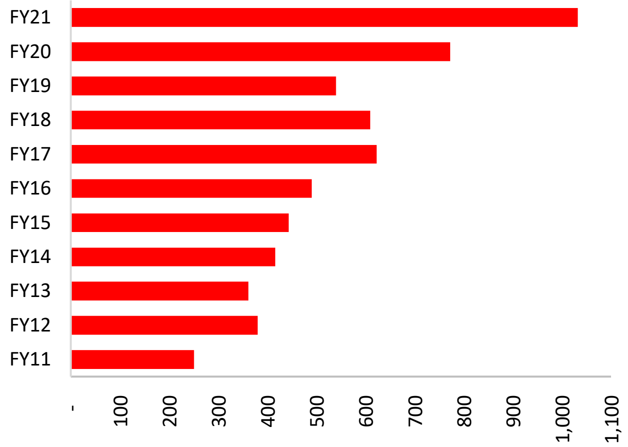
Source: PSX, Foundation Research, January 2022

Fig 104: Growth in UIN's accelerated after Covid (000)



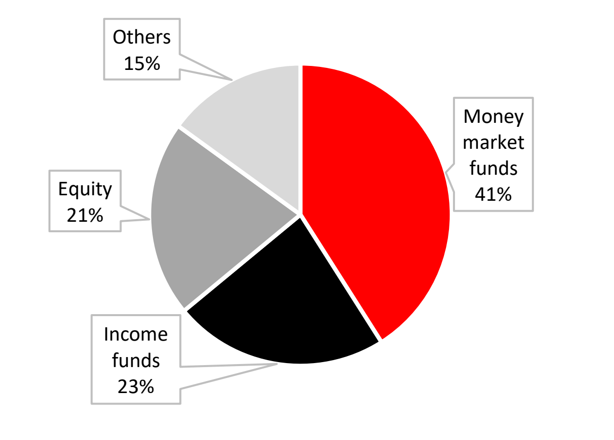
Source: PSX, Foundation Research, January 2022

Fig 105: Mutual Funds Net AUM (PKR Bn)



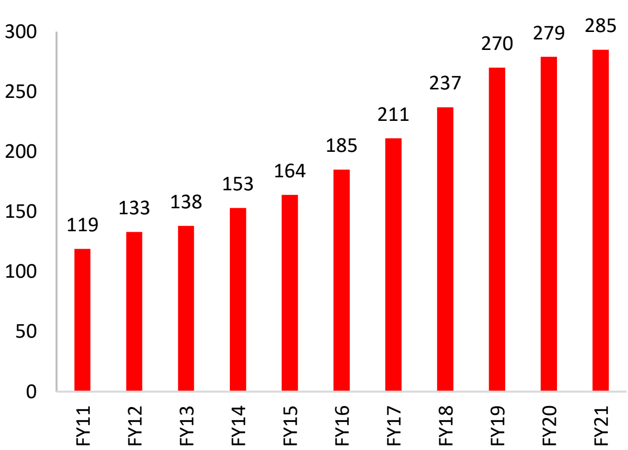
Source: PSX, Foundation Research, January 2022

Fig 106: AUMs of Mutual Fund Industry FY20



Source: MUFAP, Foundation Research, January 2022

Fig 107: Number of Mutual Funds



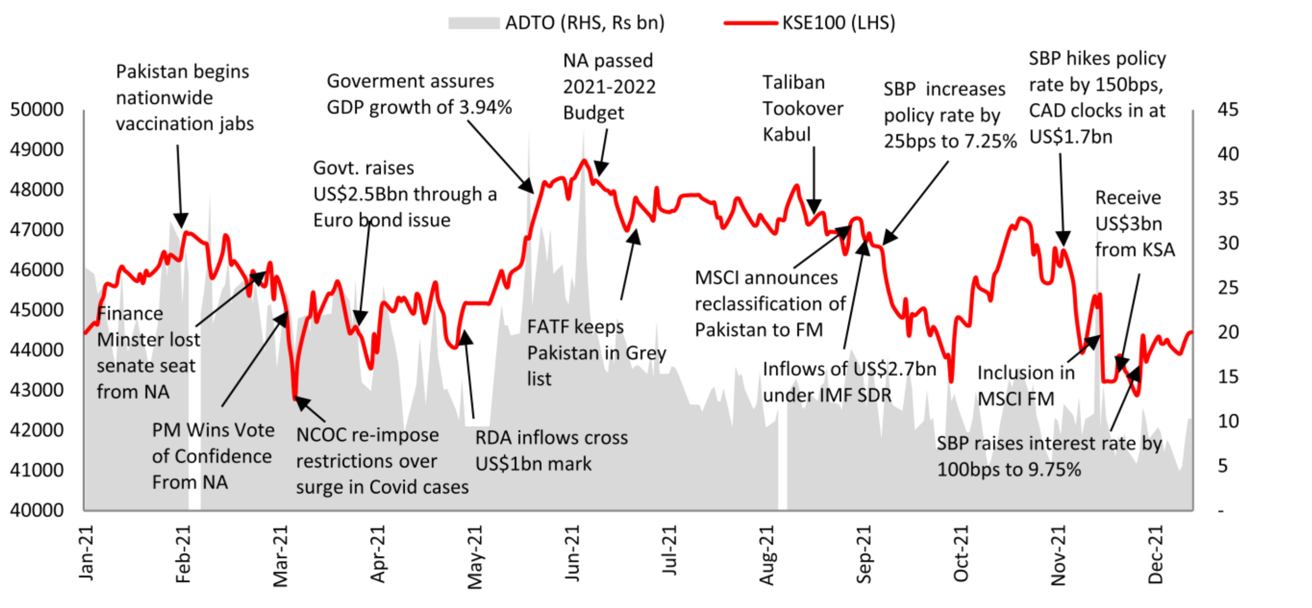
Source: PSX, Foundation Research, January 2022

KSE100 in CY21 remained muted

Reclassification of MSCI Pakistan Index from Emerging market to Frontier market with growing concerns over Current Account amid heightened political noise and US withdrawal from Afghanistan has kept the Index under pressure. Index yielded return of 7.7% till Aug'21 before shredding gains due to US withdrawal from Afghanistan and MSCI reclassification of Pakistan to frontier markets. Moreover, external account pressures on escalating trade deficit during the latter part of the year continued to keep Index under pressure.

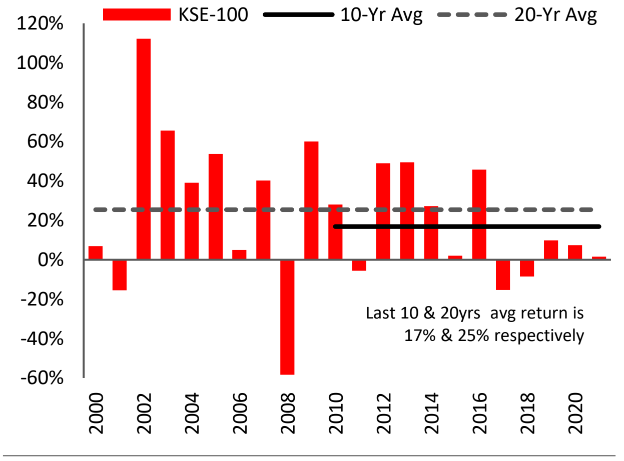
Domestic robust demand due to fiscal incentive and lax monetary policy along with construction package amid higher commodity prices had caused economy overheating. Subsequently, Current account deficit started to grow to a level where it stuck in ever increasing imports, recorded at US$7.1bn in 5MFY22 compared to surplus of US$1.9bn in 5MFY21. . However, monetary tightening has gathered pace over last 2 months (policy rate up by 250bps) which coupled with falling Rs-US$ parity (down 0.5/3.3/10.7% in last 1/3/6months) would help to rein in domestic domand and curtail imports. However, remittances continue to provide support to external account as inflows are sustaining their level of well above US$2bn per month mark for the last 20 months. Despite aforementioned factors, positive tone adopted by SBP in the last MPC about the future outlook of policy rate has helped KSE-100 to close the year in green with return of ~1.6% (~-8.2% in $US terms) in CY21.

Fig 108: KSE-100 remained muted over macroeconomic and geopolitical concerns



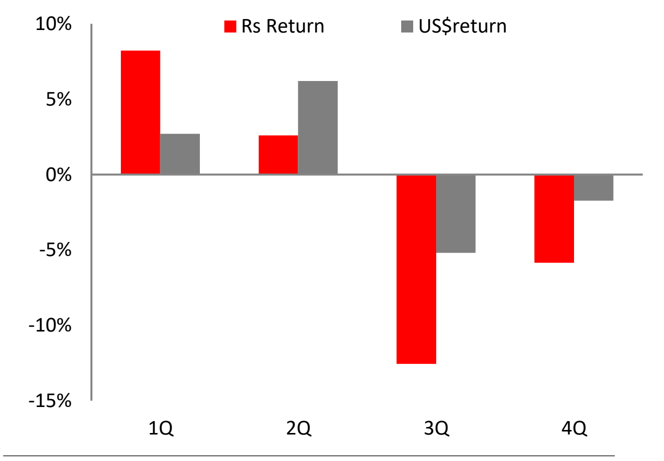
Source: PSX, Foundation Research, January 2022

Fig 109: Market posted way below than average returns in last five years



Source: PSX, Foundation Research, January 2022

Fig 110: KSE-100 provided return of 1.6% during CY21

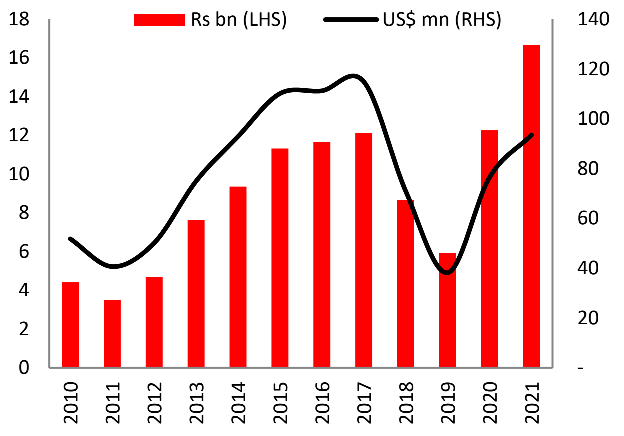


Source: PSX, Foundation Research, January 2022

Liquidity at all time high but kept on deteriorating throughout the year on macroeconomic and political concerns

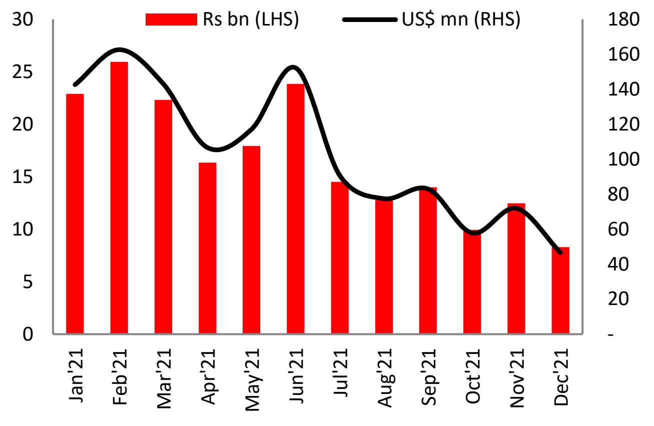
The Average Daily Turnover (ADTO) hit all time high increasing by 35.7% YoY to Rs16.6bn (increased 34.8% in US$ terms to US$102mn) in CY21. In dollar terms the ADTO was highest since CY17. Market depth responded negatively to continuous deteriorating economic indicators in particular escalating inflation and higher CAD during the year. This is evident from reducing market activity, where ADTO decreased by 56% from ~Rs21.5bn (or US$137mn) in 1HCY20 to ~Rs12.0bn (or US$71mn) in 2HCY21. During the last quarter of CY21 ADTO reduced to ~Rs10.2bn, down 39% when compared to full year average and even down by 16.5% compared to last year average of ~Rs12.3bn .

Fig 111: ADTO increased by 36% to Rs16.6bn (US$75mn)



Source: PSX, Foundation Research, January 2022

Fig 112: …liquidity continues to drop on macroeconomic concerns

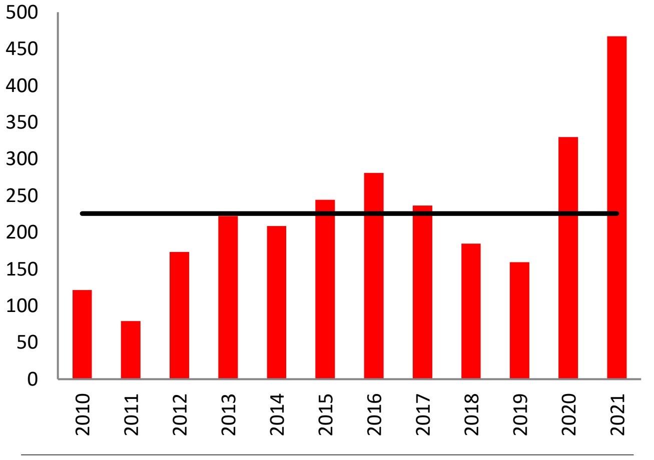


Source: PSX, Foundation Research, January 2022

In terms of shares traded (a more common liquidity barometer for domestic investors), average volumes have reached all time high. Traded volume clocked in at ~464mn shares in CY21 against 330mn last year, up by 41% YoY. However, significant drop in volumes was seen throughout the year, averaging 337mn shares in second half vs 592mn shares in the first half of CY21. Subsequently, this made it to cross ten year average of 225mn shares easily.

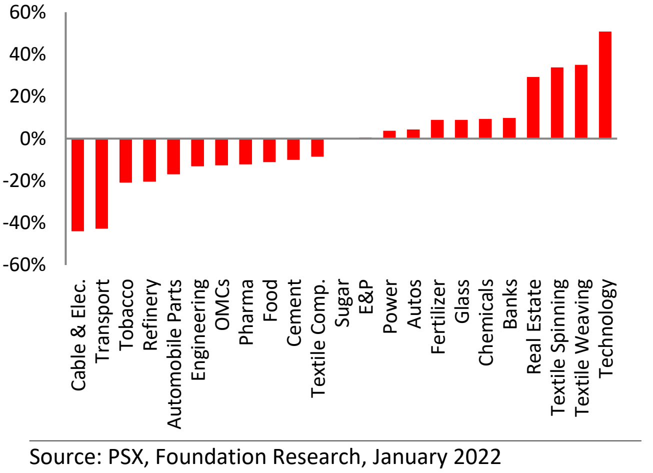
During the year positive performance of Technology, Textile weaving, Textile Spinning, Real Estate, Banks, Chemicals, Fertilizer, Autos and Power overshadowed negative returns of Cable & Electric, Tobacco, Refinery, Automobile Parts, Engineering, OMCs, Food, Pharma, Cement and Textile composite. Technology remained the best performing sector in CY21 with return of ~51% followed by ~35% return of Textile weaving, ~34% of Textile spinning, ~29% of Real Estate and ~10% of Banks. On the other hand, Cable & Electric (-43.9%), Tobacco (-20.8%), Refinery (-20.4%), Automobile parts (-16.9%), Engineering (-13.1%), OMCs (-12.7%), Pharm (-12.2%), Food (-11.1%), Cement (-10.0%) and Textile composite (-8.6%) posted negative return in CY21.

Fig 113: Volume hit all time high of 463mn shares



Source: PSX, Foundation Research, January 2022

Fig 114: …Technology and cyclical performed better than defensive given gov't stimulus package

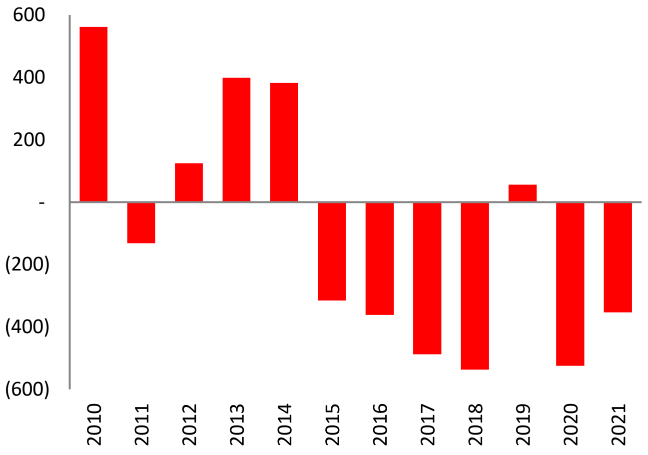


Source: PSX, Foundation Research, January 2022

Foreigners remained seller given MSCI reclassification and regional uncertainty

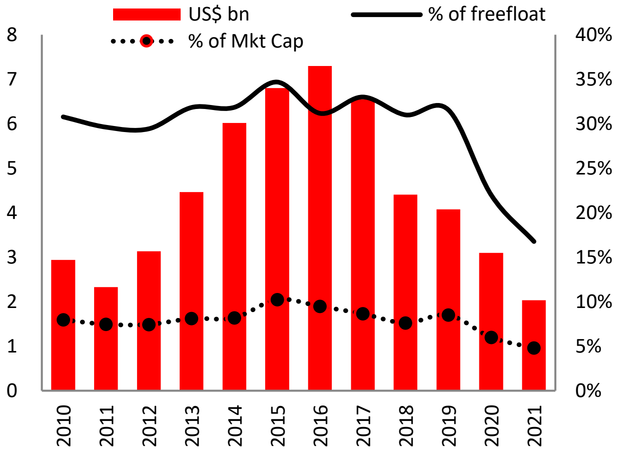
Foreign investors turned negative for the consecutive year given Pakistan's reclassification by MSCI and uncertain situation of Afghanistan after US withdrawal. However, the trend of foreign inflows remained mix in the regional markets with bigger markets like Japan and India witnessed inflows while relatively smaller regional markets like South Korea, Taiwan etc witnessed foreign outflows. During the year, Foreigner's sold ~US$353.9mn worth of shares, causing significant drop in percentage holding of market. Foreigners holding dropped to 17% of market on free float and 5% of market on total market cap basis, lowest level in a decade. During the last ten years foreigners trimmed position in PSX by ~US$1.6bn most of which came in latter five years. Shifting of funds from relatively smaller Emerging Markets (EM) and reclassification of Pakistan from Emerging Markets to Frontier Market seems be the primary reason for foreign outflows. Moreover, remaining on the FATF grey list, coupled with increasing political strife and Taliban takeover of Afghanistan after withdrawal of US, restricted foreigners from adopting any country specific approach.

Fig 115: Foreigners trim holding in equities by US$354mn during CY21



Source: NCCPL, Foundation Research, January 2022

Fig 116: …causes FII's holding to drop significantly in KSE-100

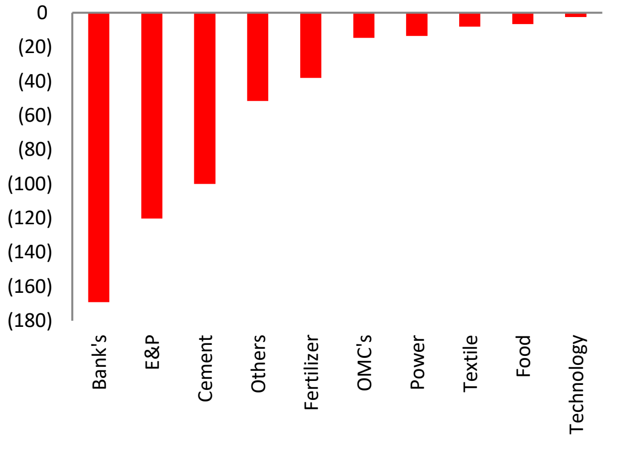


Source: SBP, PSX, Foundation Research, January 2022

Almost all the sectors, barring Technology and Power, witnessed net outflow during the year, with Banks seeing the majority of outflows (~US$168mn) followed by Others (US$79mn), E&Ps (US$58mn), Fertilizer (~US$55mn), Cement (US$13mn), OMCs (US$8mn), Food (US$7mn) and Textile (US$5mn). Technology that remained best performing sector in CY21 witnessed inflows of US$37mn during the year.

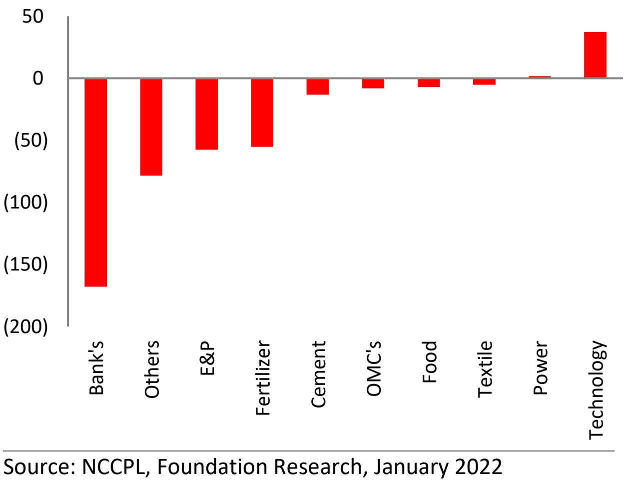
Resumption of IMF program would help the country in achieving sustainable economic growth through focus on structural reforms. Adoption of market based exchange rate with building international reserves provides exchange rate sustainability. However, ending of stimulus by FED and uncertainty over fate of Afghanistan would keep foreign investors at bay but industry or sector specific response could not be ruled out.

Fig 117: FIIs trimmed their exposure across the board in CY21 (US$ mn)



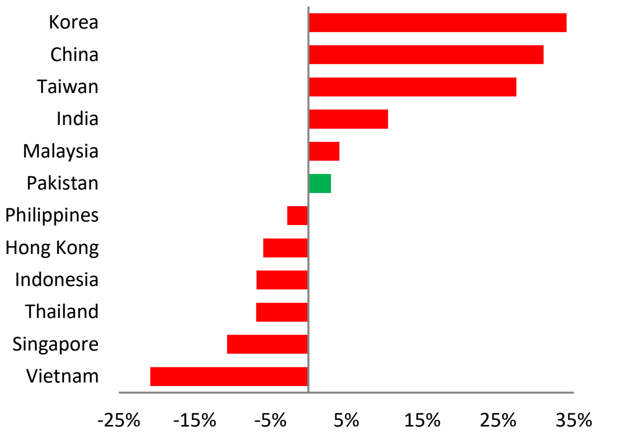
Source: NCCPL, Foundation Research, January 2022

Fig 118: Technology sector witnessed inflows in CY21 (US$ mn)



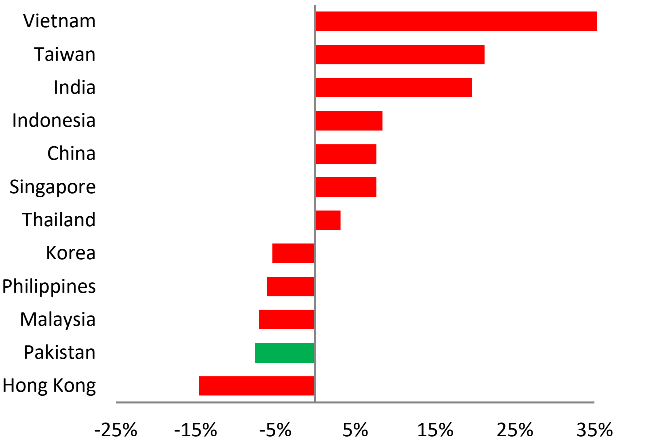
Source: NCCPL, Foundation Research, January 2022

Fig 119: KSE-100 shows resilience by posting positive return in CY20…



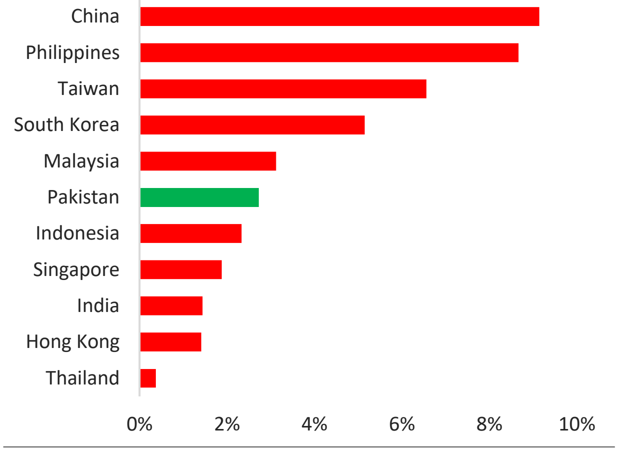
Source: Bloomberg, Foundation Research, January 2022

Fig 120: … Rupee depreciation made returns negative among emerging markets in CY21…



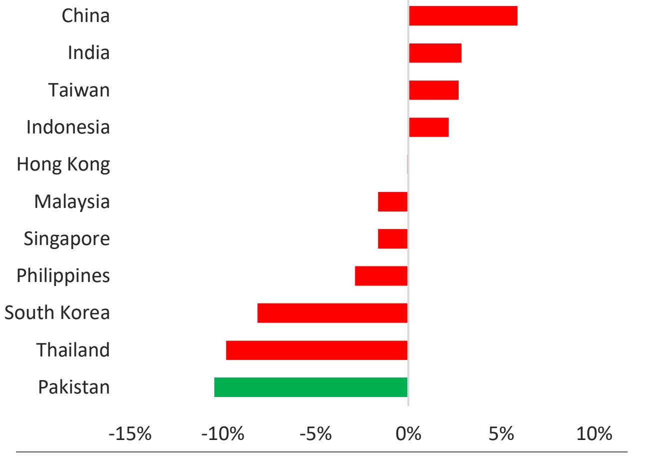
Source: Bloomberg, Foundation Research, January 2022

Fig 121: …Pak rupee performed better in CY20 despite market based determination of exchange rate …



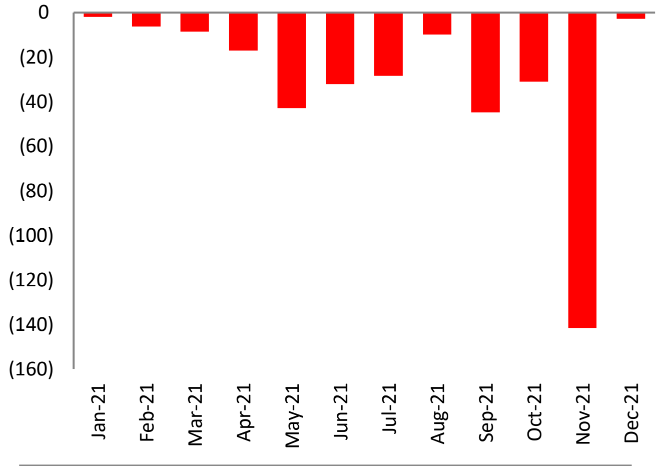
Source: Bloomberg, Foundation Research, January 2022

Fig 122: …facing the brunt of higher commodity prices in CY21



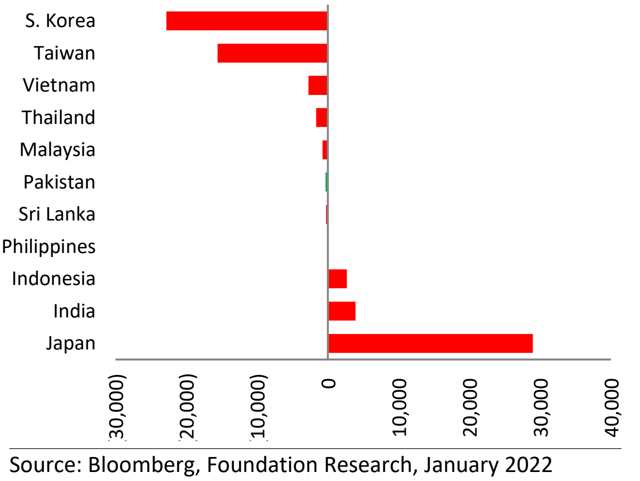
Source: Bloomberg, Foundation Research, January 2022

Fig 123: ...foreigners selling gained momentum on MSCI reclassification (US$ mn)



Source: Bloomberg, Foundation Research, January 2022

Fig 124: … mix trend witnessed in regional markets during CY21



Source: Bloomberg, Foundation Research, January 2022

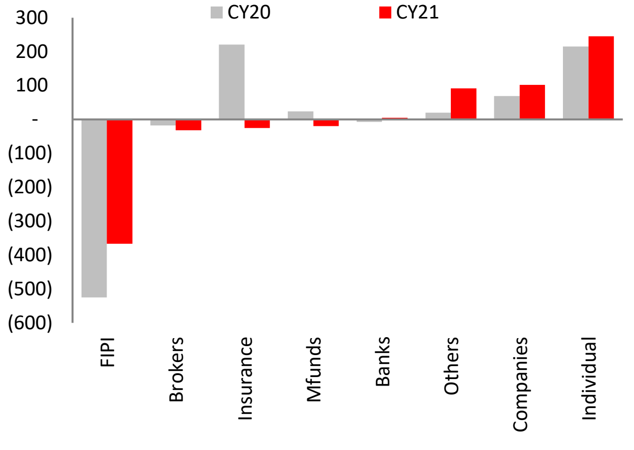
Individuals, Insurance and companies among liquidity providers

This year, Companies and NBFC were key liquidity providers alongside Individuals in supporting the market and the exit of foreign investors and Insurance. Interestingly, exit was provided to Foreign Investors by a mix of local participants other than Insurance, Brokers and Mutual Funds. Individuals have bought US$233mn worth of shares, enhancing their exposure in majority of the sectors other than Technology, Textile and Cement. They tilted towards the Fertilizer sector with ~US$98mn worth of stocks followed by Power, Banks, E&P, OMCs, Others and Food with value of ~US$49mn, ~US$48mn, US$44mn, ~US$24mn, ~US$15mn and ~US$7mn respectively. Companies in Technology, Textile and Cement sectors failed to draw interest of individuals, witnessing an outflow of ~US$44mn, ~US$4.3mn and ~US$3.6mn.

Insurance reduced their equity exposure to the tune of US$20mn with a mixed trend. Insurance mainly reduced exposure in E&Ps, Banks and Fertilizer with net selling of US$37mn, US$28mn and US$27mn. They also reduced exposure in OMCs and Power by ~US$13mn and ~US$12mn respectively. In Technology, insurance build their exposure by US$20mn against last year selling of US$16mn. Companies and Banks enhanced their exposure in equities by ~US$107mn and ~US$4mn respectively during the year. Companies enhanced their exposure mainly in Banks and others with net buying of ~US$85mn and US$76mn. Among local participants, Mutual Funds trimmed their exposure in shares by US$21mn.

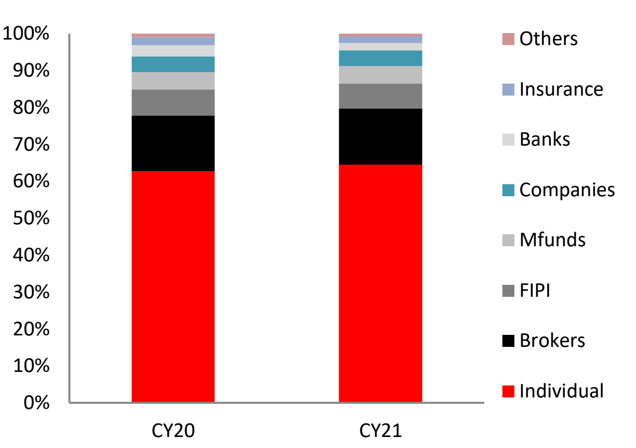
In terms of trading, individuals (including HNWI) remained the lead liquidity provider with a market participation of 64.5% in total ADTO during CY21. Brokers' contribution to ADTO remained slightly above this year with participation of 15.1% against 15.0% in CY20. Mutual Funds participation witnessed increase of 10bps to 4.8% in CY21, while participation of all other sectors dropped slightly.

Fig 125: Individuals and Companies mainly absorbed Foreigners sell-off (US$ mn)



Source: NCCPL, Foundation Research, January 2022

Fig 126: Liquidity continued to be provided by individuals and brokers



Source: NCCPL, Foundation Research, January 2022

Table 16: CY21 trading activity summary

	FIPI	MF	Banks	Brokers	Ind.	Insurance	Comp	Others
Gross Activity								
Buy	2,432.06	1,811.79	785.38	5,804.65	24,855.92	655.14	1,685.19	347.84
Sell	(2,785.92)	(1,832.43)	(781.54)	(5,838.17)	(24,622.48)	(675.31)	(1,578.60)	(263.50)
Net	(353.86)	(20.63)	3.83	(33.52)	233.43	(20.18)	106.59	84.34
Sector wise net position								
Banks	(167.92)	6.75	4.78	(1.18)	48.14	(28.30)	85.12	52.61
E&P	(57.59)	(1.67)	14.63	8.84	43.79	(36.57)	16.48	12.09
Cement	(13.24)	25.58	18.99	2.98	(3.62)	(25.26)	(1.18)	(4.24)
Fertilizer	(55.20)	(8.30)	(7.22)	(5.45)	98.42	3.55	(34.35)	8.53
Power	1.59	2.55	(32.19)	1.31	49.31	(11.84)	(22.27)	11.53
OMCs	(7.96)	1.78	7.02	3.99	15.02	(12.58)	1.38	(8.66)
Food	(7.12)	(7.10)	(3.88)	(3.37)	6.79	16.42	(7.81)	6.07
Technology	37.27	(4.01)	(0.77)	(8.75)	(43.98)	20.60	(6.19)	5.83
Textile	(5.16)	8.50	(1.29)	(1.02)	(4.40)	2.49	(0.10)	0.99
Others	(78.53)	(44.71)	3.77	(30.88)	23.96	51.31	75.50	(0.42)
Total	**(353.86)**	**(20.63)**	**3.83**	**(33.52)**	**233.43**	**(20.18)**	**106.59**	**84.34**

Source: NCCPL, Foundation Securities, January 2022

Table 17: Covered universe performance review for 2021

Sector/scrip	CY21 return	CY21 catalyst
Commercial Banks		
HBL	-6%	Low payout by the bank and range bound CAR
MCB	-2%	Defensive in play with lower risks of NPLs
UBL	31%	Declining NPLs due to diversification in international portfolio and increased payout
BAFL	10%	Earnings growth due to higher NIMs
MEBL	59%	Higher ROE, above industry deposit growth and low infection
AKBL	8%	Earnings growth due to higher NIMs and good dividend payout
FABL	37%	Inching closer to Islamic conversion and earnings growth
Fertilizer		
FFC	5%	Higher pricing power, better DAP trading margins and higher income on financial assets
ENGRO	-3%	Concerns over revision in ROE of power business
EFERT	59%	Delay in GIDC payment, higher DAP trading margins and improved Urea prices
FFBL	-2%	Further investment in FFL and decline in Urea production
Oil & Gas Exploration		
OGDC	-11%	Delay in implementation of circular debt management plan and lower dividend payout
PPL	-9%	Delay in implementation of circular debt management plan and lower dividend payout
POL	4%	Increase in earnings given higher oil prices and strong dividend yield
MARI	38%	Removal of dividend cap
Cement		
LUCK	-2%	Increase in energy cost, delay in COD of power plant and decline in cement demand in 2HCY21
DGKC	-27%	Interest rate reversal cycle, increase in energy cost and decline in cement demand in 2HCY21
FCCL	-15%	Higher energy cost and decline in cement demand in 2HCY21
CHCC	3%	Increased consumption of local coal in energy mix
PIOC	-14%	Interest rate reversal cycle, increase in energy cost and decline in cement demand in 2HCY21
KOHC	-14%	Interest rate reversal cycle, increase in energy cost and decline in cement demand in 2HCY21
ACPL	-5%	Decline in exports and higher energy cost due to surge in coal prices
Power Generation		
HUBC	0%	Delay in receipt of payment of Narrowal plant and CPHGC project close
KAPCO	73%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
NCPL	6%	Expectation of payment in lieu of IPPs renegotiation agreement
NPL	-10%	Delay in receipt of payment due to NOC from NAB
PKGP	44%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
LPL	44%	Receipt of payment under IPPs renegotiation agreement deal and dividend payout
Oil & Gas Marketing		
PSO	-9%	Build up LNG receivables diluted the positives of white oil market share recovery
APL	2%	Higher earnings growth and strong dividend payout
Auto Assembler		
INDU	15%	Volumetric growth, higher localization and good dividends
HCAR	-27%	Increase in competition given start of production by new entrants
PSMC	-4%	Below expectations earnings growth
Food Producers		
FCEPL	3%	Market leadership in UHT, higher ice-cream sales and reliance on domestic milk powder
Textile		
ILP	14%	Increased exports leads to higher earnings growth and expansion into apparel
NML	-19%	Subdued portfolio performance
Chemical		
EPCL	53%	Increase in PVC-Ethylene margins towards record high and COD of new plant
LOTCHEM	7%	Higher PTA-PX margins and strong cash position
Engineering		
ASTL	-7%	Increase in scrap cost
AGHA	-30%	Continuous delay in expansion, higher finance cost and volumetric constraints
MUGHAL	69%	Positive outcome of copper exports segment and COD of rebar mill
ISL	-21%	Ending of ADD duty on imports from China and Ukraine
Technology		
SYS	101%	Better margins due to increased business in North America and Europe region

Source: KSE, Foundation Research, January 2022

Table 18: Bonus shares in CY21

S. #	Symbol	Securities	Issue Date	% of Bonus
1	MTL	Millat Tractors	19-Feb-21	13%
2	BNL	Bunnys Limited	26-Feb-21	30%
3	PAKOXY	Pak Oxygen Ltd.	1-Mar-21	20%
4	SUTM	Sunrays Textile	1-Mar-21	200%
5	IDYM	Indus Dyeing	1-Mar-21	200%
6	BOK	Bank Of Khyber	2-Mar-21	5%
7	SYS	Systems Limited	4-Mar-21	10%
8	HINOON	Highnoon (Lab)	25-Mar-21	10%
9	RICL	Reliance Ins.	25-Mar-21	8%
10	ASIC	Asia Insurance	30-Mar-21	10%
11	SRVI	Service Ind.Ltd	31-Mar-21	100%
12	AVN	Avanceon Ltd	21-Apr-21	20%
13	GATM	Gul Ahmed	28-Apr-21	20%
14	CEPB	Century Paper	27-Jul-21	15%
15	COLG	Colgate Palm	29-Jul-21	15%
16	AHL	Arif Habib Ltd.	2-Aug-21	10%
17	PTL	Panther Tyres Ltd.	2-Aug-21	20%
18	MEBL	Meezan Bank	12-Aug-21	15%
19	SPEL	Synthetic Prod	25-Aug-21	8%
20	ATBA	Atlas Battery	27-Aug-21	15%
21	NATF	National Foods	7-Sep-21	25%
22	PSYL	Pak Synthetics	7-Sep-21	10%
23	GGL	Ghani Glo Hol	9-Sep-21	15%
24	HTL	HI-Tech Lub.	13-Sep-21	20%
25	ILP	Interloop Ltd.	15-Sep-21	3%
26	MTL	Millat Tractors	17-Sep-21	20%
27	MUGHAL	Mughal Iron	17-Sep-21	15%
28	SURC	Suraj Cotton	20-Sep-21	10%
29	AGHA	Agha Steel Ind.	20-Sep-21	5%
30	FLYNG	Flying Cement	21-Sep-21	5%
31	JVDC	Javedan Corp.	23-Sep-21	20%
32	BIFO	Biafo Ind.	23-Sep-21	10%
33	PREMA	At-Tahur Ltd.	23-Sep-21	12%
34	SAZEW	Sazgar Eng	25-Sep-21	30%
35	ECOP	ECOPACK Ltd	27-Sep-21	10%
36	SHFA	Shifa Int.Hosp	27-Sep-21	2%
37	DEL	Dawood Equities	27-Sep-21	10%
38	SHEZ	Shezan Inter.	27-Sep-21	10%
39	IBLHL	IBL HealthCare	29-Sep-21	20%
40	ASHT	Ashfaq Textile	30-Sep-21	10%
41	PAKD	Pak Datacom	30-Sep-21	10%
42	CPHL	Citi Pharma Ltd	30-Sep-21	10%
43	TOMCL	The Organic Meat	1-Oct-21	10%
44	SEARL	The Searle Co.	4-Oct-21	30%
45	AIRLINK	Air Link Commun	5-Oct-21	8%
46	SNAI	Sana Ind	6-Oct-21	10%
47	TELE	Telecard Limited	7-Oct-21	5%
48	ICL	Ittehad Chem.	27-Oct-21	18%
49	TPLP	TPL Properties	28-Oct-21	20%
50	EWIC	East West Ins.XB	23-Nov-21	15%

Source: PSX, Foundation Research, January 2022

Across the board support in earnings growth

Using the FSL universe as a proxy (~65% of FF Market Cap), we forecast earnings growth of ~10.5% for the year 2022. The cement sector would be a major contributor to our universe earning growth with growth of ~31% during next year as we expect coal prices to normalize amid robust GDP growth at the advent of election year. Thus, results in better capacity utilization along with improved cement retention prices. Moreover, start of monetary easing by the end of year would significantly improve profitability of cement sector given high leverage.

