

Pakistan Equity | Strategy

Jun 30, 2022

KSE-100 decline by 8% QoQ in 2Q2022; down 12% in FY22

IMF Program, Commodity Prices & Inflation to look out for next quarter



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Pakistan**
Best Local Brokerage
House 2015-16, FY2020

ASIAMONEY

Best Local Brokerage House
Brokers Poll 2011-14, 2016-21



FinanceAsia
Best Brokerage
House 2018,19-20



Best Research
House 2019-20



Best Brokerage
House 2019-21

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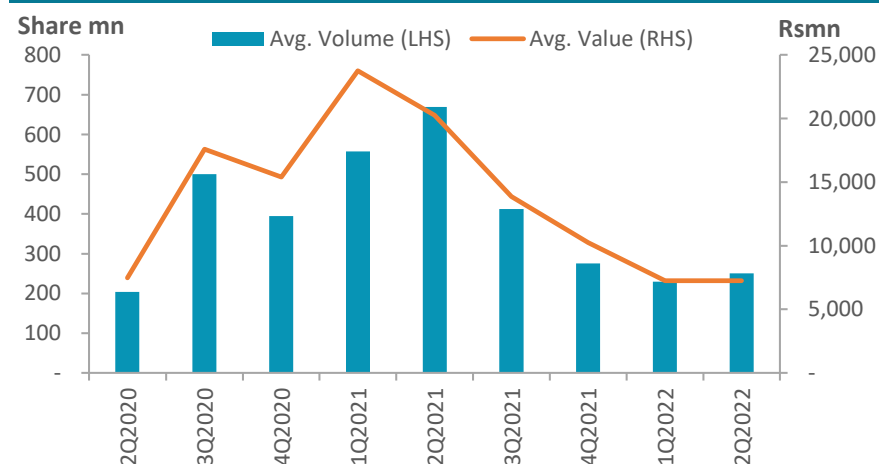
KSE 100 index down 8% QoQ, highest drop after eight quarters

KSE-100 quarterly returns

	PKR Return	USD Return
2Q2020	18%	17%
3Q2020	18%	20%
4Q2020	8%	12%
1Q2021	2%	6%
2Q2021	6%	3%
3Q2021	-5%	-12%
4Q2021	-1%	-4%
1Q2022	-1%	-4%
2Q2022	-8%	-17%

Source: PSX, Topline Research

PSX average volumes/value per day (Cash and Ready market)



Source: PSX, Topline Research

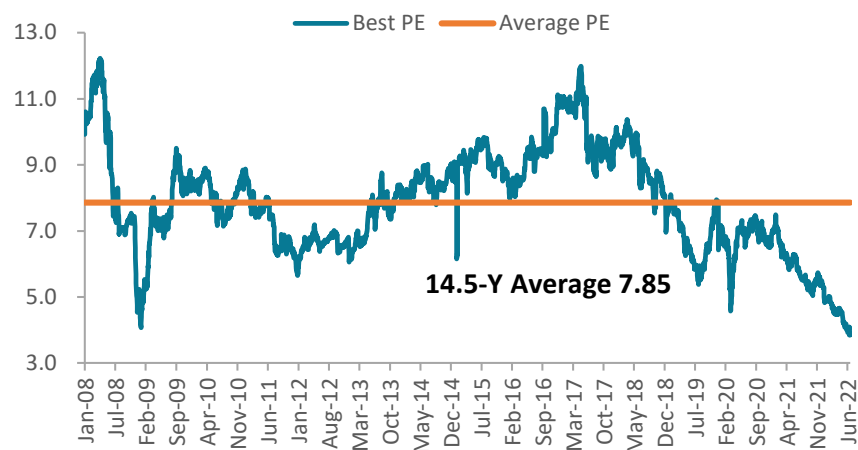
- Pakistan's benchmark KSE-100 index witnessed largest decline after eight quarters where index was down by 8% QoQ basis. It was also down 17% in USD terms in 2Q2022.
- Delay in IMF program, increased political uncertainty, rise in inflation, and expanding Current Account Deficit (CAD) continued to impact market during the quarter.
- KSE 100 index was down by 12% in FY22 as against increase of 38% in FY21.
- As per Bloomberg data, Pakistan was not amongst the top or worst performers during this period. Srilanka (-33%), Namibia (-27%), and Peru (-27%) were the worst performing markets during the quarter, whereas Lebanon (+45%), Russia (+33%), and Jordan (+11%) were the top performing markets. These are total returns in USD terms.
- In 2Q2022, average traded volumes in the Cash and Ready market declined by 63% YoY while increased by 9% QoQ to 250mn shares/day. The average traded value also deteriorated by 64% YoY while remained flat on QoQ basis to Rs7.2bn/day during 2Q2022.
- The average volumes in the Futures market also declined by 28% YoY while increased by 7% QoQ to 106mn shares/day. The average traded value of the same declined by 65% YoY and 10% QoQ to Rs3.4bn/day.
- No IPO was seen in main board during 2Q2022. However, we saw one IPO in GEM Board of Supernet Limited (GEMSPNL) in 2Q2022 where company raised Rs475mn at a strike price of Rs22.5/share.
- Mutual Funds were top sellers during the quarter with net selling of US\$59mn followed by Insurance of US\$58mn, Foreign Corporates of US\$38mn, and Brokers of US\$3mn. Individuals, Banks, and Companies were key buyers with net buying of US\$76mn, US\$34mn, and US\$29mn respectively.
- Key cyclical sectors that underperformed market during the quarter included Cements, Automobile Parts and Engineering. The key sectors that outperformed were Refinery and Oil & Gas Marketing driven by higher refinery margin & news flows of hike in gas prices.

Factors to look out for in the next quarter

- Following are few of the key factors to look out for in 3Q2022:
- **Revival of IMF program:** Delay in IMF program and release of its scheduled tranches has significantly increased economic uncertainty in the country during recent times. In 2Q2022, reserves held by SBP are already down by 28% to US\$8.2bn as of June 17, 2022. This has been due to lack of IMF & other foreign flows, rising current account deficit, and debt repayments.
- IMF had completed sixth review for Pakistan in Feb 2022 and the program was initially scheduled to conclude by Sep 2022. However, due to huge subsidies given by Pakistan on fuel from March to May 2022 and Pakistan's failure to impose Petroleum Development Levy (PDL), we saw delay in revival of IMF program.
- With removal of fuel subsidies and increased taxation measures in the amended finance bill, major hurdles for revival of IMF program have been removed. OGRA and NEPRA have also approved hike in gas and electricity prices which is to be approved by Federal Cabinet soon that should pave way for resumption of program. The size of the IMF program is anticipated to increase from US\$6bn to US\$8bn and IMF is expected to complete the combined sixth and seventh review. The program is also likely to be extended for another year. The release of IMF funds along with rollover of Chinese loan will bode well for Pakistan's economic and market outlook.
- **Commodity Prices:** Outlook on Pakistan economy will remain dependent upon commodity price trend as this not only exerts pressure on our external account but also result in higher inflation. International oil prices have been up 6% during the quarter however fears of recession in global economies and drop in commodity index has have led to hopes that situation in terms of commodity prices will improve. S&P GSCI, which is used as benchmark for commodities, is down by 10% from peak seen on Jun 9, 2022.
- **Inflation:** There is an expectation of sharp rise in inflation from Jun onwards where inflation could peak at 21% in Aug 2022 and could average ~16% in FY23. A higher-than-expected inflation number could be negative for the market as we are expected to witness such high inflationary numbers after 2008-09.
- **FATF:** FATF is also likely to carry out an on-site visit which could lead to Pakistan's removal from grey list which will be positive for investor sentiment.
- **Politics:** After calling off sit-in by Imran Khan in Islamabad on May 26, 2022, the ex-Prime Minister is again planning to stage protest on July 2nd in Islamabad against government. We believe that political noise had subsided since IK called off protest/sit-in and PDM's decision to hold general election as per its schedule in 2H2023. However, any rise in political noise and uncertainty could also be negative for the market.