Profitability of the banking sector is likely to grow by an avg. 10% during 2022 on the back of (i) surge in Net Interest Income (NIIs) amid higher Net Interest Margins (NIMs) due to expected increase in policy rate to 10.75%, (ii) enhanced capacity of cash payout due to restriction imposed by SBP in CY20 as a preventive measure to secure liquidity in an economy hit by COVID, and (iii) general provisioning buffer to mitigate high NPL risk.

Unlike previous year E&P sector is likely to post profitability growth of 17% YoY during 2022 as we expect Arab Light to average at US$74.5/bbl during FY22 compared to Arab Light of US$53.9/bbl in FY21. Moreover, volumetric growth along with pricing of newer flows on higher rates would allow the sectoral profitability would further strengthen our conviction. Unlike 22% YoY growth in profitability of the fertilizer sector in CY21, we expect profitability to drop by 6% YoY during CY22 given payment of Rs187bn in lieu of Gas Infrastructure and Development Cess (GIDC) amid ending of concessionary flows for EFERT PA. However, despite payment of GIDC FFC PA is likely to post earnings growth of 8% YoY in CY22 given improved dividend income from subsidiaries.

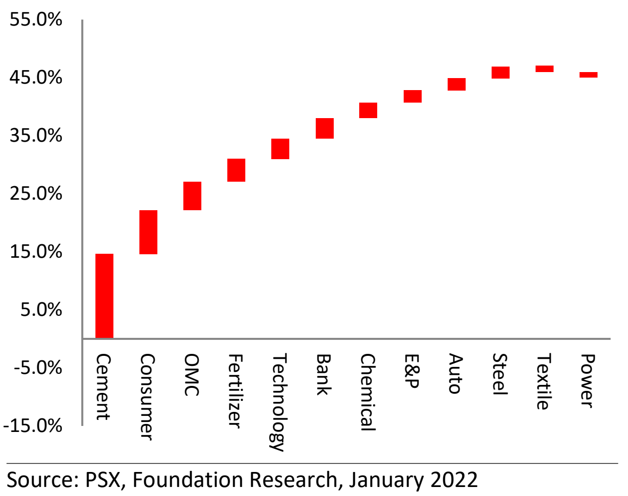
We also expect Power sector to show significant growth of 10% given a higher dollar indexation along with expansion into cheaper coal power plants by Hub Power Company despite assuming revision in tariff of KAPCO from "take or pay" to "take and pay". However, energy sector reforms, in particular revision 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 and (iii) unchanged gas/electricity tariffs. Textile sector is also major beneficiary of TERF facility which is in addition to LTFF and ERF.

We expect OMCs earnings to drop by 11%YoY due to lower inventory gains and normalization of one-offs despite consistent growth in MS/HSD demand due to economic growth and higher margins. Auto sector is expected to grow by 34% in next 5-Yrs due to volumetric increase, stable currency, lower borrowing cost and improved buying capacity. Technology sector profitability is likely to slow down to 26% YoY in CY22 due to lower rupee depreciation and absence of one offs. However, IT sector remains beneficiary of Government focus on digital initiatives.

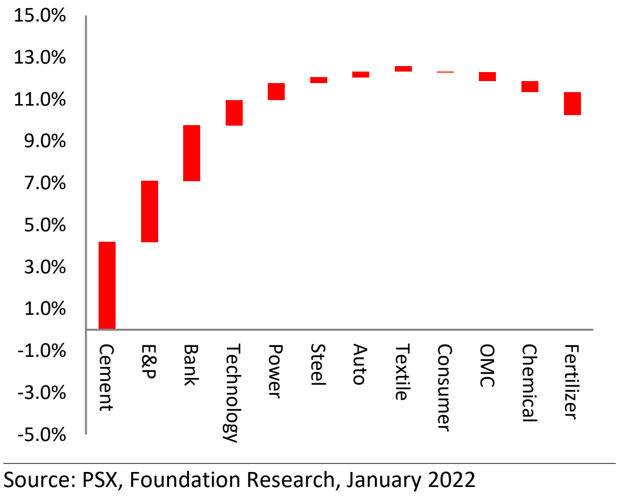
The Steel sector would remain beneficiary of economic growth and a shrinking share of importers amid cooling-off of commodity prices. The Chemical sector's profitability to post negative 28% YoY during CY22 after having robust profitability last year due to normalization of margins along with resumption of trade as commodity prices start to ease off.

Fig 127: CY'21 earnings to grow over 47% YoY



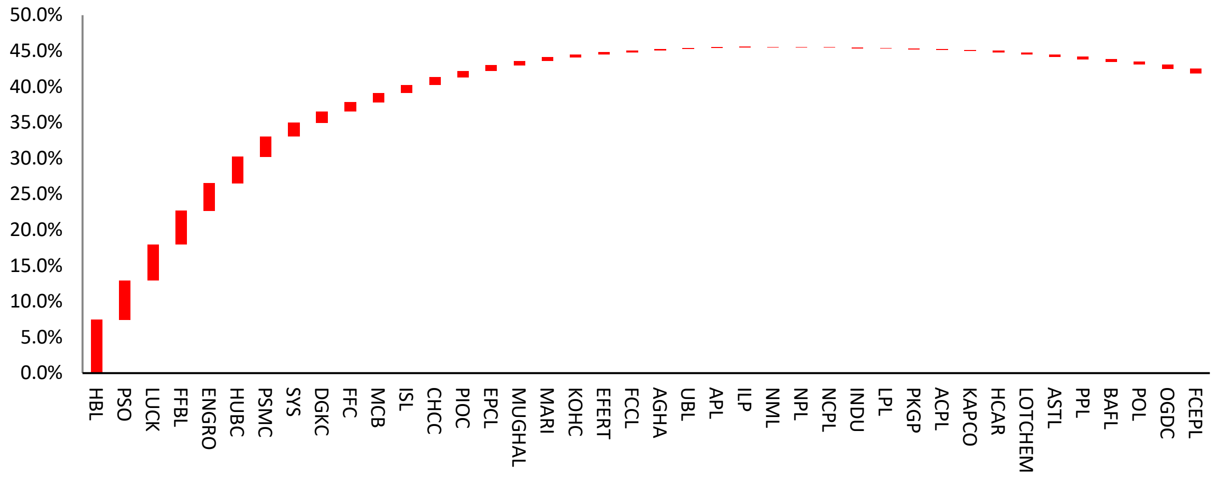
Source: PSX, Foundation Research, January 2022

Fig 128: Next year earnings growth expected to be ~10.5%



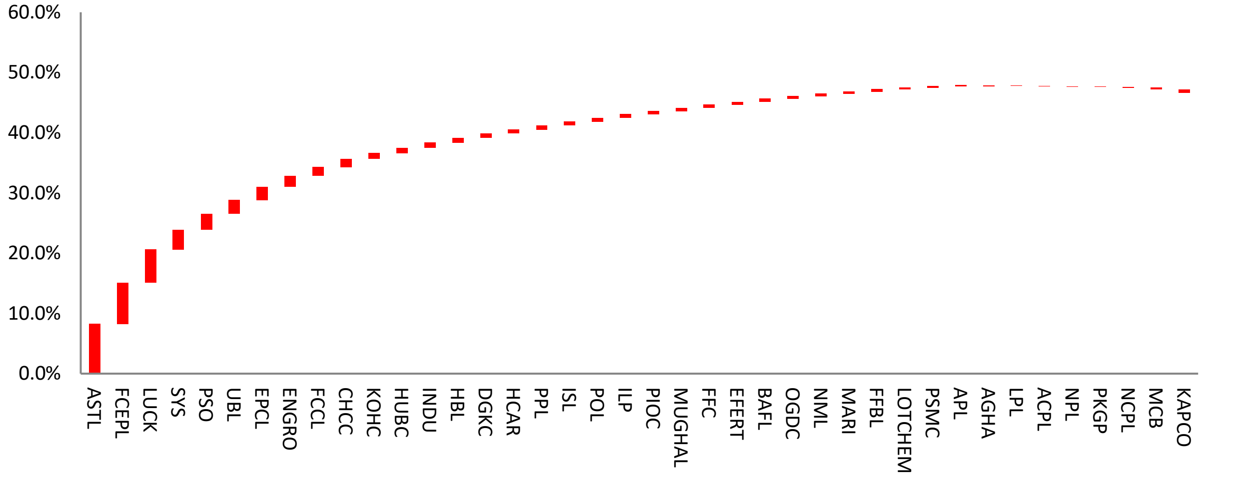
Source: PSX, Foundation Research, January 2022

Fig 129: Stock wise earning growth (2020)



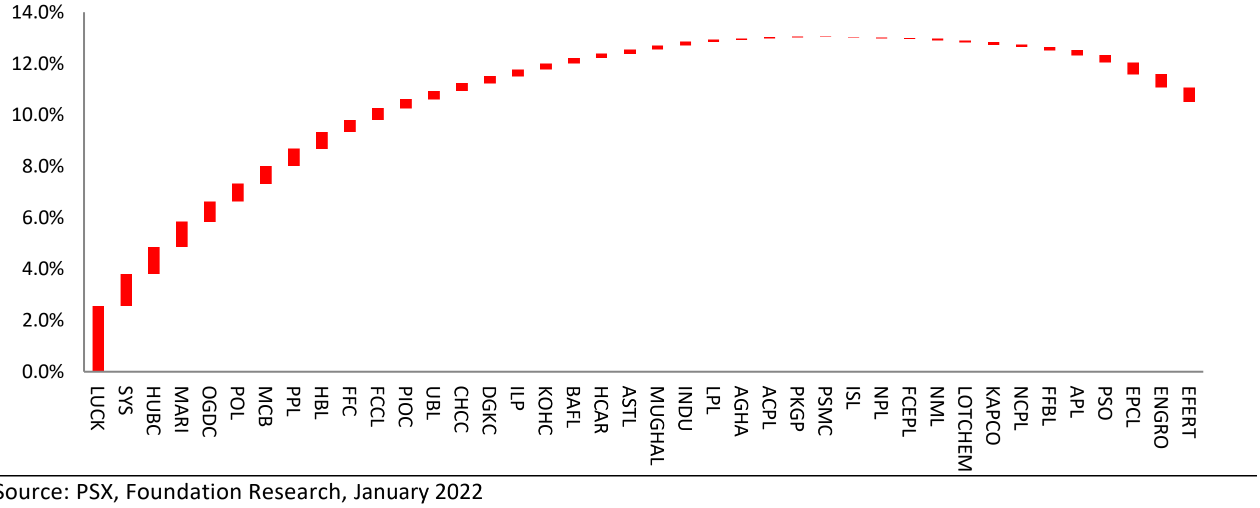
Source: PSX, Foundation Research, January 2022

Fig 130: Stock wise earning growth (2021)



Source: PSX, Foundation Research, January 2022

Fig 131: Stock wise earning growth (2022)



Source: PSX, Foundation Research, January 2022

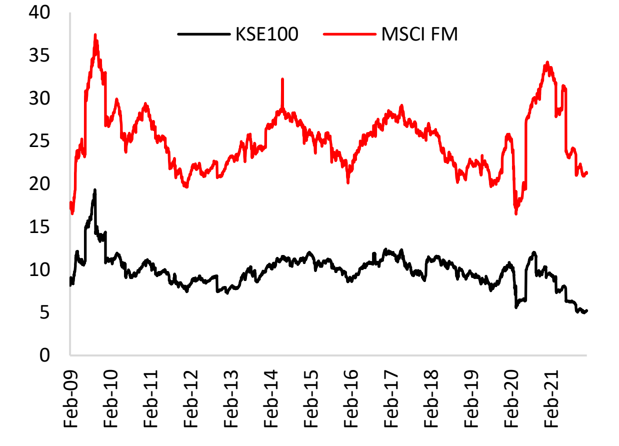
All set to outperform MSCI FM

Concerns over manageability of external account and regional changing landscape along with Pakistan's placement in FATF grey list and delay in approval of IMF sixth review 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 FM provided a significant return of ~20.1% and 16.4% while MSCI EM declined ~4.6% during the year. This has enhanced KSE-100 discount to 68% from 40% two year earlier against the historical average of 26%.

During the year, MSCI reclassified MSCI Pakistan Indexes from Emerging Markets to Frontier Markets in one step coinciding with November Index Review as the Pakistan's market no longer meets EM standards for size. Three Pakistani securities has been added to the MSCI Frontier Markets Index at an aggregate weight of 1.25%. The MSCI Pakistan FM index has total 17 companies (3 mid cap and 14 small cap) compared to the current 16 companies in MSCI Pakistan EM (3 mid cap and 13 small cap). (1) Easing of commodity prices, (2) resumption of IMF program and (3) growth oriented policies of government along with ease in regional tensions would allow KSE-100 index to outperform the MSCI FM Index.

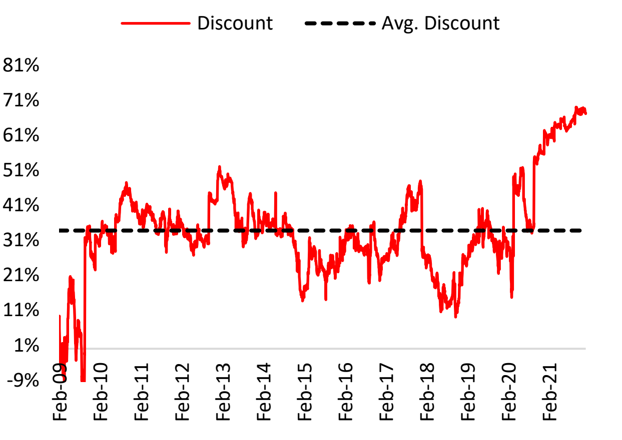
These changes, along with the improvement in balance of payment and reserve cushion ought to enhance foreigners comfort with investing in local currency assets.

Fig 132: PE comparison: KSE100 vs MSCI FM



Source: Bloomberg, FSL Research, January 2022

Fig 133: KSE100 at 67% discount vs 14yr avg of 34%



Source: Bloomberg, FSL Research, January 2022

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 ~7.8% compared to the regional average of ~2.6%.

Table 19: Trading at a significant discount to Regional Peers

	PER (x)		P/BVS (x)		Dividend Yield (%)	
	2020E	2021F	2020E	2021F	2020E	2021F
Pakistan	**4.83**	**4.41**	**0.90**	**0.89**	**7.79**	**7.66**
Thailand	17.94	15.70	1.76	1.66	2.60	2.90
Taiwan	14.43	14.00	2.45	2.30	3.63	3.68
Singapore	13.12	11.57	1.05	0.99	4.20	4.57
Malaysia	14.90	13.83	1.47	1.41	4.01	4.27
Indonesia	15.85	14.27	2.10	1.94	2.12	2.39
China	11.51	10.25	1.42	1.29	2.62	2.90
Korea	10.74	9.71	1.08	0.99	1.83	1.90
Hong Kong	10.68	9.43	1.11	1.02	3.26	3.58
India	26.04	21.90	3.74	3.27	1.13	1.30
Philippines	16.69	13.75	1.63	1.51	1.68	1.92
Vietnam	14.15	11.43	2.36	1.99	1.14	1.38
Regional Avg.	**15.10**	**13.26**	**1.83**	**1.67**	**2.57**	**2.80**
Discount/Premium to Region	***-68.0%***	***-66.7%***	***-50.9%***	***-46.7%***	***5.2***	***4.9***

Source: Bloomberg, Foundation Research, January 2022

Table 20: MSCI FM (Main Index) Pakistan weight

Company	Free Float Market Cap (USD mn)	MSCI Weight
LUCK	582	0.5%
HBL	421	0.3%
MCB	566	0.5%
Total	**1,569**	**1.3%**

Source: MSCI, PSX, Foundation Research, January 2022

Table 21: MSCI FM (Small Cap) Pakistan Constituents

Company	Free Float Market Cap (USD mn)	MSCI Weight
ENGRO	474	1.0%
HUBC	461	1.0%
UBL	401	0.8%
FFC	305	0.6%
TRG	290	0.6%
SYS	278	0.6%
PPL	243	0.5%
POL	220	0.5%
EFERT	222	0.5%
PSO	234	0.5%
MARI	263	0.5%
SEARL	130	0.3%
MTL	210	0.4%
BAFL	147	0.3%
Total	**3,880**	**8.1%**

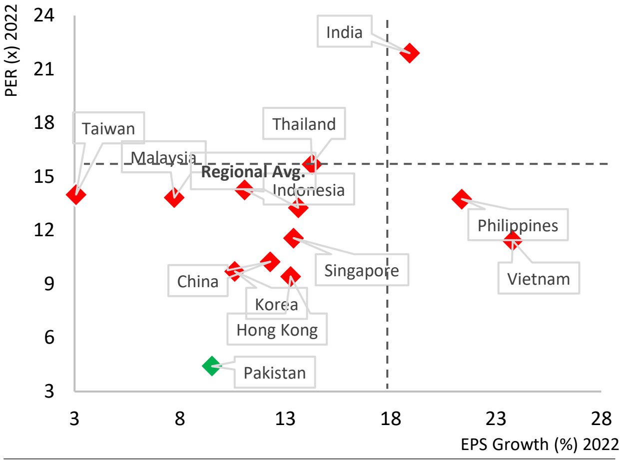
Source: MSCI, PSX, Foundation Research, January 2022

Table 22: Portfolio investments since Pakistan reclassification to MSCI Frontier market (From Sep 7'21 to Nov 30'21)

	F-Corp.	O.S. Pak	F. Total	Fund's	Bank's	Broker's	Indiv.	Insur.	Comp.	Other's
Gross Activity										
Buy	225.68	295.74	523.95	336.14	132.28	964.58	3,961.17	182.85	361.15	87.29
Sell	(478.21)	(255.81)	(734.99)	(321.75)	(102.91)	(966.78)	(3,907.16)	(122.72)	(338.23)	(54.85)
Net	(252.53)	39.92	(211.04)	14.38	29.37	(2.20)	54.01	60.12	22.92	32.44
Sector wise net position										
Bank's	(138.84)	9.69	(129.05)	18.36	8.76	0.59	10.87	17.76	64.74	7.97
E&P	(23.60)	1.61	(22.07)	8.41	1.48	2.11	5.01	1.46	(2.28)	5.88
Cement	(46.87)	4.87	(42.03)	8.40	10.20	0.96	(0.75)	14.96	5.73	2.53
Fertilizer	(51.18)	0.80	(50.38)	13.19	0.31	0.69	27.92	9.00	(7.31)	6.58
Power	(8.74)	17.20	8.46	4.49	(5.61)	(0.30)	16.80	(7.65)	(20.08)	3.89
OMC's	(3.58)	0.56	(3.10)	(0.29)	1.44	(0.49)	1.48	(1.08)	1.51	0.53
Food	(2.49)	1.52	(0.79)	(3.66)	0.76	(1.22)	(5.55)	7.06	0.35	3.05
Technology	8.97	1.39	11.75	(4.68)	3.28	(3.12)	(7.20)	7.97	(9.72)	1.71
Textile	(0.56)	0.24	(0.32)	3.48	0.25	0.05	(4.16)	(0.12)	(2.60)	3.41
Others	14.37	2.03	16.48	(33.33)	8.49	(1.46)	9.60	10.76	(7.42)	(3.12)

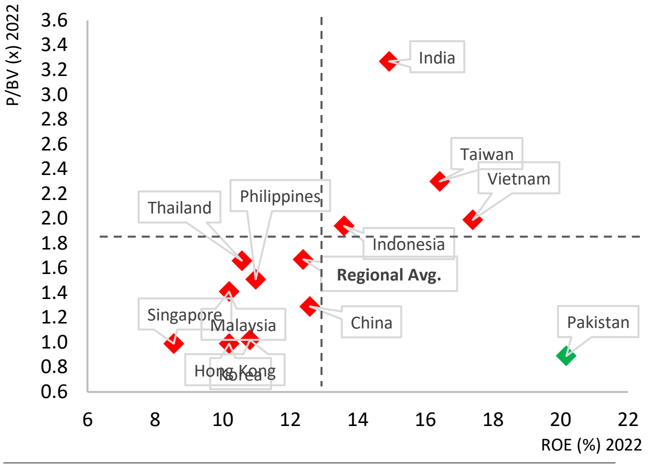
Source: NCCPL, Foundation Research, January 2022

Fig 134: Cheapest among peers on EPSg with low PE



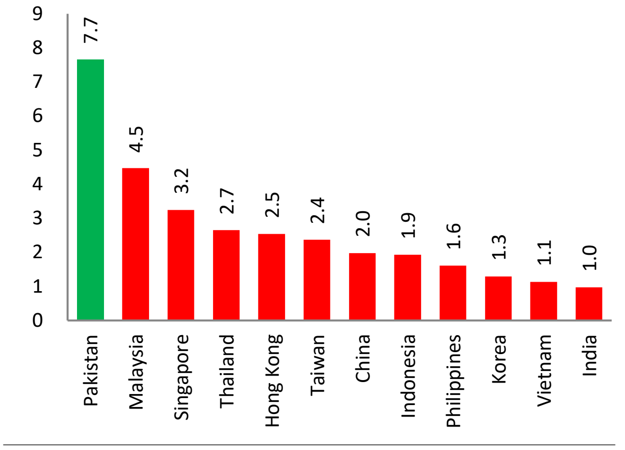
Source: Bloomberg, FSL Research, January 2022

Fig 135: …on PBV vs ROE as well…



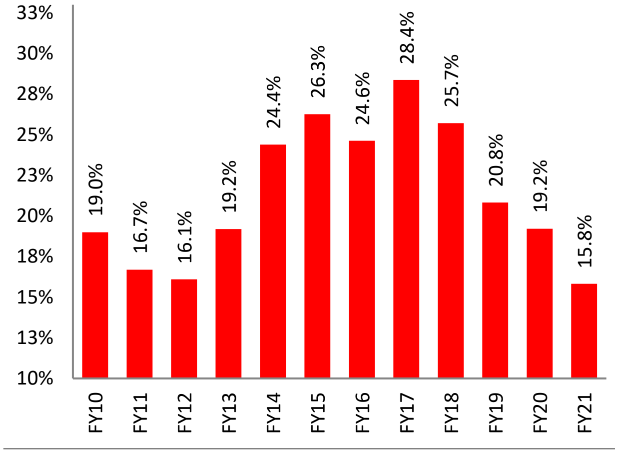
Source: Bloomberg, FSL Research, January 2022

Fig 136: …highest DY among peers (%)



Source: PSX, SBP, FSL Research, January 2022

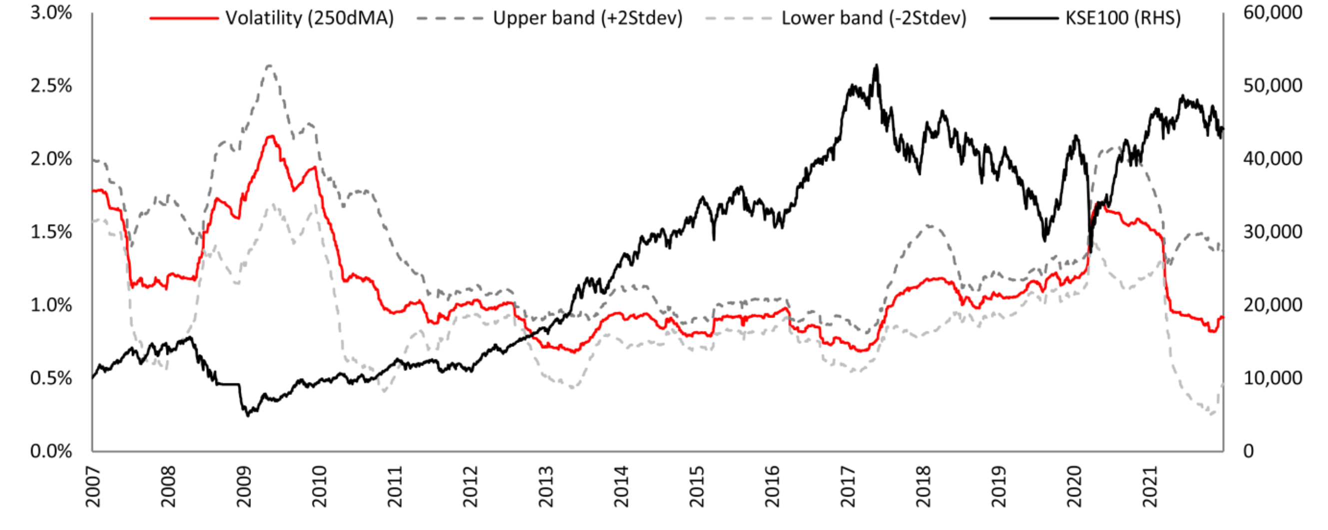
Fig 137: Political uncertainty drops Mkt cap to GDP



Source: PSX, SBP, FSL Research, January 2022

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 138: Volatility increased in comparison to recent past



Source: PSX, Foundation Research, January 2022

Approaching the stock market

Bottom-up approach yielding an index target of 57,750 by Dec-2022

We have adopted a Bottom-up approach for Pakistan in CY22 and have arrived at a modest KSE100 index target of 57,750 by December 2022, implying a return of ~29.5% (~21.7% in US$ terms) along with an impressive dividend yield of ~7.4%. This translates into total market return of ~36.9% (~28.7% in US$ term). Our index target is primarily a function of our FSL's universe Dec-22 TP based on Rf of 11.5% and market risk premium of 6.5%. Key sectors driving this return include the E&P sector which is going to largely 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. Foreseen growth in hydrocarbon production would provide further impetus to PPL PA and MARI PA. We believe Banking sector would be another sector 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 HBL PA and MCB PA along with FABL PA for its conversion to Islamic story.

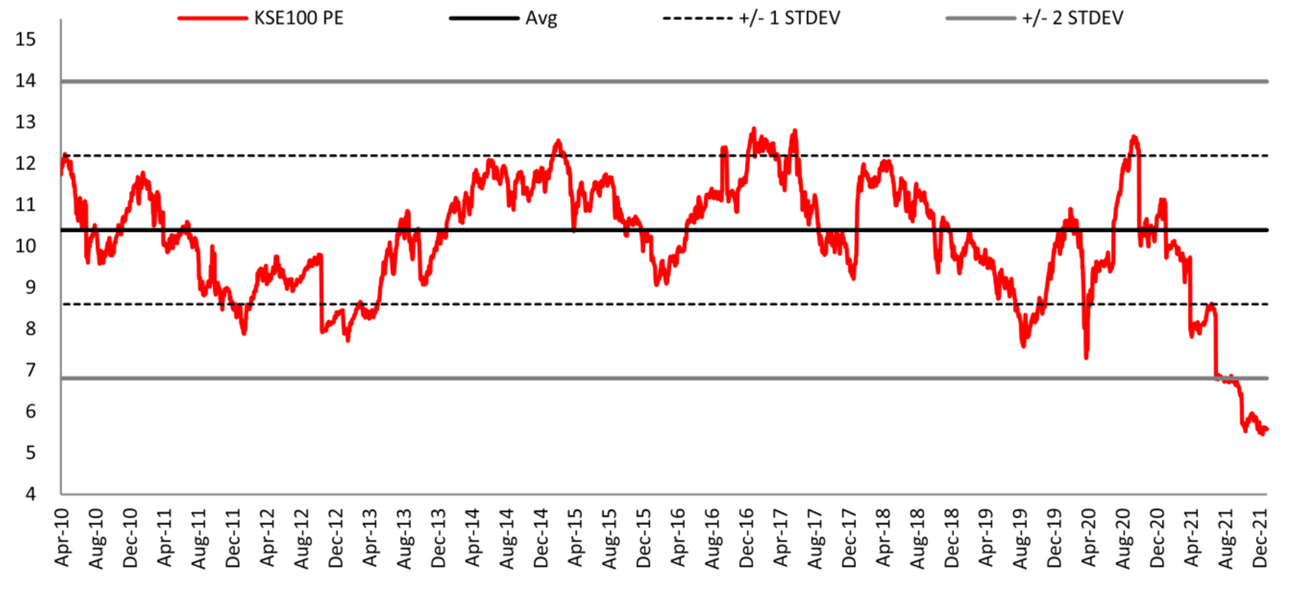
Fertilizers that have performed better for the last three years are expected to continue their upward trajectory and will remain in investor's radars in CY22 on the back of improving farmer's economics and government focus towards lowering perishable prices and ensuring food supply chain. The Power sector will remain in fashion given the likelihood of higher dividend payouts due to improved cash position on payments received in lieu of energy sector reforms. OMCs are expected to benefit from volumetric recovery 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 remain a beneficiary of drop in commodity cycle amid robust economic growth with improving retention prices and export of clinkers. LUCK PA, being conglomerate and FCCL on merger with Askari Cement are our top in the sector.

The auto sector would once again be on it's upwards trajectory as demand is expected to increase by the end of this year due to monetary easing, relatively stable rupee and improving economic metrics. On the other hand, Textile sectors will benefit from government export friendly policies. Steel sector is likely to rebound owing to reduced importers' market share. Technology is likely to take correction given rerating of multiples in line with 26% profitability growth. Chemicals are likely to remain under pressure due to normalization of margins as trade normalizes with the recovery of COVID.

Even earning growth approach yielding an index target of 58,938 by Dec-2022

Based on the earnings growth approach, our index target comes at 58,938 pts, implying an upside of ~32.8% (~24% in US$ terms) along with dividend yield of 7.4%. This translates into a total return of ~39.7% (~31.4% in US$ term). The target is primarily a function of an average FSL universe 10.5% earnings growth for the next year. Furthermore, we predict a slight rerating in market current PE multiple to last eleven years lower band of 6.3x against its recent value of 5.2x as the recent rally has priced in most of the negatives and trading even below negative standard deviation.

Fig 139: KSE-100 trading way below -2STDEV



Source: PSX, Foundation Research, January 2022

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. The PDM gaining substantial support or taking a drastic measure could create challenges for the government.
- ✓ Prolonged stay of Covid Omicron variant 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.
- ✓ Tougher rhetoric from the US administration in regards to changes in policy towards region after change in Government in Afghanistan post withdrawal of US forces could increase geopolitical uncertainty.
- ✓ 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 recovering local demand, 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.
- ✓ Stringent policies set by the FATF/failure of the government to comply with the recommendations could keep the country in the grey list for a prolonged period of time. Worsening of the AML/CTF situation, although highly unlikely, could even push the country into the black list.
- ✓ 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 23: Sector positioning in Model portfolio

Sector	Portfolio Stance	KSE-100 weight	Comments
Banks	Overweight	23%	Banks are expected to post sharp recovery in profitability in CY21-22 on the back of (1) surge in NIIs amid higher NIMs as interest rate rises, (2) over all recovery in non-interest income due to gain on sale of securities/FX and higher fee income given better trade cycle. This will be sufficient address the concern of provisioning risk as NPLs are expected to dilute given diversification of loan book. Banks are also attractive given recovery in PBV justifying their ROEs and higher dividend payout to play dividend yield.
Fertilizers	Overweight	12%	Strong agronomics given better performance of wheat/sugarcane/rice would allow base players to retain pricing power amid constrained Urea supply. Further support to profitability will came from (1) 4.0x higher landed cost for imported Urea compared to local price, (2) fiscal constraints to give subsidy to RLNG based fertilizer companies will for a longer tenure, (3) higher DAP trading margins and (4) delay in GIDC payment.
E&P	Overweight	11%	Elevated oil prices along with resolution of circular debt through energy sector reforms including rationalization of both electricity and gas tariffs would help to improve cash generation. Thus opening up avenues of growth through higher expenditure on exploration and development.
Cement	Overweight	9%	Higher cement retention prices in domestic market given increased demand. Exports of south region are also in recovery phase as freight charges are coming down and new venues for exports are opened. In FY23, in addition to private sector demand from public sector infrastructure will drive growth as we move closer to elections year. Availability of TERF/LTFF facilities for expansions will keep financing cost and debt repayment on lower side due to their long term and subsidized features.
Technology	Under Weight	7%	Sector is currently trading at significant premium to market given embedded risks. FSL technology universe reliance on business from associates (based on common directors not ownership structure) to drive growth has increased significantly that warrants a discount to comparable multiples as well but stocks are trading at vice versa. Furthermore, technology sector remain prone to inherent risks of (1) lower preference of long term contracts towards Pakistan due to risks of sustainability and (2) increased compliance due to presence of Pakistan in FATF grey list. Due to aforementioned reasons, some notable companies have already started expanding their operations in neighboring countries to gain business from developed markets.
Power	Market Weight	5%	Change in tariff structure from “Take or Pay” to “Take and Pay” structure would substantially dent sectors profitability.
OMCs	Overweight	3%	Volumes are expected to continue on growth trajectory given robust domestic demand and improved buying power amid economic growth. White oil margin revision would increase sector profitability going forward. Benefit of circular debt reform given payments to IPPs would be balanced by buildup of LNG receivables which would result in increased debt and finance cost amid monetary tightening in FY22.
Autos	Overweight	3%	Robust automobile demand coupled with recent price hike and high cash position of banks would keep profitability on higher side. The recent price hike would absorb pressure from currency depreciation and would keep margins intact. New players would create competitive landscape for HCAR, however PSMC and INDU would remain broad uncontended.
Chemical	Under Weight	3%	Decline in margins from record highs and increase in gas and electricity prices would dampen profitability. However, demand is expected to remain strong as economic growth continues.
Consumers	Overweight	3%	Sector will remain beneficiary due to (1) shift of consumers from loose milk to processed milk products, (2) reliance on domestic milk powder production, and (3) introduction of new products,.
Textiles	Overweight	3%	Electricity and gas availability at subsidized rate should improve sector profitability. Forthcoming textile policy and concessional financing (TERF/LTFF/EFS) would also provide a breather. Emergence of new COVID variant poses threat to textile exports in affected markets. Higher cotton prices pass through could be limited adversely affecting sector profitability.
Engineering	Overweight	2%	Market dynamics are improving for both flat/long steel companies. Flat steel sector profitability will improve due to 1) declining profit margins for private importers given higher HRC-CRC spread and 2) increased regulatory checks to curb under invoicing. However, long steel manufacturers will benefit from 1) shift of consumers from un-graded to graded sector, 2) start of price increase cycle and 3) increased penetration in retail segment. Furthermore, sector will benefit from decline in operating cycle.

Source: Foundation Research, January 2022

Table 24: Valuation Summary

Stocks	Mkt Cap	Mkt Price	TP	Upside	EPS			DPS			PE			PB		
	(US$ mn)	(Rs/sh)	(Rs/sh)	%	2021	2022	2023	2021	2022	2023	2021	2022	2023	2021	2022	2023
COMMERCIAL BANKS																
HBL	966	117	176	51%	23.5	25.6	27.3	7.0	8.0	10.0	5.0	4.6	4.3	0.6	0.6	0.6
MCB	1,027	153	212	38%	23.4	26.3	30.4	19.0	20.5	20.0	6.6	5.8	5.0	0.1	0.1	0.1
BAFL	347	35	46	33%	7.7	8.5	8.9	4.0	4.0	4.0	4.5	4.1	3.9	0.7	0.6	0.6
UBL	945	137	166	22%	24.5	25.9	30.2	16.0	16.0	16.0	5.6	5.3	4.5	0.8	0.8	0.7
MEBL	1,233	134	137	2%	17.1	18.7	19.5	5.2	6.0	8.0	7.8	7.2	6.9	2.5	2	1.7
FABL	197	23	36	55%	5.5	5.7	6.5	1.5	2.0	2.0	4.2	4.1	3.5	0.5	0.5	0.4
AKBL	157	22	35	59%	12.2	15.1	18.2	3.0	3.0	4.0	1.8	1.5	1.2	0.5	0.4	0.4
OIL & GAS EXPLORATION COMPANIES																
OGDC	2,095	86	150	74%	21.3	28.1	29.2	6.9	7.0	6.0	4.1	3.1	2.9	0.5	0.4	0.4
POL	574	358	408	14%	48.5	74.5	70.0	50.0	60.0	56.0	7.4	4.8	5.1	2.6	2.2	2.1
PPL	1,215	79	152	92%	19.5	24.6	25.9	2.0	2.0	3.0	4.1	3.2	3.0	0.6	0.5	0.4
MARI	1,247	1,654	2,039	23%	235.7	281.7	369.7	141.0	140.0	140.0	7.0	5.9	4.5	1.6	1.3	1.1
PSO	482	182	289	59%	62.1	58.6	52.2	15.0	14.0	17.0	2.9	3.1	3.5	0.6	0.5	0.5
APL	177	314	414	32%	49.4	53.7	36.9	27.0	37.5	27.5	6.4	5.8	8.5	1.4	1.3	1.2
FERTILIZER																
ENGRO	887	272	322	18%	55.4	51.5	46.4	29.0	23.0	30.0	4.9	5.3	5.9	0.6	0.5	0.5
FFBL	181	25	40	61%	8.1	6.7	7.8	2.0	3.0	3.0	3.1	3.7	3.2	0.9	0.8	0.7
FFC	721	100	142	42%	17.9	19.3	20.9	14.4	16.4	17.8	5.6	5.2	4.8	2.6	2.5	2.3
EFERT	574	76	62	-18%	15.6	13.3	11.4	15.0	6.5	5.0	4.9	5.7	6.7	2.3	2.4	2.4
POWER GENERATION & DISTRIBUTION																
HUBC	523	71	89	25%	26.0	26.6	35.1	8.0	7.0	9.6	2.7	2.7	2.0	0.8	0.7	0.5
KAPCO	161	32	54	67%	11.6	9.2	10.1	10.0	9.2	6.1	2.8	3.5	3.2	0.4	0.4	0.4
LPL	30	14	16	11%	(1.5)	10.3	2.6	3.0	4.0	2.1	(9.1)	1.4	5.4	0.3	0.3	0.3
PKGP	50	24	26	8%	2.9	8.4	3.6	4.0	7.5	3.6	8.2	2.9	6.6	0.4	0.4	0.4
NPL	40	20	32	60%	7.6	7.8	5.8	1.5	1.5	8.0	2.6	2.5	3.4	0.3	0.2	0.2
NCPL	33	16	17	3%	6.8	5.6	4.4	-	2.0	3.0	2.3	2.9	3.7	0.3	0.2	0.2
CEMENT																
ACPL	108	139	150	8%	8.1	5.8	10.1	4.0	1.2	2.0	17.2	24.0	14	0.9	0.9	0.8
DGKC	205	83	130	57%	8.5	6.2	11.0	1.0	-	1.0	9.8	13.5	7.5	0.5	0.5	0.4
CHCC	163	148	188	27%	16.5	18.7	24.1	2.2	1.0	2.2	9.0	7.9	6.2	2.1	1.7	1.4
LUCK	1,241	679	918	35%	70.7	91.8	125.3	-	3.0	8.0	9.6	7.4	5.4	1.4	1.1	0.9
KOHC	214	189	224	19%	17.4	19.6	25.7	-	-	-	10.8	9.6	7.3	1.7	1.4	1.2
FCCL	143	18	31	66%	2.5	3.7	4.8	-	-	-	7.3	5.0	3.8	1.1	0.9	0.7
PIOC	114	89	121	37%	8.7	9.1	15.3	-	1.0	1.5	10.2	9.8	5.8	1.3	1.2	1.0
AUTOMOBILE ASSEMBLER																
INDU	546	1,229	1,570	28%	163.2	217.3	201.1	103.5	108.5	141.0	7.5	5.7	6.1	2.0	1.7	1.6
PSMC	108	233	301	29%	32.2	26.6	32.1	-	8.0	8.0	7.3	8.8	7.3	0.7	0.7	0.6
HCAR	191	237	283	20%	12.6	26.9	24.4	4.5	7.0	7.0	18.9	8.8	9.7	1.9	1.6	1.4
FOOD & PERSONAL CARE PRODUCTS																
FCEPL	367	85	97	15%	3.4	3.2	5.0	-	-	-	25.1	26.6	16.8	5.8	4.8	3.7
CHEMICAL																
LOTCHEM	117	14	17	24%	2.6	2.1	2.1	1.5	1.3	1.3	5.3	6.4	6.5	1.0	1.0	0.9
EPCL	278	54	41	-24%	16.4	11.4	7.2	12.0	5.0	6.5	3.3	4.7	7.5	1.6	1.4	1.3
TEXTILE COMPOSITE																
NML	158	80	129	63%	16.8	22.1	14.7	4.0	5.2	4.0	4.7	3.6	5.4	0.3	0.3	0.3
ILP	369	73	105	44%	7.0	8.9	12.2	2.4	3.2	6.8	10.4	8.1	6.0	3.2	2.5	1.9
TECHNOLOGY & COMMUNICATION																
SYS	593	760	524	-31%	28.0	35.2	41.3	7.0	8.8	10.3	27.1	21.6	18.4	9.1	6.8	5.3
ENGINEERING																
MUGHAL	197	104	110	6%	10.2	14.5	16.7	2.2	5.0	6.0	10.2	7.2	6.2	3.1	2.3	1.8
AGHA	89	26	37	43%	3.4	3.7	4.7	-	-	0.9	7.8	7.0	5.5	1.1	1.0	0.9
ASTL	75	45	72	62%	4.6	9.4	12.7	-	2.0	3.0	9.7	4.7	3.5	1.4	1.1	0.9
ISL	162	66	123	86%	17.2	20.2	17.0	10.0	10.0	10.0	3.9	3.3	3.9	1.5	1.2	1.1

Source: PSX, Foundation Research, January 2022

CY22 Major Events Timeline

January
- IMF board meeting to discuss 6th review
- Mini Budget Approval
- MPC meeting
- PIB Auction with a Target of Rs175bn
- T Bill Auction with a Target of Rs1.375tr
- COD of LEPCL

February
- FATF: Pakistan's fourth progress report
- MSCI Quarterly Index Review
- PIB Auction with a Target of Rs175bn
- T Bill Auction with a Target of Rs900bn
- OPEC+ planned to increase of oil output target by 400,000 barrels per day

March
- MPC meeting
- Local Body Elections in Punjab
- Second phase of LB polls in KP
- TEL COD of 330MW power plant
- Launch of Suzuki Swift by PSMC
- IMF Seventh Review
- US FED meeting

April
- MPC meeting
- FATF's review session
- 720MW Karot Hydropower Project, AJK/Punjab
- MARI GTH gas processing phase I

May
- MSCI Semi-Annual Index Review
- US FED meeting to decide policy rate

June
- MPC meeting
- COD of Thal Nova 330 MW coal power plant
- FY23 Budget
- Disbursement of circular debt payment
- MARI GTH gas processing phase II

July
- US FED meeting to decide policy rate
- MARI GTH gas processing phase III

August
- MSCI Quarterly Index Review
- Thar Coal Block-I Power Generation Co. Ltd. COD

September
- US FED meeting to decide policy rate
- IMF Eighth review
- LOADS to achieve COD of allow wheel project

October
- Expiry of KAPCO PPA
- FATF Review Session

November
- MSCI Semi-Annual Index
- US mid Term Elections

December
- Suki Kinari Hydropower Project
- INDU to launch first Hybrid Vehicle
- COD of LUCK 3.1mn tons cement plant

TOP PICKS

LARGE CAP

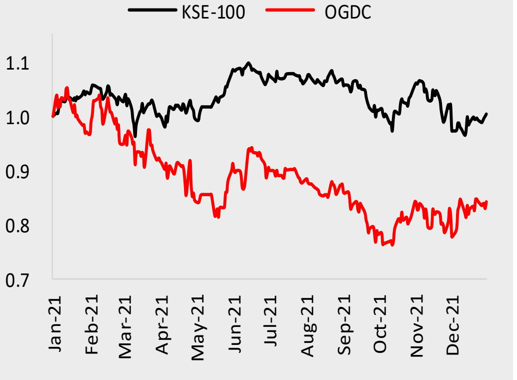
OGDC PA **Outperform**

Price (31 Dec 21 CP)	Rs	86.2
Dec-22 Target Price	Rs	149.6
Upside/Downside	%	73.5
12M Target Price	Rs	149.6
- Reserve Based Methodology		
Sector		E&P
Market cap	Rs bn	370.7
30-day avg turnover	$ m	1.4
Market cap	$ m	2,391.9
Freet float	%	15.0
Shares issued	m	4,300.9

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	239,104	300,600	306,382	302,414
EBITDA	m	163,937	211,349	209,835	202,052
EBITDA Growth	%	(14.3)	22.3	28.0	(4.4)
PBT	m	128,986	181,051	177,020	178,181
Recurring Profit	m	91,534	120,787	125,685	126,509
Net Profit	m	91,534	120,787	125,685	126,509
EPS reported	Rs	21.3	28.1	29.2	29.4
Rev growth	%	(2.3)	25.7	1.9	(1.3)
EPS growth	%	(8.5)	32.0	4.1	0.7
PE	x	4.1	3.1	2.9	2.9
DPS	Rs	6.9	7.0	6.0	10.0
Div. Yield	%	8.0	8.1	7.0	11.6
ROA	%	9.9	12.1	11.4	10.6
ROE	%	12.4	14.8	13.8	12.6
EV/EBITDA	x	1.1	0.7	0.8	0.7
Net D/E	x	(0.2)	(0.3)	(0.2)	(0.2)
Price to Book	x	0.5	0.4	0.4	0.4
Price to Sales	x	1.6	1.2	1.2	1.2

OGDC KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Oil and Gas Development Company

Circular debt resolution to rerate the multiple

Event

- Higher oil prices, dollar hedged revenue, debt free balance sheet and improving cash flows given better recoveries from gas make a strong investment case for the stock. 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. During FY21 OGDC has generated cash flow of ~Rs50bn despite the fact that company's receivable increased by 17% YoY. In our base case, we have assumed receivables to grow by an average 60% of gas revenue for the period of next three years.