Valuations remain attractive, foreign inflows remain key

KSE-100 index PE vs Historical average PE



Source: Bloomberg, Topline Research

- Pakistan market currently trade at attractive valuations with 2022 P/E of around 4x and Dividend Yield of 9%. If we exclude circular debt companies, PE comes out at around 5x which is still very attractive in terms of its historical average PE of 8x.
- We prefer companies that benefits from rising interest rates, PKR devaluation, and have cash rich balance sheets. We also suggest high quality names with dividend yield of higher than 15% dividend yields.
- Our top picks includes Meezan Bank (MEBL), MCB Bank (MCB), United Bank (UBL), Engro Fertilizer (EFERT), Hub Power (HUBC), Lucky Cement (LUCK), Mari Petroleum (MARI), Pakistan Oil Field (POL), Interloop (ILP), and Systems Limited (SYS).

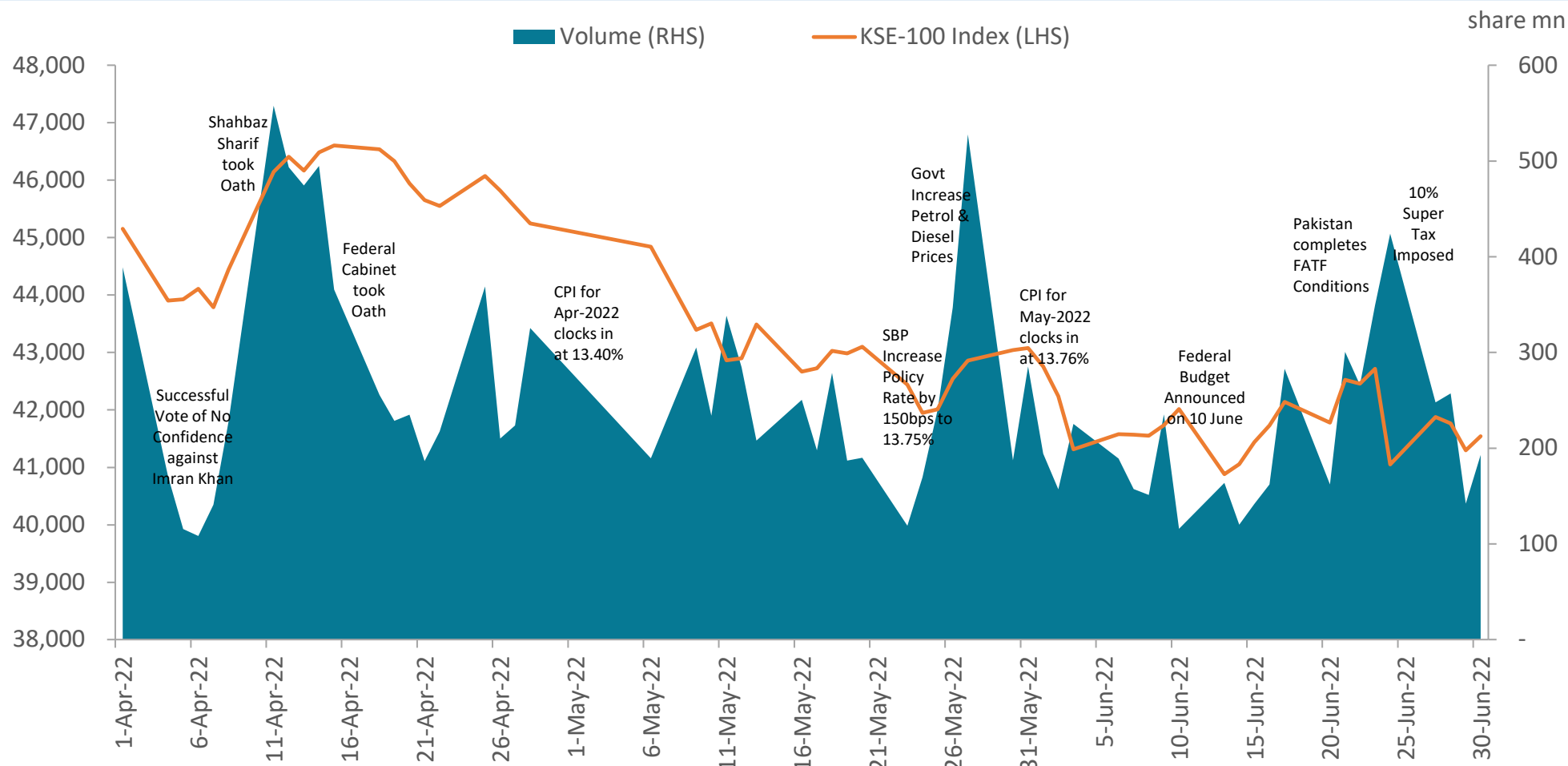
Pakistan Stock Market: Key Numbers

	2019A	2020A	2021A/E	2022E	2023F
PE	7.0	5.8	4.3	4.2	3.5
Earnings Growth	0%	20%	35%	4%	16%
PBV	1.0	0.9	0.8	0.7	0.6
Dividend Yield	6%	7%	9%	9%	10%
ROE	15%	16%	19%	19%	19%

Source: Topline Research

Pakistan Equities: Index trend and Events in 2Q2021

Tracing key events with KSE-100 index performance during 2Q2021

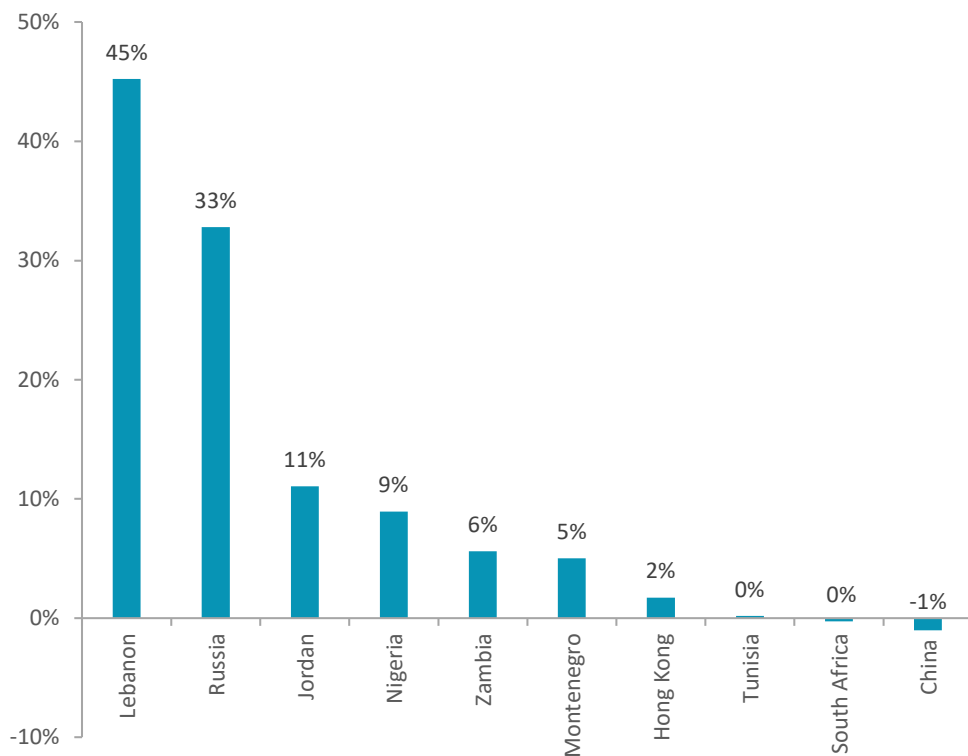


Source: PSX, Topline Research

Pakistan Equities: Comparison with International Markets

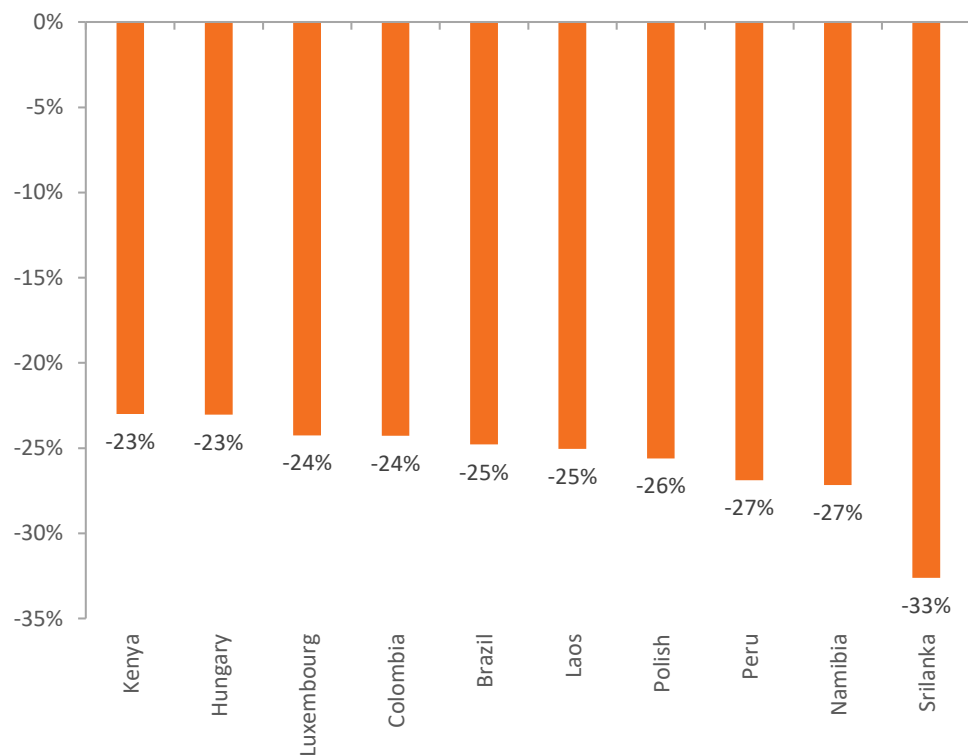
Pakistan was not amongst the top or worst performers during this period. Lebanon and Russia were top performers whereas Srilanka and Namibia were underperformers.

Best performing markets in 2Q2022 (Total Return in USD terms)



Source: Bloomberg (WEIS), Topline Research

Worst performing markets in 2Q2022 (Total Return in USD terms)

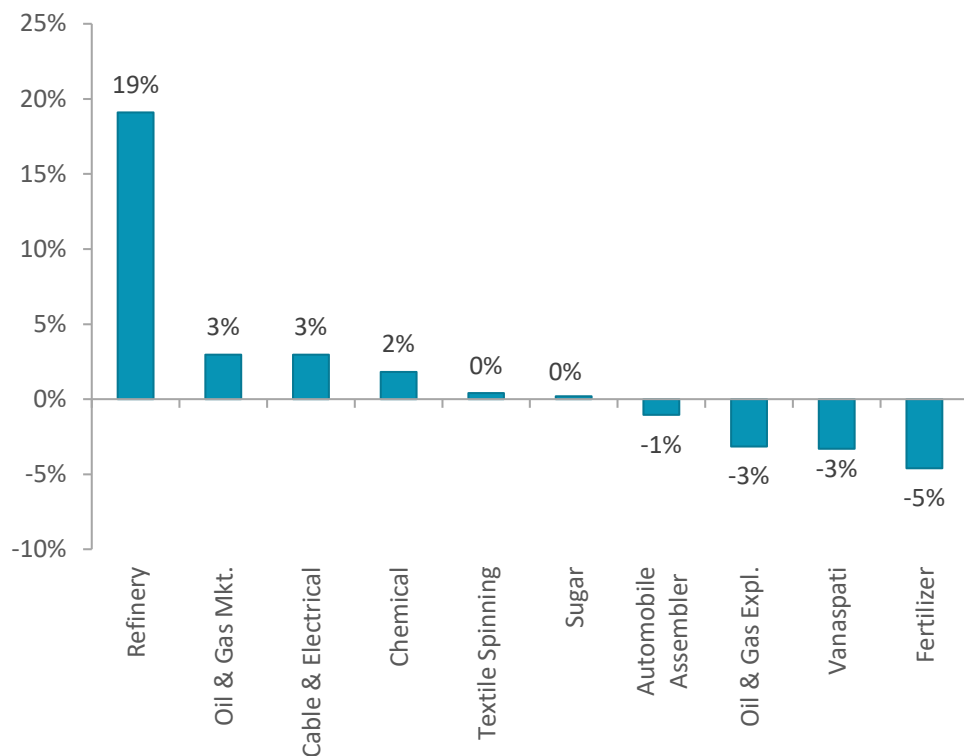


Source: Bloomberg (WEIS), Topline Research

Pakistan Equities: Sector performance in 2Q2022

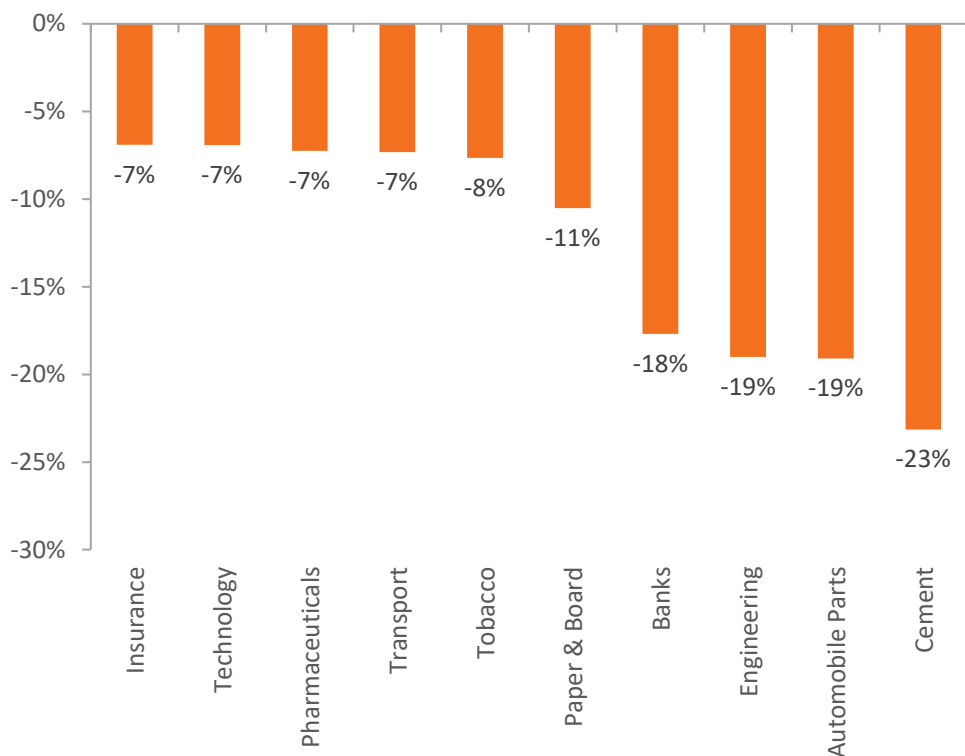
Refinery, Oil & Gas Marketing and Cable & Electrical sectors outperformed the market during the quarter, while Cement, Automobile Parts and Engineering sectors lagged behind.