- **Production plateau expected to sustain:** OGDCL exploratory efforts yielded significant discovery of 37mmcfd of gas and 2,850bpd of oil at Wali Block KPK province with reserve size of 293bcf of gas and 2,850 bpd of oil. This discovery includes flows from Kawagarh, Hangu and Lockhart formation of Wali-1. The discovery would have an EPS impact of Rs1.0/2.1/2.2 in FY23E/FY24E/FY25E. Subsequently, translates into TP impact of ~Rs11/sh based.

- Moreover, increase in oil prices would expedite exploration and development activities at multiple locations including Qadirpur, Meru-Reti, Dakhni, KPD-TAY, Uch, Mela, Khewari, Gundanwari & Chabro and Nashpa. These efforts would help company to maintain its' production profile. These activities would sustain gas flows and maintain its production from ageing fields. Newer flows would replace gas flows priced at lower rates with those priced at higher pricing.

- **Sustained oil prices to enhance certainty of profitability:** Arab light averaging at US$76.9/bbl during 1HFY22 (up by 76.8% YoY) as demand rebounded amid constrained supply. However, we expect AL to drop going forward to average US$60bbl in the long run, which would be still ~11% higher than the level witnessed during FY20/FY21. This would enhance our comfort on our forecasted profitability. To highlight, we have kept our Arab light assumption at US$74.5/64.0/60.0/bbl for FY22/23/FY24 onwards.

Earnings Revision

- We revise up our earnings by 17%/14% for FY22/FY23 as we tweak assumption of dollar, volumetric, AL and exploration expense.

Price Catalyst

- Dec-22 TP: Rs149.6/sh based on Reserve Based Methodology.

- Catalyst: (1) Energy sector reforms in particular resolution of circular debt, (2) commencement of Nashpa, Qadirpur and Uch compression facility and (3) subdued electricity demand.

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

Outlook

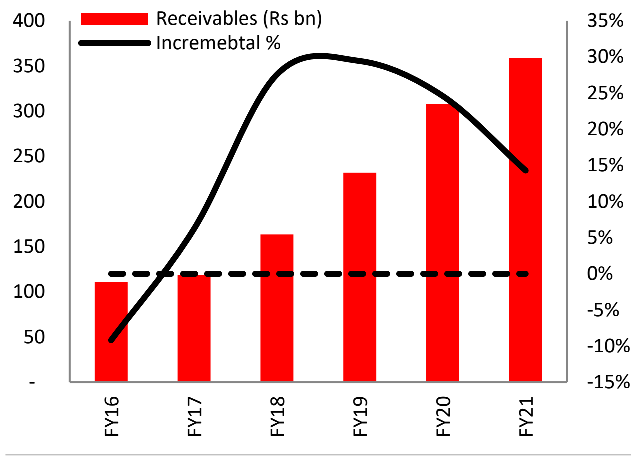
- We have an 'Outperform' rating on the stock that is trading at FY22/23 PE of 3.1/2.9x.

Table 25: Development projects of OGDC

Name of Project	Location of Project	Working Interest Owners	Completion Date	Current Status
Qadirpur Compression	Ghotki, Sindh	75%	Nov-21	Installation under way
Maru-Reti Compression	Ghotki, Sindh	57.76%	Aug-22	Hiring of PC contractor for installation is in progress
Dakhni Compression	Attock, Punjab	100%	Mar-23	Hiring of EPC contractor is in progress
KPD-TAY Compression	Hyderabad, Sindh	KPD: 100% TAY: 77.50%	Jul-23	Hiring of EPC contractor is in progress
Uch Compression	Dera Bugti, Balochistan	100%	Oct-23	Hiring of EPC contractor is in progress

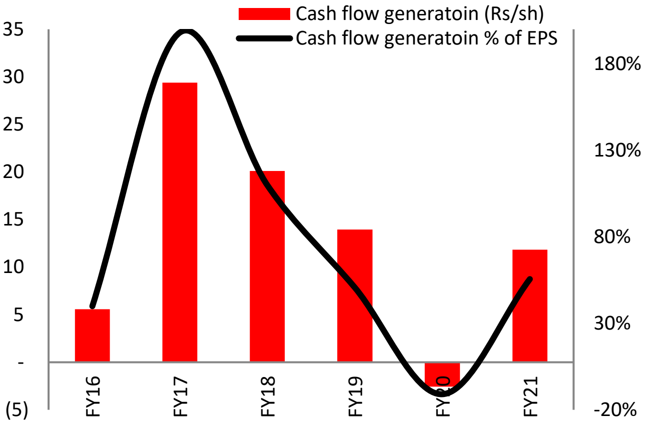
Source: Company Accounts, Foundation Research, January 2022

Fig 140: Receivables accumulation slowing down…



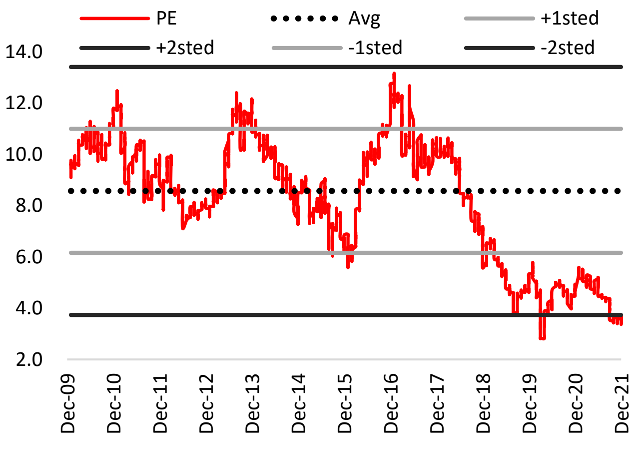
Source: Company reports, FSL Research, January 2022

Fig 141: …as cash flow generation started to improve



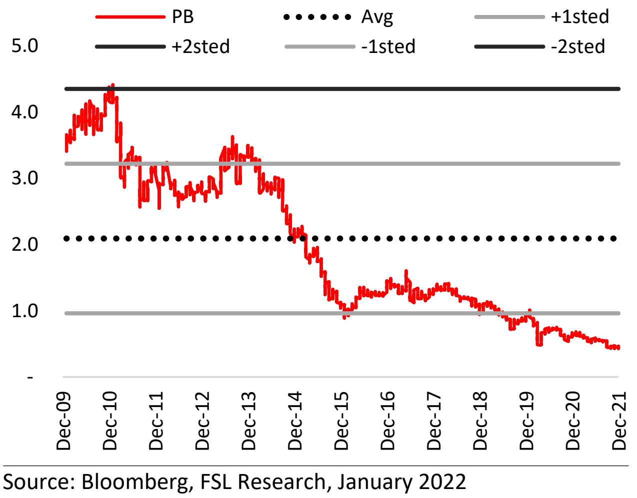
Source: PPIS, FSL Research, January 2022

Fig 142: Trading at -2Sted on PE basis



Source: Bloomberg, FSL Research, January 2022

Fig 143: … down on P/B as well



Source: Bloomberg, FSL Research, January 2022

Table 26: Oil and Gas Development Company Limited (OGDC PA, 'Outperform', Dec-22 TP Rs149.6/sh)

Balance Sheet		FY21A	FY22E	FY23E	FY24E
PP&E	m	210,394	209,936	219,493	219,946
Cash & ST inv	m	186,267	222,529	209,993	237,107
LT invest	m	45,526	45,526	45,526	45,526
Inventory	m	19,574	22,236	22,655	22,361
Acct. Rec	m	358,822	448,079	548,226	607,795
Other Assets	m	135,411	100,441	102,619	104,552
Total Assets	**m**	**955,994**	**1,048,747**	**1,148,511**	**1,237,286**
Acct. payable	m	72,357	90,592	88,101	91,099
Deffered tax	m	27,668	26,604	25,581	24,597
Dism. Allow	m	28,992	28,992	28,992	28,992
Others	m	57,332	42,235	45,634	48,896
Total Liab	**m**	**186,350**	**188,423**	**188,308**	**193,584**
Paid-up Capital	m				
Reserves	m	43,009	43,009	43,009	43,009
SH' Equity	**m**	726,635	817,315	917,194	1,000,693
L+E	**m**	**769,644**	**860,324**	**960,203**	**1,043,702**

Profit & Loss		FY21A	FY22E	FY23E	FY24E
Net Sales	m	239,104	300,600	306,382	302,414
Op. Cost	m	71,935	75,976	87,883	93,800
Royalty	m	27,422	37,374	35,220	34,763
Gross Profit	**m**	**139,746**	**187,250**	**183,279**	**173,852**
S&A	m	4,668	6,118	5,996	6,414
Exp. Write off	m	17,366	20,483	19,813	8,322
Other Inc	**m**	20,268	32,618	30,111	29,708
Other Charges	m	6,789	9,529	7,873	7,956
EBIT	**m**	**131,191**	**183,738**	**179,708**	**180,868**
Finance cost	m	2,205	2,687	2,687	2,687
PBT	**m**	**128,986**	**181,051**	**177,020**	**178,181**
Taxation	m	37,452	60,264	51,336	51,673
PAT	**m**	**91,534**	**120,787**	**125,685**	**126,509**
EPS (rep)	Rs	21.3	28.1	29.2	29.4
EPS growth	%	-9%	32%	4%	1%
DPS	Rs	6.9	7.0	6.0	10.0

Quarterly		1Q'22A	2Q'22E	3Q'22E	4Q'22E
Net Sales	m	71,531	74,992	77,594	76,483
Op. Cost	m	16,575	18,727	19,621	21,053
Royalty	**m**	8,242	9,374	10,197	9,560
Gross Profit	m	**46,714**	**46,891**	**47,776**	**45,870**
S&A	m	1,545	1,497	1,549	1,527
Exp. Write off	m	2,283	4,700	6,500	7,000
Other Inc	m	12,697	7,961	5,980	5,980
Other Charges	**m**	2,751	2,397	2,250	2,131
EBIT	**m**	**52,833**	**46,257**	**43,456**	**41,192**
Fin Cost	m	563	708	708	708
PBT	**m**	**52,270**	**45,549**	**42,748**	**40,484**
Tax	m	18,640	13,966	15,245	12,413
PAT	**m**	**33,629**	**31,583**	**27,503**	**28,071**
EPS (rep)	Rs	7.8	7.3	6.4	6.5
DPS (rep)	Rs	1.5	2.0	1.5	2.0

Key ratios		FY21A	FY22E	FY23E	FY24E
BVPS	Rs	178.9	200.0	223.3	242.7
EPS	Rs	21.3	28.1	29.2	29.4
PE	x	4.1	3.1	2.9	2.9
PBv	x	0.5	0.4	0.4	0.4
GP margins	%	58%	62%	60%	57%
EBITDA margin	%	69%	70%	69%	67%
EBIT margin	%	55%	61%	59%	60%
Net margin	%	38%	40%	41%	42%
ROE	%	12%	14%	13%	12%
ROA	%	10%	12%	11%	11%
Earnings yield	%	22%	29%	31%	31%
Payout Ratio	%	32%	25%	21%	34%
Dividend Yield	%	8%	8%	7%	12%
EV/EBITDA	x	1.0	0.8	0.8	0.8

Source: Company data, Foundation Research, January 2022
All figures in Rs unless noted

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

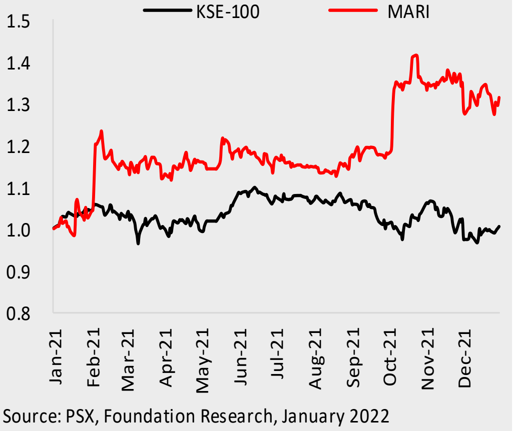
MARI PA **Outperform**

Price (31 Dec 21 CP)	Rs	1,654.2
Dec-22 Target Price	Rs	2,039.2
Upside/Downside	%	23.3
12M Target Price	Rs	2,039.2
- DCF methodology		
Sector		E&P
Market cap	Rs bn	220.7
30-day avg turnover	$ m	0.3
Market cap	$ m	1,423.7
Freet float	%	20.0
Shares issued	m	133.4

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	73,018	89,572	112,113	114,481
EBITDA	m	52,171	67,923	81,705	82,206
EBITDA Growth	%	18.6	28.2	56.6	21.0
PBT	m	43,931	53,378	68,670	69,726
Recurring Profit	m	31,445	37,584	49,319	50,198
Net Profit	m	31,445	37,584	49,319	50,198
EPS reported	Rs	235.7	281.7	369.7	376.3
Rev growth	%	1.4	22.7	25.2	2.1
EPS growth	%	3.7	19.5	31.2	1.8
PE	x	7.0	5.9	4.5	4.4
DPS	Rs	141.0	140.0	140.0	155.0
Div. Yield	%	8.5	8.5	8.5	9.4
ROA	%	22.7	23.2	25.6	22.5
ROE	%	25.2	25.1	27.4	24.3
EV/EBITDA	x	3.3	2.5	1.9	1.8
Net D/E	x	(0.4)	(0.3)	(0.3)	(0.3)
Price to Book	x	1.6	1.3	1.1	1.0
Price to Sales	x	3.0	2.5	2.0	1.9

MARI KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Mari Petroleum Company Ltd

Focusing on growth with aim of diversification

Event

- Materialization of lower Goru-B reserves, enhanced probability of continuation of flows on incremental pricing from HRL, immunity to circular debt, aggressive exploration drive in Hydrocarbon enrich areas and expanding offshore compel us to have "Outperform" rating for the stock.

Impact

- **GTH to enhance production capacity by 30% in years' time:** Installation of GTH gas processing facility would enable the company to process 280mmcfd of gas in one years' time. Company is planning to add processed gas to the system in phased manner. In Phase-1 40mmcfd of gas from Tipu would be added to the system by 3QFY22. Afterwards, in phase-2 gas Goru-B gas would be added to the system in 4QFY22. By Jul'22 the processing facility would be able to process unutilized volumes of HRL. Total volume of the processed gas from the project would be ~150mmcfd. This project would add ~Rs57/Rs69/Rs73 to company's profitability of FY23/FY24/FY25 and increase our target price by ~25%.
- **…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 would help to sale 40mmcfd of HRL incremental flows to SNGPL. Right now company is selling 8-10 mmcfd of HRL to SNGPL by using Pak Arab gas infrastructure. This compression facility could be enhanced to inject ~45mmcfd of gas to SNGPL.
- Simultaneously company is working to maintain gas pressure for which 16 flow loops were identified out which 14 loops has been commissioned, resulting in a pressure gain of 60-70psig at the same flow rate. These debottlenecking measures at Habib Rahi Limestone (HRL) along with drilling of wells would enable the company to sustain and prolong period of 650mmcfd plateau, in our view. We have assumed sustainability of the plateau till FY24 with average flows of 650mmcfd in our valuations.
- **Peripheral exploration may yield significant results:** Company has started seismic and exploration activities in Bannu west and block-28 that has the potential for discoveries equivalent to Sui and Mari. Drilling of first ever exploratory well in Bannu West in in progress while acquisition of seismic data has been completed for Block-28.

Earnings Revision

- We have revised our earnings forecast up by 9.2%/24.2% for FY22/FY23 given change in assumption of flows from MARI HRL, Tipu and lower Goru B along with change in dollar appreciation and Arab Light. Subsequently, revised our TP upward for Dec-22 by 7.7%.

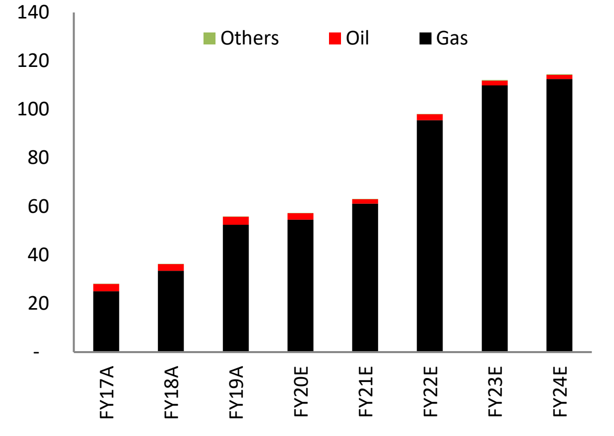
Price Catalyst

- Dec-22 TP: Rs2,039.2/sh based on Reserve based methodology
- Catalyst: 1) Materialization of potential flows from MARI HRL, Tipu & Lower Goru B, 2) sustainability of MARI HRL flows at these levels, 3) successful find from exploratory activities in Bannu West Block, 4) positive result of seismic activity and exploratory well in Block-28, and 5) commencement of work at mining project in Balochistan.
- Risks: 1) Major reliance of revenue on MARI field, 2) higher dry well cost and 3) fall in flows of MARI HRL.

Outlook

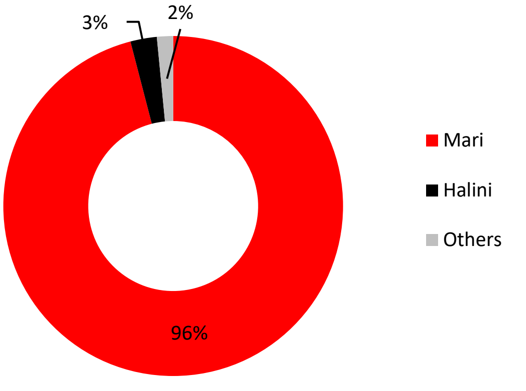
- We have an "Outperform" stance on the scrip with TP of Rs2,039.2/sh.

Fig 144: Gas forms the major chunk of revenue



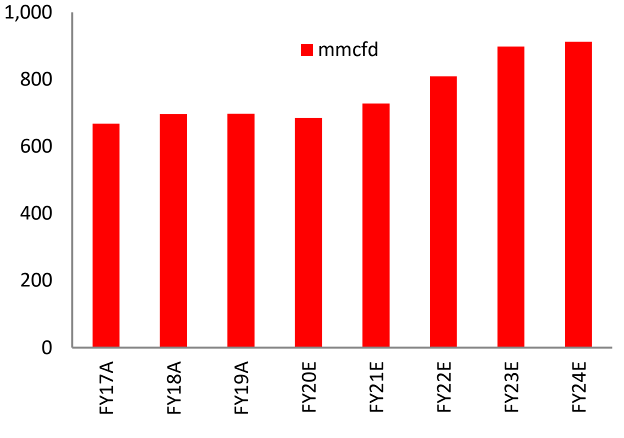
Source: PPIS, Foundation Research, January 2022

Fig 145: with majority of revenue coming from MARI



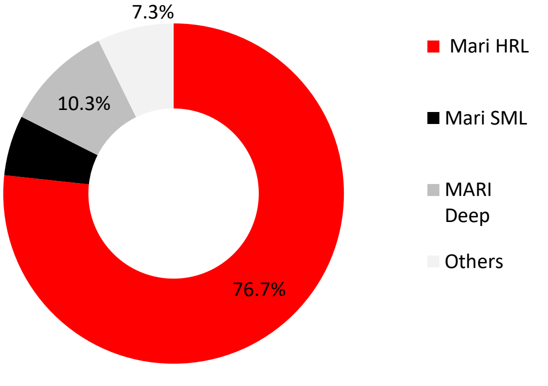
Source: PPIS, Foundation Research, January 2022

Fig 146: Gas flows to cross 900 mmcfd by FY24



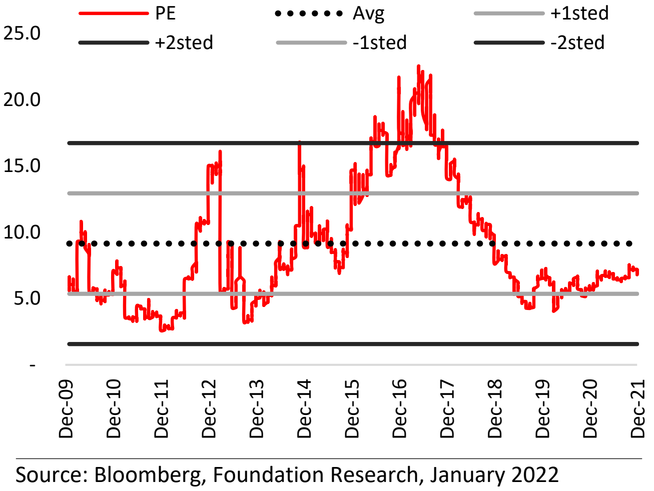
Source: PPIS, Foundation Research, January 2022

Fig 147: with slight reduction in reliance on MARI HRL



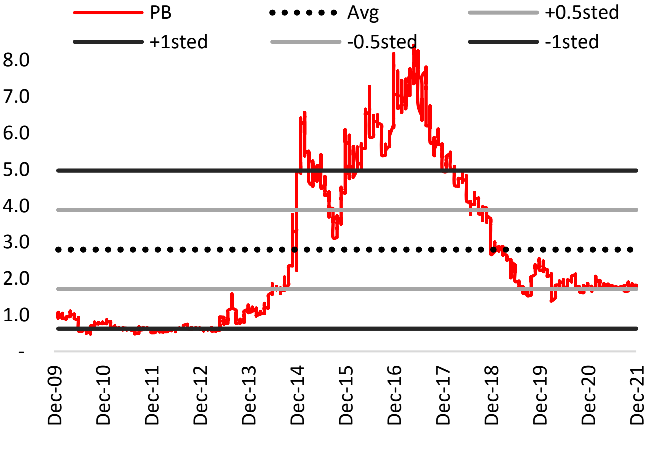
Source: PPIS, Foundation Research, January 2022

Fig 148: Trading below historical average on PE…



Source: Bloomberg, Foundation Research, January 2022

Fig 149: …lower on PB as well



Source: Bloomberg, Foundation Research, January 2022

Table 27: MARI Petroleum Limited (MARI PA, Outperform, Dec-22 Target price Rs2,039.2)

Balance Sheet		2021A	2022E	2023E	2024E
Fixed Assets	m	61,069	75,747	93,325	103,396
Others	m	3,587	3,587	3,587	3,587
Total NC Assets	m	**64,925**	**79,603**	**97,181**	**107,252**
Inventories	m	2,867	3,540	4,431	4,524
Accounts rec	m	28,047	30,888	36,524	41,998
Cash & Inv	m	48,604	53,638	65,977	74,310
Current Asset	m	**85,462**	**94,306**	**113,484**	**127,713**
Reserves	m	**114,200**	**133,106**	**163,747**	**193,267**
Sh' equity	m	**115,534**	**134,440**	**165,081**	**194,601**
LT financing	m	-	-	-	-
Non-current Liab	m	**11,172**	**11,554**	**12,005**	**12,499**
Trade payables	m	17,257	21,169	26,496	20,783
Others	m	6,424	6,745	7,083	7,083
Current Liab	m	**23,681**	**27,914**	**33,579**	**27,865**
SH.Equity + Liab	m	**150,386**	**173,909**	**210,665**	**234,965**

Profit & Loss		2021A	2022E	2023E	2024E
Revenue	**m**	**73,018**	**89,572**	**112,113**	**114,481**
Op cost	m	11,532	10,240	15,213	16,759
Royalty	m	9,315	11,409	15,195	15,516
EBITDAX	m	**52,171**	**67,923**	**81,705**	**82,206**
D&A	m	3,508	6,159	7,372	8,121
Dismantling cost	m	274	332	397	437
Exp & Devel		4,544	7,749	3,635	3,181
EBIT	**m**	**44,120**	**54,016**	**70,698**	**70,905**
Interest income	m	4,205	3,544	4,023	4,948
Financial cost	m	1,310	774	1,120	1,120
Other charges	m	3,082	3,408	4,931	5,007
PBT	m	**43,931**	**53,378**	**68,670**	**69,726**
Tax expense	m	12,486	15,794	19,351	19,528
PAT	m	**31,445**	**37,584**	**49,319**	**50,198**
EPS	**Rs**	**235.7**	**281.7**	**369.7**	**376.3**
DPS	**Rs**	141.0	140.0	140.0	155.0

Q'Profit and Loss		1QFY22	2QFY22	3QFY22	4QFY22
Revenue	m	20,726	20,719	23,633	24,494
Operating & D&A	m	3,273	4,273	4,357	4,496
Royalty	m	2,640	2,639	3,010	3,120
Exp.write -offs	m	**1,749**	**1,800**	**2,000**	**2,200**
EBIT	m	13,064	12,007	14,266	14,678
Interest income	**m**	**871**	**891**	**891**	**891**
Financal cost	m	99	225	225	225
Other charges	m	788	788	899	932
PBT	**m**	**13,047**	**11,885**	**14,033**	**14,412**
Tax expense	m	3,949	3,497	4,119	4,229
PAT	**m**	**9,099**	**8,389**	**9,914**	**10,183**
EPS	**Rs**	**68.2**	**62.9**	**74.3**	**76.3**
DPS	**Rs**	**-**	**60.0**	**-**	**80.0**

Key Ratios		2021A	2022E	2023E	2024E
EPS rep	Rs	235.7	281.7	369.7	376.3
EPS Growth	%	3.7	19.5	31.2	1.8
EBITDAX margins	%	71.4	75.8	72.9	71.8
EBIT margins	%	60.4	60.3	63.1	61.9
Net margins	%	43.1	42.0	44.0	43.8
BVPS	Rs	866	1,008	1,237	1,459
P/BV	x	1.9	1.6	1.3	1.1
P/E	x	7.0	5.8	4.4	4.4
DPS	Rs	141.0	140.0	140.0	155.0
Payout	**%**	59.8	49.7	37.9	41.2
ROA	**%**	22.7	23.2	25.6	22.5
ROE	%	25.2	25.1	27.4	24.3

Source: Company data, Foundation Research, January 2022
All figures are in Rs unless noted

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

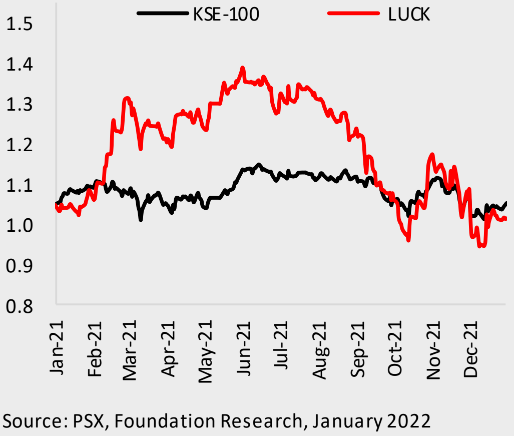
LUCK PA — Outperform

Price (31 Dec 21 CP)	Rs	679.3
Dec-22 Target Price	Rs	918.0
Upside/Downside	%	35.1
12M Target Price	Rs	918.0
- Sum-of-Parts		
Sector		Cements
Market cap	Rs bn	219.7
30-day avg turnover	$ m	1.9
Market cap	$ m	1,417.2
Freet float	%	40.0
Shares issued	m	323.4

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	207,159	296,832	380,715	435,500
EBITDA	m	36,941	44,572	66,058	73,449
EBITDA Growth	%	101.4	292.1	78.8	64.8
PBT	m	33,002	43,395	58,383	68,374
Recurring Profit	m	22,858	29,689	40,512	44,815
Net Profit	m	22,858	29,689	40,512	44,815
EPS reported	Rs	70.7	91.8	125.3	138.6
Rev growth	%	67.4	43.3	28.3	14.4
EPS growth	%	272.8	29.9	36.5	10.6
PE	x	9.6	7.4	5.4	4.9
DPS	Rs	-	3.0	8.0	28.0
Div. Yield	%	-	0.4	1.2	4.1
ROA	%	7.0	7.9	-	-
ROE	%	15.8	17.0	18.9	17.5
EV/EBITDA	x	7.9	6.8	4.7	4.2
Net D/E	x	0.5	0.4	0.4	0.3
Price to Book	x	1.4	1.1	0.9	0.8
Price to Sales	x	1.1	0.7	0.6	0.5

LUCK KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Lucky Cement Limited

A sum-of-the-parts story; solid all across

Event

- Company will maintain its dominant position as largest domestic cement player post ongoing expansion cycle of FY21-24 and will post earnings 3 years earnings CAGR of 21%. Furthermore, LUCK is expected to witness continuous growth in profitability due to (1) better cement retention prices in domestic market amid higher volumes, (2) COD of 660MW LEPCL coal fired power plant, (3) increased profit contribution from LMC given introduction of new variants and pricing power, (4) better profitability of ICI amid increased shareholding in NutriCo Pakistan and (5) higher share of profit from Iraq/Congo cement businesses.

Impact

- **LUCK will maintain its position as largest domestic cement player:** Post expansion of 3.1mn tons capacity at its Pezu site LUCK capacity will be increased to 15.4mn tons and company would keep its dominancy in domestic cement industry with market share of 16% (13/29% in north/south regions). The company would benefit from rising construction demand with domestic dispatches growth expected at 5.6/10.5/6.1% in FY22/23/24. In southern region, industry is expected to take lead in domestic cement dispatches growth due to strong institutional demand but its impact would be restricted by decline in exports. To highlight, south region will witness growth of 14/11/7% in domestic dispatches in FY22/23/24, while north region domestic growth would be 4/11/6% in FY22/23/24, in our view.

- On pricing front we expects domestic players would retain pricing discipline in companies will pass on the impact of higher fuel/energy cost and inflation impact in a timely manner as utilization will be increased to 91% in FY23. To highlight, recent surge in coal prices is expected to normalize in 4QFY22 as winter demand eases.

- **Lucky Motor Corporation and ICI to provide stability in earnings:** LMC within a short span of time has become the third largest automobile domestic company with its leadership position in SUV segment. To highlight, LMC will contribute Rs20.3/22.1/sh in LUCK profitability in FY22/23. Furthermore, support to profitability would came from higher profitability of ICI given better Polyester and Soda Ash segment profitability amid increased shareholding in NutriCo Pakistan (Private) Limited.

- **With earnings contribution ~40% LEPCL to dominate earnings growth:** Apart from earnings diversification LEPCL upcoming 660MW coal fired power plant would also dilute the impact of rupee depreciation on company's profitability given dollar indexation. The project is delayed from its targeted COD date due to cross border travel restrictions post COVID outbreak and connectivity issues with the grid. The project is expected to contribute Rs25.1/52.5/55.2/sh in FY22/23/24 profitability.

Earnings Revision

- We have revised up down our FY22/23 EPS by 4/2% due to revised assumption of cement demand and higher commodity prices.

Price Catalyst

- Dec-22 TP: Rs918.0/sh based on sum of the Parts (SOTP) methodology.

- Catalyst: (1) better cement retention prices, (2) 3.1mn tons expansion in north and (3) COD of 660MW LEPCL power plant.

- Risk: (1) delay in expansion projects, (2) price war, and (3) revision of LEPCL tariff.

Outlook

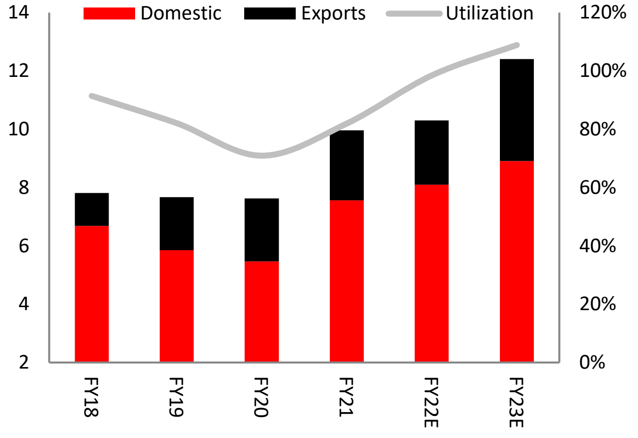
- We have an 'Outperform' stance on the stock with Dec-22 TP of Rs918.0/sh.