Key Top Performing Sectors during 2Q2022



Source: PSX, *based on market capitalization, Topline Research

Key Underperforming Sectors during 2Q2022

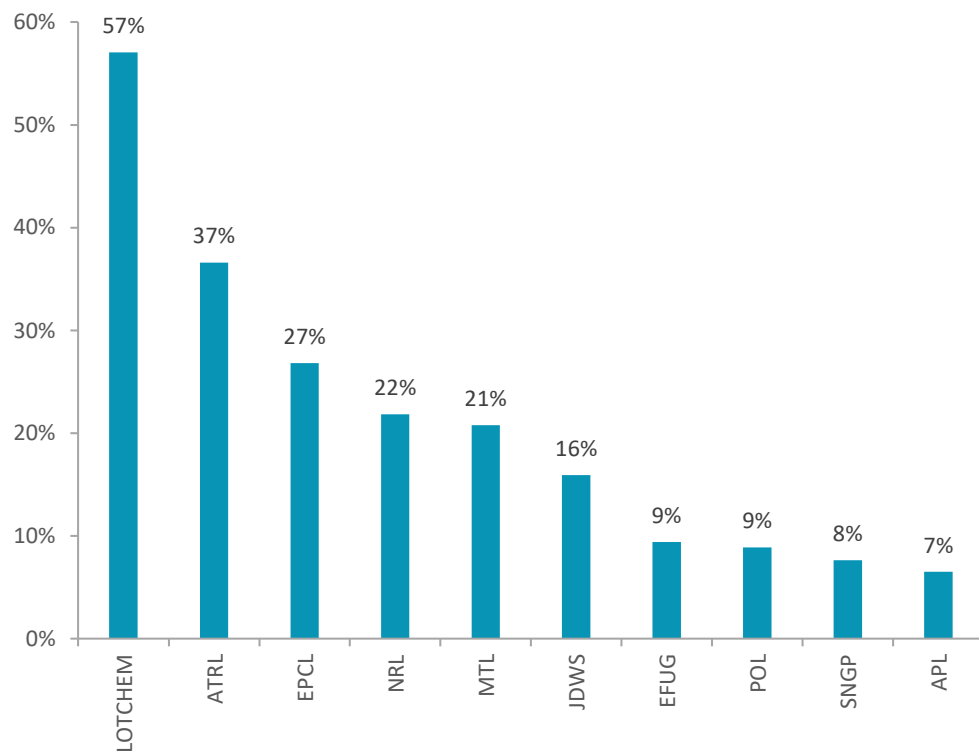


Source: PSX, *based on market capitalization, Topline Research

Pakistan Equities: Stocks performance charts in 2Q2022

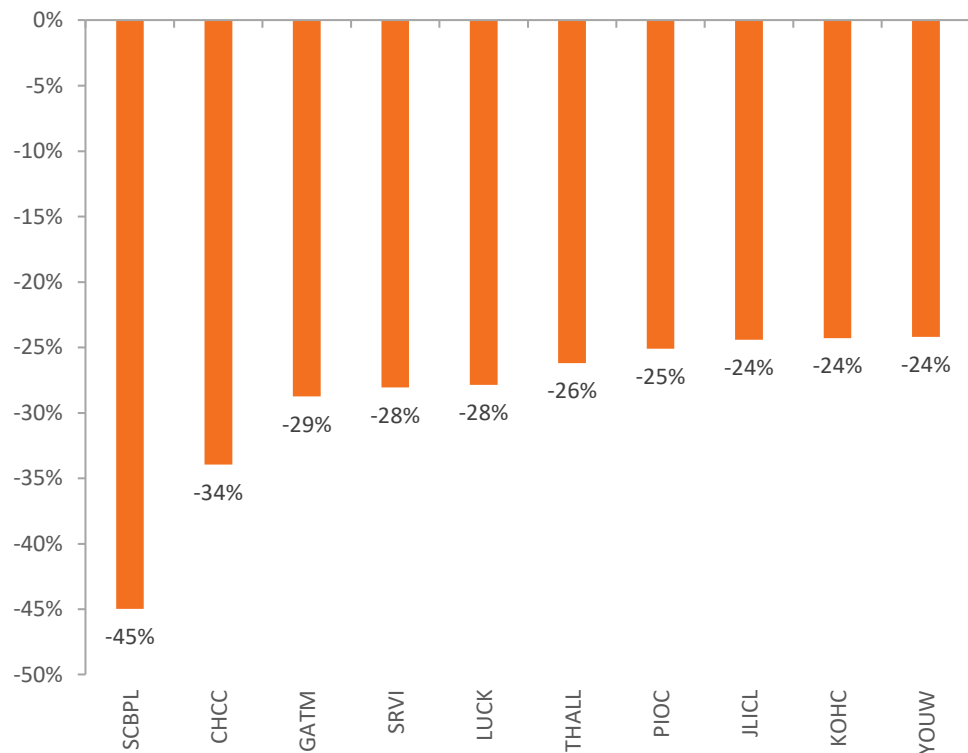
LOTCHM, ATRL and EPCL were amongst top stocks in the KSE-100 during the quarter, while SCBPL, CHCC and GATM were notable underperformers.

Best performing stocks in KSE-100 index during 2Q2022



Source: Bloomberg, *based on adjusted prices, Topline Research

Worst performing stocks in KSE-100 index during 2Q2022



Source: Bloomberg, *based on adjusted prices, Topline Research

Pakistan Equities: Foreign participation in PSX in 2Q2022

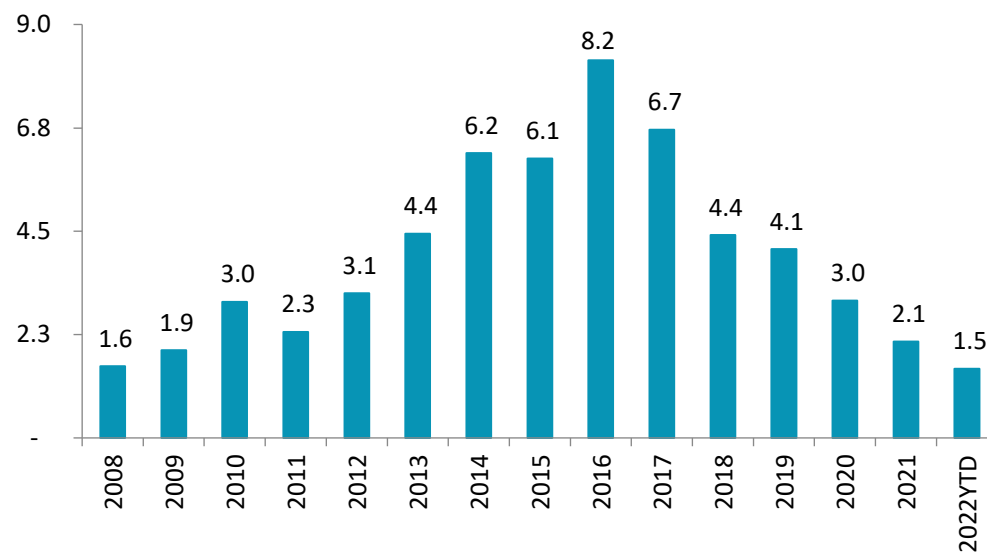
Foreigners continue to be key sellers in the market during the quarter. Net selling recorded at US\$27mn during the quarter. Overall foreign ownership in PSX have come down to US\$1.5bn as per SBP.

Quarterly Foreign Portfolio Investments

US\$m	Total Foreign Portfolio Investment			Foreign Corporate		
	G.Buy	G.Sell	Net	G.Buy	G.Sell	Net
2Q2020	275.7	(430.4)	(154.6)	112.3	(274.6)	(162.3)
3Q2020	565.9	(660.6)	(94.7)	142.3	(248.7)	(106.4)
4Q2020	526.9	(711.1)	(183.9)	123.2	(263.5)	(140.3)
1Q2021	849.0	(867.0)	(18.0)	253.4	(292.3)	(38.9)
2Q2021	725.6	817.8	(92.2)	206.6	(293.6)	(86.9)
3Q2021	509.1	(583.6)	(74.5)	169.8	(267.6)	(97.8)
4Q2020	445.5	(614.3)	(166.9)	165.1	(372.0)	(206.9)
1Q2021	284.6	(301.6)	(17.0)	86.7	(107.7)	(21.0)
2Q2022	223.7	(250.4)	(26.7)	53.7	(91.6)	(37.9)

Source: NCCPL, *till Jun 29, 2022, Topline Research

Foreign Ownership in PSX (US\$bn) – period end



Source: SBP, Topline Research

Pakistan Equities: Local participation in PSX in 2Q2022

Amongst the local participants, Mutual Funds, Insurance, and Brokers were key sellers during the quarter while Individuals, Banks and Companies were top buyers.

Quarterly Net Buying/Selling by Local Mutual Funds, Insurance & Banks

US\$m	Mutual Fund	Insurance	Banks
2Q2020	27.1	40.4	(3.7)
3Q2020	16.4	29.7	(46.4)
4Q2020	2.9	58.9	(17.5)
1Q2021	0.5	(31.2)	(25.2)
2Q2021	4.3	(59.1)	(2.9)
3Q2021	(3.1)	10.1	17.7
4Q2021	(5.4)	56.2	10.3
1Q2022	(48.3)	(5.3)	41.3
2Q2022	(59.4)	(57.8)	33.6

Source: NCCPL, *as of Jun 29, 2022, Topline Research

Quarterly Net Buying/Selling by Local Companies, Individuals & Brokers

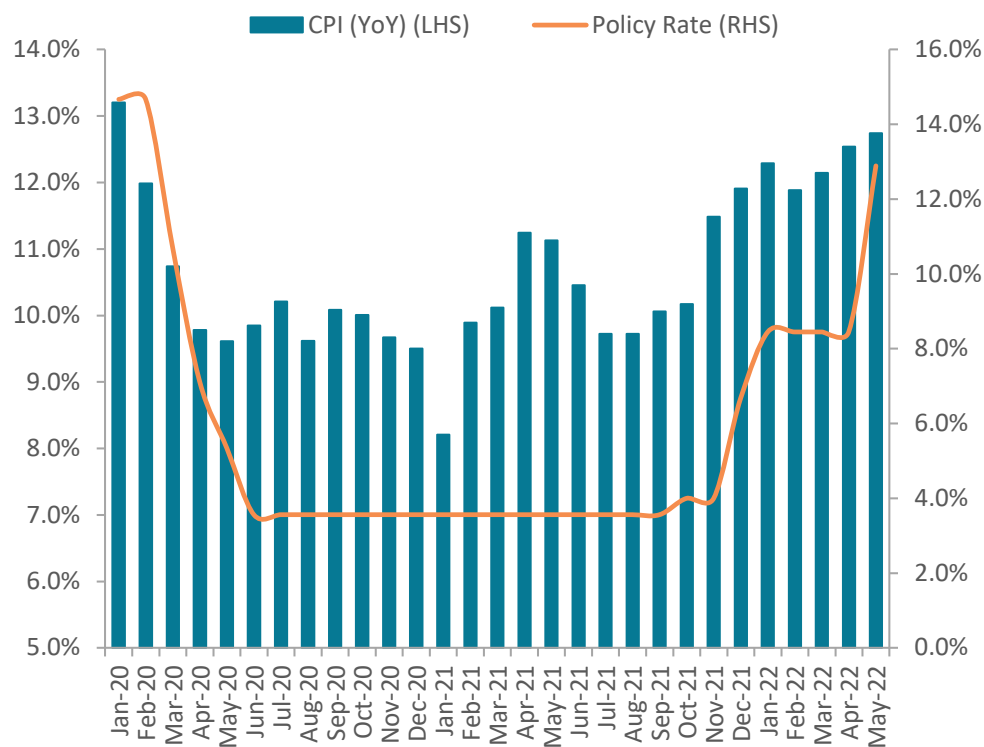
US\$m	Companies	Individuals	Brokers Inv.
2Q2020	22.0	69.9	(4.5)
3Q2020	13.5	107.9	(17.9)
4Q2020	78.7	50.7	9.0
1Q2021	28.2	74.9	(24.1)
2Q2021	16.2	83.5	3.1
3Q2021	12.3	32.4	(14.9)
4Q2021	47.6	38.5	3.0
1Q2022	22.8	10.3	(3.5)
2Q2022	29.3	76.4	(3.0)

Source: NCCPL, *as of Jun 29, 2022, Topline Research

Pakistan Economy: CPI and Interest Rates in 2Q2022

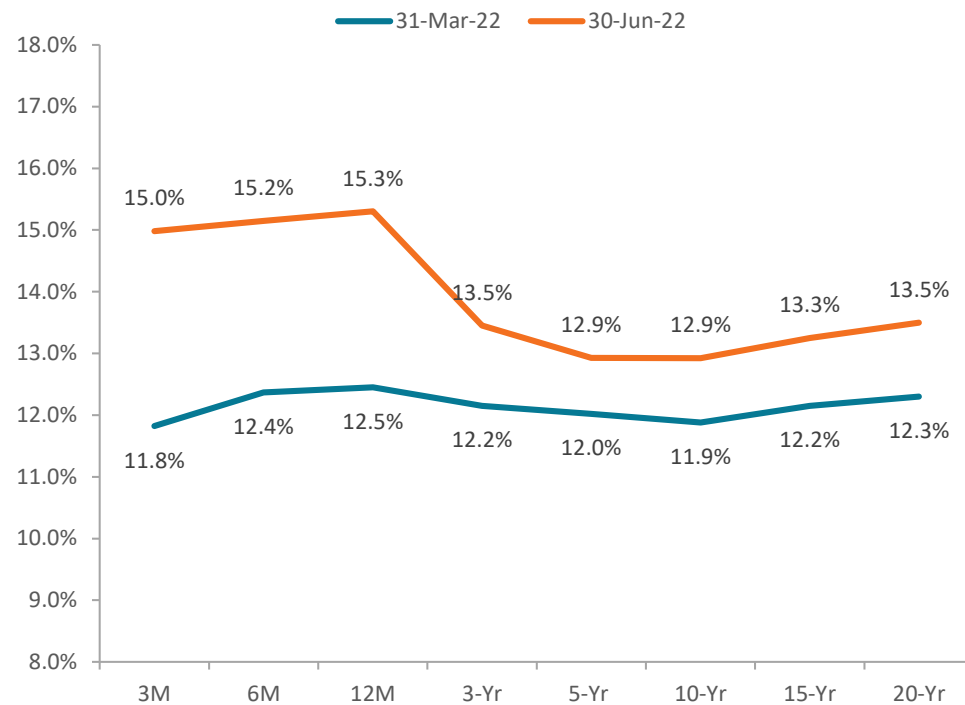
The monthly CPI readings during the quarter came in higher than expectation due to higher food prices. SBP in its MPS in May-2022 increased the policy rate by 150bps to 13.75%, keeping Real Interest Rates flat. The yields in the secondary markets have edged up by 90-320bps during the quarter.