Table 28: LUCK sum of the parts valuation (Rs/sh)

Company	Valuation (Rs mn)	Shares held (%)	Portfolio Discount	LUCK share in value	Rs/sh TP contribution	% Contribution in TP
Cement standalone	142,484			142,484	440.6	48%
LEPCL (Power)	57,826	100%	25%	43,369	134.1	15%
LMC (KIA)	78,522	71%	25%	41,895	129.6	14%
ICI	73,888	55%	20%	32,511	100.5	11%
Iraq	57,866	50%	25%	21,700	67.1	7%
Congo	34,730	50%	25%	13,024	40.3	4%
Yunus Energy	13,384	20%	30%	1,874	5.8	1%
No of shares outstanding (mn)				323		
Dec-22 TP (PKR)					**918.0**	**100%**

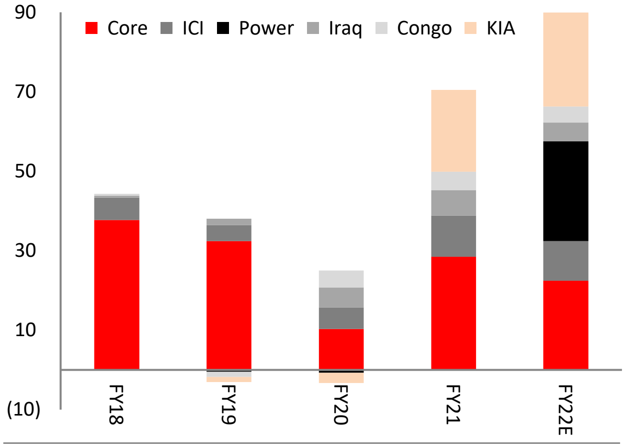
Source: Company Accounts, Foundation Research, January 2022

Fig 150: Dispatches to grow above industry avg (mn tons)



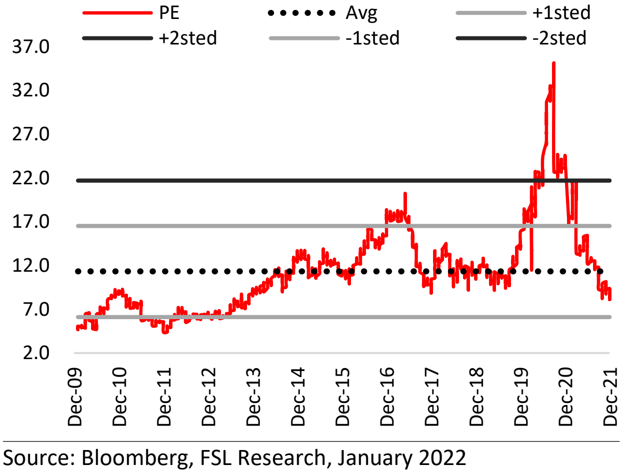
Source: Company reports, FSL Research, January 2022

Fig 151: LEPCL earnings contribution to start from FY22



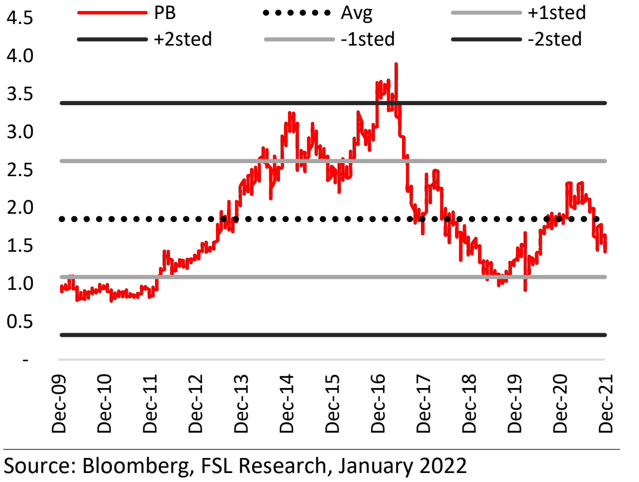
Source: Company reports, FSL Research, January 2022

Fig 152: Trading below historical average on PE



Source: Bloomberg, FSL Research, January 2022

Fig 153: Trading below historical average on PB



Source: Bloomberg, FSL Research, January 2022

Table 29: Lucky Cement Company Limited (LUCK PA, 'Outperform', Dec-22TP Rs918.0/sh)

Balance sheet		**FY21A**	**FY22E**	**FY23E**	**FY24E**
PP&E	m	215,725	238,725	256,725	249,725
Trade debt	m	5,645	8,839	11,839	14,839
Cash & Inv	m	39,664	40,862	44,091	54,729
Other assets	m	100,363	131,472	153,243	164,604
Total Assets	**m**	**361,398**	**419,898**	**465,898**	**483,898**
Total debt	m	110,911	127,111	138,311	119,311
Trade payable	m	70,918	74,518	66,518	59,518
Other Liab	m	22,542	28,496	30,970	34,600
Total Liab	**m**	**204,371**	**230,125**	**235,799**	**213,429**
Paid-up capital	m	3,234	3,235	3,239	3,243
Others	m	153,793	186,538	226,860	267,226
SH' Equity	**m**	**157,026**	**189,773**	**230,099**	**270,469**
Liab + Equity	**m**	**361,398**	**419,898**	**465,898**	**483,898**

Profit & Loss		**FY21A**	**FY22E**	**FY23E**	**FY24E**
Net sales	m	207,159	296,832	380,715	435,500
COGS	m	159,614	236,015	292,012	334,961
Gross profit	**m**	**47,545**	**60,817**	**88,703**	**100,539**
S&A exp	m	15,531	21,442	28,658	33,329
Other exp	m	4,915	2,787	5,615	4,501
Other Income	m	7,367	10,374	10,076	11,917
EBIT	m	**34,466**	**46,961**	**64,506**	**74,626**
Finance cost	m	1,464	3,566	6,124	6,253
PBT	**m**	**33,002**	**43,395**	**58,383**	**68,374**
Taxation	m	4,773	7,252	12,601	16,826
PAT	**m**	**28,229**	**36,143**	**45,782**	**51,548**
Att to comp	m	**22,858**	**29,689**	**40,512**	**44,815**
EPS(rep)	Rs	70.7	91.8	125.3	138.6
EPS growth YoY	%	273%	30%	36%	11%
DPS	Rs	-	3.0	8.0	28.0

Quarterly		**1QFY22A**	**2QFY22E**	**3QFY22E**	**4QFY22E**
Net sales	m	54,982	71,282	86,828	83,740
COGS	m	43,320	59,270	68,513	64,912
Gross profit	**m**	**11,662**	**12,012**	**18,314**	**18,829**
S&A exp	m	3,842	5,928	5,939	5,733
Other exp	m	775	491	629	892
Other Income	m	3,890	1,894	1,872	2,718
EBIT	**m**	**10,935**	**7,487**	**13,618**	**14,922**
Finance cost	m	340	332	1,420	1,474
PBT	m	10,595	7,155	12,198	13,448
Taxation	m	1,736	1,437	1,730	2,350
PAT	**m**	**8,859**	**5,718**	**10,468**	**11,098**
Att to comp	m	6,651	4,362	9,113	9,562
EPS(rep)	**Rs**	**20.6**	**13.5**	**28.2**	**29.6**

Key ratios		**FY21A**	**FY22E**	**FY23E**	**FY24E**
BVPS	Rs	485.6	586.9	711.6	836.4
EPS	Rs	70.7	91.8	125.3	138.6
PE	x	9.6	7.4	5.4	4.9
P/Bv	x	1.4	1.2	1.0	0.8
P/S	x	1.1	0.7	0.6	0.5
GP margins	%	23.0%	20.5%	23.3%	23.1%
EBIT margin	%	16.6%	15.8%	16.9%	17.1%
Net margin	%	13.6%	12.2%	12.0%	11.8%
ROE	%	19%	23%	28%	26%
ROA	%	12%	11%	12%	12%
EY	%	10%	14%	18%	20%
Payout Ratio	%	-	3.3	6.4	20.2
DY	%	0%	0%	1%	4%

Source: Company Accounts, Foundation Research, January 2022

All figures in thousands unless told

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

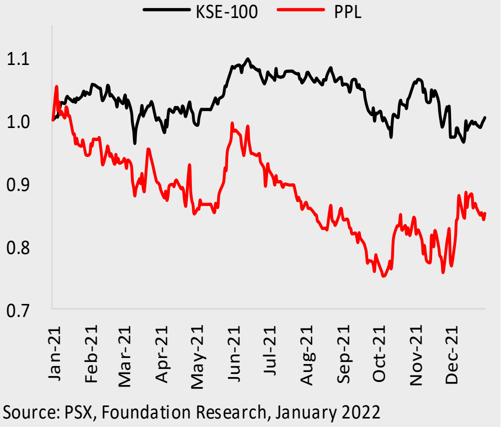
PPL PA **Outperform**

Price (31 Dec 21 CP)	Rs	79.0
Dec-22 Target Price	Rs	151.9
Upside/Downside	%	92.2
12M Target Price	Rs	151.9
- Reserve Based Methodology		
Sector		E&P
Market cap	Rs bn	215.1
30-day avg turnover	$ m	1.1
Market cap	$ m	1,387.5
Freet float	%	24.5
Shares issued	m	2,721.0

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	148,969	177,670	200,637	196,457
EBITDA	m	102,968	126,658	142,615	137,609
EBITDA Growth	%	(12.6)	16.4	38.5	8.6
PBT	m	69,122	95,467	99,344	98,893
Recurring Profit	m	52,971	66,805	70,534	70,214
Net Profit	m	52,971	66,805	70,534	70,214
EPS reported	Rs	19.5	24.6	25.9	25.8
Rev growth	%	(5.5)	19.3	12.9	(2.1)
EPS growth	%	5.4	26.1	5.6	(0.5)
PE	x	4.1	3.2	3.0	3.1
DPS	Rs	2.0	2.0	3.0	4.0
Div. Yield	%	2.5	2.5	3.8	5.1
ROA	%	10.3	11.8	11.3	10.4
ROE	%	14.4	15.9	14.6	12.9
EV/EBITDA	x	1.2	1.0	1.0	1.3
Net D/E	x	(0.2)	(0.2)	(0.1)	(0.1)
Price to Book	x	0.6	0.5	0.4	0.4
Price to Sales	x	1.4	1.2	1.1	1.1

PPL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Pakistan Petroleum Ltd

Liquidity to accelerate exploration

Event

- Positive cash flow generation for the last five quarters, 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. Further improvement in cash flows due to resolution of circular debt given resumption of IMF program would help to expedite exploration and development activities. Subsequently, this would help to exploit potential of Sui, Gambat South, Margand and kandhkot fields.
- Aforementioned factors along with company's quest to expand Offshore compels us to have an "Outperform" rating for the scrip with Dec-22 TP of Rs151.9/sh.

Impact

- **Liquidity to enhance exploration & development activities:** During FY21 Company has generated cash flow of Rs50bn which would help to expedite exploration and production activities. Subsequently helps to maintain flows from Sui field and enhance production from Gambat South field. At present Sui Field is producing ~350mmcfd of gas. Flows from Gambat South are aggregated to ~140mmcfd against potential of ~240mmcfd and company planned output of 160-180mmcfd. An addition of 20 mmcfd from Gambat South would have an impact of Rs1.2/sh on company profitability.
- Moreover, rationalization of gas prices after resumption of IMF program would further enhance company's liquidity as energy sector reform remain at the helm of IMF focus. However, we have assume an average 60% of gas revenue to be stuck in receivables for the next three years as the government is approaching election year.
- **Rejuvenation of flows from Kandhkot – a short term trigger:** Rejuvenation of flows from kandhkot either by GENCO or selling it directly to SNGPL would add Rs3.0/sh to our profitability. At present kandhkot is producing on average ~80 mmcfd of gas compared to its potential of 200mmcfd. Company has also sought permission from regulatory bodies for allocation of idle flows (~100mmcfd) to any other buyer.
- **Expanding offshore may prove to be a big success:** In a first ever concession award for Pakistani company in UAE, PPL led consortium comprising of OGDC, MARI and Government holding company (GHPL) has been awarded Offshore Block 5 in Abu Dhabi. The block covers an area of 6,223 sq kilometer with each member having 25% stake. We await further clarity before incorporating the said in our valuation.

Earnings Revision

- We revise our FY22/23 estimates by 22.1%/18.9% as we tweak our dollar, volumetric Arab Light and exploration expense assumptions.

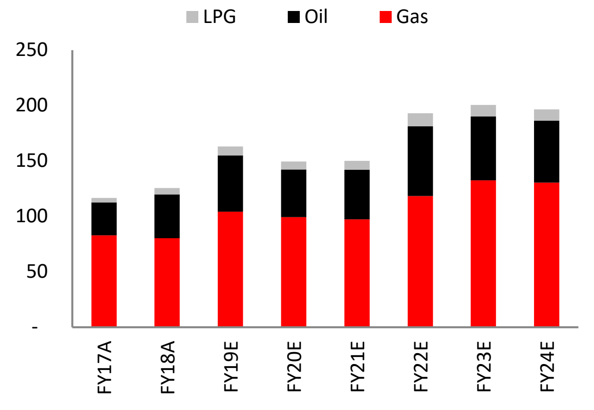
Price Catalyst

- Dec- 22 TP: Rs151.9/sh based on Reserve based DCF methodology.
- Catalyst: (1) Production enhancement from Gambat South, Dhok Sultan & Nashpa, (2) development of Margand Field, (3) energy sector reforms (4) commencement of work on Lead and Zinc Mining, (5) hiting of discoverie at Offshore Block 5 Abu Dhabi, (6) rejuvenation of gas flows from kandhkot field and (7) resolution of circular debt.
- Risks: (1) Unfavorable TAL block verdict, (2) unsuccessful result of Iraq block, (3) earlier than expected ageing of Sui field and (4) delay in Gambat South production.

Outlook

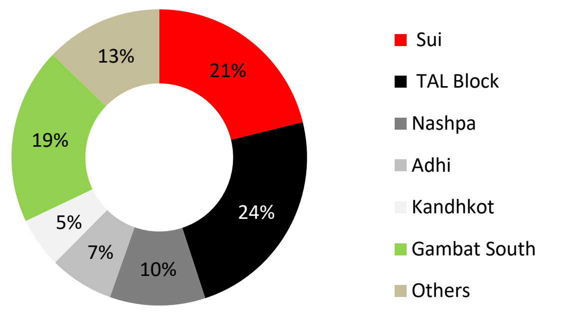
- We assign an "Outperform" rating to PPL with a Dec-22 TP of Rs151.9/sh trading at P/E of 3.0x.

Fig 154: Gas to remain dominant in revenue (Rs bn)….



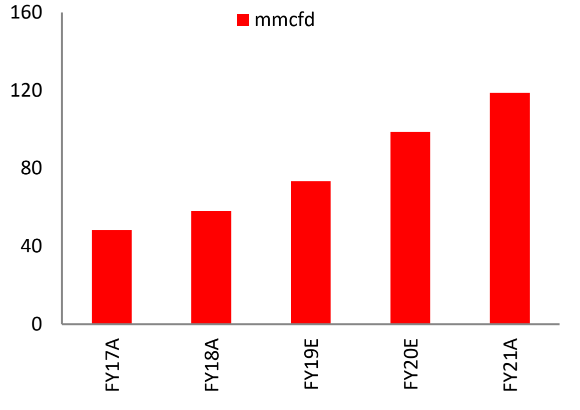
Source: Company reports, FSL Research, January 2022

Fig 155: … as major contribution coming from Sui/TAL



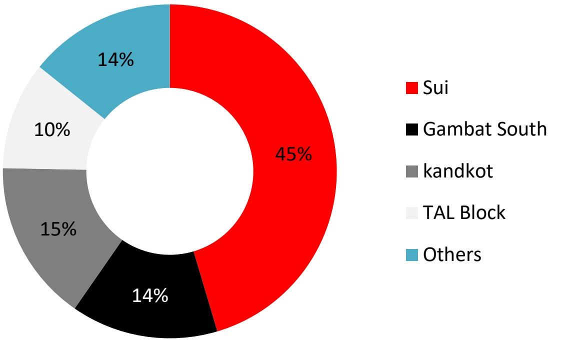
Source: PPIS, FSL Research, January 2022

Fig 156: Gambat South field production is increasing



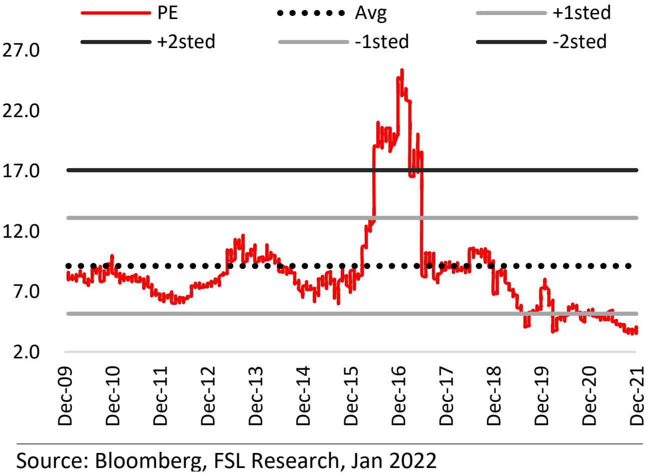
Source: Company reports, FSL Research, Jan 2022

Fig 157:… as its composition



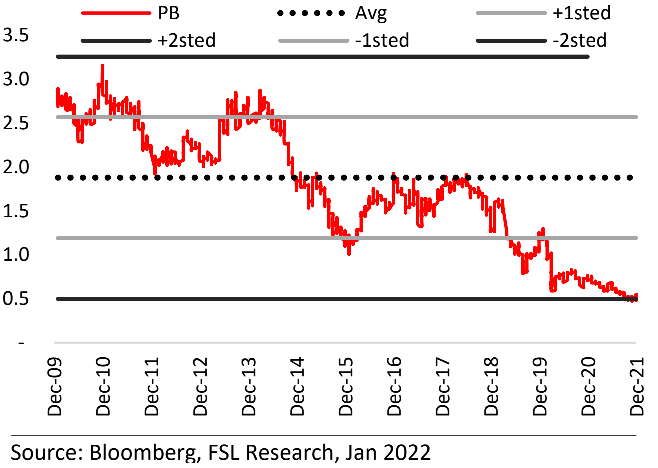
Source: PPIS, FSL Research, January 2022

Fig 158: Trading at -2stdev of historical PE average



Source: Bloomberg, FSL Research, Jan 2022

Fig 159: Also trading low on PB



Source: Bloomberg, FSL Research, Jan 2022

Table 30: Pakistan Petroleum Limited (PPL PA, 'Outperform', Dec-22 TP Rs151.9/sh)

Balance Sheet		**FY20A**	**FY21E**	**FY22E**	**FY23E**	**Profit & Loss**		**FY20A**	**FY21E**	**FY22E**	**FY23E**
PP&E	m	141,096	140,032	125,342	127,248	Net Sales	m	148,969	177,670	200,637	196,457
Cash	m	89,255	89,192	69,126	37,644	Op. Cost	m	41,705	44,838	49,895	54,818
Receivables	m	282,285	340,699	423,644	503,095	Royalty	m	22,057	25,787	28,226	27,457
Other Assets	m	24,247	29,324	31,632	33,340	**Gross Profit**	**m**	**85,206**	**107,045**	**122,517**	**114,182**
Total Assets	**m**	**536,883**	**599,247**	**649,744**	**701,327**	Exp. Write-off	m	10,277	11,619	21,862	14,541
						EBIT	**m**	72,766	93,078	95,534	96,773
Acct. payable	m	85,992	88,002	77,102	70,296	Other Inc	**m**	4,056	12,152	9,651	8,023
Deferred tax	m	29,830	28,821	27,847	26,905	Other Exp	m	7,700	9,763	5,841	5,903
Dism. Allow	m	26,928	26,928	26,928	26,928	**PBT**	**m**	**69,122**	**95,467**	**99,344**	**98,893**
Others	m	3,605	3,605	3,605	3,605	Tax	m	16,150	28,662	28,810	28,679
Total Liab.	**m**	**146,356**	**147,356**	**135,482**	**127,734**	**PAT**	**m**	**52,971**	**66,805**	**70,534**	**70,214**
Paid-up Capital	m	27,210	27,210	27,210	27,210						
Others	m	363,318	424,681	487,053	546,383	EPS(rep)	Rs	19.5	24.6	25.9	25.8
SH' Equity	**m**	**390,528**	**451,891**	**514,262**	**573,593**	EPS growth	%	5%	26%	6%	0%
L+E	**m**	**536,883**	**599,247**	**649,744**	**701,327**	DPS	Rs	2.0	2.0	3.0	4.0

Q perf		**1Q'22A**	**2Q'22E**	**3Q'22E**	**4Q'22E**	**Key Ratios**		**FY20A**	**FY21E**	**FY22E**	**FY23E**
Net Sales	m	43,154	42,092	45,742	46,682	BVPS		143.5	166.1	189.0	210.8
Op. Cost	m	11,036	11,618	12,224	12,308	EPS		19.5	24.6	25.9	25.8
Royalty	m	6,309	6,095	6,623	6,760	PE	x	4.4	4.1	3.2	3.0
Gross Profit	**m**	**25,808**	**24,379**	**26,895**	**27,614**	PBv	x	0.6	0.5	0.5	0.4
Exp. Write-off	m	4,719	2,300	2,300	2,300	GP margins	%	57%	60%	61%	58%
EBIT	m	21,090	22,079	24,595	25,314	EBITDA margin	%	69%	71%	71%	70%
Other Inc	m	4,536	3,321	2,146	2,149	Net margin	%	36%	38%	35%	36%
Other Exp	m	2,353	2,294	2,525	2,591	ROE	%	14%	14%	16%	15%
PBT	m	23,273	23,107	24,216	24,872	ROA	%	14%	10%	12%	11%
Tax	**m**	**6,282**	**7,163**	**7,507**	**7,710**	Earnings yield	%	21%	27%	28%	28%
PAT	m	16,991	15,944	16,709	17,161	Payout Ratio	%	10%	8%	12%	16%
						Dividend Yield	%	2%	2%	3%	4%
EPS(rep)	Rs	6.2	5.9	6.1	6.3	EV/EBITDA	x	3.1	2.5	2.2	2.3
DPS(rep)	Rs	-	-	-	2.0	Net Debt/Equity	x	-22.9%	-19.7%	-13.4%	-6.6%

Source: Company data, Foundation Research, January 2022

All figures in Rs unless noted

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: A.F. Ferguson & Co. Chartered Accountants

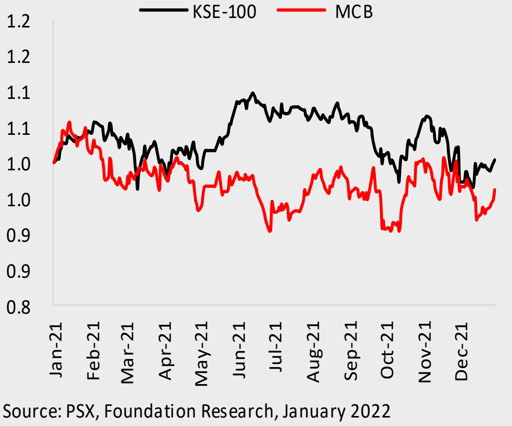
MCB PA **Outperform**

Price (31 Dec 21 CP)	Rs	153.4
Dec-22 Target Price	Rs	212.0
Upside/Downside	%	38.2
12M Target Price	Rs	212.0
- Two stage Gordon Growth Model		
Sector		Banks
Market cap	Rs bn	181.7
30-day avg turnover	$ m	0.6
Market cap	$ m	1,172.4
Freet float	%	35.0
Shares issued	m	1,185.1

Investment fundamentals

Year end Dec		2020A	2021F	2022F	2023F
NII	mn	75,843	66,875	74,616	86,861
NFI	m	19,269	20,113	24,424	25,997
Non Markup Exp	m	39,037	42,050	45,515	49,165
Provisions	m	7,330	(3,222)	694	2,569
PBT	m	49,318	48,160	52,831	61,124
PAT	m	29,410	27,741	31,189	36,071
EPS	Rs	24.8	23.4	26.3	30.4
NII growth	%	19.0	(11.8)	11.6	16.4
EPS growth	%	23.2	(5.7)	12.4	15.7
PE	x	6.2	6.6	5.8	5.0
DPS	Rs	20.0	19.0	20.5	20.0
DY	%	13.0	12.4	13.4	13.0
NIMs	%	5.1	3.8	3.8	4.0
ADR	%	43.1	40.2	41.0	41.5
Infection Ratio	x	8.7	8.0	7.2	6.8
Coverage Ratio	x	97.6	91.9	91.9	91.9
IDR	x	74.6	76.0	74.6	72.9
Deposit growth	x	13.2	16.7	10.2	10.2

MCB KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

MCB Bank Limited

Proactive on treasury

Event

- MCB bank with its prudent nature is expected to ride along yield curve, by diligently deploying assets. Bank's IDR remains on higher side that would be sufficient to generate comfortable ROE of 17%. The investment book is positioned with shorter duration to keep flexible with the interest rate. The bank has the highest CASA amongst peers of 88%, which keeps cost of deposits on lower side. We have an Outperform on the stock with Dec'22 TP of Rs212.0, and dividend yield of 13%.

Impact

- **Robust Profitability:** To ride the cycle of rising interest rates, MCB is expected to keep its profitability upbeat. Profitability would be driven from (1) increase in NII as asset repricing comes into play, (2) higher fee income given improving trade cycle, and (3) lower provisioning given low risk profile and adequate coverage ratio. NIM for the bank is expected to remain around 4%. Deposit base is expected to grow by 10%. Bank is expected to post EPS of Rs26.3/30.4 per sh in CY22/23, which would be followed by DPS of Rs21/20.
- **Prudent asset deployment:** With deposit base of Rs1.5tn, asset deployment remains optimally prudent, with IDR/ADR clocking in at 76/39%. IDR remains in line with peers, however ADR is on lower side in the industry with industry averaging at 50%. Bank would maintain its prudent nature with low ADR and capitalize on investment. Meanwhile Bank's infection ratio is at 8.33% which is expected to decrease going forward, as bank becomes more discreet in minimizing NPLs. Low level of NPLs would keep coverage ratio at comfortable level at north of 90%.
- **Flexible Investment book:** Investment book is parked in shorter duration with 45% in T-bill, concentrated in 6M paper (79% of T-bills). Similarly PIB segregates to 44/27/29% for 3/5/10yr, with ~70% of PIBs are placed in floating to facilitate increasing interest rate. Bank is well versed to ride the increasing yield curve ahead. Similarly bank is well geared to change its position as interest rate peaks keeping its investment book flexible. We expect interest rate peak of 10.8% by 2QCY23, and reversal thereafter as inflation tames down.
- **Highly cost efficient:** MCB's CASA is highest amongst peers, clocking in at 88%, with CA contribution of 36%. CASA translates to cost of deposit to lower side at 5.08/4.54% (8.55/7.56% excluding CA) for CY22/23. Similarly Cost/income ratio for the bank is 42.5% which is expected to improve as total income improves going forward.
- **Sufficient CAR to uphold dividend stream:** The bank's CAR is currently at 17.87%, which is well above the regulatory requirement. Risk weighted assets are expected to grow at 3y-CAGR of 1%. This would further improve CAR to 20% by CY23. Bank's ROE generation is currently at 15% which is expected to improve to 17-18% going forward, as interest rate stabilizes. Sufficient CAR provides buffer to maintain its dividend stream, which is currently at 80% payout.

Earnings Revision

- We revise down our CY21/CY22 earnings by 7/8% due to result update expectation.

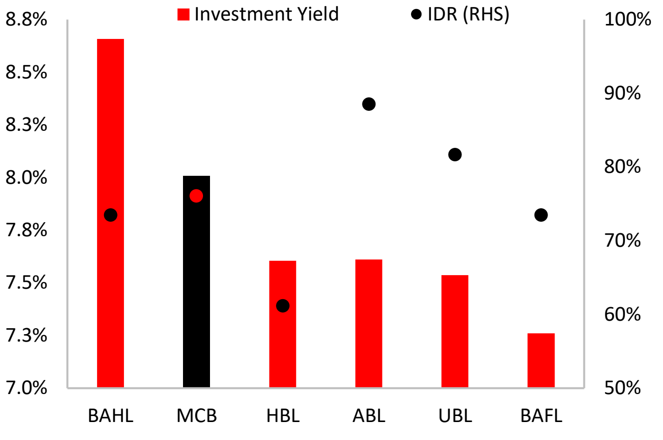
Price Catalyst

- Dec- 22 TP: Rs212/sh based on 2-stage Gordon growth model.
- Catalyst: (1) interest rate hike, (2) lower provisioning and (3) higher CASA.
- Risks: (1) high IDR, (2) sensitive treasury book and (3) lower spread.

Outlook

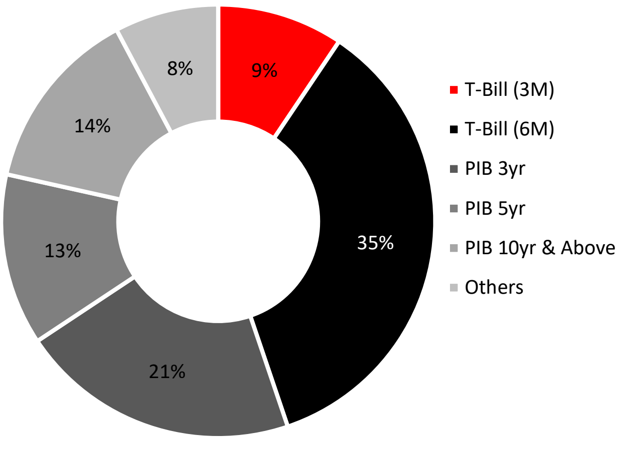
- We have an "Outperform" stance on the scrip with Dec-22 TP of Rs212/sh.

Fig 160: Prudent asset deployment to keep IDR high



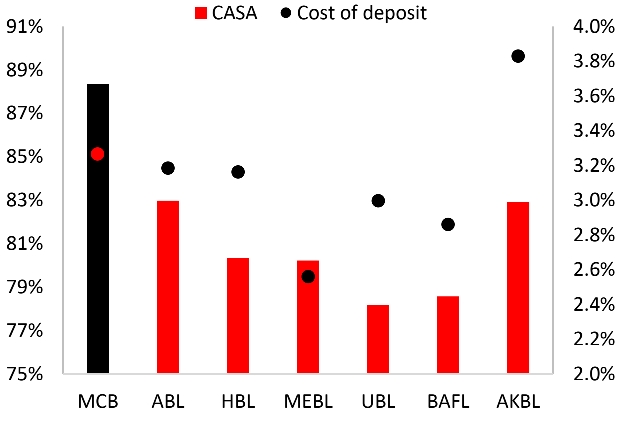
Source: Company Acc, Foundation Research, Jan 2022

Fig 161: ..... focused on building flexible investment book



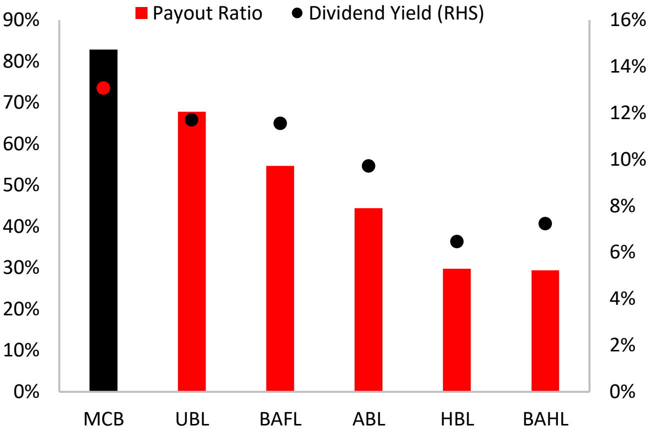
Source: Company Acc, Foundation Research, Jan 2022

Fig 162: CASA highest amongst peers



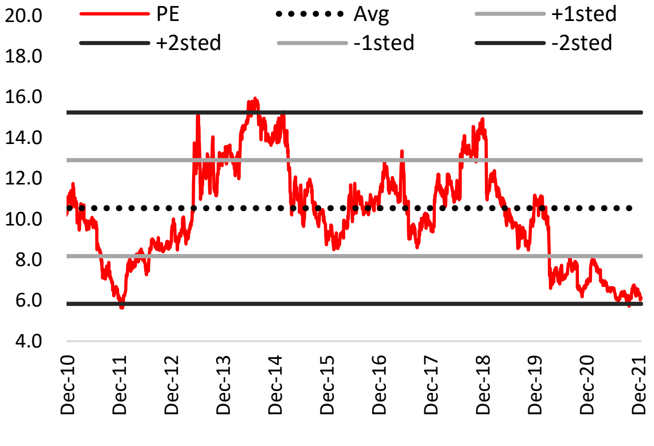
Source: Company Acc, Foundation Research, Jan 2022

Fig 163: Highest payout and dividend yield in industry



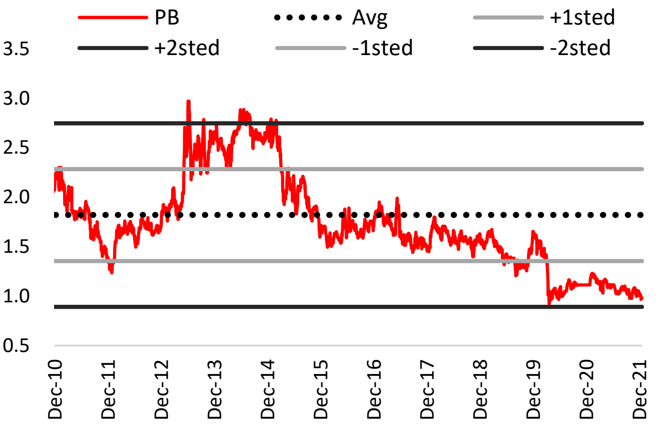
Source: Company Acc, Foundation Research, Jan 2022

Fig 164: Trading below historical average on PE...



Source: Bloomberg, Foundation Research, January 2022

Fig 165: ...lower on PB as well



Source: Bloomberg, Foundation Research, January 2022

Table 31: MCB Bank limited (MCB PA, Outperform, Dec-22 TP Rs212/sh)

Balance Sheet		**CY20**	**CY21E**	**CY22E**	**CY23E**
Cash	m	132,053	132,984	146,597	161,603
Investments	m	1,036,218	1,230,858	1,332,865	1,436,090
Advances	m	547,686	602,993	683,968	765,344
Fixed Assets	m	63,679	62,509	62,245	62,137
Total Assets	**m**	**1,891,276**	**2,142,532**	**2,343,998**	**2,549,159**
Deposits	m	1,388,738	1,620,078	1,785,920	1,968,738
Borrowings	m	184,577	225,209	240,464	235,816
Other Liab	m	124,970	118,661	130,807	144,198
Total Liab	**m**	**1,698,285**	**1,963,947**	**2,157,191**	**2,348,752**
Net Assets	m	192,991	178,585	186,807	200,407
Share Capital	m	11,851	11,851	11,851	11,851
Acc. Profits	m	70,499	62,009	69,859	83,368
Total Equity	**m**	**192,991**	**178,585**	**186,807**	**200,407**

Income Statement		**CY20**	**CY21E**	**CY22E**	**CY23E**
NII	m	75,843	66,875	74,616	86,861
NFI	m	19,269	20,113	24,424	25,997
Fee Inc	m	11,971	13,519	14,466	15,636
Total Inc	m	95,685	86,988	99,040	112,858
Opex Exp	m	39,037	42,050	45,515	49,165
Admin Exp	m	37,764	40,505	43,773	47,210
Provisions	m	7,330	(3,222)	694	2,569
PBT	m	49,318	48,160	52,831	61,124
PAT	**m**	**29,410**	**27,741**	**31,189**	**36,071**
EPS	Rs	24.8	23.4	26.3	30.4
DPS	Rs	20.0	19.0	20.5	20.0
EPS growth	%	23.4	(5.7)	12.4	15.7
Payout	%	80.6	78.7	75.6	63.7

Quarterly I/S		**3Q'21**	**4Q'21**	**1Q'22E**	**2Q'22E**
NII	m	17,316	15,827	15,531	16,965
NFI	m	6,937	4,705	4,975	5,126
Fee Inc	m	3,134	3,180	3,637	2,975
Total Inc	m	24,253	20,532	20,506	22,091
Opex Exp	m	10,627	10,804	11,010	11,257
Admin Exp	m	10,297	10,477	10,660	10,847
Provisions	m	(1,501)	279	(103)	292
PBT	m	16,587	9,884	11,674	13,972
PAT	**m**	**7,972**	**5,748**	**5,895**	**6,456**
EPS	Rs	6.73	4.85	4.97	5.45
DPS	Rs	4.50	5.00	4.50	5.00

Key Ratios		**CY20**	**CY21E**	**CY22E**	**CY23E**
NIMs	%	5.1	3.8	3.8	4.0
ADR	%	43.1	40.2	41.0	41.5
Infection	%	8.7	8.0	7.2	6.8
Coverage	%	97.6	91.9	91.9	91.9
IDR	%	74.6	76.0	74.6	72.9
Deposit gr	%	13.2	16.7	10.2	10.2
CASA	%	89.8	88.3	87.7	86.8
Cost/Income	%	39.5	46.6	44.2	41.8
CAR	%	19.7	17.4	18.7	20.3
ROE	%	16.0	15.0	17.0	19.0
BV	x	162.9	150.7	157.6	169.1

All figures are in Rs unless noted
Source: Company Accounts, FSL Research, January 2022

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

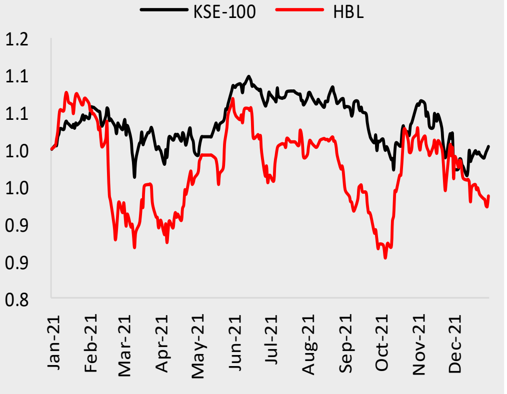
HBL PA **Outperform**

Price (31 Dec 21 CP)	Rs	116.6
Dec-22 Target Price	Rs	176.0
Upside/Downside	%	50.9
12M Target Price	Rs	176.0
- Two stage Gordon Growth Model		
Sector		Banks
Market cap	Rs bn	171.1
30-day avg turnover	$ m	2.3
Market cap	$ m	1,103.6
Freet float	%	50.0
Shares issued	m	1,466.9

Investment fundamentals

Year end Dec		2020A	2021F	2022F	2023F
NII	mn	130,104	126,232	124,516	141,808
NFI	m	27,632	31,181	36,568	34,711
Non Markup Exp	m	95,449	94,775	98,006	107,013
Provisions	m	12,220	5,824	2,752	5,216
PBT	m	53,031	59,495	63,038	67,052
PAT	m	30,892	34,529	37,587	39,980
EPS	Rs	21.1	23.5	25.6	27.3
NII growth	%	28.4	(3.0)	(1.4)	13.9
EPS growth	%	101.5	11.8	8.9	6.4
PE	x	5.5	5.0	4.6	4.3
DPS	Rs	4.2	7.0	8.0	10.0
DY	%	3.6	6.0	6.9	8.6
NIMs	%	4.4	3.7	3.3	3.4
ADR	%	46.1	47.2	48.2	49.2
Infection Ratio	x	6.3	5.6	5.1	4.8
Coverage Ratio	x	99.7	100.3	100.5	100.5
IDR	x	68.8	60.2	59.2	58.2
Deposit growth	x	16.1	13.0	10.2	10.2

HBL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Habib Bank Limited

Changing profile to unlock horizon

Event

- Improving demand for credit and well positioning of investment book, HBL is well geared to play upcoming interest rate cycle. Further Banks repositioning towards Chinese investment would likely unlock growth potentials for CPEC and BRI initiative. Aforementioned factors would overshadow investor's concerns regarding asset quality and capital adequacy. Thus, we maintain our "Outperform" stance with a Dec-22 TP of Rs176.0/sh.

Impact

- **Favorable turns to uplift profitability**: As interest rate cycle tops out, with positive real interest rate, HBL profitability is expected to report EPS of 25.6/27.3 in CY22/23, as asset repricing takes into play. The increasing in profitability would mainly be driven from (1) higher NII as investment book reprices, (2) upbeat fee income from international trade, and (3) lower provisioning expense given low risk profile and (4) capital gains as interest reverses. We expect interest rates to peak at 10.8% in 3QCY22.

- **Adjusting bank's profile to impede risk and digitalization:** HBL expansion in China, repositioning its international portfolio, would channel Chinese investment providing RMB intermediation for CPEC and BRI corridor flows. The New York incident has compelled the bank to strengthening compliance and geographically diversify. Bank is also aggressively investing in IT infrastructure and enhancing digitalization, which has allowed HBL to acquire 16% of market share of commercial bank users. A few of HBL digital products include Konnect app, RDA account, Tap & Pay, HBL Infinity etc.

- **Robust loan growth:** With the improving domestic trade economics, credit cycle is has upturned and HBL is head on to steer. With the overall increase in credit demand, HBL advances are expected to increase by 3y-CAGR of 14%. This would increase ADR for the bank to 50% by CY23. International advances also grew by 20% YTD to stand at US$1.5bn. Due to audacious lending, infection ratio is expected to dilute. HBL has plans to lend into the SME and agri sector to promote low income segment. Aggressive lending profile would gradually decrease IDR by 2ppt.

- **Well positioned investment book:** HBL currently has IDR of 61%, with an investment book of Rs2tn, which is expected to grow by 3y-CAGR of 8%. Tbills/PIBs account for 28/54% of total investments, moreover PIBs consist of 43% of floater paper. We believe HBL is well equipped to play the upcoming interest rate cycle.

- **CAR to remain range bound:** Incorporating additional CAR requirement under D-SIB, HBL is expected keep dividend payout on lower side, staying above the management's target of keeping minimum cushion of 2ppts over regulatory requirements. We expect this to address concerns over capital adequacy. Currently HBL has CAR of 16.7%, this is expected to remain range bound given high ADR. Currently HBL maintains consistent payout ratio at Rs8/sh, which is expected to gradually increase.

Earnings Revision

- We revise up CY21/CY22 earnings by 11/18% due to earlier than expected interest rate hike.

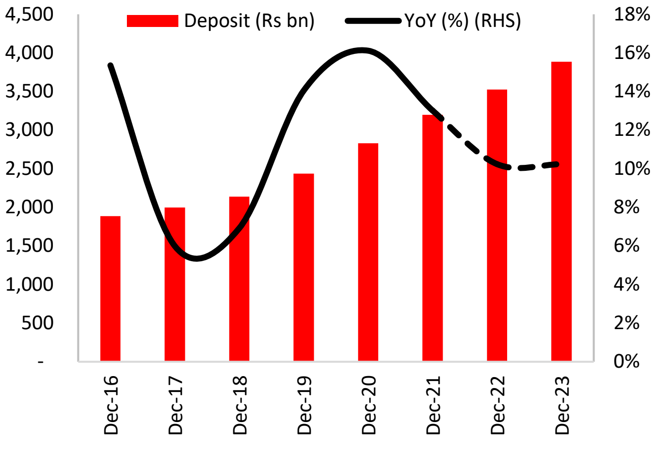
Price Catalyst

- Dec- 22 TP: Rs176/sh based on 2-Stage Gordon growth model.
- Catalyst: (1) low provisioning, (2) drop in admin cost and (3) higher PIB exposure.
- Risks: (1) high NPLs, (2) breaching of CAR limit, (3) international exposure.