Monthly CPI inflation vs. Policy Rate



Source: PBS, SBP, Topline Research

Yield Curve

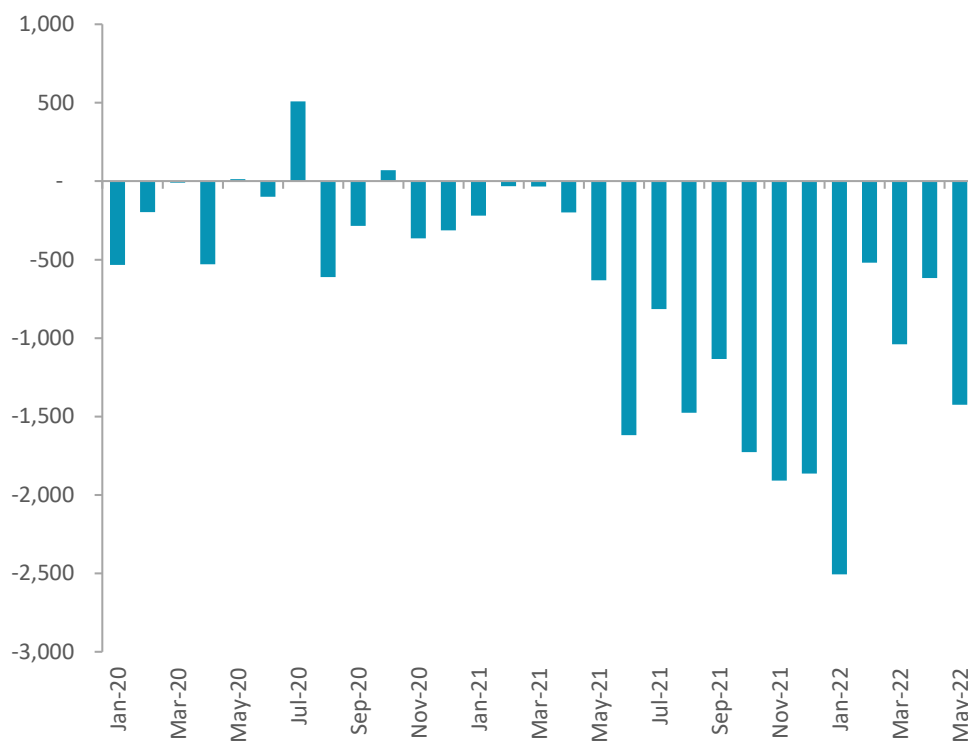


Source: MUFAP, Topline Research

Pakistan Economy: External Account in 2Q2022

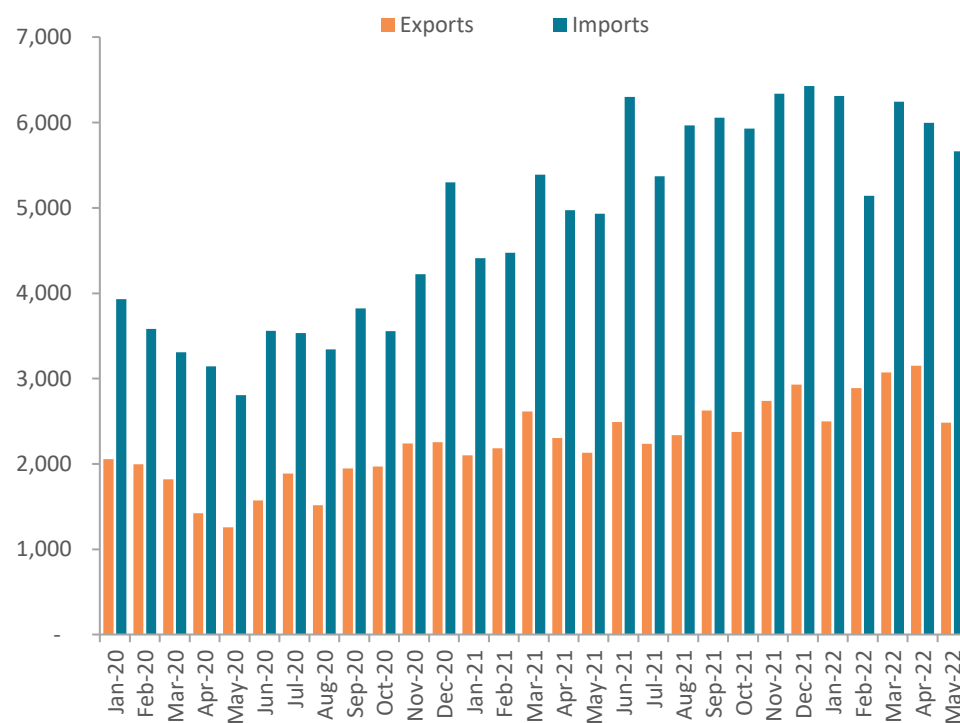
Pressures on Pakistan external account remains as current account deficit (CAD) has now increased to US\$15.2bn in 11MFY22 vs. US\$1.1bn same period last year. After a soft reading in April 2022 where CAD clocked in at US\$618mn, May 2022 CAD increased to US\$1.4bn due to rise in trade deficit & lower remittances.

Pakistan Monthly Current Account Balance (US\$mn)



Source: SBP, Topline Research

Breakdown of Current Account Balance (US\$mn)

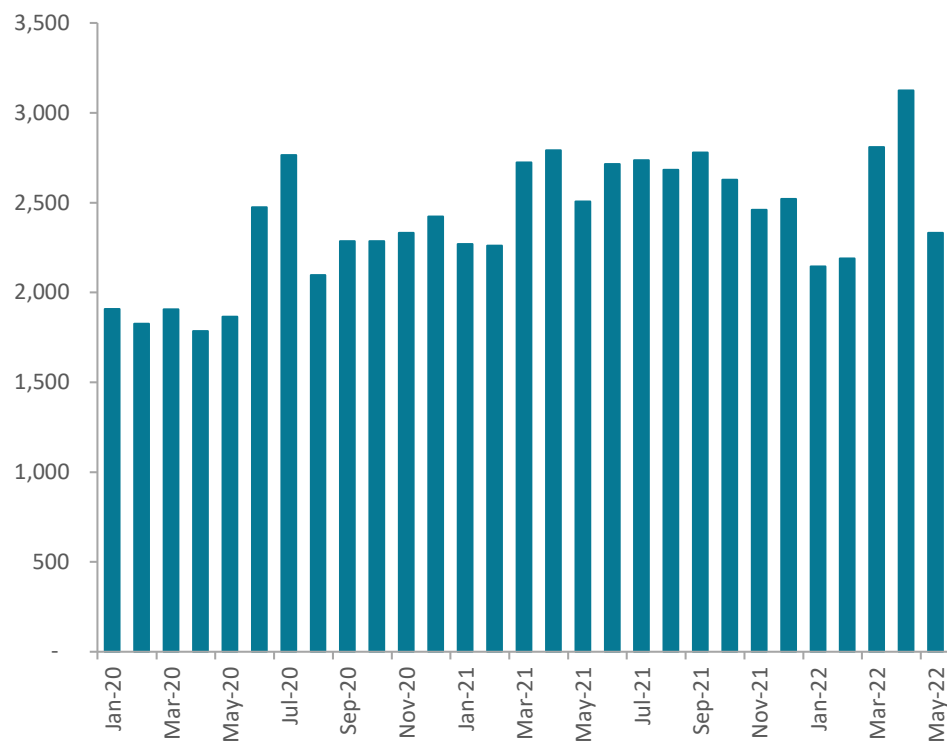


Source: SBP, Topline Research

Pakistan Economy: Home Remittances and FDI in 2Q2022

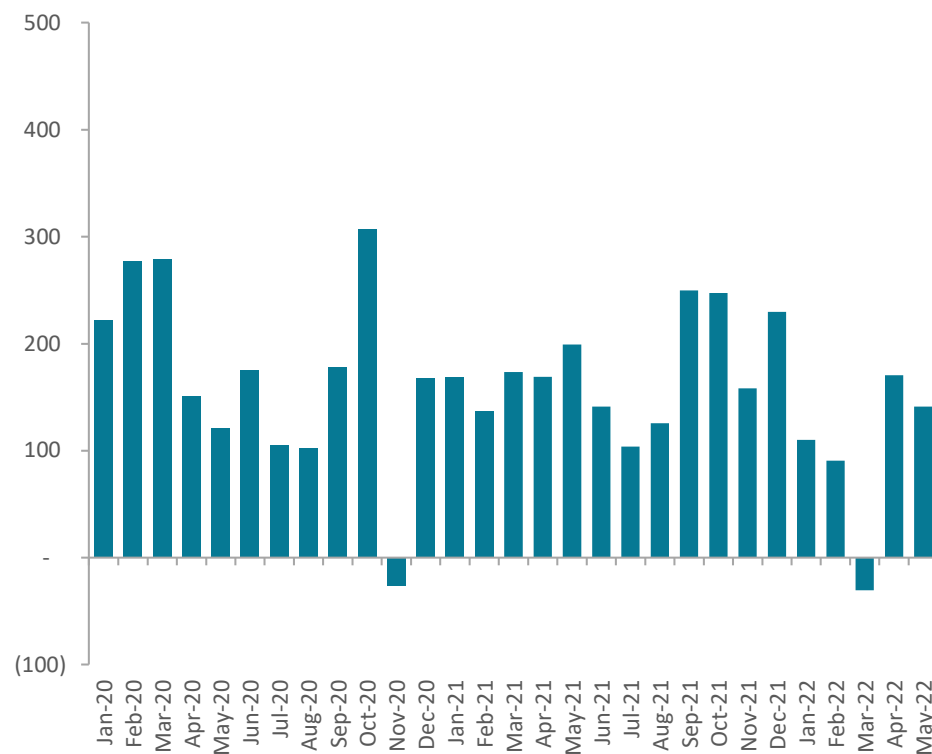
Pakistan Home Remittances have shown great strength to continuously clock in a monthly figure of above US\$2bn. The net Foreign Direct Investment (FDI) remains stable, though nothing remarkable.