Outlook

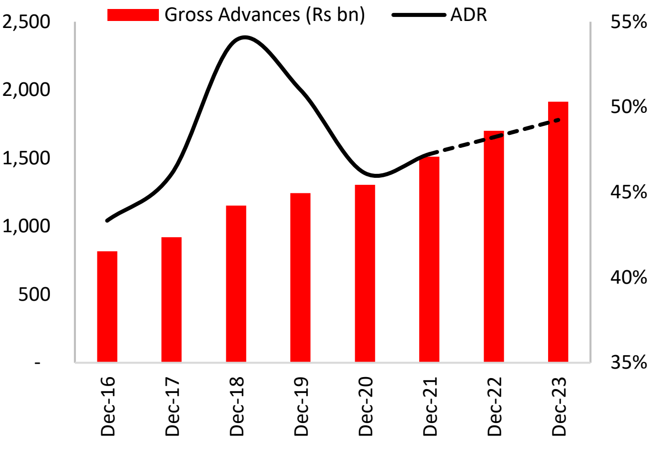
- We have an 'Outperform' stance on the stock due to expected recovery in earnings as interest rate increases. The bank would be on the forefront as industry transforms into digitalization.

Fig 166: Moderate Deposit growth as digitalization moves



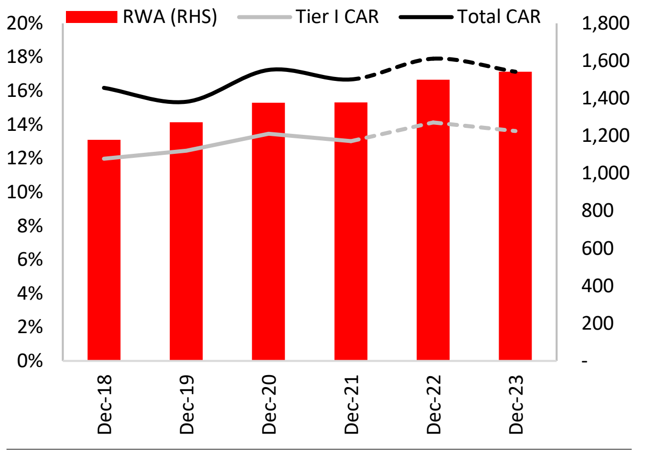
Source: Company Acc, Foundation Research, Jan 2022

Fig 167: Increasing ADR to keep NPLs diluted



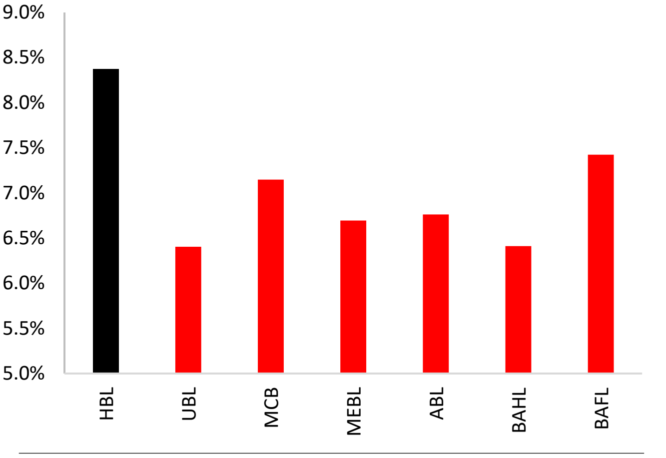
Source: Company Acc, Foundation Research, Jan 2022

Fig 168: CAR is slightly above regulatory requirement



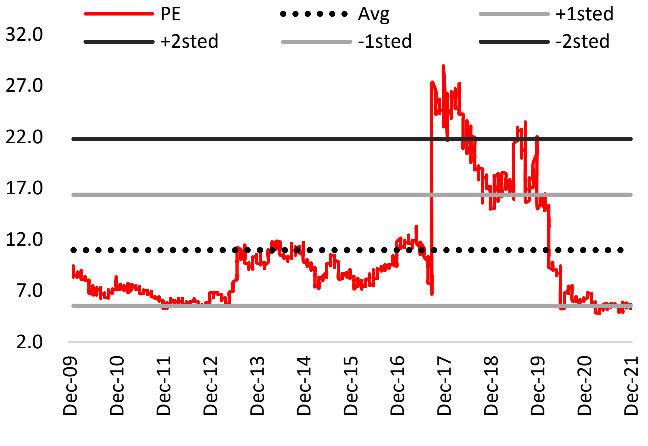
Source: Company Acc, Foundation Research, Jan 2022

Fig 169: Highest NIMs compared to peers



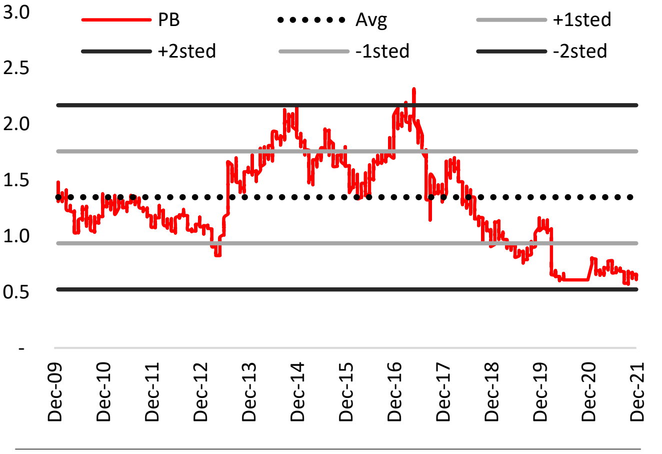
Source: Company Acc, Foundation Research, Jan 2022

Fig 170: Trading at below average PE



Source: Bloomberg, Foundation Research, Jan 2022

Fig 171: Trading low on PB as well



Source: Bloomberg, Foundation Research, Jan 2022

Table 32: Habib Bank Limited (HBL PA, Outperform, Dec-22 Target price Rs176/sh)

Balance Sheet		**CY20**	**CY21E**	**CY22E**	**CY23E**
Cash	m	375,280	329,444	363,168	400,344
Investments	m	1,948,577	1,926,012	2,087,149	2,260,393
Advances	m	1,223,510	1,426,097	1,612,973	1,821,184
Fixed Assets	m	89,190	95,655	96,948	97,478
Total Assets	**m**	**3,849,063**	**4,130,501**	**4,534,861**	**4,977,535**
Deposits	m	2,830,371	3,198,597	3,526,027	3,886,974
Borrowings	m	544,108	401,738	442,863	488,197
Other Liab.	m	209,088	236,969	261,226	287,967
Total Liab	**m**	**3,583,568**	**3,837,303**	**4,230,116**	**4,663,139**
Net Assets	m	265,495	293,198	304,745	314,396
Share Capital	m	14,669	14,669	14,669	14,669
Acc Profits	m	138,208	156,147	170,631	182,008
Total Equity	**m**	**265,495**	**279,333**	**294,505**	**306,125**

Income Statement		**CY20**	**CY21E**	**CY22E**	**CY23E**
NII	m	130,104	126,232	124,516	141,808
NFI	m	27,632	31,181	36,568	34,711
Fee Inc	m	18,796	23,983	25,864	27,955
Total Inc	m	160,699	160,094	163,797	179,282
Opex Exp	m	95,449	94,775	98,006	107,013
Admin Exp	m	94,018	93,521	96,772	105,669
Provisions	m	12,220	5,824	2,752	5,216
PBT	m	53,031	59,495	63,038	67,052
PAT	**m**	**30,892**	**34,529**	**37,587**	**39,980**
EPS	**Rs**	**21.1**	**23.5**	**25.6**	**27.3**
DPS	Rs	4.3	7.0	8.0	10.0
EPS Growth	%	99.4	11.8	8.9	6.4
Payout	%	20.2	29.7	31.2	36.7

Quarterly I/S		**3Q'21**	**4Q'21E**	**1Q'22E**	**2Q'22E**
NII	m	32,288	29,081	27,731	29,186
NFI	m	6,104	6,111	7,963	8,411
Fee Inc	m	4,484	5,412	5,904	5,873
Total Inc	m	38,393	35,191	35,694	37,597
Opex Exp	m	23,463	23,773	23,981	24,232
Admin Exp	m	23,161	23,508	23,744	23,981
Provisions	m	1,758	329	201	780
PBT	m	17,074	10,127	14,508	16,689
PAT	**m**	**9,051**	**7,821**	**7,044**	**7,522**
EPS	Rs	6.17	5.33	4.80	5.13
DPS	Rs	1.75	1.75	2.00	2.00

Key Ratios		**CY20**	**CY21E**	**CY22E**	**CY23E**
NIMs	%	4.4	3.7	3.3	3.4
ADR	%	46.1	47.2	48.2	49.2
Infection	%	6.3	5.6	5.1	4.8
Coverage	%	99.7	100.3	100.5	100.5
IDR	%	68.8	60.2	59.2	58.2
Deposit growth	%	16.1	13.0	10.2	10.2
CASA	%	83.1	81.1	81.9	83.1
Cost/Income	%	58.5	58.4	59.1	58.9
CAR	%	17.2	16.7	17.9	17.1
ROE	%	13.0	13.0	13.0	13.0
BV	x	181.0	190.4	200.8	208.7

All figures are in Rs unless noted
Source: Company Accounts, FSL Research, January 2022

About the Bank

HBL, Pakistan's largest bank, was the first commercial bank to be established in Pakistan in 1947. Over the years, HBL has grown its branch network and maintained its position as the largest private sector bank in Pakistan with over 1,650+ branches and 2,100+ ATMs globally, serving 23 million+ customers worldwide.

Auditors: M/s KPMG Taseer Hadi & Co. Chartered Accountants


MID CAP

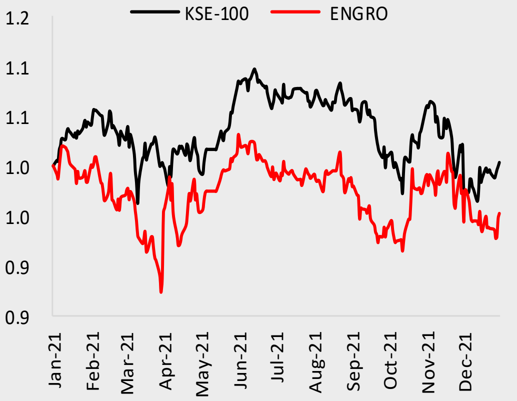
ENGRO PA **Outperform**

Price (31 Dec 21 CP)	Rs	272.4
Dec-22 Target Price	Rs	321.6
Upside/Downside	%	18.1
12M Target Price	Rs	321.6
- Sum-of-Parts		
Sector		Fertilizer
Market cap	Rs bn	157.0
30-day avg turnover	$ m	0.6
Market cap	$ m	1,012.6
Freet float	%	55.0
Shares issued	m	576.2

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	318,175	332,642	347,017	368,128
EBITDA	m	95,605	89,321	84,241	84,138
EBITDA Growth	%	65.9	26.3	(11.9)	(5.8)
PBT	m	78,091	71,217	65,223	62,787
Recurring Profit	m	31,897	29,688	26,809	23,826
Net Profit	m	31,897	29,688	26,809	23,826
EPS reported	Rs	55.4	51.5	46.5	41.4
Rev growth	%	27.9	4.5	4.3	6.1
EPS growth	%	27.1	(6.9)	(9.7)	(11.1)
PE	x	4.9	5.3	5.9	6.6
DPS	Rs	29.0	23.0	30.0	30.0
Div. Yield	%	10.6	8.4	11.0	11.0
ROA	%	5.7	5.4	4.7	4.1
ROE	%	13.3	10.5	8.3	6.7
EV/EBITDA	x	2.3	2.1	1.7	1.3
Net D/E	x	0.2	0.1	(0.0)	(0.1)
Price to Book	x	0.6	0.5	0.5	0.4
Price to Sales	x	0.5	0.5	0.5	0.4

ENGRO KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Engro Corporation Limited

Kicking off the diversification drive

Event

▪ Our liking for the scrip stem from company's aggressive plans of diversification for deployment of cash by venturing into Tower sharing, Petrochemical and Renewable energy projects. Moreover, commencement of dividend income from Power business helps to keep dividend payout intact during expansion phase.

Impact

▪ **EPTL Project completion to substitute dividend decline from other subsidiaries:** 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, in our view. The project achieves CoD two years ago on Jul 10'19.

▪ 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 are trading at an all-time high.

▪ **Enfrashare success could change company's landscape:** ENGRO venturing into Towersharing business for stable and inflation hedged revnues through its subsidiary Enfrashare to bank on strong demand of 4G and 5G through providing savings for service providers. At present it has portfolio of 2,030 towers (out of 37,905 towers) with 2,219 tenants with strong relations with all MNOs.

▪ Company is targeting to become a 5,000 tower company by 2025 with tenancy ratio of 1.33x. Beyond 2025 Enfrashare can pursue second phase of portfolio expansion by targeting 5G customer base. Further growth would be achieved by engaging in a sale and lease back transaction from existing MNOs. Company expects EBITDA generation of US$40mn by 2025. However, we have value the company at its book value as we wait for further clarity regarding this segment.

▪ **PDH & PP Complex too in infancy stage:** ENGRO is eyeing to establish PDH & PP complex in Pakistan with an investment size of US$1.3-1.7bn that would substitute imports worth US$350mn out of total market of US$500mn. BoD has approved US$32mn for a detailed feasibility and FID is expected to achieve by 4QCY22 contingent upon outcomes of the technical study. 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 by 1.7%/8.2% for CY21/CY22 as we tweak our assumption of PVC-Ethylene margin.

Price Catalyst

▪ Dec- 22 TP: Rs321.9/sh based on Sum of the part methodology.

▪ Catalyst: (1) Delay in payment of GIDC, (2) Project completion of EPTL, (3) Success in venture 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 and (3) discouraging results of Enfrashare.

Outlook

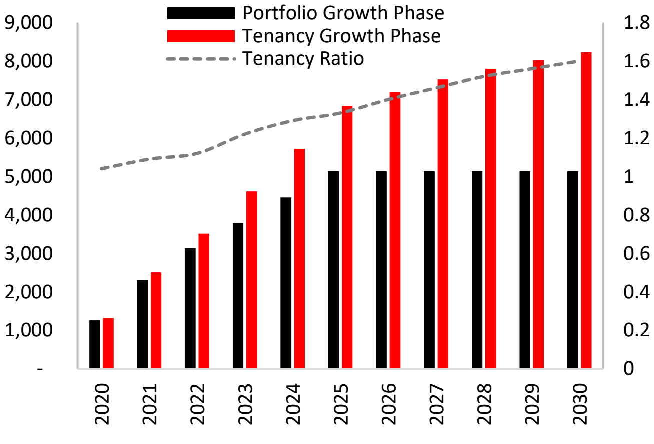
▪ We have an "Outperform" rating on the stock given company's aggressive plan of diversification amid commencement of dividend stream from EPTL.

Table 33: Engro sum of the parts valuation (Rs/sh)

Company	Valuation (Rs mn)	Dec-22TP	Shares held (%)	Portfolio Discount	Engro's share in valuation	Rs/sh TP contribution	% Contt in TP
EFERT	83,240	62.54	56%	20%	37,591	65.2	20%
EPTPL	87,261	151.5	50%	25%	32,788	56.9	18%
FCEPL	74,459	97.2	40%	25%	22,282	38.7	12%
EPCL	37,407	41.2	56%	20%	16,815	29.2	9%
Engro Enfrashare	19,970	34.7	100%	25%	14,978	26.0	8%
SECMC	93,981	163.1	12%	30%	7,835	13.6	4%
EPQL	8,927	27.6	69%	20%	4,913	8.5	3%
Engro Elengy	13,986	24.3	42%	25%	4,406	7.6	2%
Engro Eximp (Pvt) Ltd	4,541	8.7	100%	30%	3,178	5.5	2%
Engro Vopak Terminal Ltd	3,606	6.9	50%	30%	1,262	2.2	1%
Add: Cash position	39,393				39,393	68.4	21%
No of shares outstanding (mn)					576		
Dec-22 TP (PKR)						**321.9**	**100%**

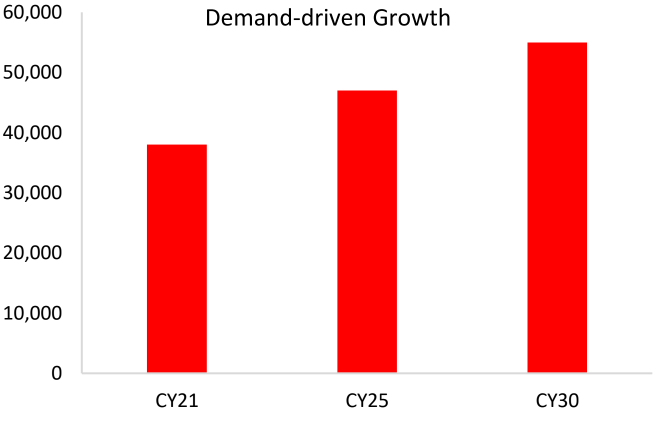
Source: Company Accounts, Foundation Research, January 2022

Fig 172: Enfrashare to grow its tower to 5k by 2025



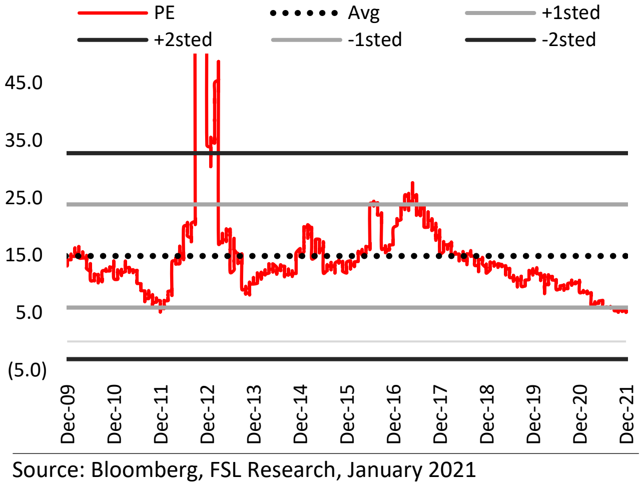
Source: PSX, FSL Research, January 2022

Fig 173: Tower demand to grow at CAGR of 3-5%



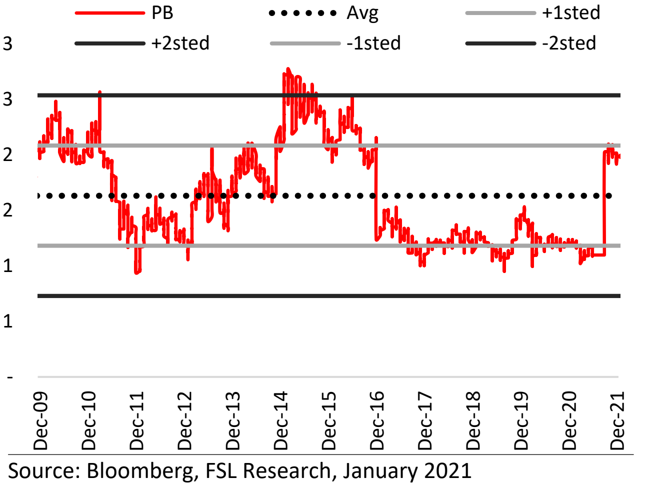
Source: PSX, FSL Research, January 2022

Fig 174: Trading below historical average of PE



Source: Bloomberg, FSL Research, January 2021

Fig 175: …and lower on PB



Source: Bloomberg, FSL Research, January 2021

Table 34: Engro Corporation Limited (ENGRO PA, 'Outperform', Dec-22 Target price:321.9)

Balance Sheet		**CY20A**	**CY21E**	**CY22E**	**CY23E**
PP&E	m	261,957	253,350	245,400	237,267
Cash & ST inv	m	116,846	47,998	63,351	90,422
LT invest	m	32,045	32,205	32,392	32,596
Other Assets	m	169,638	204,470	213,349	219,269
Total Assets	**m**	**580,487**	**538,023**	**554,493**	**579,554**
LT Loan	m	135,230	77,488	63,229	42,804
Ot Liabilities	m	225,662	199,604	186,397	196,835
Total Liab	**m**	**360,892**	**277,092**	**249,626**	**239,639**
Paid-up Capital	m	5,762	5,762	5,762	5,762
Premium	m	13,068	13,068	13,068	13,068
Minority	m	71,179	98,420	124,190	148,562
Others	m	129,586	143,682	161,847	172,524
SH' Equity	**m**	**219,595**	**260,932**	**304,867**	**339,915**
L+E	**m**	**580,487**	**538,023**	**554,493**	**579,554**

Profit & Loss		**CY20A**	**CY21E**	**CY22E**	**CY23E**
Net sales	m	248,818	318,175	332,642	347,017
Cost of sales	m	172,773	215,749	237,153	257,028
Gross Profit	**m**	**76,045**	**102,426**	**95,489**	**89,988**
S&A	m	15,030	15,957	17,350	18,177
Other Income	m	17,738	10,297	10,192	8,658
Share JV		2,796	3,101	3,458	4,292
Other exp	m	6,416	5,844	4,725	4,497
EBIT	**m**	**75,133**	**94,023**	**87,063**	**80,266**
Finance cost	m	20,473	15,932	15,847	15,043
PBT	m	54,660	78,091	71,217	65,223
Taxation	m	9,030	18,952	15,758	14,042
PAT	**m**	**45,630**	**59,138**	**55,458**	**51,181**
Attibt. PAT	**m**	**25,100**	**31,897**	**29,688**	**26,809**
EPS(rep)	Rs	43.6	55.4	51.5	46.5
EPS growth YoY	%	52%	27%	-7%	-10%
DPS	Rs	26.0	29.0	23.0	30.0

Q performance		**1Q'21A**	**2Q'21A**	**3Q'21A**	**4Q'21E**
Net sales	m	70,866	68,453	84,262	94,594
Cost of sales	m	46,050	45,623	61,269	62,807
Gross Profit	**m**	**24,816**	**22,831**	**22,993**	**31,787**
S&A	m	2,918	3,372	3,430	6,237
Other charges	m	1,132	1,880	2,285	547
Other income	m	2,438	3,250	2,159	2,449
Share JV	m	1,019	859	531	692
Finance cost	m	3,589	4,360	3,591	4,392
PBT	**m**	**20,634**	**17,327**	**16,377**	**23,753**
Taxation	m	5,856	2,994	4,983	5,119
PAT	**m**	14,779	14,332	11,394	18,633
Attribt. PAT	m	8,337	8,717	6,119	8,725
EPS(rep)		14.5	15.1	10.6	15.1

Key ratios		**CY20A**	**CY21E**	**CY22E**	**CY23E**
BVPS	Rs	257.6	282.1	313.6	332.1
EPS	Rs	43.6	55.4	51.5	46.5
PE	x	6.2	4.9	5.3	5.8
PBv	x	1.1	1.0	0.9	0.8
GP margins	%	31%	32%	29%	26%
EBITDA margin	%	28%	30%	27%	24%
NP margin	%	10%	10%	9%	8%
ROE	%	13%	11%	8%	7%
ROA	%	6%	5%	5%	4%
EY	%	16%	20%	19%	17%
Payout Ratio	%	60%	52%	45%	64%
DY	%	10%	11%	8%	11%
EV/EBITDA	x	3.0	2.3	2.1	1.7

Source: Company data, Foundation Research, January 2022
All figures in Rs unless noted

About the Company

Currently, Engro's portfolio consists of a varied business portfolio, which include fertilizers, foods, chemical storage & handling, trading, energy 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

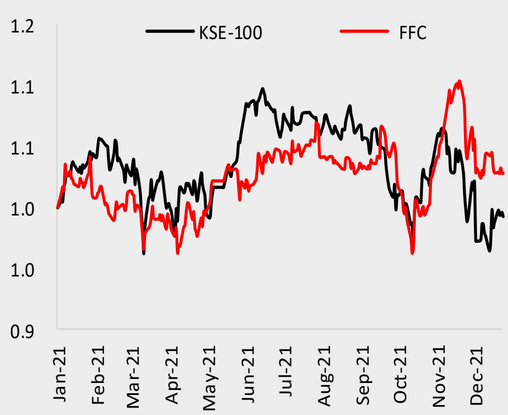
FFC PA **Outperform**

Price (31 Dec 21 CP)	Rs	100.3
Dec-22 Target Price	Rs	141.9
Upside/Downside	%	41.5
12M Target Price	Rs	141.9
- Sum-of-Parts		
Sector		Fertilizer
Market cap	Rs bn	127.6
30-day avg turnover	$ m	1.4
Market cap	$ m	822.9
Freet float	%	55.0
Shares issued	m	1,272.2

Investment fundamentals

Year end Dec		2020A	2021F	2022F	2023F
Net Revenues	mn	97,655	110,459	132,861	149,475
EBITDA	m	26,039	33,934	32,236	36,578
EBITDA Growth	%	22.2	37.2	23.8	7.8
PBT	m	29,591	31,786	33,653	36,556
Recurring Profit	m	20,819	22,832	24,549	26,650
Net Profit	m	20,819	22,832	24,549	26,650
EPS reported	Rs	16.4	17.9	19.3	20.9
Rev growth	%	(7.7)	13.1	20.3	12.5
EPS growth	%	21.7	9.7	7.5	8.6
PE	x	6.1	5.6	5.2	4.8
DPS	Rs	11.2	14.4	16.4	17.8
Div. Yield	%	11.2	14.4	16.4	17.8
ROA	%	12.8	12.5	13.2	15.3
ROE	%	53.3	50.2	49.5	50.2
EV/EBITDA	x	6.4	5.2	5.5	4.7
Net D/E	x	0.9	1.0	1.0	0.8
Price to Book	x	3.0	2.6	2.5	2.3
Price to Sales	x	1.3	1.2	1.0	0.9

FFC KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Fauji Fertilizer Company

Rerating overdue due to multiple growth catalysts ahead

Event

- Strong agronomics given increase in support prices for major cash crops and constrained supply during ongoing Rabi season due to decline in domestic production and fiscal constraints to provide subsidy to RLNG based fertilizer players would keep Urea pricing power with base players, in our view. Thus, providing ability to pass on the impact of probable gas price hike. We have an "Outperform" stance on the stock with Dec-22 TP of Rs141.9/sh. Furthermore, dividend resumptions by FFBL and expansion into new ventures would provide further support to the growth.

Impact

- **Pricing power to remain with base players despite higher production in CY23:** Urea production is expected to increase due to (1) additional supply of ~60mmcfd gas by Mari petroleum to the fertilizer sector, (2) Gov't decision to supply maximum 63/58mmcfd gas to FFBL/Pak Arab as per quota and (3) supply of gas to RLNG based fertilizer plants at subsidized rate. However, Urea would still be in limited supply due to below buffer level current inventory position and 4.0x price difference with international prices.

- Further support to pricing power would came from better farmer agronomics given better prices of Wheat, Sugarcane, Cotton and Maize crop. To highlight, company margins in DAP trading will also remain on higher side due to record high landed cost for DAP given higher feedstock gas and supply constraints internationally.

- **Balance sheet to remain strong given delay in GIDC repayment:** FFC's current ~Rs82bn cash position is sufficient to pay overdue Rs62.6bn GIDC. Company will have Rs8.2/16.4/16.4/8.2/sh cash outflow in CY22/23/24/25 as we have assumed GIDC payment from FY23 in 48 monthly installments. To highlight, FFC will have positive cash flow impact of Rs18.6/sh if its receivables of Rs23.6bn are adjusted against GIDC.

- **Time for stock to rerate as company looks forward toward expansions to fuel growth:** FFC has recently closed acquisition of 100/80% stake in FEW I/II for Rs13.5bn and is ventured into TEL, a project of 330MW lignite-based mine-mouth power plant, and an offshore complex in Tanzania that would provide stable dollar hedged revenues, in our view. Majority of work on TEL has been completed to achieve COD in 1HCY22. This would enhance our TP by ~Rs3.0. Furthermore, in recent analyst briefing company has also discussed its plans to establish new DAP plant in Pakistan in order to substitute imports. To highlight, increased dividend income from investments and strong cash position would support FFC to enter into new ventures.

Earnings Revision

- We have increased our EPS for CY21/22/23 by 6/14/15% due to delay in GIDC payment and change in Urea price assumption.

Price Catalyst

- Dec 22 TP: Rs141.9/sh based on sum of the part methodology.

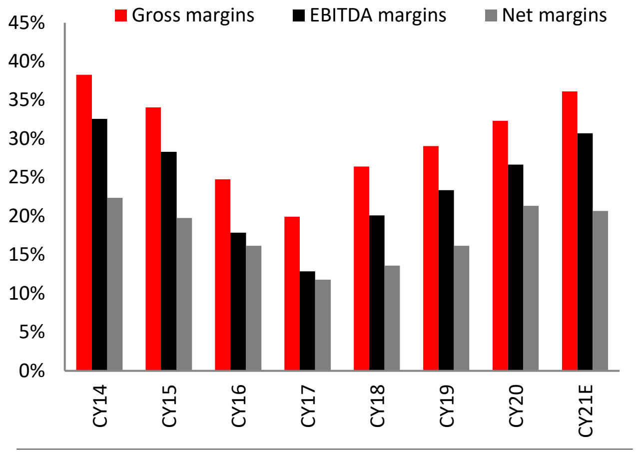
- Catalyst: (1) pricing power in UREA market, (2) revival of higher dividends from FFBL and (3) expansion into 1.3mn fertilizer complex and 330MW coal power plant.

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

Outlook

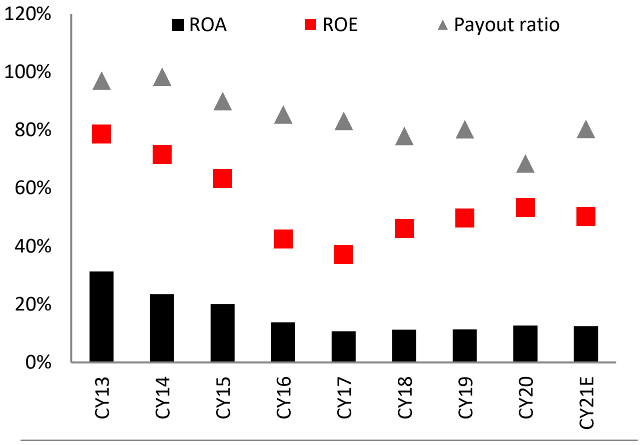
- We have an "Outperform" stance given attractive DY of 16.4/17.8% for CY22/23.

Fig 176: Pricing power and GIDC reduction would allow FFC to retain pricing power



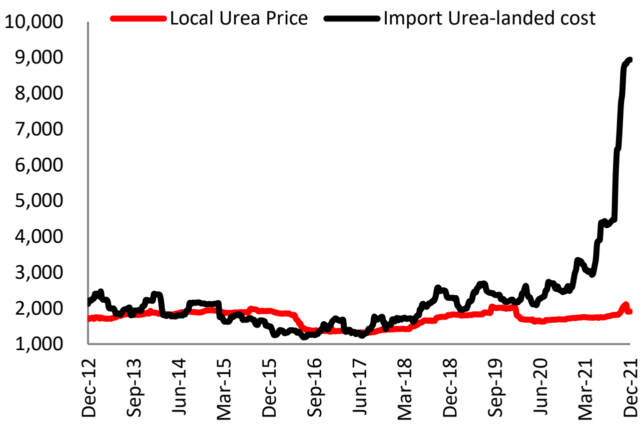
Source: Company Acc, Foundation Research, January 2022

Fig 177: Dividend payout to increase due to waiver of mark-up on GIDC amount withheld



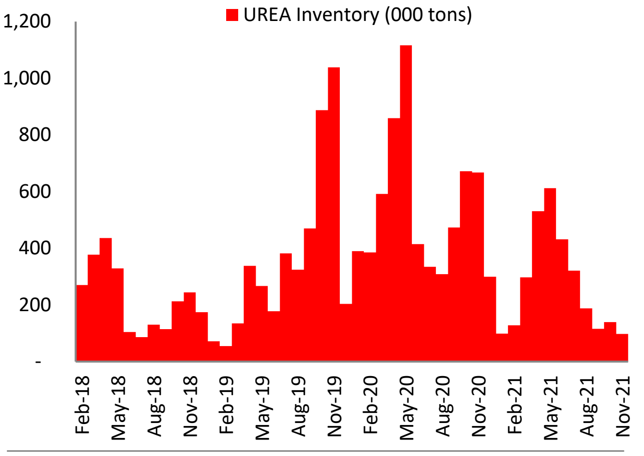
Source: Company Acc, Foundation Research, January 2022

Fig 178: Pricing power to remain intact due to ↑ landed cost for and fiscal constraints for subsidy (Rs/bag)…



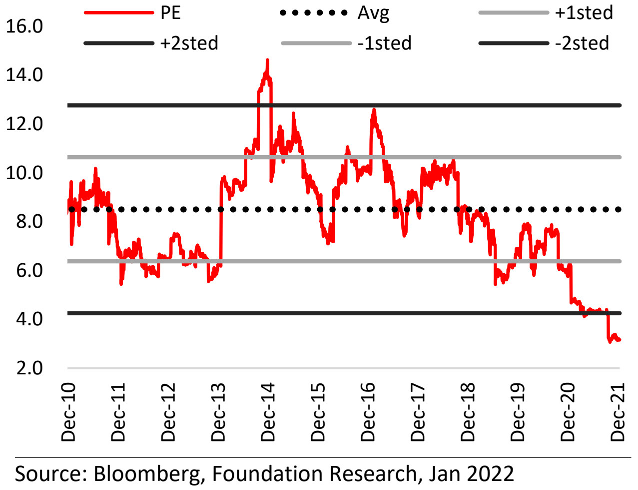
Source: NFDC, Bloomberg Foundation Research, Jan 2022

Fig 179: further support to profitability would came from lower Urea inventory which is below buffer level



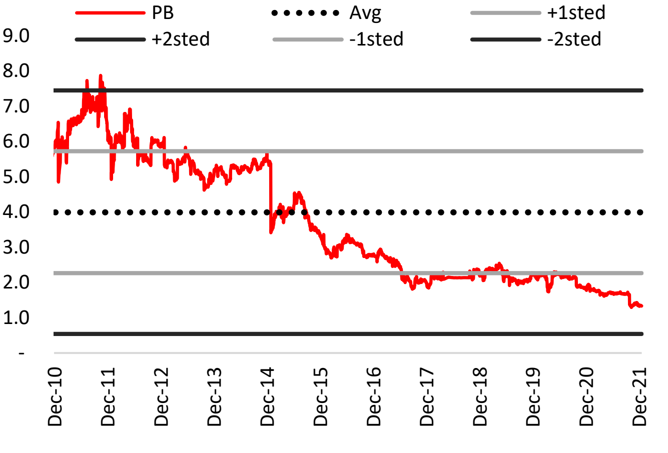
Source: NFDC, Foundation Research, January 2022

Fig 180: Trading at below average PE



Source: Bloomberg, Foundation Research, Jan 2022

Fig 181: Trading low on PB as well



Source: Bloomberg, Foundation Research, Jan 2022

Table 35: Fauji Fertilizer Company Limited (FFC PA, 'Outperform', TP: Rs141.9/sh)

Balance Sheet		CY20A	CY21E	CY22E	CY23E
PP&E	m	22,841	23,531	24,283	25,095
Cash & ST invest	m	83,056	83,859	73,246	57,279
LT invest	m	34,675	46,256	46,256	46,256
Other Assets	m	32,378	37,767	38,141	37,681
Total Assets	**m**	**172,949**	**191,413**	**181,926**	**166,311**
LT+ST debt	m	35,944	44,619	46,516	54,800
Acct. payable	m	46,621	46,621	46,621	46,621
Deferred tax	m	38,056	38,131	27,690	6,809
Others	m	9,792	13,591	10,291	2,721
Total Liabilities	**m**	**130,413**	**142,962**	**131,118**	**110,951**
Paid-up Capital	m	12,722	12,722	12,722	12,722
Others	m	29,813	35,729	38,085	42,637
SH' Equity	**m**	**42,536**	**48,452**	**50,808**	**55,359**
L+E	**m**	**172,949**	**191,414**	**181,926**	**166,311**

Profit & Loss		CY20A	CY21E	CY22E	CY23E
Net Sales	m	97,655	110,459	132,861	149,475
Cost of Sales	m	66,071	70,539	93,909	105,616
Gross Profit	**m**	**31,583**	**39,919**	**38,953**	**43,859**
S&A	m	7,848	8,409	9,268	9,968
Other income	**m**	12,356	7,608	9,742	8,516
Other exp	m	4,626	4,959	3,198	3,572
EBIT	**m**	**31,465**	**34,159**	**36,229**	**38,834**
Finance cost	m	1,874	2,373	2,576	2,278
PBT	**m**	**29,591**	**31,786**	**33,653**	**36,556**
Taxation	m	8,772	8,953	9,104	9,907
PAT	**m**	**20,819**	**22,832**	**24,549**	**26,650**
EPS		16.4	17.9	19.3	20.9
EPS growth yoy	%	21.7%	9.7%	7.5%	8.6%
DPS		11.2	14.4	16.4	17.8

Q performance		4Q'21E	1Q'22E	2Q'22E	3Q'22E
Net Sales	m	36,867	30,291	26,172	40,583
Cost of Sales	m	24,323	21,222	16,854	30,132
Gross Profit	**m**	**12,543**	**9,068**	**9,318**	**10,451**
S&A	m	2,359	2,110	2,191	2,498
Other income	m	1,693	4,507	1,713	2,256
Other exp	m	1,042	758	772	843
EBIT	m	**10,836**	**10,708**	**8,068**	**9,366**
Finance cost	**m**	593	644	644	644
PBT	m	**10,243**	**10,064**	**7,424**	**8,722**
Taxation	**m**	2,970	2,465	2,090	2,391
PAT	m	**7,272**	**7,599**	**5,334**	**6,331**
EPS		5.7	6.0	4.2	5.0
EPS growth yoy		3%	78%	9%	37%
DPS		4.6	5.1	3.6	4.2

Key ratios		CY20A	CY21E	CY22E	CY23E
BVPS	x	33.4	38.1	39.9	43.5
EPS	x	16.4	17.9	19.3	20.9
PE	x	6.0	5.4	5.1	4.7
PBv	x	2.9	2.6	2.4	2.2
GP margins	%	32%	36%	29%	29%
EBITDA margin	%	27%	31%	24%	24%
Net margin	%	21%	21%	18%	18%
ROE	%	53%	50%	49%	50%
ROA	%	13%	13%	13%	15%
Earnings yield	%	17%	18%	20%	21%
Payout Ratio	%	68%	80%	85%	85%
DY	%	11%	15%	17%	18%
EV/EBITDA	x	3.1	2.7	3.2	3.2
Operat. cycle	x	(165.9)	(253.7)	(198.5)	(143.6)
Debt/Equity	x	0.9	1.1	1.0	0.9

Source: Company data, Foundation Research, January 2021
All figures in Rs unless noted

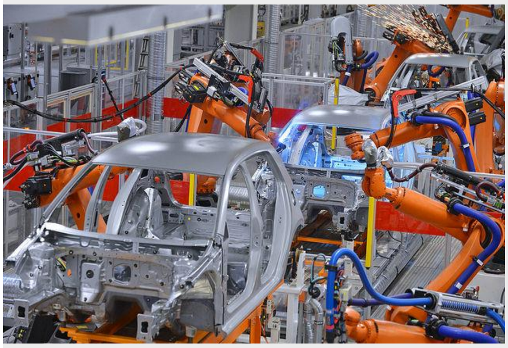
About the company

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 OLlVE 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

INDU PA Outperform

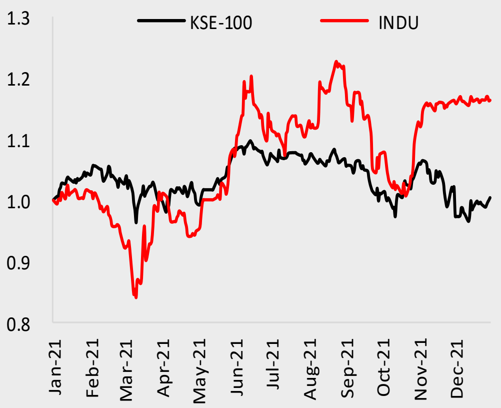


Price (31 Dec 21 CP)	Rs	1,229.0
Dec-22 Target Price	Rs	1,570.0
Upside/Downside	%	27.7
12M Target Price	Rs	1,570.0
- DCF methodology		
Sector		Auto
Market cap	Rs bn	96.6
30-day avg turnover	$ m	0.3
Market cap	$ m	623.2
Freet float	%	17.1
Shares issued	m	78.6

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	179,162	204,780	214,821	255,306
EBITDA	m	21,294	27,634	25,696	32,656
EBITDA Growth	%	0.8	170.7	20.7	18.2
PBT	m	18,199	24,096	22,267	25,901
Recurring Profit	m	12,829	17,078	15,810	18,389
Net Profit	m	12,829	17,078	15,810	18,389
EPS reported	Rs	163.2	217.3	201.1	234.0
Rev growth	%	107.9	14.3	4.9	18.8
EPS growth	%	4,331.5	33.1	(7.4)	16.3
PE	x	7.5	5.7	6.1	5.3
DPS	Rs	103.5	108.5	141.0	164.0
Div. Yield	%	8.4	8.8	11.5	13.3
ROA	%	12.0	12.7	10.6	11.3
ROE	%	28.7	32.9	27.1	28.5
EV/EBITDA	x	4.4	2.2	1.8	2.1
Net D/E	x	(0.0)	(0.7)	(0.8)	(0.4)
Price to Book	x	2.0	1.7	1.6	1.4
Price to Sales	x	0.5	0.5	0.4	0.4

INDU KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Indus Motor Company

Consolidating on Brand Equity

Event

- Driving on a consumer confidence road, Indus Motor Company (INDU) would maintain its high brand equity due to high penetration in rural segment and ease of maintenance. Due to its high demand, INDU maintains strong cash position is expected to remain intact which provides buffer to profitability. Furthermore INDU's high localization rate makes it less receptive to adverse changes in exchange rate. Therefore, we revise our Dec'22 target Price for INDU at Rs1,570/sh; with upside of 30% and dividend yield of 9%.

Impact

- **Demand on high roads:** INDU has strong penetration into rural segment (50% of total sales) due to its durability of product offering and ease of maintains. We expect this product positioning to remain largely intact despite new players that would play a dilution factor in the urban segment. Due to high portion of rural and B2B sales, INDU sales remain least effected by any potential interest rate amid economic growth. INDU's growth trajectory is expected to remain unhampered with volumetric growth Furthermore, production issues are expected to normalize given better procurement of inventory and resolving of global shortage semi-conductors.

- **Strong Brand equity:** INDU marketability of product, given market presence of 3 decades, have stimulated vertical integration through related party and improved localization. The long standing market presence provides consumer base ease of repair and maintenance with well-established aftermarket sales service, which new players lack. Even though Yaris is expected to experience dissipating novelty factor given higher competition, INDU would keep strong hold in sedan segment whereas high-end SUV and LCV segment still remains broadly unchallenged.

- **Expansion turn:** INDU plans to invest aggregated amount of US$100mn over the course of 3yrs, to introduce first locally manufactured hybrid electric vehicle and plans to utilize this investment for upgradation and extension, and increasing localization of parts. INDU's initiative to locally manufactured HEV, with the aid of EV policy, would most likely give it the first mover advantage. Furthermore, company plans to expand its capacity by 20% by an additional investment of US30$.

- **Robust balance sheet dynamics:** Given high demand of its vehicles, INDU is expected to keep balance sheet strong, driven from sufficient cash position, which provides strong financial muscle to support profitability. To highlight INDU currently has cash position (cash+ ST investments) of Rs107bn, as of Sept'21. We expect this abnormal amount to taper off in the next few quarters but rise going forward due to high demand and effective working capital management. Therefore we expect other income to contribute Rs122/125 in FY22/23.

Earnings Revision

- We revise our FY22/23 EPS by 33/10% due to volumes revision and result update.

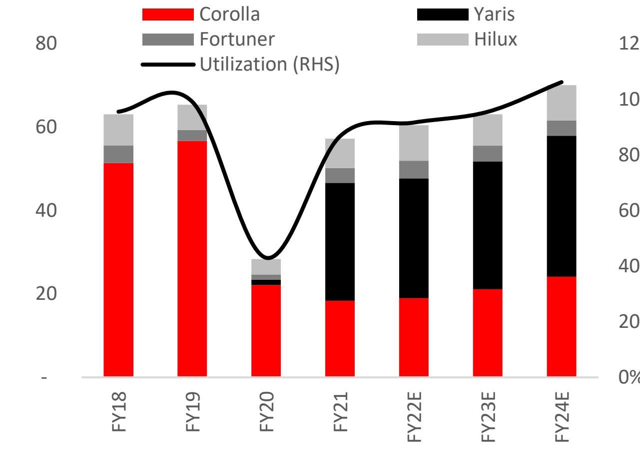
Price Catalyst

- Dec--22 TP: Rs 1,570/sh based on the DCF methodology.
- Catalysts:, 1) greater penetration in HEV/SUV market and 2) increased localization.
- Key risks: 1) Rupee depreciation, and 2) Increased competition in sedan segment.

Outlook

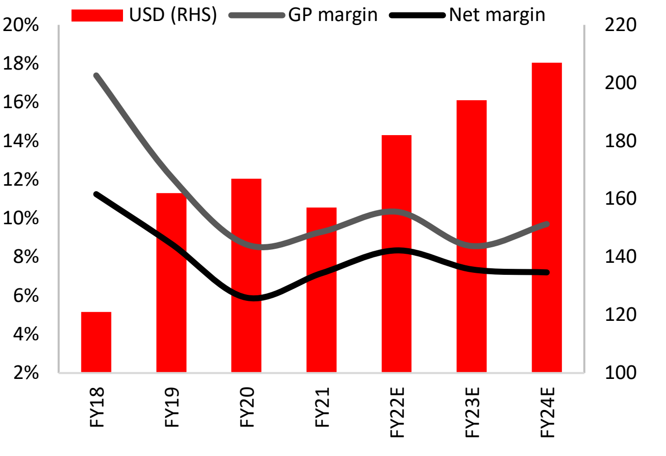
- We are bullish on the stock due to strong brand equity that seems to be standing strong despite new competition.

Fig 182: Expected market share of OEMs (K units)



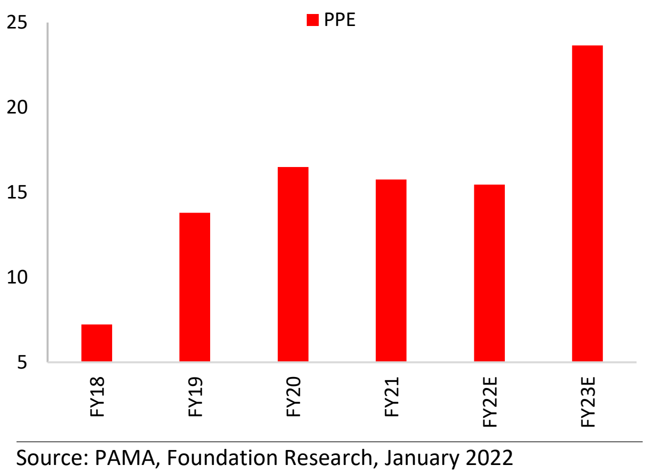
Source: PAMA, Foundation Research, January 2022

Fig 183: Average expected prices going forwards



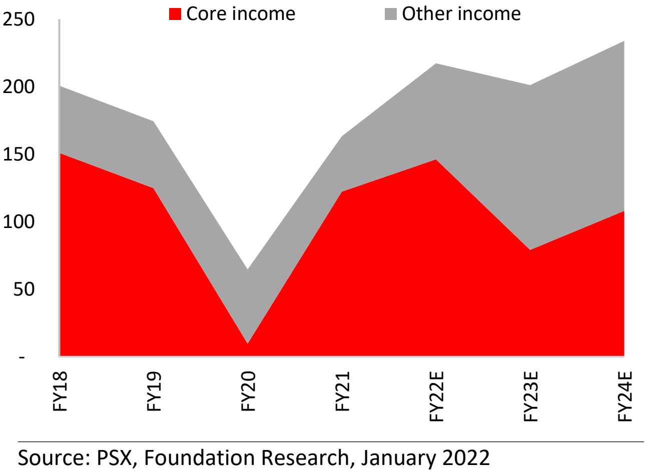
Source: Foundation Research, January 2022

Fig 184: Rising Demand and changing mix… (Rs bn)



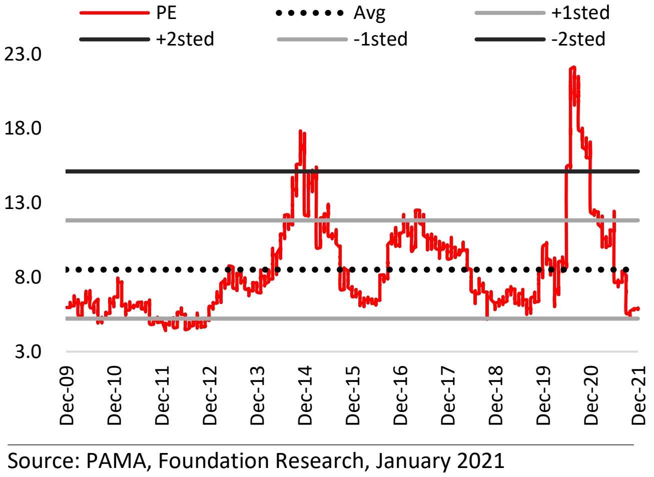
Source: PAMA, Foundation Research, January 2022

Fig 185: Results in rising earnings and margins



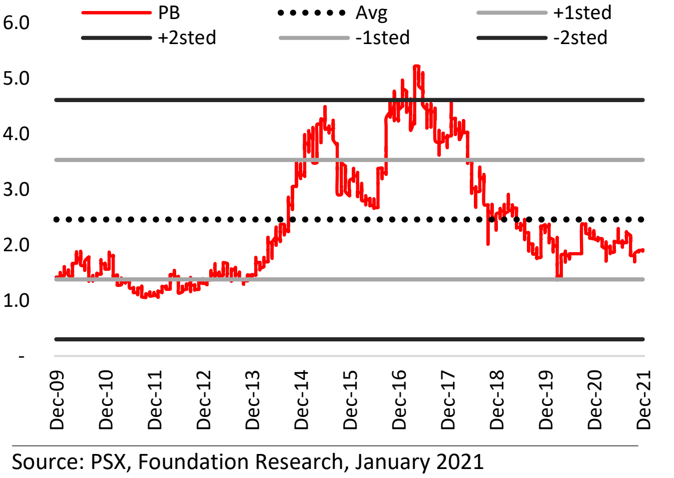
Source: PSX, Foundation Research, January 2022

Fig 186: Trading at P/E of -2stded…..



Source: PAMA, Foundation Research, January 2021

Fig 187: ..while above -1sted on P/B



Source: PSX, Foundation Research, January 2021

Table 36: Indus Motor Company Limited (INDU PA, 'Outperform', Target price Rs 1,570.0/sh)

Balance Sheet		**FY21A**	**FY22E**	**FY23E**	**FY24E**
PP&E	m	15,770	15,458	23,651	33,141
Inventory	m	22,289	14,100	16,566	21,416
Cash & ST Inv	m	84,092	89,618	105,201	87,306
Other Assets	m	11,755	16,174	17,527	19,434
Total Assets	**m**	**133,906**	**135,351**	**162,945**	**161,296**
Advances	m	51,267	53,387	63,237	63,646
Trade & other payable	m	30,288	20,055	24,043	25,372
Other Liabilities	m	4,149	6,376	14,540	4,476
Total Liabilities	**m**	**85,704**	**79,817**	**101,821**	**93,493**
Paid-up Cap.	m	786	786	786	786
Reserves	m	47,415	54,748	60,339	67,017
Sh Equity	m	**48,201**	**55,534**	**61,125**	**67,803**
Liabilities + Equity	**m**	**133,906**	**135,351**	**162,946**	**161,297**

Profit & Loss		**FY21A**	**FY22E**	**FY23E**	**FY24E**
Net Sales	m	179,162	204,780	214,821	255,306
Cost of Sales	m	162,508	183,605	196,417	230,538
Gross Profit	**m**	**16,654**	**21,175**	**18,404**	**24,768**
Dist. Cost	m	1,619	3,240	2,363	2,808
Admin Cost	m	1,465	1,859	1,800	2,139
Other expense	m	817	1,472	1,805	2,100
Other income	m	5,579	9,586	9,885	8,200
EBIT	**m**	**18,333**	**24,190**	**22,320**	**25,921**
Finance cost	m	134	94	53	20
Pre-tax Profit	**m**	**18,199**	**24,096**	**22,267**	**25,901**
Taxation	m	5,371	7,018	6,457	7,511
PAT	m	**12,829**	**17,078**	**15,810**	**18,389**
EPS	**Rs**	**163.2**	**217.3**	**201.1**	**234.0**
DPS	**Rs**	**103.5**	**108.5**	**141.0**	**164.0**

Q Performance		**1QFY22A**	**2QFY22E**	**3QFY22E**	**4QFY22E**
Net Sales	m	65,552	53,493	43,454	42,281
Cost of Sales	m	58,480	47,152	39,266	38,707
Gross Profit	**m**	**7,073**	**6,341**	**4,188**	**3,574**
Dist. Cost	m	456	1,070	869	846
Admin Expenses	m	467	535	435	423
Other expense	m	486	472	287	226
Other income	m	2,047	2,395	2,616	2,527
EBIT	**m**	**7,712**	**6,658**	**5,213**	**4,606**
Finance cost	m	29	12	10	43
PBT	**m**	**7,683**	**6,646**	**5,204**	**4,564**
Taxation	m	2,258	1,927	1,509	1,323
PAT	**m**	**5,425**	**4,719**	**3,695**	**3,240**
EPS	Rs	69.0	60.0	47.0	41.2
DPS	Rs	34.5	30.0	23.0	21.0

Key Ratios		**FY21A**	**FY22E**	**FY23E**	**FY24E**
BVPS	Rs	613.2	706.5	777.7	862.6
EPS	Rs	163.2	217.3	201.1	234.0
PE	x	7.5	5.6	6.1	5.2
PBV	x	2.0	1.7	1.6	1.4
GP margins	%	9.3%	10.3%	8.6%	9.7%
EBIT Margins	%	10.2%	11.8%	10.4%	10.2%
NP margin	%	7.2%	8.3%	7.4%	7.2%
ROE	x	26.6%	32.9%	27.1%	28.5%
ROA	x	9.6%	12.7%	10.6%	11.3%
Earnings yield	%	13.4%	17.8%	16.5%	19.2%
Payout Ratio	%	63%	50%	70%	70%
Dividend Yield	%	8.5%	8.9%	11.6%	13.5%
EV/EBITDA	x	4.40	2.13	1.77	2.08
Inventory days	x	42.9	36.2	28.5	30.1

Source: Company data, Foundation Research, January 2022
All figures in PKR unless noted

About the company

Indus Motor Company Limited (IMC) incorporated in 1989 as a joint venture company between the between the House of Habib (HOH), a local conglomerate and Toyota Motor Corporation (TMC) and Toyota Tsusho Corporation (TTC) of Japan. The company manufactures and markets Toyota brand vehicles in Pakistan. The main product offerings include several variants of the flagship “Corolla” in the passenger cars category, “Hilux” in the light commercial vehicles segment and “Fortuner” in Sport Utility Vehicle (SUV) segment. The Company also sells limited units of Daihatsu brand vehicles.

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

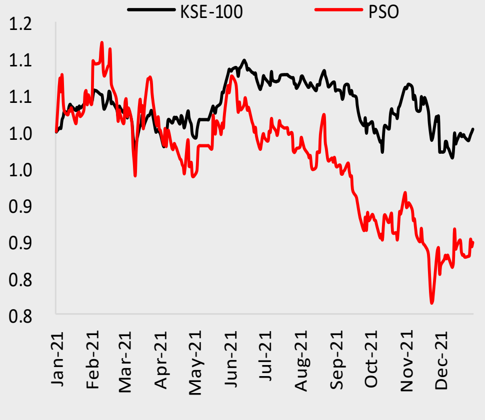
PSO PA **Outperform**

Price (31 Dec 21 CP)	Rs	181.9
Dec-22 Target Price	Rs	288.8
Upside/Downside	%	58.8
12M Target Price	Rs	288.8
- DCF Methodology		
Sector		OMCs
Market cap	Rs bn	85.4
30-day avg turnover	$ m	0.7
Market cap	$ m	550.9
Freet float	%	45.0
Shares issued	m	469.5

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	1,204,247	1,950,532	2,019,779	2,108,493
EBITDA	m	46,170	45,416	44,871	49,641
EBITDA Growth	%	85.0	1,658.9	(2.8)	9.3
PBT	m	44,056	42,125	39,649	41,475
Recurring Profit	m	29,139	27,496	24,500	25,662
Net Profit	m	29,139	27,496	24,500	25,662
EPS reported	Rs	62.1	58.6	52.2	54.7
Rev growth	%	8.7	62.0	3.6	4.4
EPS growth	%	NA	NA	(10.9)	4.7
PE	x	NA	3.1	3.5	3.3
DPS	Rs	15.0	14.0	17.0	26.0
Div. Yield	%	8.2	7.7	9.3	14.3
ROA	%	8.1	6.5	4.6	3.9
ROE	%	23.0	18.3	14.5	13.8
EV/EBITDA	x	3.0	3.2	6.6	7.4
Net D/E	x	0.4	0.4	1.2	1.5
Price to Book	x	0.6	0.5	0.5	0.4
Price to Sales	x	0.1	0.0	0.0	0.0

PSO KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Pakistan State Oil Company Limited

Rising market share amid storage additions

Event

- Oil segment is expected to continue its upward trajectory as economic growth is set to endure. As a result, PSO being the largest OMC in Pakistan, stands in a strong position to benefit from this due to (1) rising demand of oil, (2) increasing market share, and (3) increase in margins. Therefore, we have an outperform stance on the scrip with Dec'22 TP of Rs288.8/sh.

Impact

- **Improved market share on the back of infrastructure investment:** Now that the economy is growing robustly, the white oil segment has been on an upwards trajectory as evident by MS/HSD rising by 10/17% YoY in 1HFY22. Furnace Oil has also surged by 17% YoY in 1HFY22 due to increased demand from power generation amid shortage of gas. Likewise, PSO was able to secure a higher market share of 45/49% in MS/HSD during 1HFY22 as opposed to 42/48% in 1HFY21. PSO's market share of FO also increased to 61% in 1HFY22 compared to 50% in 1HFY21.

- 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 is investing in North (Punjab and KPK) given that consumption share of North is 66-70% but storage is only 25%. Company has recently completed storage facilities of 43KT at Shikarpur, Faisalabad and Taru Jabba (KPK), 62KT at Zulfiqarabad and 47KT at Machike and Juglot (GB). Company has also converted 180K tons of FO storage to MS/HSD storage. Besides PSO added 71 New Vision Retail Outlets across the country in FY21.

- **LNG receivables to weigh on balance sheet:** Company's receivables from SNGPL on account of LNG sales have increased to Rs116bn from Rs99bn in 3 months to Sept'30, 21. We expect that LNG receivables would increase significantly going forward as quantum of LNG sales increases resulting in higher ST borrowing that would also increase its finance cost and negatively impact net profits. Higher policy rate would also adversely affect finance cost. We foresee finance cost to clock in at Rs13.7/20.7/30.8/sh during FY22/23/24.

Earnings Revision

- We revise up our FY22/23 EPS by 65/24% due to result update and higher than expected margin revision.

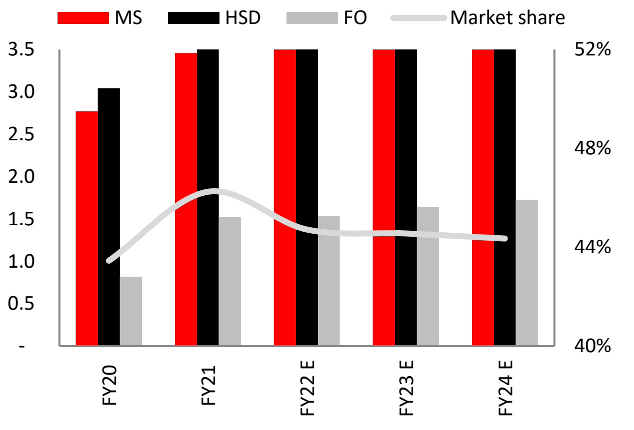
Price Catalyst

- Dec- 22 TP: Rs288.8/sh based on DCF methodology.
- Catalyst: (1) margin revision and (2) increased payout.
- Risk: (1) build up of LNG receivables and (2) debt pile up.

Outlook

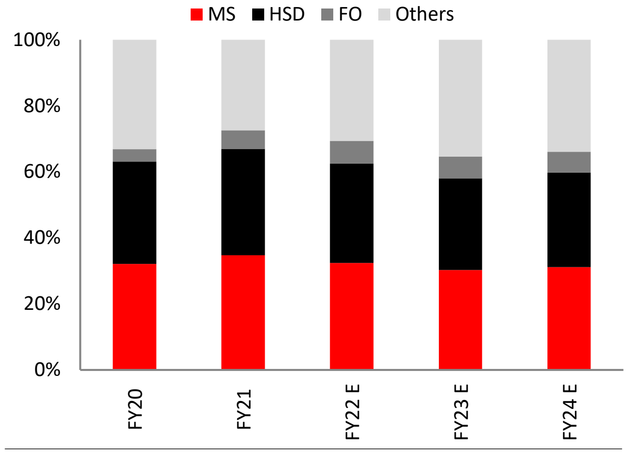
- We have "Outperform" rating with Dec'22 TP of Rs288.8/sh owing to improved market share and margin revision.

Fig 188: White oil led market share recovery



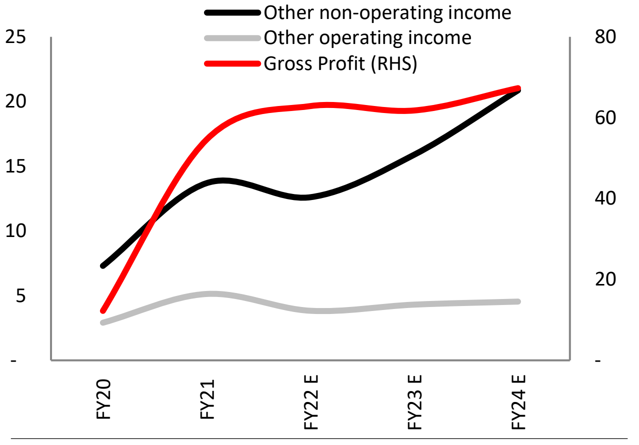
Source: OCAC, FSL Research, January 2022

Fig 189: MS/HSD gross profit mix continue expanding



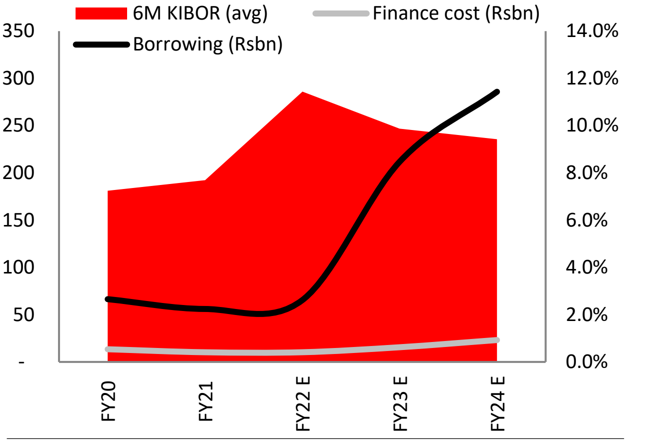
Source: OCAC, FSL Research, January 2022

Fig 190: Rising GP due to increase in OMC margin



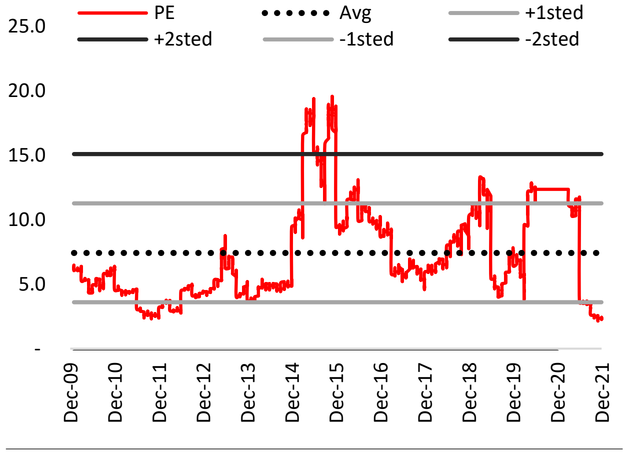
Source: Company reports, FSL Research, January 2022

Fig 191: Finance cost to drop



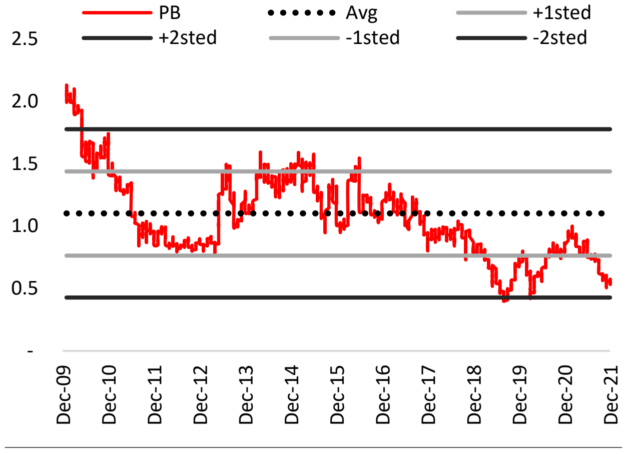
Source: PPIS, FSL Research, January 2022

Fig 192: Trading below -2sted



Source: Bloomberg, FSL Research, January 2022

Fig 193: ...and lower on PB



Source: Bloomberg, FSL Research, January 2022

Table 37: Pakistan State Oil (PSO PA, 'Outperform', Dec-22 TP Rs288.8/sh

Balance Sheet		FY21A	FY22E	FY23E	FY24E
PP&E	m	51,297	53,284	55,819	58,582
Trade Debt	m	220,196	244,213	381,154	451,922
Cash & equi	m	2,902	7,041	1,093	2,701
Other Assets	m	104,864	160,138	168,327	184,992
Total Assets	**m**	**379,258**	**464,676**	**606,393**	**698,197**
ST Borrowing	m	56,043	65,417	211,820	285,873
Trade Payable	m	167,694	223,820	201,988	203,929
Other Liab	m	15,545	15,289	15,071	14,891
Total Liab	**m**	**239,281**	**304,526**	**428,879**	**504,693**
Paid-up Capital	m	4,695	4,695	4,695	4,695
Others	m	135,282	155,455	172,819	188,809
SH' Equity	**m**	**139,977**	**160,150**	**177,514**	**193,504**

Profit & Loss		FY21A	FY22E	FY23E	FY24E
Net Sales	m	1,204,247	1,950,532	2,019,779	2,108,493
COGS	m	1,149,638	1,887,648	1,957,986	2,041,180
Gross Profit	**m**	**54,609**	**62,883**	**61,793**	**67,313**
Dist exp	m	11,833	20,220	20,938	21,857
Admin exp	m	3,057	3,390	3,657	3,929
Other exp	m	4,829	4,608	3,611	3,854
Other Inc	m	19,408	17,736	21,625	26,976
EBIT	**m**	**54,298**	**52,401**	**55,212**	**64,648**
Finance cost	m	10,242	10,276	15,563	23,173
PBT	**m**	**44,056**	**42,125**	**39,649**	**41,475**
Taxation	m	14,917	14,629	15,148	15,814
PAT	**m**	29,139	27,496	24,500	25,662
EPS (rep)	Rs	**62.1**	**58.6**	**52.2**	**54.7**
EPS growth	%	N/A	-6%	-11%	5%
DPS	Rs	15.0	14.0	17.0	26.0

Q Results		2QFY21	3QFY21	4QFY21	1QFY22
Net Sales	m	286,667	285,529	351,286	459,224
Cost of Sales	m	277,675	268,279	334,416	437,170
Gross Profit	**m**	**8,993**	**17,251**	**16,869**	**22,054**
Dist+Adim exp	m	3,943	3,291	4,345	3,956
Other Charges	m	1,217	845	1,727	1,570
Other Income	m	3,319	874	13,826	1,900
EBIT	**m**	**7,152**	**13,989**	**24,623**	**18,428**
Finance cost	m	579	1,064	7,741	626
PBT	**m**	**6,573**	**12,925**	**16,882**	**17,802**
Taxation	m	2,196	4,205	5,985	5,808
PAT	**m**	4,378	8,720	10,897	11,994
EPS (rep)	Rs	9.3	18.6	23.2	25.5
DPS	Rs	5.0	-	10.0	-

Key ratios		FY21A	FY22E	FY23E	FY24E
BVPS	Rs	298.2	341.1	378.1	412.2
EPS	Rs	62.1	58.6	52.2	54.7
PE	x	2.9	3.0	3.4	3.2
PBv	x	0.6	0.5	0.5	0.4
GP margin	%	4.5%	3.2%	3.1%	3.2%
EBIT margin	%	4.5%	2.7%	2.7%	3.1%
Net margin	%	2.4%	1.4%	1.2%	1.2%
ROE	%	23.0	18.3	14.5	13.8
ROA	%	8.1	6.5	4.6	3.9
EY	%	13.2%	12.5%	11.1%	11.6%
Payout	%	24.2	23.9	32.6	47.6
DY	%	8.5	7.9	9.6	14.6
EV/EBITDA	x	3.0	3.1	6.6	7.4

All figures in PKR unless noted
Source: Company data, Foundation Research, January 2022

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 ~61% in black oil market and 49% share in the white oil market. 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


QQL $119.49
0.14 $44.10
SMALL CAP
$37.30
0.55
UYV $7.02
ISN $7.01
VCX $44.34
PLB $14.90
IZO $7.02
SER $5.19

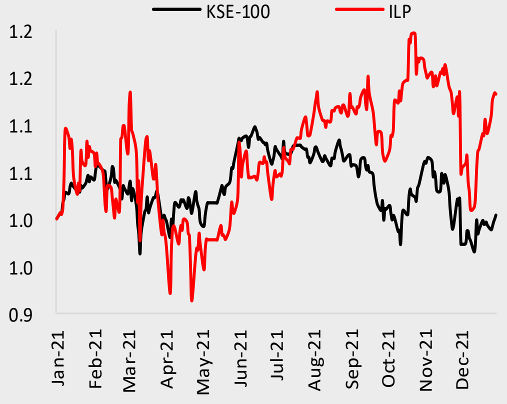
ILP PA **Outperform**

Price (31 Dec 21 CP)	Rs	72.7
Dec-22 Target Price	Rs	104.8
Upside/Downside	%	44.2
12M Target Price	Rs	104.8
- DCF Methodology		
Sector		Textile
Market cap	Rs bn	65.3
30-day avg turnover	$ m	0.3
Market cap	$ m	421.3
Freet float	%	14.5
Shares issued	m	898.4

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	54,962	65,202	72,166	79,941
EBITDA	m	10,300	12,725	15,887	17,586
EBITDA Growth	%	27.8	143.1	54.2	38.2
PBT	m	6,873	8,757	11,961	13,774
Recurring Profit	m	6,292	8,016	10,950	12,609
Net Profit	m	6,292	8,016	10,950	12,609
EPS reported	Rs	7.0	8.9	12.2	14.0
Rev growth	%	51.4	18.6	10.7	10.8
EPS growth	%	250.3	27.4	36.6	15.2
PE	x	10.4	8.1	6.0	5.2
DPS	Rs	2.4	3.2	6.8	7.8
Div. Yield	%	3.3	4.3	9.3	10.7
ROA	%	11.9	12.6	16.2	18.1
ROE	%	33.3	34.2	36.0	33.4
EV/EBITDA	x	9.2	7.4	5.5	4.6
Net D/E	x	1.4	1.1	0.6	0.4
Price to Book	x	3.2	2.5	1.9	1.6
Price to Sales	x	1.2	1.0	0.9	0.8

ILP KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Interloop Limited

Best play in textile sector

Event

▪ Interloop is among the leaders in socks manufacturing globally and the most attractive play in Pakistan textile universe due to its (1) superior margins and ROE generation compared to industry peers, (2) diversification into apparel manufacturing by adding a seamless activewear plant and a denim plant, (3) US$300mn expansion and investment projects over next 5 years, (4) continuous efforts at innovation by running pilot projects, and (5) geographically diversified client base with a mix of high end and retail customers. Hence, we have an "Outperform" stance on the scrip with Dec-22 TP of Rs104.8/sh.

Impact

▪ **Superior profitability:** ILP's attractiveness is based on its margins and ROE being superior to industry peers which exhibits management's commitment to transparency and the company's greater operational efficiencies (see Table 1 below). The sustainability of this feature of the company's profitability is confirmed by historical analysis (see Fig 11 and 12 below). We believe management's commitment to achieving higher profitability bodes well for company's future outlook and shareholders returns.

▪ **Diversifying into Apparels:** ILP has forayed into apparel manufacturing by adding a denim plant with 12 mn pieces per year capacity which will be fully operational in FY22. Ramp up of this unit is expected over the next few years which would add significantly to company's bottom line. ILP is in the process of adding a knitwear apparel plant with capacity of 14mn garments per year which would be fully online by Q2FY23. Company's expansion plans include seamless activewear plant which would allow it to move into a segment which is in high demand globally as consumer trends shift towards more versatile clothing. These expansions are a result of successful pilot projects of yesteryears.

▪ **Five year expansion plans of US$300mn:** Company announced in April 2021 its plan to double sales in next 5 years and to achieve this target and its Vision 2025 ("To become a full family clothing partner of choice"), it will add a (1) knitwear apparel plant, (2) Active Wear plant, (3) denim fabric mill, (4) 6th hosiery plant and (5) enhance its spinning and yarn dyeing capacity. The capital outlay for these projects is estimated at US$300mn. However, we have not incorporated this in our valuation as we await details of capacities, timelines and costs. We believe that company's plan is realistic given its recent stellar performance as evidenced by 3/5yr revenue CAGR of 21/16%. It is worth noting that Net Profit grew in tandem recording 3/5yr CAGR of 17/11%.

Earnings Revision

▪ No change

Price Catalyst

▪ Dec-22 TP: Rs104.8 /sh based on DCF methodology.

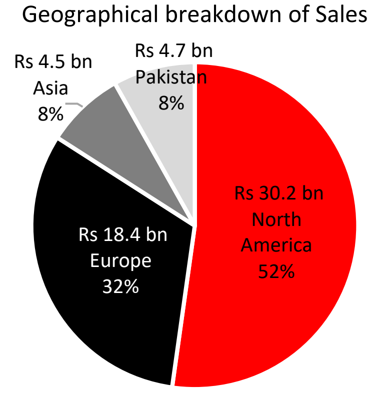
▪ Catalyst: (1) Currency devaluation, (2) successful pilot projects of new products, (3) Gov't textile policy and (4) continuation of subsidized energy tariffs.

▪ Key Risks: (1) Economic slowdown amid resurgence of COVID and (2) loss of a few key clients.

Outlook

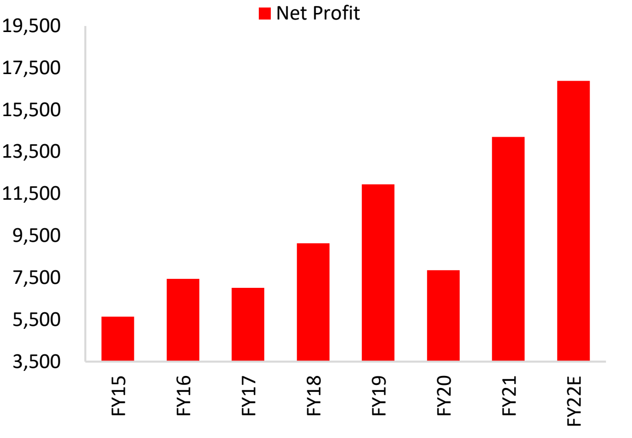
▪ With expansion into apparel and plans for further investments of US$300mn, we believe ILP is well positioned for further improvement in profitability. We have an "Outperform" stance on the scrip with Dec-22 TP of Rs104.8/sh.

Fig 194: Breakdown of topline…



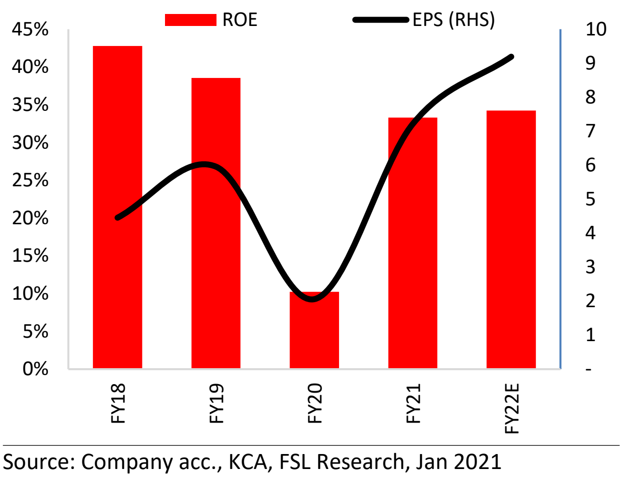
Source: Company accounts, FSL Research, Jan 2021

Fig 195: …export sales following currency depreciation



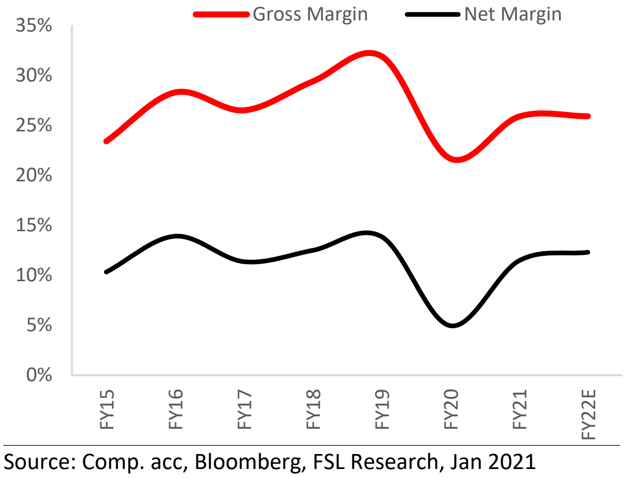
Source: Comp. acc, Bloomberg, FSL Research, Jan 2021

Fig 196: Gross profit and changes in cotton prices



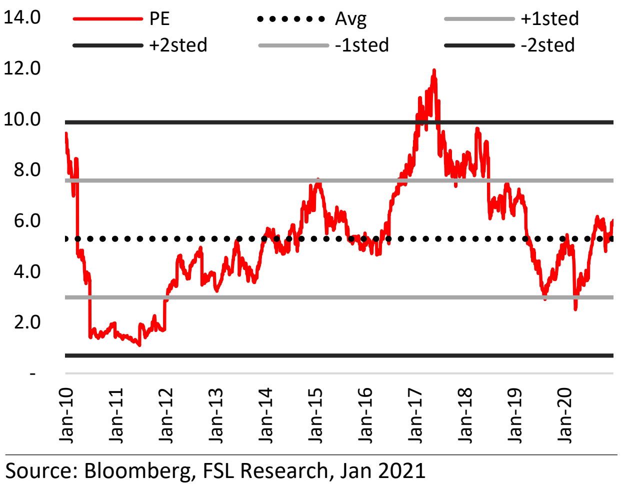
Source: Company acc., KCA, FSL Research, Jan 2021

Fig 197: Gross profit and currency depreciation



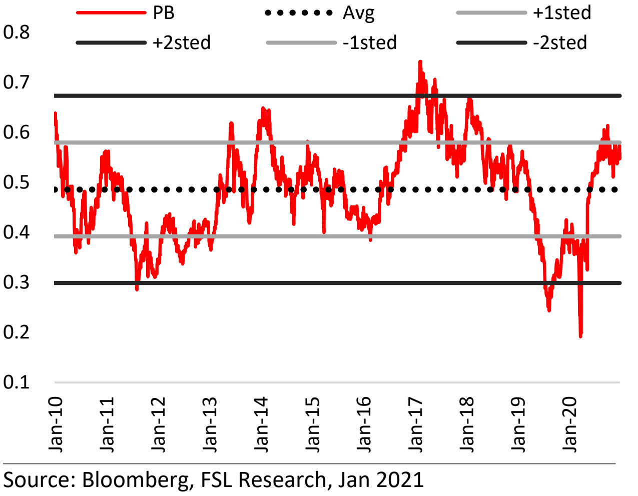
Source: Comp. acc, Bloomberg, FSL Research, Jan 2021

Fig 198: Trading at average PE



Source: Bloomberg, FSL Research, Jan 2021

Fig 199: Trading above average PB



Source: Bloomberg, FSL Research, Jan 2021

Table 38: Interloop Ltd (ILP PA, 'Outperform', Target priceRs104.8/sh.)