Pakistan Monthly Remittances (US\$mn)



Source: SBP, Topline Research

Pakistan Monthly net FDI (US\$mn)

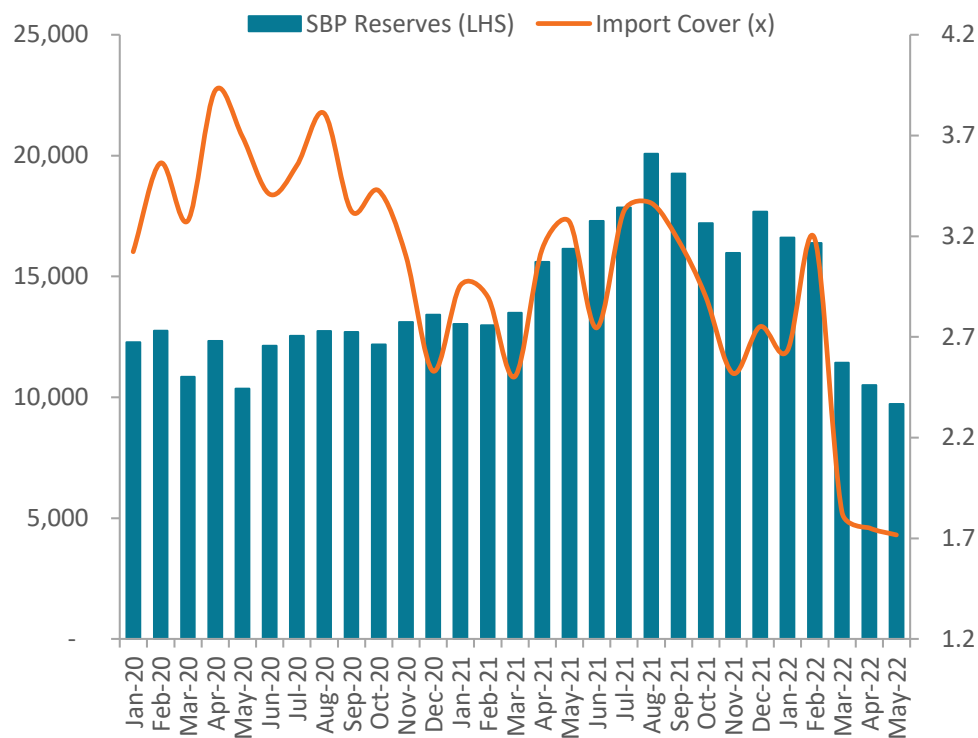


Source: SBP, Topline Research

Pakistan Economy: SBP FX reserves and swap positions in 2Q2022

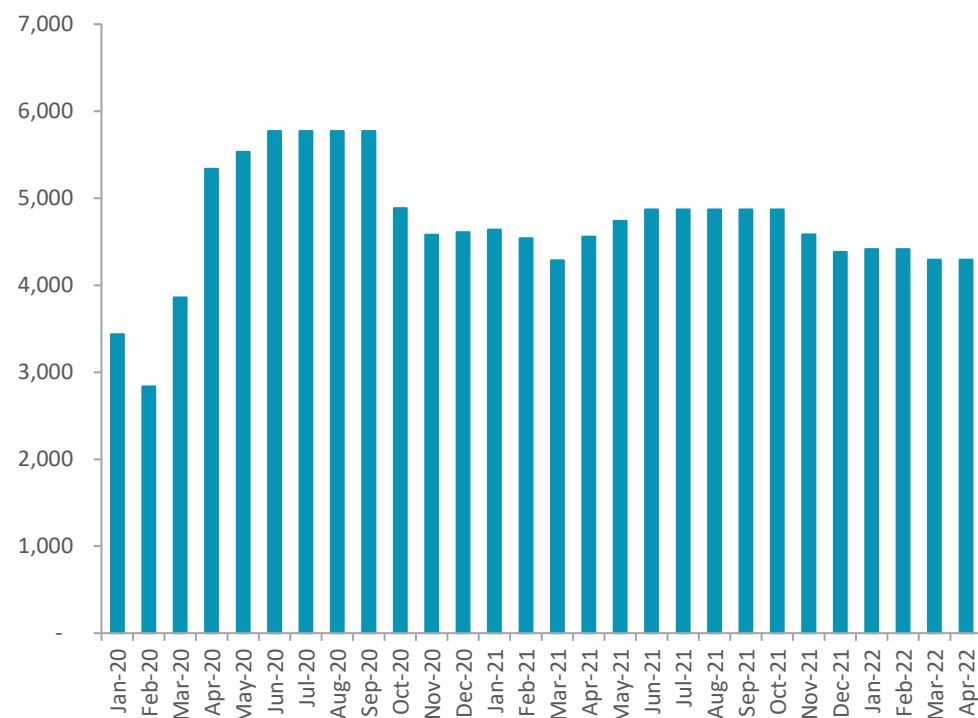
SBP foreign exchange reserves continued to decline during 2Q2022 dropping by 28% to US\$8.2bn. The net swap positions remained steady.

SBP FX Reserves (US\$mn) and Import Cover (x)



Source: SBP, Topline Research

Swaps/forwards Net Short Positions (US\$mn)

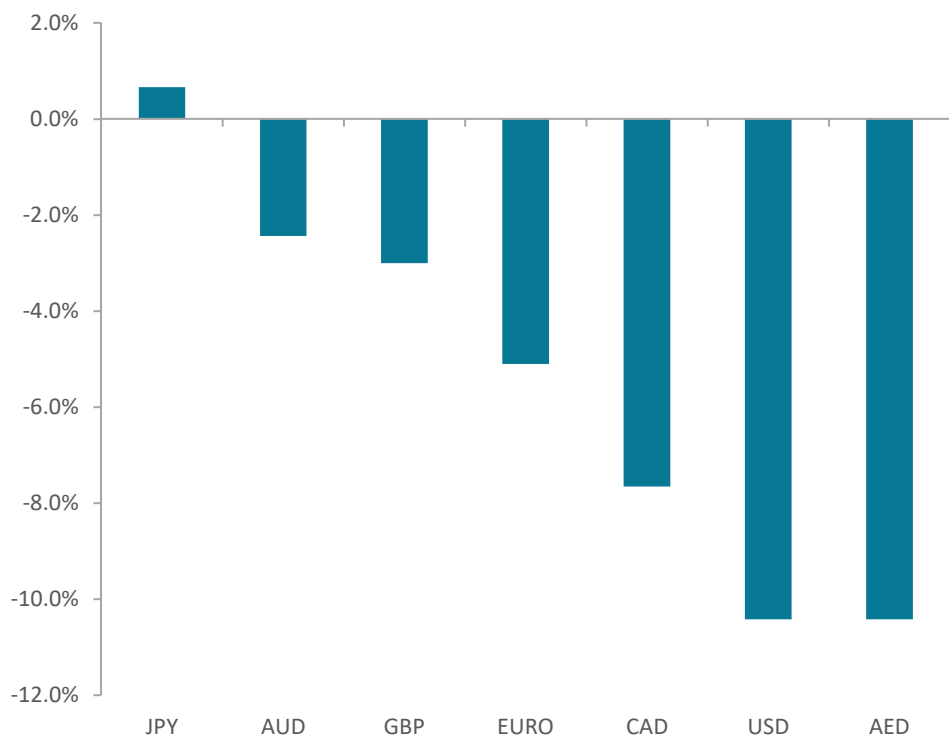


Source: SBP, Topline Research

Pakistan Economy: PKR performance and REER in 2Q2022

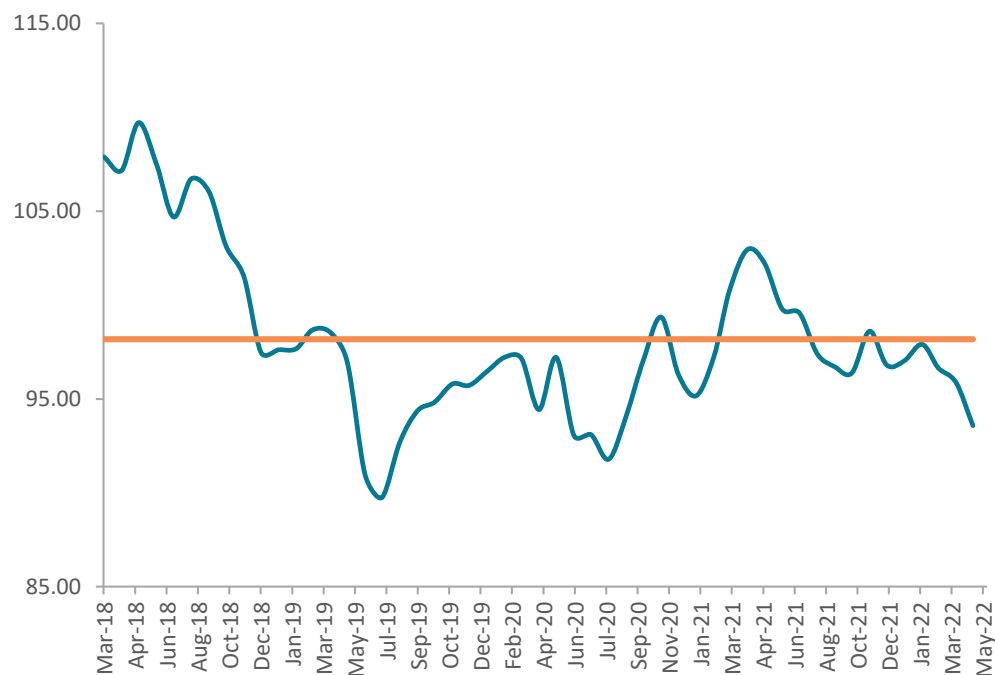
PKR depreciated by 10% against USD in 2Q2022 due to pressures on foreign exchange reserves. Pakistan's REER index is now down 3% from Mar 2022, much below its long term average.

Quarterly PKR movements vs. other currencies



Source: SBP, Topline Research

Pakistan REER vs. its long term average

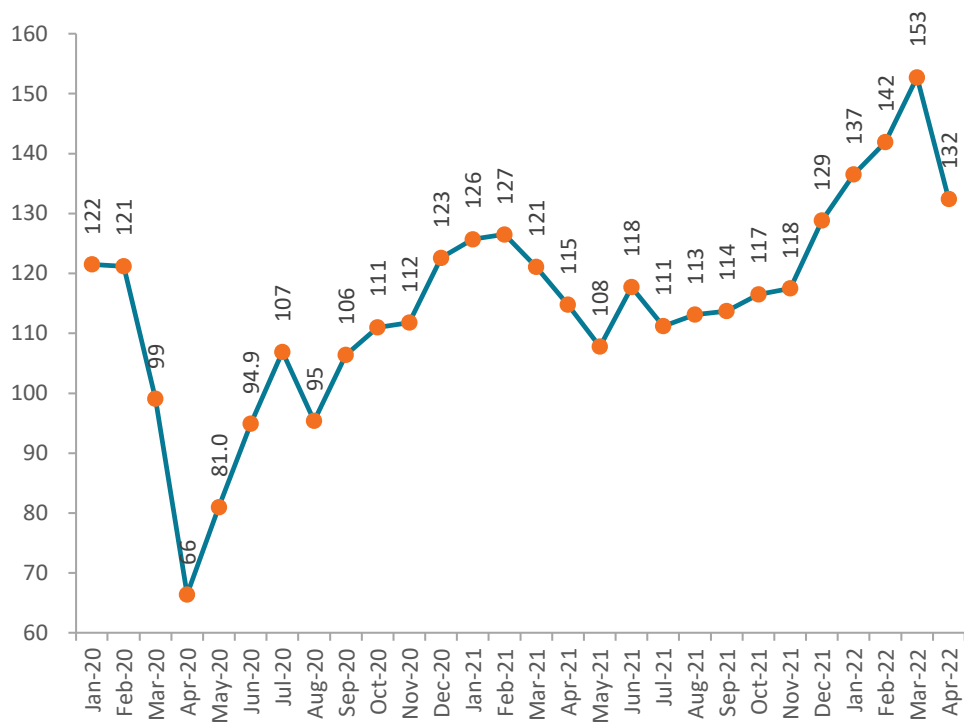


Source: SBP, Topline Research

Pakistan Economy: LSM and fiscal account in 2Q2022

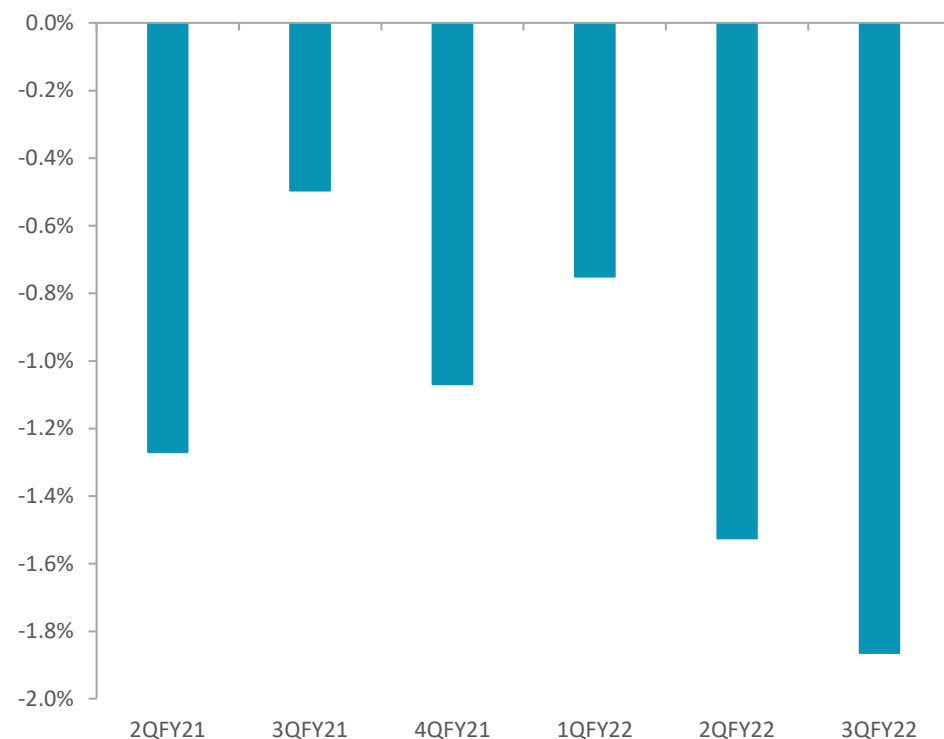
After remaining strong during 9MFY22, LSM Index has started showing signs of weakness amid macro challenges. Fiscal deficit is also witnessing an increasing trend which is likely to rise further due to fuel subsidies given in 4QFY22.

Large Scale Manufacturing trend



Source: PBS, Topline Research

Quarterly Fiscal Deficit % of GDP



Source: Ministry of Finance, Topline Research

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Buy	Stock will outperform the average total return of stocks in universe
Neutral	Stock will perform in line with the average total return of stocks in universe
Sell	Stock will underperform the average total return of stocks in universe

For sector rating, Topline Securities employs three tier ratings system, depending upon the sector’s proposed weight in the portfolio as compared to sector’s weight in KSE-100 Index:

Rating	Sector’s Proposed Weight in Portfolio
Over Weight	> Weight in KSE-100 Index
Market Weight	= Weight in KSE-100 Index
Under Weight	< Weight in KSE-100 Index

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