Balance Sheet		FY21A	FY22E	FY23E	FY24E
PP&E	m	26,193	27,720	26,542	24,740
Cash & Inv	m	874	396	521	719
Other assets	m	33,627	38,550	41,644	45,012
Total Assets	**m**	**60,695**	**66,665**	**68,708**	**70,471**
Long term Loan	m	8,214	9,957	7,970	6,579
Other Liabilities	m	31,966	30,358	26,272	22,923
Total Liabilities	**m**	**40,180**	**40,315**	**34,242**	**29,502**
Paid-up capital	m	8,722	8,722	8,722	8,722
Reserves	m	11,793	17,628	25,743	32,247
SH' Equity	**m**	**20,515**	**26,350**	**34,465**	**40,969**
Liab+Equity	**m**	**60,695**	**66,665**	**68,708**	**70,471**

Profit & Loss		FY21A	FY22E	FY23E	FY24E
Net sales	m	54,962	65,202	72,166	79,941
COGS	m	40,750	48,319	51,674	57,301
Gross profit	**m**	**14,212**	**16,883**	**20,492**	**22,640**
Dist expense	m	2,640	2,772	2,910	3,056
Admin expenses	m	2,796	3,076	3,383	3,722
Other charges	m	919	891	1,074	1,171
Other Income	m	163	39	18	23
EBIT	**m**	**8,020**	**10,184**	**13,142**	**14,715**
Finance cost	m	1,147	1,428	1,181	941
PBT	m	6,873	8,757	11,961	13,774
Taxation	m	581	741	1,012	1,165
PAT	**m**	**6,292**	**8,016**	**10,950**	**12,609**
EPS(rep)	Rs	7.0	8.9	12.2	14.0
EPS growth	%	240%	27%	37%	15%
DPS	Rs	2.5	3.3	7.0	8.0

Q Performance		3QFY21A	4QFY21A	1QFY22A	2QFY22E
Net sales	m	12,507	16,193	19,330	17,359
COGS	m	8,763	12,191	13,793	12,846
Gross profit	**m**	**3,743**	**4,003**	**5,537**	**4,513**
Dist expense	m	667	769	808	694
Admin expenses	m	731	778	938	814
Other charges	m	213	270	580	323
Other Income	m	18	70	5	10
EBIT	**m**	**2,152**	**2,255**	**3,215**	**2,692**
Finance cost	m	301	330	360	426
PBT	**m**	**1,851**	**1,925**	**2,855**	**2,266**
Taxation	m	154	235	165	213
PAT	**m**	**1,697**	**1,690**	**2,690**	**2,053**
EPS(rep)	Rs	1.9	1.9	3.0	2.3

Key ratios		FY21A	FY22E	FY23E	FY24E
BVPS	x	22.8	29.3	38.4	45.6
EPS	x	7.0	8.9	12.2	14.0
PE	x	10.4	8.2	6.0	5.2
PBv	x	3.2	2.5	1.9	1.6
GP margin	%	26%	26%	28%	28%
EBITDA margin	%	19%	20%	22%	22%
Net margin	%	11%	12%	15%	16%
ROE	x	33%	34%	36%	33%
ROA	x	12%	13%	16%	18%
EY	%	10%	12%	17%	19%
Payout	%	36%	36%	57%	57%
DY	%	3%	4%	10%	11%
EV/EBITDA	x	9.2	7.4	5.5	4.6

Source: Company data, Foundation Research, January 2022
All figures in Rs unless noted

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.

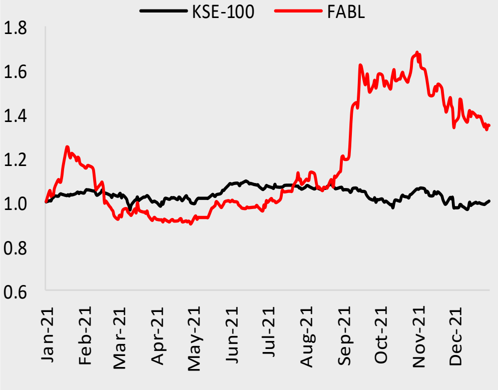
FABL PA **Outperform**

Price (31 Dec 21 CP)	Rs	23.0
Dec-22 Target Price	Rs	35.6
Upside/Downside	%	54.8
12M Target Price	Rs	35.6
- Two stage Gordon Growth Model		
Sector		Banks
Market cap	Rs bn	34.9
30-day avg turnover	$ m	0.1
Market cap	$ m	225.2
Freet float	%	25.0
Shares issued	m	1,517.7

Investment fundamentals

Year end Dec		2020A	2021F	2022F	2023F
NII	mn	24,548	25,953	30,693	36,444
NFI	m	8,352	9,024	9,232	9,229
Non Markup Exp	m	19,911	21,096	24,806	27,932
Provisions	m	2,254	303	990	1,612
PBT	m	10,891	13,578	14,129	16,130
PAT	m	6,681	8,272	8,619	9,840
EPS	Rs	4.4	5.5	5.7	6.5
NII growth	%	16.2	5.7	18.3	18.7
EPS growth	%	11.3	23.8	4.2	14.2
PE	x	5.2	4.2	4.1	3.5
DPS	Rs	-	1.5	2.0	2.0
DY	%	-	6.5	8.7	8.7
NIMs	%	4.4	3.9	4.2	4.4
ADR	%	62.8	63.7	65.0	65.0
Infection Ratio	x	7.7	5.9	5.1	4.5
Coverage Ratio	x	82.2	86.9	91.7	94.4
IDR	x	51.1	51.0	21.9	20.9
Deposit growth	x	18.1	16.9	12.6	19.3

FABL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Faysal Bank Limited

Proselytism to enhance stature

Event

- FABL on the track to conversion to Islamic bank with it swift book transfer to sharia compliance and strong asset quality would keep bank strong and safe. The main hindrance for the bank is conversation of investment book to sharia compliance instrument, which is expected to complete and become fully fledged Islamic bank by CY22. Furthermore we expect adequate asset quality to continue with higher coverage for NPLs and diluting infections. We expect earnings to grow at 3y-CAGR of 14% as interest rate cycle tends to peak out. Our Dec-22 of TP Rs35.6/sh, with stable annual dividend of Rs2/sh.

Impact

- **Navigation in change of faith**: FABL conversion to Islamic banking is on progress as bank changes its direction, by revamping its investment book and converts its operation into a full fledge Islamic bank. Bank has converted almost all of its branches to Islamic operations, while deposit base 53% is sharia compliant, 67/59% CA/SA with fixed deposits on lower side conversion, depending on the maturity profile. Similarly more than 80% of loan book is transferred. However main concerns arise from the investment portfolio which is still lagged on conversion with 20% (as 3QCY21). The bank has plans to convert its complete books by 2QCY22.

- **Conversion of asset base:** Asset base is expected to convert swiftly as liquidity arises for investment and operational facilitation for advances. We expect majority of the chunk to converge by mid of CY22 and few in latter half. However concerns arise from sluggish conversion of 21% of investment book. The delinquent nature of investment book remains as client facilitation and lack of availability of sharia compliant instruments slows down conversion. Issuance of GOP's Ijarah sukuk has been encouraging in recent past but still remained short of fulfilling the growing need of Islamic industry appetite. Going forward, we expect bank's IDR to likely to take a dip post conversion to sync with the Islamic peers.

- **Improving Asset Quality:** The bank has started to gain momentum to purify loan book, which can be inferred by higher coverage of NPLs. The increasing provisioning of bad books have increased by 5ppt YTD, as of 3QCY21. Better governance, due diligence by the management, and frequent write-offs have substantially decreased the infection ratio. This prudent approach is expected to continue as bank reliance on sharia compliance instruments increase. Furthermore the concentration of loan book in corporate would also provide stability to the loan book. FABL's ADR to hover in the early to mid-60s, and infection to remain minimized at 5-4%.

- **Strong capital buffers:** Bank currently operates at a sufficient total CAR of 18.7%, and Tier 1 of 16%, which is well above the regulatory requirement. This would help bank to continue the recent initiation of dividend stream. Bank is expected to maintain a consistent dividend payout policy of Rs2/sh, which translates into 35% payout.

Earnings Revision

- We revise up CY21/CY22 earnings by 6/6% due to result update expectation.

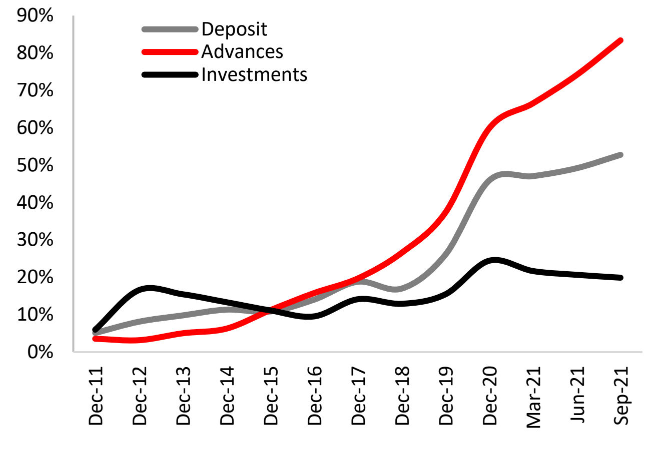
Price Catalyst

- Dec- 22 TP: Rs35.6/sh based on 2-Stage Gordon growth model
- Catalyst: (1) higher deposit growth, (2) Availability of sukuk issuance and (3) increase in interest rates.
- Risks: (1) lower coverage, (2) lower availability of Sukuk

Outlook

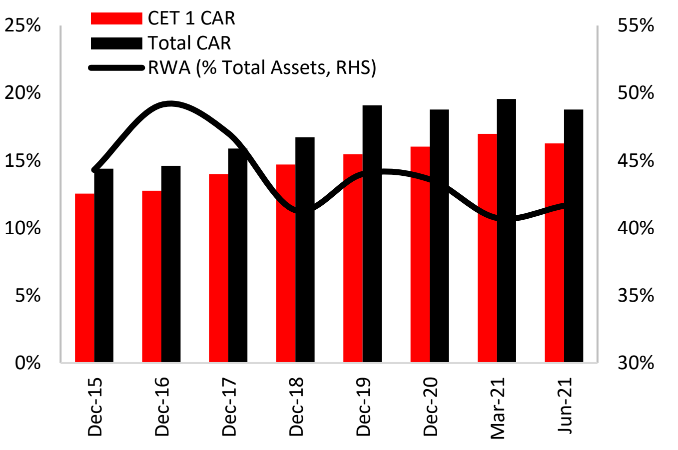
- We have an "Outperform" stance on the scrip with Jun-22 TP of Rs35.6/sh.

Fig 200: Islamic conversion since inception…



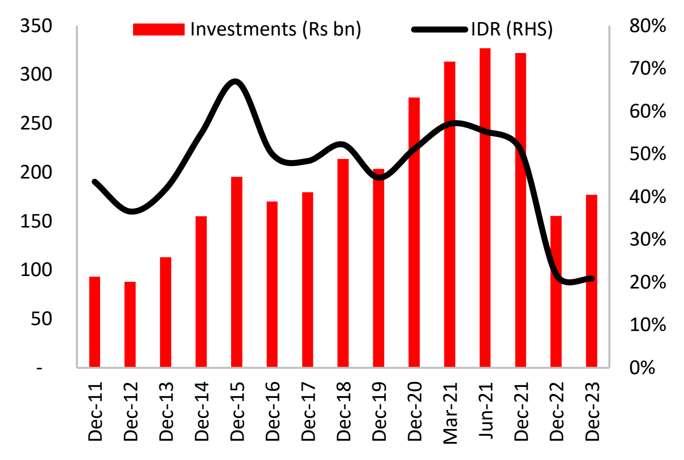
Source: Company accounts, FSL Research, Jan 2022

Fig 201: CAR to remain range bound



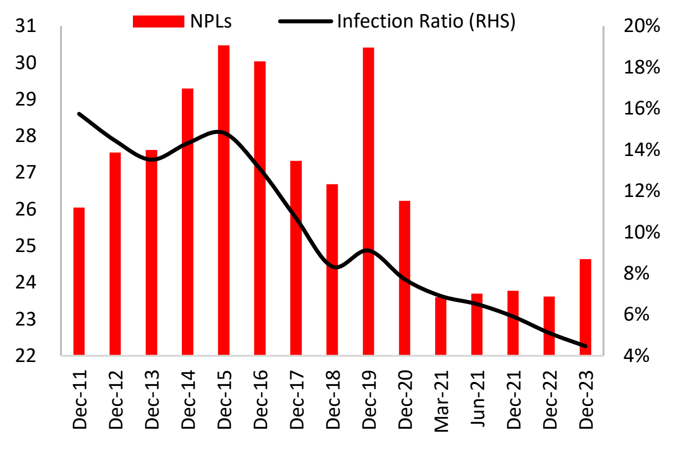
Source: Comp. acc, Bloomberg, FSL Research, Jan 2022

Fig 202: IDR to dip post conversion



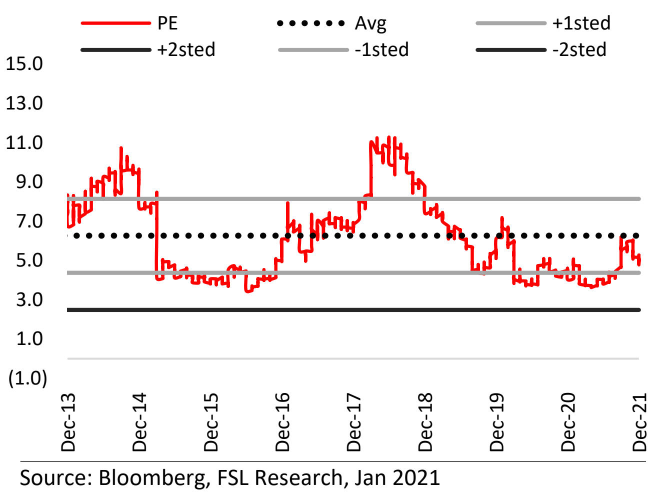
Source: Company acc., KCA, FSL Research, Jan 2022

Fig 203: NPLs diluting as gross advances increase



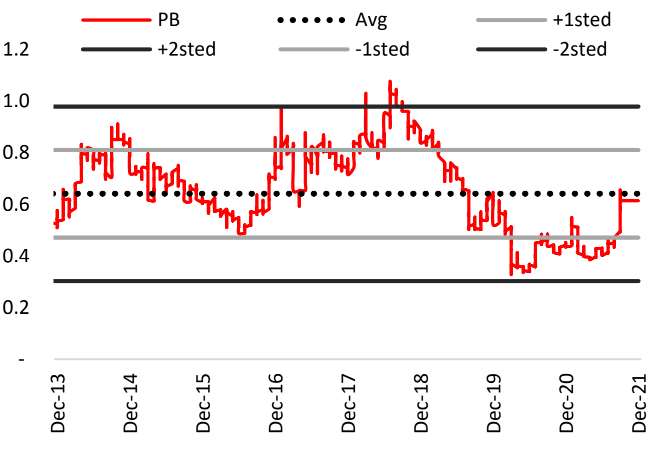
Source: Comp. acc, Bloomberg, FSL Research, Jan 2022

Fig 204: Trading below average PE



Source: Bloomberg, FSL Research, Jan 2021

Fig 205: …and PB



Source: Bloomberg, FSL Research, Jan 2022

Table 39: Faysal Bank limited (FABL PA, Outperform, Target Price Rs35.6/sh)

Balance Sheet		CY20	CY21E	CY22E	CY23E
Cash	m	59,881	63,199	71,131	84,825
Investments	m	276,470	322,129	155,448	177,028
Advances	m	318,180	381,660	440,693	528,092
Fixed Assets	m	24,102	25,860	27,646	28,377
Total Assets	**m**	**710,064**	**854,069**	**867,524**	**1,068,304**
Deposits	m	540,632	631,987	711,307	848,247
Borrowings	m	58,447	101,863	23,751	69,285
Other Liab	m	50,767	53,087	59,750	71,253
Total Liab	**m**	**649,846**	**786,937**	**794,809**	**988,785**
Net Assets	m	60,218	67,132	72,715	79,519
Share Capital	m	15,177	15,177	15,177	15,177
Acc. Profits	m	24,981	32,848	38,431	45,235
Total Equity	**m**	60,218	67,132	72,715	79,519

Income Statement		CY20	CY21E	CY22E	CY23E
NII	m	24,548	25,953	30,693	36,444
NFI	m	8,352	9,024	9,232	9,229
Fee Inc	m	4,085	5,504	5,737	5,782
Total Inc	m	33,056	34,977	39,924	45,674
Opex Exp	m	19,911	21,096	24,806	27,932
Admin Exp	m	19,570	20,808	24,501	27,576
Provisions	m	2,254	303	990	1,612
PBT	m	10,891	13,578	14,129	16,130
PAT	**m**	**6,681**	**8,272**	**8,619**	**9,840**
EPS	**Rs**	**4.4**	**5.5**	**5.7**	**6.5**
DPS	Rs	-	1.5	2.0	2.0
EPS growth	%	11.3	23.8	4.2	14.2
Payout	%	-	27.2	35.2	30.8

Quarterly I/S		1Q'21	2Q'21	3Q'21	4Q'21E
NII	m	7,007	7,023	7,675	7,419
NFI	m	2,416	1,938	2,226	2,150
Fee Inc	m	1,014	1,357	1,216	1,439
Total Inc	m	9,423	8,961	9,901	9,569
Opex Exp	m	5,596	5,759	5,940	6,103
Admin Exp	m	5,520	5,686	5,856	6,032
Provisions	m	227	87	720	40
PBT	m	2,773	1,802	3,540	3,098
PAT	m	**2,138**	**2,150**	**2,046**	**2,188**
EPS	Rs	1.41	1.42	1.35	1.44
DPS	Rs	-	1.00	-	1.00

Key Ratios		CY20	CY21E	CY22E	CY23E
NIMs	%	4.4	3.9	4.2	4.4
ADR	%	62.8	63.7	65.0	65.0
Infection	%	7.7	5.9	5.1	4.5
Coverage	%	82.2	86.9	91.7	94.4
IDR	%	51.1	51.0	21.9	20.9
Deposit gr	%	18.1	16.9	12.6	19.3
CASA	%	71.1	76.4	79.6	82.5
Cost/Income	%	59.2	59.5	61.4	60.4
CAR	%	18.8	18.3	16.6	16.3
ROE	%	12.0	13.0	12.0	13.0
BV	x	39.7	44.2	47.9	52.4

All figures are in Rs unless noted

Source: Company Accounts, FSL Research, January 2022

About the company

Faysal Bank Limited was incorporated in Pakistan on October 3rd, 1994 as a Public Limited Company under the Companies Ordinance, 1984. The Bank's shares are listed on Pakistan Stock Exchange. Faysal Bank is engaged in Commercial, Retail, Corporate and Islamic banking activities. Faysal Bank's footprint now spreads over more than 200 cities with over 550 (including 414 Islamic) branches. With total assets in excess of PKR 601.974 Billion, placing it amongst the significant players in Pakistan's banking industry. Faysal Bank's aim is to achieve leadership in providing shariah compliant products and services to its customers.

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

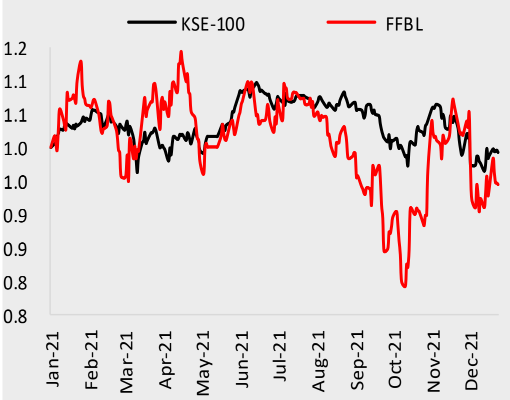
FFBL PA **Outperform**

Price (31 Dec 21 CP)	Rs	24.8
Dec-22 Target Price	Rs	39.8
Upside/Downside	%	60.7
12M Target Price	Rs	39.8
- Sum-of-Parts		
Sector		Fertilizer
Market cap	Rs bn	32.0
30-day avg turnover	$ m	0.5
Market cap	$ m	206.4
Freet float	%	25.3
Shares issued	m	1,291.3

Investment fundamentals

Year end Dec		2020A	2021F	2022F	2023F
Net Revenues	mn	98,061	134,368	130,996	121,222
EBITDA	m	13,204	25,966	16,389	17,351
EBITDA Growth	%	106.8	3,349.7	24.1	(33.2)
PBT	m	9,507	15,240	11,584	12,634
Recurring Profit	m	6,455	10,478	8,684	10,041
Net Profit	m	6,455	10,478	8,684	10,041
EPS reported	Rs	5.0	8.1	6.7	7.8
Rev growth	%	20.3	37.0	(2.5)	(7.5)
EPS growth	%	NA	62.3	(17.1)	15.6
PE	x	5.0	3.1	3.7	3.2
DPS	Rs	-	2.0	3.0	3.0
Div. Yield	%	-	8.1	12.1	12.1
ROA	%	4.8	7.6	6.1	7.2
ROE	%	38.9	37.3	23.4	23.1
EV/EBITDA	x	3.3	1.7	2.6	2.7
Net D/E	x	0.5	0.4	0.2	0.3
Price to Book	x	1.4	0.9	0.8	0.7
Price to Sales	x	0.3	0.2	0.2	0.3

FFBL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022

(all figures are in Rs unless noted)

Fauji Fertilizer Bin Qasim Ltd

Trading Up - Stairway To Heaven

Event

- FFBL profitability is expected to remain upbeat given higher core business profitability and improvement in subsidiaries business operations. Furthermore, we expect FFBL to benefit from (1) pricing power in DAP market given higher landed cost for importers and constrained supply internationally, (2) higher Urea production due to restoration of gas supplies as per quota to meet the shortfall, (3) improved cash flows due to higher payouts from power ventures and PMP and (4) decline in loss contribution of food businesses. Hence, we reiterate our “Outperform” stance with Dec-22 TP of Rs39.8.

Impact

- **DAP prices to remain on higher side given constrained global supply and lower inventory levels:** FFBL is expected to retain pricing power in DAP market given (1) increased working capital cost for traders due to higher landed cost of imported DAP amid elevated international prices, (2) constrained global supply due to restricted exports from China and Russia, (3) higher feedstock prices amid surge in coal/gas prices internationally, (4) lower inventory position in major importing countries (Pakistan and India) and (5) 125% increase in phosphoric acid prices from lower levels seen in 2020.

- Furthermore, (1) higher breakeven for RLNG based fertilizer players, (2) ~4x subsidy requirement from current prices for imported Urea and (3) better farmer agronomics amid higher Wheat/Sugarcane/Maize crop prices would allow base players to retain pricing power in Urea market as well and pass on the impact of inflation and hike in gas prices in a timely manner.

- **Restructuring of food businesses to reduce loss contribution:** Financial restructuring and cost rationalization measures would allow FFL to further reduce its losses and recover its market share lost earlier to other players. We expect company losses to further reduce in future due to (1) change in management strategy towards increased penetration in household retail segment, (2) conversion of consumer preferences from loose milk to packaged milk products and (3) decline in finance cost due to conversion of Rs5.9bn sponsors debt into equity and fresh equity injection. To highlight, FFL’s loss is expected to decline by 47/13/21% YoY in CY21/22/23.

- **Higher profitability of PMP and investment in power sector to dilute the impact of rupee depreciation:** Higher phosphoric acid prices and repayment of complete debt would allow PMP profitability to increase by 163% YoY in CY21. Furthermore, FFBL would benefit from maintenance of payout policy by FPCL given better profitability amid dollar indexed revenue and reliance on KE due to lower fuel cost and its energy deficit situation in south region. To highlight, company has also requested NEPRA for issuance of generation license for 76.6MW RLNG based power plant.

Earnings Revision

- We have increased our earnings for CY21/CY22/CY23 by 73%/32%/14% given better DAP margins and increased profitability of portfolio companies.

Price Catalyst

- Dec 22 TP: Rs39.8/sh based on sum of the part methodology.

- Catalyst: (1) higher core business profitability given better DAP margins, (2) rejuvenation of FFL business, (3) increased income from portfolio companies.

- Risk: (1) Prolongation of lean commodity cycle and (2) increase in gas & coal prices.

Outlook

- We have an “Outperform” stance on the scrip given growth in core business.

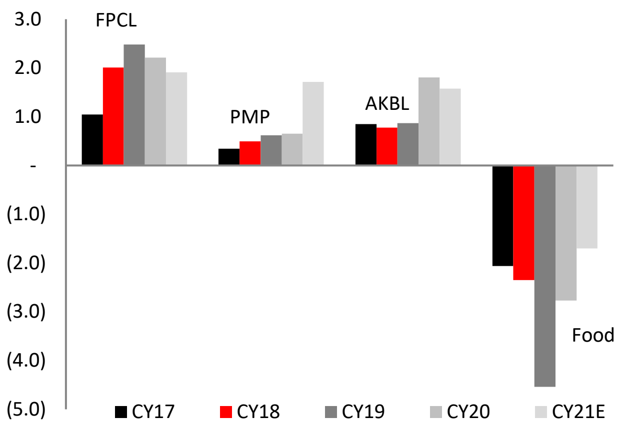
Table 40: FFBL sum of the parts valuation detail

Company	Valuation Technique	Dec-22 TP	Share held (%)	Portfolio Discount	FFBL Share	Contribution to value
Standalone	DDM				**12.3**	**31%**
FPCL*	DDM	22.0	75%	30%	11.6	29%
AKBL	Blended	38.0	22%	20%	6.4	16%
PMP*	DDM	25.5	25%	30%	4.5	11%
FFL	FCFF	6.1	72%	20%	4.3	11%
FML*	FCFF	1.3	90%	30%	0.8	2%
Total					**39.8**	

Source: Company accounts, Foundation Research, January 2022

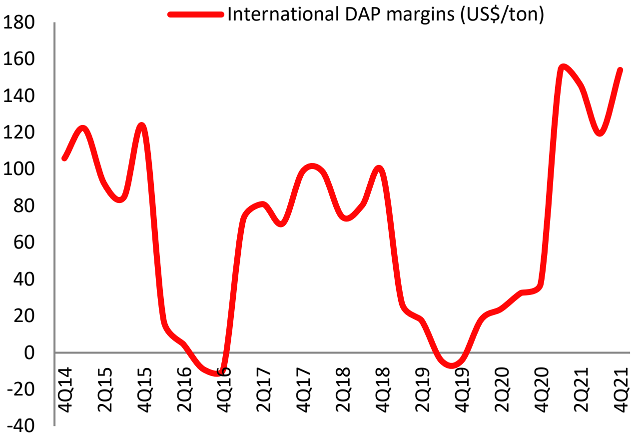
* At FFBL number of shares

Fig 206: Better profit of PMP would allow FFBL to witness higher ever income share from its investments (EPS/sh)



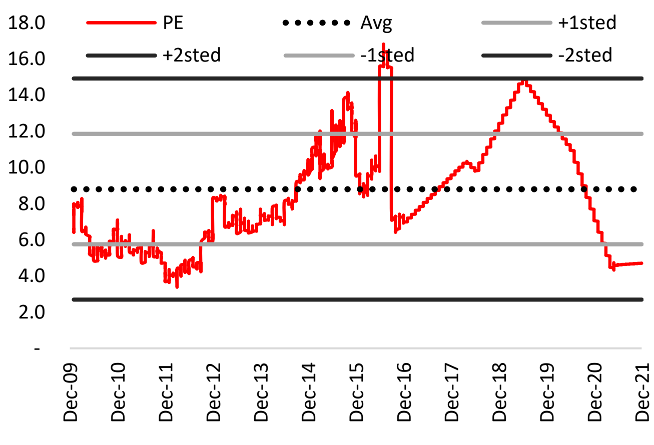
Source: Company Accounts, Foundation Research, Jan 2022

Fig 207: DAP international prices reached to record levels due to supply chain constraints and lower inventory levels



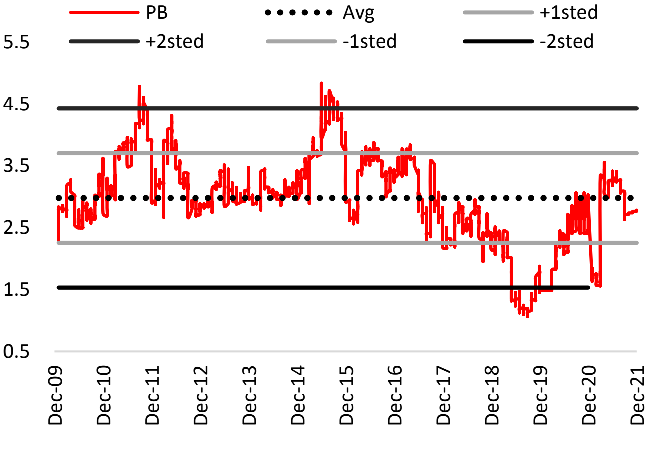
Source: Company Accounts, Foundation Research, Jan 2022

Fig 208: Trading below historical average PE



Source: Bloomberg, FSL Research, Jan 2022

Fig 209: hovering around average on PB



Source: Bloomberg, FSL Research, Jan 2022

Table 41: Fauji Fertilizer Bin Qasim Limited (FFBL PA, 'Outperform', Dec-22 Target price: Rs39.8/sh)

Balance Sheet		**CY20A**	**CY21E**	**CY22E**	**CY23E**
PP&E	m	49,228	48,608	47,812	47,083
Cash & ST invest	m	29,906	22,961	24,620	20,489
LT invest	m	24,287	18,661	22,608	27,259
Trade debts	m	3,161	9,189	7,233	6,282
Other Assets	m	28,540	41,760	41,677	35,663
Total Assets	**m**	**135,122**	**141,179**	**143,950**	**136,776**
LT debt	m	35,085	41,413	33,846	28,835
ST debt	m	32,708	17,910	29,951	30,402
Payable & oth	m	44,881	48,159	39,732	31,052
Total Liabilities	**m**	**112,674**	**107,482**	**103,530**	**90,289**
Paid-up Capital	m	9,341	12,913	12,913	12,913
Others	m	13,107	20,785	27,508	33,574
SH 'Equity	**m**	**22,448**	**33,698**	**40,421**	**46,487**
L+E	**m**	**135,122**	**141,179**	**143,950**	**136,776**

Profit & Loss		**CY20A**	**CY21E**	**CY22E**	**CY23E**
Net Sales	m	98,061	134,368	130,996	121,222
Cost of Sales	m	79,159	103,938	107,715	97,491
Gross Profit	**m**	**18,902**	**30,429**	**23,281**	**23,732**
S&A	m	8,447	8,935	9,617	10,418
Other income	**m**	8,457	6,978	6,621	7,417
Other expenses	m	1,060	8,045	2,097	1,982
EBIT	**m**	**17,851**	**20,428**	**18,188**	**18,749**
Finance cost	m	8,344	5,188	6,604	6,115
PBT	**m**	**9,507**	**15,240**	**11,584**	**12,634**
Taxation	m	3,473	4,421	2,589	2,643
PAT	**m**	**6,034**	**10,819**	**8,995**	**9,990**
PAT att to owner	**m**	6,455	10,478	8,684	10,041
EPS		5.0	8.1	6.7	7.8
EPS growth yoy		N/A	62%	-17%	16%
DPS		-	2.0	3.0	3.0

Q performance		**4Q'21E**	**1Q'22E**	**2Q'22E**	**3Q'22E**
Net Sales	m	52,730	19,278	30,038	39,866
Cost of Sales	m	42,224	15,733	25,452	35,050
Gross Profit	**m**	**10,506**	**3,545**	**4,587**	**4,816**
S&A	m	2,560	1,574	2,280	2,747
Other income	m	2,070	1,649	1,590	1,691
Other expenses	m	2,116	195	251	230
EBIT	m	**7,900**	**3,424**	**3,645**	**3,531**
Finance cost	**m**	1,497	1,513	1,582	1,755
PBT	m	**6,403**	**1,911**	**2,064**	**1,776**
Taxation	**m**	1,544	242	276	646
PAT	m	**4,859**	**1,669**	**1,788**	**1,130**
PAT att to owner	**m**	4,800	1,619	1,686	1,025
EPS		3.72	1.25	1.31	0.79
DPS		2.00	-	-	-

Key ratios		**CY20A**	**CY21E**	**CY22E**	**CY23E**
BVPS	x	17.4	26.1	31.3	36.0
EPS	x	5.0	8.1	6.7	7.8
PE	x	4.9	3.0	3.6	3.1
PBv	x	1.4	0.9	0.8	0.7
GP margins	%	19%	23%	18%	20%
EBITDA margin	%	22%	18%	16%	18%
Net margin	%	6%	8%	7%	8%
ROE	%	39%	38%	23%	22%
ROA	%	4%	8%	6%	7%
Earnings yield	%	20%	33%	27%	32%
Payout Ratio	%	0%	25%	45%	39%
Dividend Yield	%	0%	8%	12%	12%
EV/EBITDA	x	3.4	5.4	5.1	4.5
Operating cycle	x	(111)	(65)	(70)	(64)
Debt/Equity	x	3.0	1.8	1.6	1.3

Source: Company data, Foundation Research, January 2022
All figures in Rs unless noted

About the company

Fauji Fertilizer Bin Qasim is the sole DAP and Granular urea producer in Pakistan. Initially named as FFC-Jordan Fertilizer Company (FJFC), FFBL was formed on 17th Nov 1993, with FFC (30%), FF (10%) and JPMC (10%) as main sponsors. The company was formally listed with stock exchanges in May 1996 and commercial production commenced wef Jan 2000. The company was renamed as Fauji Fertilizer Bin Qasim Ltd. (FFBL) in 2003, as Jordan Phosphate Mines Co. (JPMC) had sold its entire equity in the company. FFC currently owns a 49.9% stake in FFBL.

Subsidiaries

- Fauji Foods Limited (FFL)
- Fauji Meat Limited (FML)
- FFBL Power Company Limited (FPCL)

Joint Venture

- Pak Maroc Phosphore (PMP)

Investments

- Askari Bank Limited (AKBL)

Auditors: EY Ford Rhodes Chartered Accountants

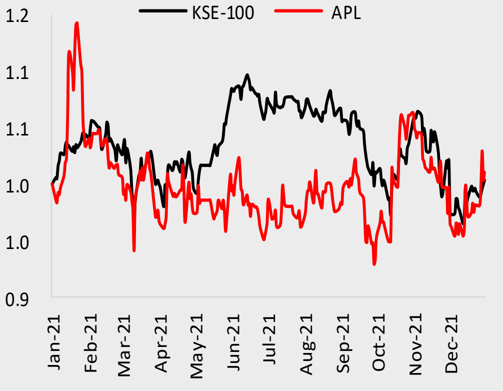
APL PA **Outperform**

Price (31 Dec 21 CP)	Rs	314.0
Dec-22 Target Price	Rs	413.6
Upside/Downside	%	31.7
12M Target Price	Rs	413.6
- DCF Methodology		
Sector		OMCs
Market cap	Rs bn	31.3
30-day avg turnover	$ m	0.1
Market cap	$ m	201.6
Freet float	%	25.0
Shares issued	m	99.5

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	188,645	261,874	268,562	280,304
EBITDA	m	9,160	9,419	8,534	9,051
EBITDA Growth	%	50.7	336.1	(6.8)	(3.9)
PBT	m	6,939	7,530	5,688	6,302
Recurring Profit	m	4,920	5,346	3,674	4,199
Net Profit	m	4,920	5,346	3,674	4,199
EPS reported	Rs	49.4	53.7	36.9	42.2
Rev growth	%	(6.2)	38.8	2.6	4.4
EPS growth	%	388.1	8.7	(31.3)	14.3
PE	x	6.4	5.8	8.5	7.4
DPS	Rs	27.0	37.5	27.5	31.5
Div. Yield	%	8.6	11.9	8.8	10.0
ROA	%	8.7	8.4	5.5	6.0
ROE	%	23.9	22.6	14.6	16.1
EV/EBITDA	x	2.3	3.1	3.0	2.9
Net D/E	x	(0.4)	(0.1)	(0.2)	(0.2)
Price to Book	x	1.4	1.3	1.2	1.2
Price to Sales	x	0.2	0.1	0.1	0.1

APL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Attock Petroleum Limited

Expansions to drive earnings

Event

- APL is set to take advantage of the strong oil demand on the back of (1) expansion of retail network, (2) strengthening supply chain through various new storage projects, (3) rise in OMC margins, and (4) slight improvement in asphalt demand. Further support would be provided by other handling income. We expect APL to report a 3-year earnings CAGR of 7% which leads us to have an outperform stance on the scrip with a Dec-22 TP of Rs413.6/sh.

Impact

- **Continued expansionary mode to strengthen volumetric drive:** APL increased it's overall market share to 10.3% from 9.9% in 1QFY22 and regained its position of the 2nd largest OMC in the country. Company has also managed to sustain it's maintain share in the white oil segment at 7.4/7.2%. APL is on an aggressive drive to increase its retail network as evident by the total number of retail outlets standing at 746 as opposed to 714 in 1QFY21.

- Furthermore, the company is focusing on strengthening its supply chain by adding the Port Qasim Bulk Oil Terminal recently and work on the Taru Jabba Bulk Oil Terminal is currently underway. To highlight, APL also successfully expanded the Shikarpur and Machike Terminals and commissioned the Sahiwal and Daulatpur terminals. We believe that the improvement in supply chain would aid APL in improving its market share in the future. Thus, we estimate volumes to grow by 9/5% in FY22/23.

- **White oil segment will continue to drive earnings**: Volumetric growth along with expected increase in OMC margins 2HFY21 onwards would lead to an EPS of 32.0/24.8/33.7/39.2 in FY22/23/24/25, depicting a 3-year CAGR of 7%. Increase in margins would increase the contribution of white oil to gross margins from 71% in FY21 to 72% in FY22 and result in higher cash sales for the company.

- To highlight, 1QFY22 was a difficult quarter for asphalt as industry demand declined by 2% YoY due to decrease in infrastructure and development projects. Whereas, APL sales of asphalt increased by 17%. Decline in government development spending and moderation in construction activity would curb demand for asphalt in the FY22, in our view.

- **High other income contribution:** The company is expected to benefit from high finance income to the likes of Rs16.8/10.4/11.9 in FY22/23/24. As of 1QFY22, cash & ST investments currently stand at Rs10.5bn. The bottom line would also be bolstered by Rs6.3/6.0/6.0/sh from other handling income in FY22/23/24 respectively.

Earnings Revision

- We revise down our earnings estimate for FY22/23 EPS by 46/2% due to higher inventory gains.

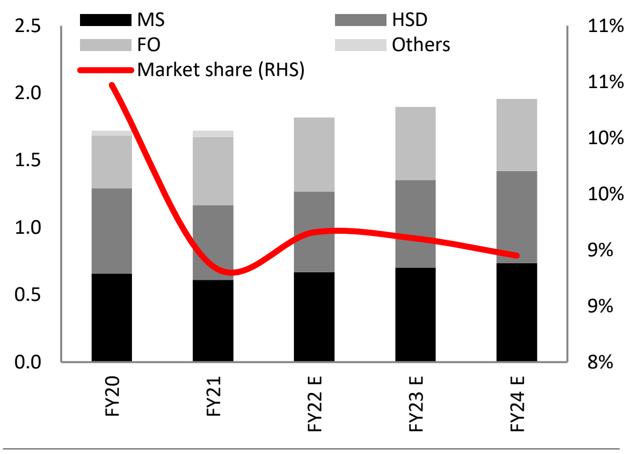
Price Catalyst

- Dec- 22 TP: Rs413.6/sh based on DCF methodology
- Catalyst: (1) higher volumes, (2) Naphtha volumes handling, (3) Asphalt demand.
- Risk: (1) Competition in white oil, (2) lower asphalt/FO margins.

Outlook

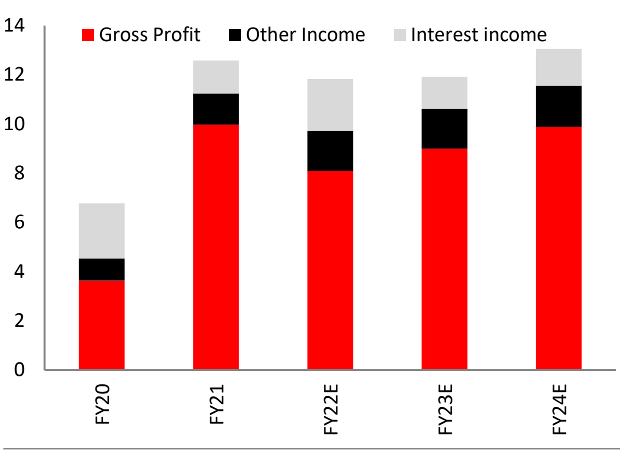
- We have an outperform stance on the script due to sustainable earnings growth (given higher margins and increased investment in supply chain and retail network), higher payout and strong balance sheet.

Fig 210: Expansions to support market share



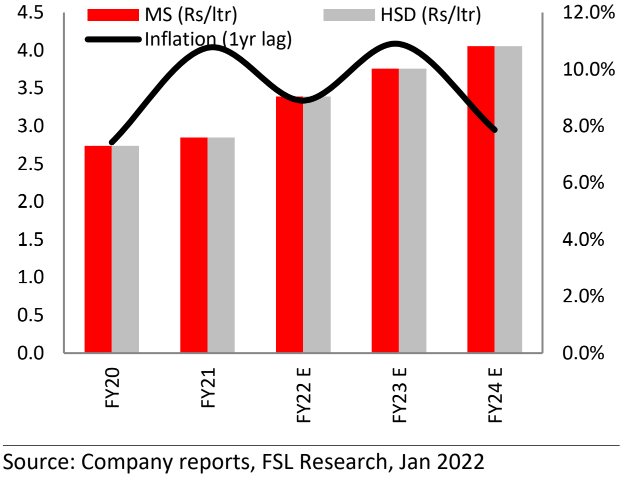
Source: Company reports, FSL Research, Jan 2022

Fig 211: High inflation to surge MS/HSD margins



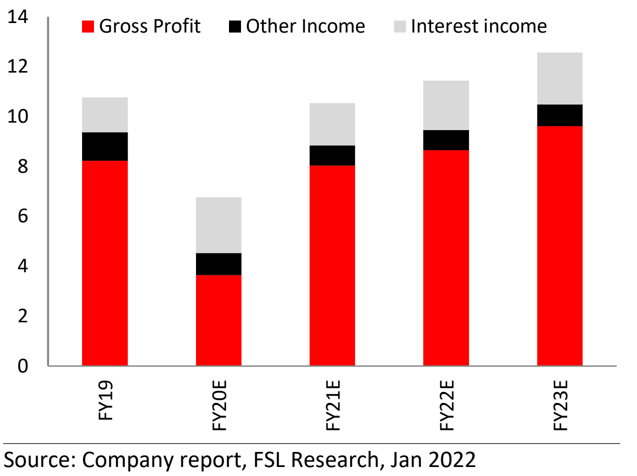
Source: Company report, FSL Research, Jan 2022

Fig 212: High liquidity and elevated int rates….



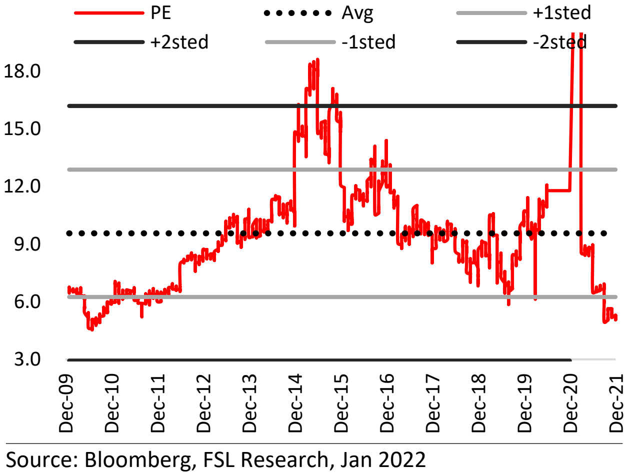
Source: Company reports, FSL Research, Jan 2022

Fig 213: …… to have sizable contribution in earnings



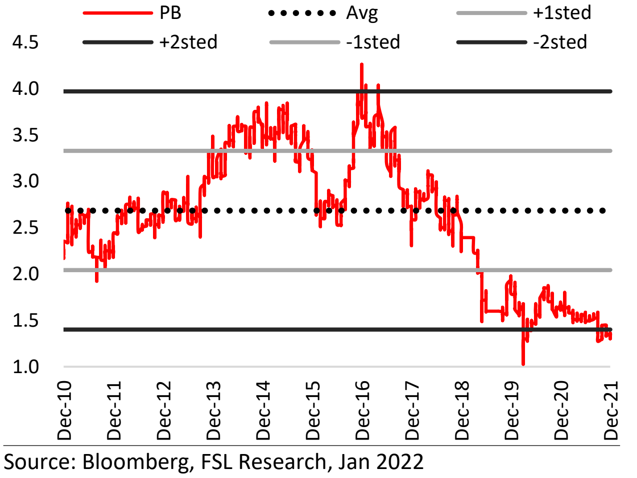
Source: Company report, FSL Research, Jan 2022

Fig 214: Trading below -2stdev PE



Source: Bloomberg, FSL Research, Jan 2022

Fig 215: …and PB



Source: Bloomberg, FSL Research, Jan 2022

Table 42: APL PA, 'Outperform', Dec-22 Target price: 413.6/sh

Balance Sheet		**FY21A**	**FY22E**	**FY23E**	**FY24E**
PP&E	m	16,617	19,904	20,167	20,732
Trade Debt	m	11,025	18,989	19,280	19,673
Cash & equivalent	m	9,831	2,443	5,358	5,240
Other Assets	m	24,425	24,702	23,544	25,488
Total Assets	**m**	**61,898**	**66,038**	**68,349**	**71,133**
ST Borrowing	m	-	-	-	-
Trade Payable	m	31,179	35,685	38,256	40,868
Ot Liabilities	m	7,997	5,719	4,523	3,631
Total Liabilities	**m**	**39,177**	**41,405**	**42,779**	**44,499**
Paid-up Capital	m	995	995	995	995
Others	m	21,726	23,638	24,575	25,639
SH' Equity	**m**	**22,721**	**24,633**	**25,570**	**26,634**

Profit & Loss		**FY21A**	**FY22E**	**FY23E**	**FY24E**
Net Sales	m	188,645	261,874	268,562	280,304
COGS	m	178,663	251,271	258,461	269,720
Gross Profit	**m**	**9,982**	**10,603**	**10,101**	**10,585**
Operating exp	m	3,743	4,869	5,556	5,606
Other charges	m	509	394	298	330
Other Income	m	1,261	1,611	1,616	1,665
EBIT	m	**6,991**	**6,951**	**5,862**	**6,313**
Associate share	**m**	34	4	15	26
Net Finance in	m	(85)	575	(189)	(38)
PBT	**m**	**6,939**	**7,530**	**5,688**	**6,302**
Taxation	m	2,019	2,184	2,014	2,102
PAT	**m**	**4,920**	**5,346**	**3,674**	**4,199**
EPS (rep)	Rs	49.4	53.7	36.9	42.2
EPS growth yoy	%	389%	9%	-31%	14%
DPS	Rs	27.0	37.5	27.5	31.5

Q performance		**2QFY21**	**3QFY21**	**4QFY21**	**1QFY22**
Net Sales	m	44,855	45,728	52,947	72,838
Gross Profit	**m**	**1,700**	**2,907**	**2,315**	**4,694**
Operating exp	m	934	900	965	1,669
Other charges	m	140	237	(26)	247
Other income	m	324	409	317	640
EBIT	**m**	**950**	**2,179**	**1,692**	**3,418**
Associate Profit	m	(20)	3	56	25
Net Finance inc	m	(68)	(25)	39	(62)
PBT	**m**	**862**	**2,157**	**1,788**	**3,381**
Taxation	m	201	639	532	993
PAT	**m**	**661**	**1,518**	**1,255**	**2,388**
EPS(rep)	Rs	6.6	15.2	12.6	24.0
DPS	Rs	2.5	-	24.5	-

Key ratios		**FY21A**	**FY22E**	**FY23E**	**FY24E**
BVPS	Rs	228.3	247.5	256.9	267.6
EPS	Rs	49.4	53.7	36.9	42.2
PE	x	6.3	5.8	8.5	7.4
PBv	x	1.4	1.3	1.2	1.2
GP margins	%	5.3%	4.0%	3.8%	3.8%
EBIT margin	%	3.7%	2.7%	2.2%	2.3%
Net margin	%	2.6%	2.0%	1.4%	1.5%
ROE	%	24%	23%	15%	16%
ROA	%	9%	8%	5%	6%
Earnings yield	%	16%	17%	12%	14%
Payout Ratio	%	54.6	69.8	74.5	74.7
Dividend Yield	%	9%	12%	9%	10%
EV/EBITDA	x	2.7	3.4	4.1	3.8

Source: Company data, Foundation Research, Jan 2022
All figures in Rs unless noted

About the company

APL was incorporated on December 3, 1995. It commenced its operations in February 1998, after it was granted the marketing license. APL was listed on Karachi Stock Exchange on March 07, 2005. The company's sponsors include Pharaon Commercial Investment Group Limited (PCIGL) and Attock Group of Companies. Pharaon Group is engaged internationally in diversified entrepreneurial activities. The Attock Group of Companies is the only fully vertically integrated group covering all aspects of the oil and gas sectors of Pakistan, ranging from exploration, production, refining to marketing of a wide range of petroleum products.

Auditors: A.F. Ferguson& Co Chartered Accountants

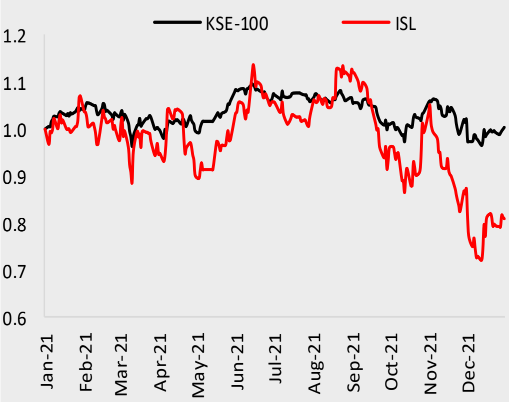
ISL PA **Outperform**

Price (31 Dec 21 CP)	Rs	66.1
Dec-22 Target Price	Rs	123.1
Upside/Downside	%	86.2
12M Target Price	Rs	123.1
- DCF methodology		
Sector		ENGINEERING
Market cap	Rs bn	28.8
30-day avg turnover	$ m	1.2
Market cap	$ m	185.6
Freet float	%	30.0
Shares issued	m	435.0

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	69,796	104,656	118,109	137,121
EBITDA	m	13,735	17,049	15,384	17,524
EBITDA Growth	%	110.2	294.6	12.0	2.8
PBT	m	10,295	12,393	10,435	12,027
Recurring Profit	m	7,466	8,799	7,409	8,539
Net Profit	m	7,466	8,799	7,409	8,539
EPS reported	Rs	17.2	20.2	17.0	19.6
Rev growth	%	21.4	49.9	12.9	16.1
EPS growth	%	NA	NA	(15.8)	15.3
PE	x	NA	3.3	3.9	3.4
DPS	Rs	10.0	10.0	10.0	9.8
Div. Yield	%	15.1	15.1	15.1	14.8
ROA	%	17.7	19.2	14.0	14.1
ROE	%	47.2	41.7	29.8	30.0
EV/EBITDA	x	2.8	2.4	2.6	2.1
Net D/E	x	0.5	0.5	0.4	0.3
Price to Book	x	1.5	1.2	1.1	0.9
Price to Sales	x	0.4	0.3	0.2	0.2

ISL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

International Steels Ltd

Regulatory safeguards better than expected; Well placed in Upcycle

Event

▪ Increase in international margins amid higher demand from private sector and declining market share of private importers would enhance pricing power of the company and will also result in lower working capital requirement due to decline in operating cycle. Aforementioned factors along with favorable regulatory regime and significant share of exports is expected to improve company's profitability. Thus, we retain our "Outperform" stance on the scrip with Dec-22 Target price of Rs123.1/sh.

Impact

▪ **Government regulatory incentives to boost profitability:** ISL is expected to benefit from (1) government decision to end regulatory duty on HRC imports, (2) Anti-dumping duty protection on imports from China, Ukraine, and Canada and (3) increased regulatory checks to curb under invoicing practice. To highlight, in FY22 budget government has ended concessionary regulatory duty of 5% imposed on HRC imports (translating into Rs4.7/sh positive impact). Furthermore, NTC has also initiated sunset review of Anti-Dumping Duty (ADD) imposed on flat steel products and is expected to announce its results in near future

▪ **Private sector spending to drive growth:** Private sector is expected to dominate the growth due in demand due to availability of excess liquidity and inflows under RDAs into construction sector and lower borrowing cost due to concessionary financing. Furthermore, demand from automobile sector has also witnessed significant growth as two wheelers/three wheelers demand increased by 28% YoY in 11CYY21.

▪ **Advance from customers to keep operating cycle and financing cost on lower side:** Strong liquidity position of the company amid lower availability of product in the market will result in decline in operating cycle of the company hence lower financing cost. To highlight, ISL is currently holding advance from customers of ~Rs1.8bn. Furthermore, we expect ISL cash conversion cycle to clock at 58/55 days in FY22/23 as compared to 73 days in FY21.

▪ **Imports to remain on lower side due to higher HRC-CRC margins:** We expect ISL to retain its pricing power going forward due to (1) sustainability of Intl margins leading towards higher CRC prices for private importers, (2) enhanced screening of private importers and (3) constrained global supply due to supply chain issues. To highlight, private imports will remain restricted even if margins are on a lower side for short period of time due to higher volatility in international prices.

Earnings Revision

▪ We have revised our EPS estimates for FY22/23 by ↑30/16% due to higher higher than expected core margins.

Price Catalyst

▪ Dec- 22 TP: Rs123.1/sh based on DCF methodology.

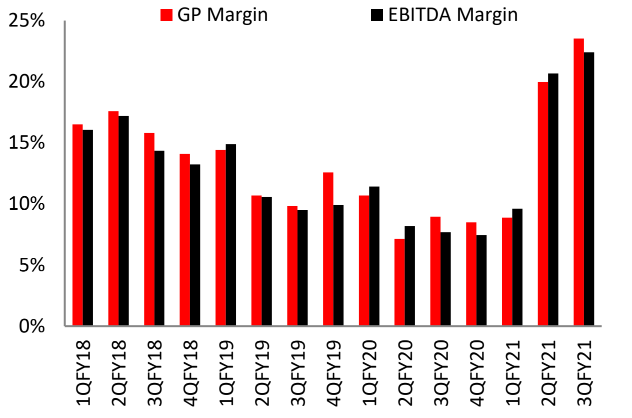
▪ Catalyst: (1) volumetric growth, (2) higher HRC-CRC margins, (3) import substitution and (4) lower working capital requirement due to higher pricing power.

▪ Risks: (1) negative outcome of ADD sunset review petition and (2) increased dumping from other countries and (3) economic slowdown due to new COVID variant outbreak.

Outlook

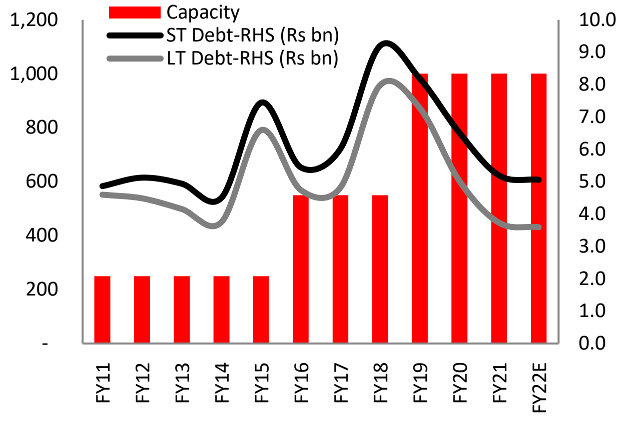
▪ We have an 'Outperform' stance on the scrip with Dec-22 TP of 123.1sh.

Fig 216: Margins making new high due to higher pricing power given decline in imports



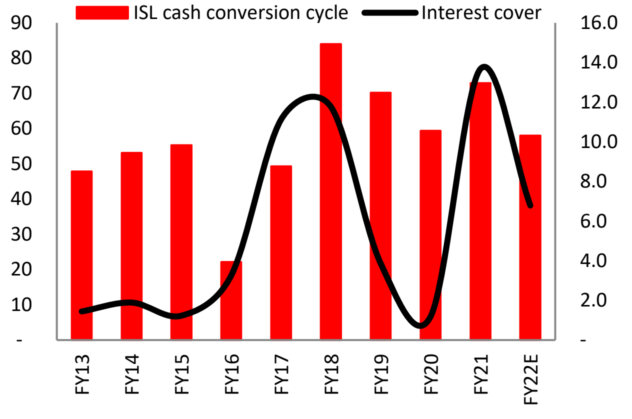
Source: Company acc, Foundation Research, January 2022

Fig 217: Debt declined due to lower working capital requirement and repayment of long-term debt (Rs bn)



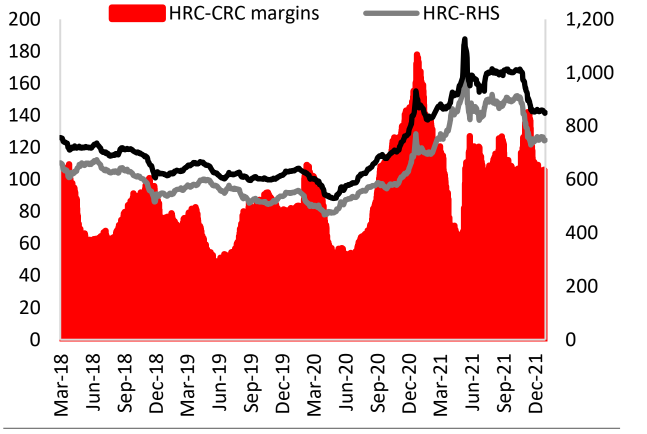
Source: Company acc, Foundation Research, January 2022

Fig 218: Decline in imports resulted in lower working capital requirement of the company (days)



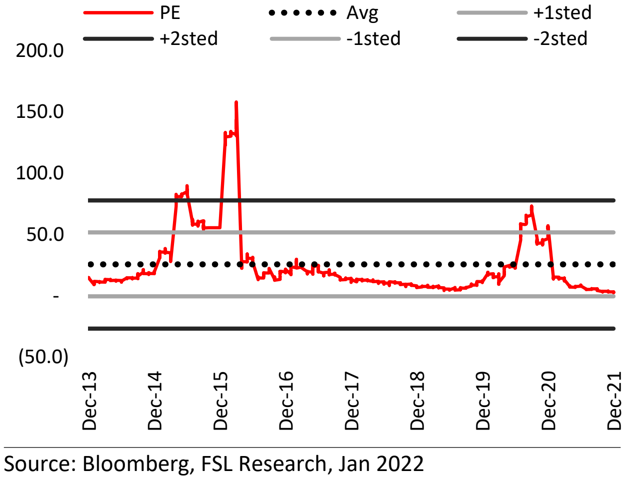
Source: Company acc, Foundation Research, January 2022

Fig 219: Margins to remain on higher side due to increase in raw material cost given decline in supply (US$/ton)



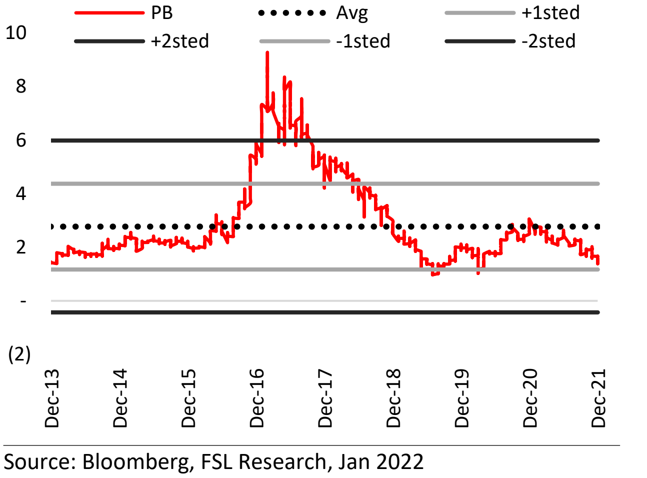
Source: PBS, Foundation Research, January 2022

Fig 220: Trading below average PE



Source: Bloomberg, FSL Research, Jan 2022

Fig 221: …and P/B



Source: Bloomberg, FSL Research, Jan 2022

Table 43: International Steels Ltd (ISL PA, 'Outperform', Dec-22 Target price Rs123.1/sh.)

Balance Sheet		FY21A	FY22E	FY23E	FY24E
PP&E	m	19,180	18,145	17,324	16,478
Inventory	m	17,081	24,112	28,333	33,037
Cash & ST invest	m	293	627	3,400	6,873
Other assets	m	5,166	6,879	7,325	7,947
Total assets	**m**	**41,720**	**49,763**	**56,382**	**64,336**
Total Debt	m	13,490	13,727	15,427	17,127
Trade payable	m	6,588	9,807	11,523	13,437
Other Liab	m	2,755	2,892	3,036	3,187
Total Liabilities	**m**	**22,832**	**26,426**	**29,987**	**33,751**
Paid-up Capital	m	4,350	4,350	4,350	4,350
Reserves	m	14,538	18,987	22,046	26,235
SH' Equity	**m**	**18,888**	**23,337**	**26,396**	**30,585**
Liab + Equity	**m**	**41,720**	**49,763**	**56,382**	**64,336**

Profit & Loss		FY21A	FY22E	FY23E	FY24E
Net Sales	m	69,796	104,656	118,109	137,121
Cost of sales	m	56,304	87,783	102,767	119,441
Gross Profit	**m**	**13,492**	**16,873**	**15,342**	**17,680**
Dist expense	m	1,063	1,110	1,266	1,468
Admin expense	m	362	334	377	426
Other charges	m	1,277	933	785	905
Other Income	m	316	39	41	45
EBIT	**m**	**11,107**	**14,535**	**12,955**	**14,925**
Finance cost	m	812	2,142	2,520	2,899
PBT	**m**	**10,295**	**12,393**	**10,435**	**12,027**
Taxation	m	2,828	3,594	3,026	3,488
PAT	**m**	**7,466**	**8,799**	**7,409**	**8,539**
EPS (rep)	x	17.2	20.2	17.0	19.6
EPS growth YoY	%	1409%	18%	-16%	15%
DPS	x	10.0	10.0	10.0	9.8

Q' performance		3QFY21A	4QFY21A	1QFY22E	2QFY22E
Net Sales	m	17,402	18,878	24,489	23,657
Cost of sales	m	13,305	14,439	20,154	19,319
Gross Profit	**m**	**4,097**	**4,439**	**4,335**	**4,338**
Dist expense	m	257	447	180	208
Admin expense	m	131	85	85	93
Other charges	m	253	667	280	268
Other Income	m	55	(49)	6	32
EBIT	**m**	**3,511**	**3,191**	**3,796**	**3,801**
Finance cost	m	158	216	176	206
PBT	m	**3,353**	**2,975**	**3,620**	**3,595**
Taxation	m	974	660	954	1,042
PAT	**m**	**2,379**	**2,315**	**2,666**	**2,552**
EPS(rep)	Rs	5.47	5.32	6.13	5.87

Key ratios		FY21A	FY22E	FY23E	FY24E
BVPS	Rs	43.4	53.6	60.7	70.3
EPS	Rs	17.2	20.2	17.0	19.6
PE	x	3.9	3.3	3.9	3.4
PBv	x	1.5	1.2	1.1	0.9
GP margins	%	19.3	16.1	13.0	12.9
EBITDA margins	%	19.7	16.3	13.0	12.8
Net margin	%	10.7	8.4	6.3	6.2
ROE	x	39.5	41.7	29.8	30.0
ROA	x	17.9	17.7	13.1	13.3
Earnings yield	%	26.0	30.6	25.8	29.7
Payout ratio	%	58	49	59	50
Dividend yield	%	15	15	15	15
EV/EBITDA	x	2.8	2.4	2.6	2.1

Source: Company data, Foundation Research, January 2022

All figures in PKR unless noted

About the company

International Steels Limited ('the Company') was incorporated on 03 September 2007 as a public unlisted company limited by shares under the Companies Ordinance, 1984 and is domiciled in the province of Sindh. The net assets of the Steel Project Undertaking amounted to Rs. 4,177.167 million were determined as at 23 August 2010 (day immediately preceding the completion date) in accordance with the Scheme of Arrangement and net assets of the Steel Project Undertaking were transferred to the Company on 24 August 2010 and 417,716,700 shares of Rs. 10 each of the Company there against were issued to International Industries Limited ('the Holding Company'). The Company was listed on the Pakistan Stock Exchange (formerly Karachi Stock Exchange) on 01 June 2011. The primary activities of the Company are manufacturing of cold rolled steel coils and galvanized coils. The Company commenced commercial operations on 01 January 2011.

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

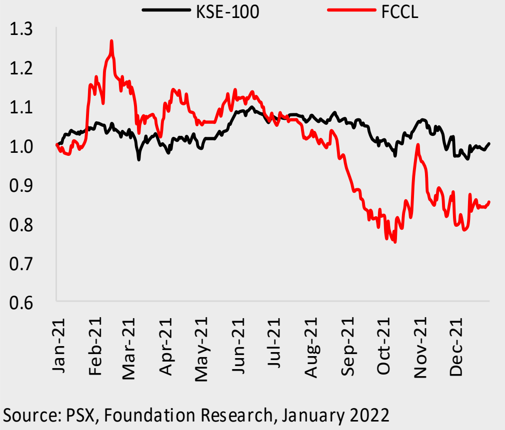
FCCL PA | **Outperform**

Price (31 Dec 21 CP)	Rs	18.4
Dec-22 Target Price	Rs	30.5
Upside/Downside	%	66.0
12M Target Price	Rs	30.5
- DCF methodology		
Sector		Cements
Market cap	Rs bn	25.3
30-day avg turnover	$ m	0.5
Market cap	$ m	163.5
Freet float	%	55.0
Shares issued	m	1,379.8

Investment fundamentals

Year end Jun		2021A	2022F	2023F	2024F
Net Revenues	mn	24,271	31,916	34,087	31,009
EBITDA	m	6,640	8,522	10,400	10,396
EBITDA Growth	%	13.7	389.5	56.6	22.0
PBT	m	5,108	7,106	9,230	6,073
Recurring Profit	m	3,471	5,051	6,627	4,357
Net Profit	m	3,471	5,051	6,627	4,357
EPS reported	Rs	2.5	3.7	4.8	3.2
Rev growth	%	40.9	31.5	6.8	(9.0)
EPS growth	%	(5,954.8)	45.5	31.2	(34.3)
PE	x	7.3	5.0	3.8	5.8
DPS	Rs	-	-	-	2.7
Div. Yield	%	-	-	-	15.0
ROA	%	11.3	12.8	12.2	6.9
ROE	%	16.1	19.6	20.9	12.0
EV/EBITDA	x	3.4	3.6	3.7	3.7
Net D/E	x	(0.1)	0.2	0.4	0.4
Price to Book	x	1.1	0.9	0.7	0.7
Price to Sales	x	1.0	0.8	0.7	0.8

FCCL KSE-100 Relative Performance



Source: PSX, Foundation Research, January 2022
(all figures are in Rs unless noted)

Fauji Cement Company Limited

It's all coming together after a long time

Event

- FCCL will now become second biggest player in North region post amalgamation of Askari cement with and into FCCL and dual expansion of 4.1mn tons (2.05mn ton each by FCCL and Askari). Furthermore, company would benefit from (1) higher concessionary debt (TERF/LTFF) taken for expansion by both FCCL/ACL post amalgamation, (2) increased demand from public sector as election related spending infrastructure would gain momentum, (3) strong private sector demand due to construction package amid increasing inflows of RDA, (4) disbursement of subsidy under NPHP and (5) decline in coal prices. Thus, we maintain our Outperform stance on the scrip with Dec-22 TP of Rs30.5/sh. Incorporation of aforementioned amalgamation into our valuation would provide upside potential to our valuations.

Impact

- **Askari amalgamation and dual expansion to make FCCL second largest North player:** FCCL market share after, Askari amalgamation along with combined capacity addition of 4.1mn ton, is expected to increase by 6.5ppt to 13.2% (10.5mn tons capacity) in FY24. With increased market share FCCL would benefit from higher demand from private/public sector as we expect domestic demand to increase by 1.3/10.0/6.1% YoY in FY22/FY23/FY24. However, post COD of 4.1mn tons option to export cement production would depend upon economic recovery of Afghanistan.

- **Debt free balance sheet and TERF/LTFF facility to keep interest rate risk on lower side:** On current debt matrix, FCCL has the lowest debt/ton that would allow it to avail debt at lower markup rates. Company total debt will be increased to Rs20bn in FY24 from current Rs1.1bn due to 2.05mn Greenfield expansion (Rs32bn expansion cost). To highlight, FCCL has already secured Rs10bn TERF/LTFF facility to finance its Rs20bn debt component of the expansion. Furthermore, post amalgamation FCCL will have competitive advantage of ~Rs18-20bn concessionary debt (@3.0% after tax for 10 years) as both companies have applied separately for TERF/LTFF facility, in our view.

- **Higher reliance on internal power generation to provide competitive edge:** FCCL reliance on internal power generation to meet its ~70% energy requirement would hold positive for the company as national grid rates are expected to increase due to resumption of IMF program. However, company fuel cost would remain on higher side in near term as coal prices are expected to remain elevated till 4QFY22.

Earnings Revision

- We have revised our EPS estimates for FY22/23 by ↑12/4/% and our TP by 4.4% from Rs29.2/sh to Rs30.5/sh due to revised retention prices assumption.

Price Catalyst

- Dec- 22 TP: Rs30.5/sh based on DCF methodology.

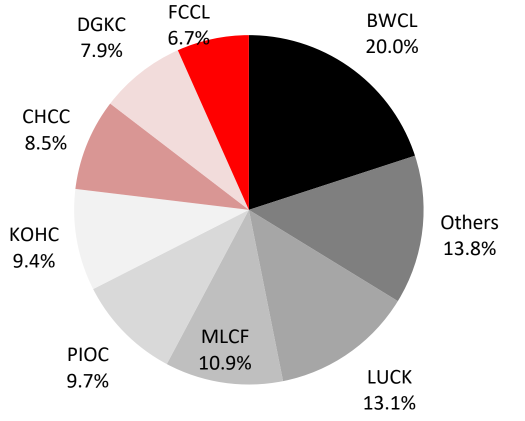
- Catalyst: (1) better retention prices, (2) increased private sector demand, (3) public sector spending before election year and (4) demand from NPHP.

- Risks: (1) start of price war, (2) higher coal prices and (3) decline in expected growth rate due to new COVID variant.

Outlook

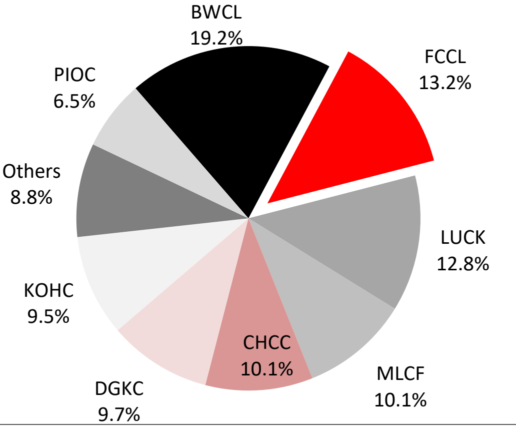
- We have 'Outperform' stance on the scrip with Dec-22 TP of Rs30.5/sh.

Fig 222: FCCL current market share in North region before merger and dual expansion of 4.1mn tons



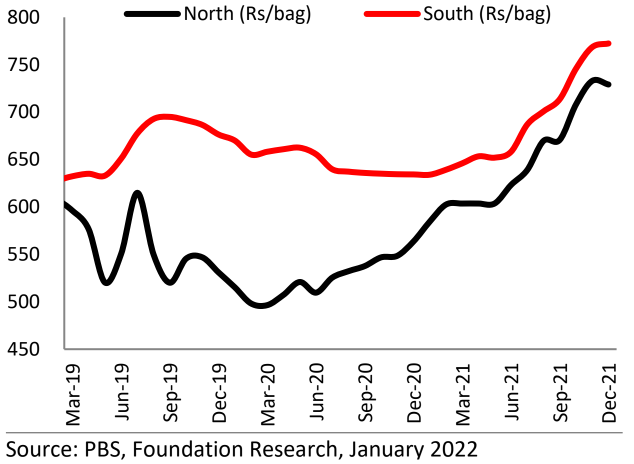
Source: Company acc, Foundation Research, January 2022

Fig 223: FCCL expected market share in North region after merger and dual expansion of 4.1mn tons



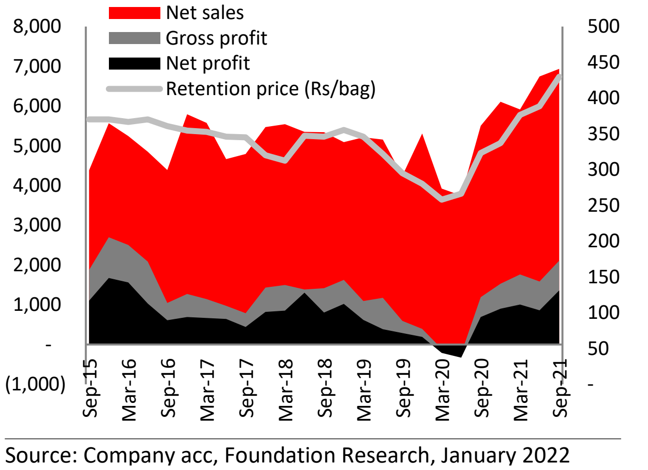
Source: Company acc, Foundation Research, January 2022

Fig 224: Cement prices increased to record levels as companies pass on the impact of higher fuel cost (Rs/bag)



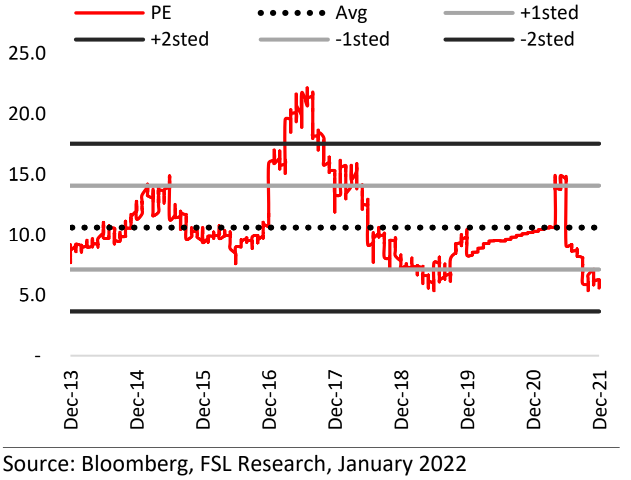
Source: PBS, Foundation Research, January 2022

Fig 225: Company profitability recovered post COVID due to strong rebound in economic activity (Rs mn)



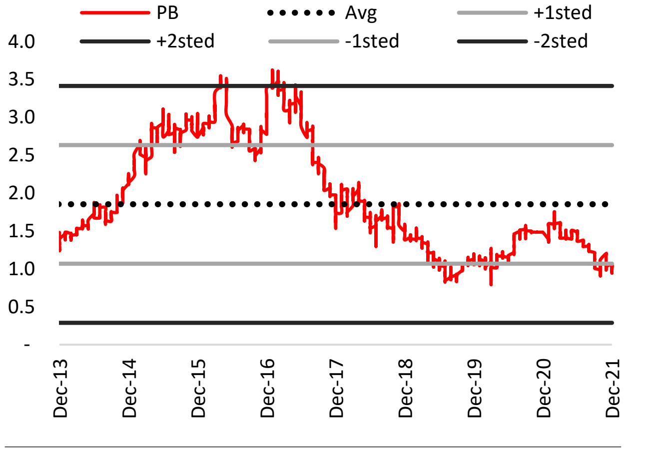
Source: Company acc, Foundation Research, January 2022

Fig 226: Trading at below average PE



Source: Bloomberg, FSL Research, January 2022

Fig 227: …and at P/B



Source: Bloomberg, FSL Research, January 2022

Table 44: Fauji Cement Company Limited (FCCL PA, 'Outperform', Target Price Rs27.6/sh)

Balance Sheet		**FY21A**	**FY22E**	**FY23E**	**FY24E**
PP&E	m	21,537	34,285	47,725	48,887
Cash & ST invest	m	3,999	5,340	6,649	7,001
Inventory	m	1,651	1,861	1,847	2,244
Other assets	m	4,892	5,350	5,658	6,720
Total Assets	**m**	**32,080**	**46,836**	**61,880**	**64,852**
LT+ST debt	m	1,082	10,855	19,865	20,269
Acct. payable	m	1,469	1,933	1,918	2,330
Deferred tax	m	4,104	3,633	3,086	2,621
Others	m	2,149	2,089	2,056	2,046
Total Liabilities	**m**	**8,804**	**18,510**	**26,926**	**27,266**
Paid-up capital	m	13,798	13,798	13,798	13,798
Others	m	9,478	14,528	21,156	23,788
SH'Equity	**m**	**23,276**	**28,327**	**34,954**	**37,586**
L+E	**m**	**32,080**	**46,836**	**61,880**	**64,852**

Profit & Loss		**FY21A**	**FY22E**	**FY23E**	**FY24E**
Net sales	m	24,271	31,916	34,087	31,009
COGS	m	18,207	23,684	23,425	22,783
Gross profit	**m**	**6,064**	**8,232**	**10,662**	**8,226**
Admin expenses	m	525	645	728	788
S&D expense	m	190	261	368	391
Other expenses	m	378	562	748	492
Other income	**m**	245	400	433	661
EBIT	**m**	**5,217**	**7,164**	**9,251**	**7,214**
Finance cost	m	110	57	21	1,142
PBT	**m**	**5,108**	**7,106**	**9,230**	**6,073**
Tax	m	1,636	2,056	2,603	1,716
PAT	**m**	**3,471**	**5,051**	**6,627**	**4,357**
EPS	X	2.5	3.7	4.8	3.2
EPS growth YoY	%	na	45.5%	31.2%	-34.3%
DPS	x	-	-	-	3

Q performance		**1Q'22A**	**2Q'22A**	**3Q'22A**	**4Q'22A**
Net sales	m	6,936	8,560	8,656	7,764
COGS	m	4,826	6,594	6,447	5,817
Gross profit	**m**	**2,110**	**1,966**	**2,208**	**1,948**
Admin expenses	m	150	157	165	173
S&D expense	m	51	61	66	84
Other expenses	m	137	139	154	133
Other income	m	113	110	88	89
EBIT	**m**	**1,886**	**1,720**	**1,912**	**1,647**
Finance cost	m	27	11	11	8
PBT	**m**	**1,859**	**1,708**	**1,901**	**1,638**
Tax	m	500	512	564	480
PAT		**1,359**	**1,197**	**1,336**	**1,159**
EPS	x	1.0	0.9	1.0	0.8
EPS growth YoY	%	95%	32%	32%	35%
DPS	x	-	-	-	-

Key ratios		**FY21A**	**FY22E**	**FY23E**	**FY24E**
BVPS	x	16.9	20.5	25.3	27.2
EPS	x	2.5	3.7	4.8	3.2
PE	x	7.6	5.3	4.0	6.1
PBv	x	1.1	0.9	0.8	0.7
GP margins	%	25%	26%	31%	27%
EBITDA margin	%	27%	27%	31%	34%
Net margin	%	14%	16%	19%	14%
ROE	%	16%	20%	21%	12%
ROA	%	11%	13%	12%	7%
Earnings yield	%	13%	19%	25%	16%
Payout Ratio	%	0%	0%	0%	87%
DY	%	0%	0%	0%	14%
EV/EBITDA	x	3.6	3.8	3.8	3.8
EV/Ton	US$	38.6	52.4	64.9	65.0
Debt/Equity	%	5%	38%	57%	54%
Operating cycle	x	15.6	10.0	6.8	8.3

Source: Company Accounts, Foundation Research, January 2022
All figures in Rs unless noted

About the company

Fauji Cement Company Limited is incorporated in Pakistan on 23 November 1992 under the Companies Ordinance, 1984 (Repealed with the enactment of the Companies Act, 2017 on May 30, 2017). The Company commenced its business with effect from 22 May 1993. The shares of the Company are quoted on Pakistan Stock Exchange. The principal activity of the Company is manufacturing and sale of different types of cement.

Factory Locations

FCCL current 3.56mn tons plant	Jhang Bahtar Tehsil Fateh Jang, District Attock
FCCL 2.05mn tons Greenfield expansion	Dera Ghazi Khan
Askari 1.1mn tons plant	Wah, Tehsil Taxila, District Rawalpindi
Askari 1.7mn tons plant	Nizampur, District Nowshera
Askari 2.05mn tons Brownfield expansion	Nizampur, District Nowshera

Auditor: M/s KPMG Taseer Hadi & Co, Chartered Accountants

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	Prolification Financing
PFS	Prolification 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 Peoples 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

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Recommendations definitions

If

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

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