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Yields will not be the 'knight in shining armor'

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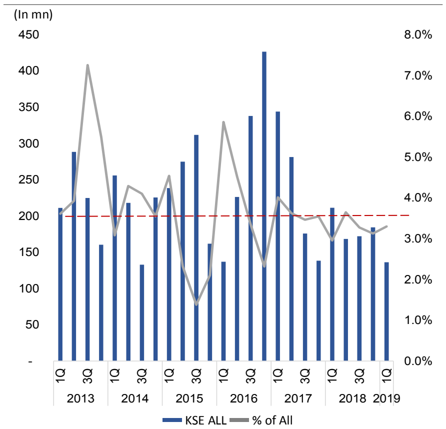
- **We set out to determine the impact of dividend yields on driving volumes, highlighting the seasonality of inflows into the top ten D/Y stocks in our coverage universe, delineating the potency of the 'bird in hand' effect on domestic equities.**
- **Between CY13-CY19TD, we assess the ability of D/Y stocks to attract volumes, comparing the same to KSE-All volumes, where the seasonality of flows is made evident, while the absence of this trend from 3QCY18 onwards is largely attributed to rising structural risks to payouts, in our view.**
- **Looking ahead, we highlight the waning attraction of dividends when faced with depreciative structural risks, namely: 1) circular debt cutting liquidity in the power, downstream and upstream energy sectors, 2) structural fragility in demand outlooks and 3) monetary tightening, where a bottom-up approach to stock selection rather than yields is a better ploy to capturing returns, in our view.**
- **Despite the relative resilience of D/Y stocks in bear markets, clearly the attractiveness has waned as evidenced through lower volumes (3.2% of total volumes in last 3Qs vs. 3.7% since past 25Qs) , where attractive returns on other asset classes can be highlighted as the major culprit; special saving certificates currently offer 11.4% one year risk-free return vs. a similar CY19F avg. dividend yield of our investment universe.**
- **With current D/Ys on offer being rather insipid considering Saving returns, we believe stock selection should focus on thematic plays offering a mix of a strong fundamental story in tandem with yield. In this context, we believe scrips with lucrative planned expansions (HUBC), adherence to macro-hedge credentials (OGDC) and themes better placed to thrive under a constrained macro outlook (MEBL, NML) are bets to take.**

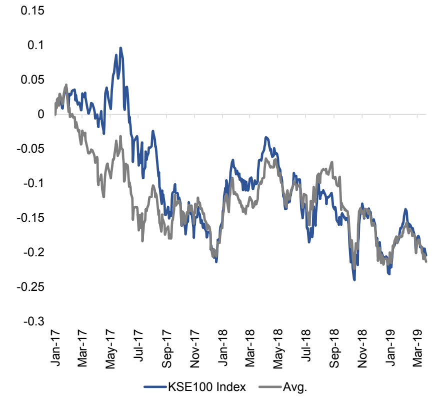
Love for yields is gone…: We analyze quarterly average volumes for the top ten D/Y scrips in our universe (ABL, MCB, FFC, APL, INDU, POL, EFERT, FATIMA, NBP & KAPCO) from CY13 onwards and contrast the same with prevailing KSE-all volumes. Highlighting the ebb and flow of volumes through comparing quarterly to KSE-All volumes of these ten stocks, the average over 25 quarters stands at 3.7%. Deviations from this average are largely observed during 1Q and 2QCY, where the average rises to 4.5% of KSE-All volumes. This phenomenon illustrates the increasing lure of high D/Y stocks in periods of payout/results announcements, where expectations of annual or interim cash disbursements attract volumes. However, during the last three quarters (3.2% average share of KSE-All volumes) the top ten D/Y stocks have barely contributed to volumes, where a juxtaposition of KSE-All QoQ volume shifts and top ten yield volume shifts shows the support provided by these scrips to sustaining volumes, which has recently remained absent.

% share of DY stock volumes % of KSE-All volumes



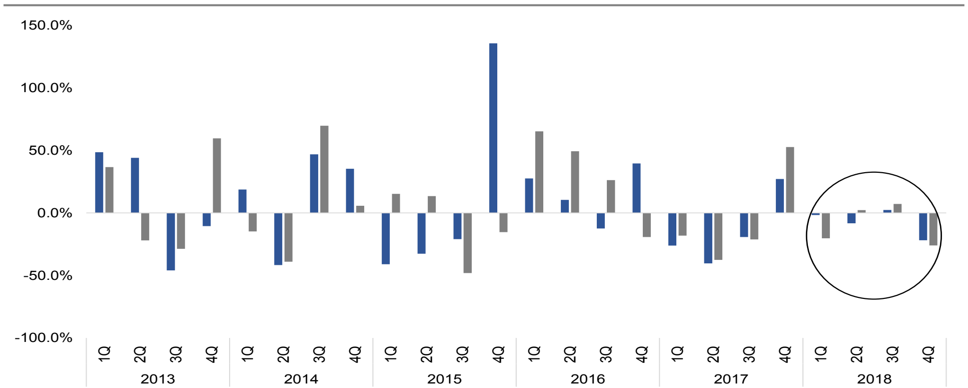
Source: PSX & AKD Research

DY stock performance vs. KSE-100 index in bear market



Source: PSX & AKD Research

QoQ volumes of dividend yielding stocks and KSE-All volume



Source: PSX & AKD Research

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…while risks make it hard to hold on: Top dividend yielding sample stocks cover Banks (ABL, MCB, NBP), Fertilizers (EFERT, FATIMA, FFC), E&P (POL), OMCs (APL), Autos (INDU) and Power (KAPCO). From a wider sectoral lens, clear risks emerge from a fragile economic backdrop, contractionary demand cycles, monetary tightening and idiosyncratic factors (circular debt, future of GIDC). That said, going forward a more bottom-up approach to targeting yield stocks is better placed to capture returns, in our view.

Pockets of value persevere: We believe MCB and ABL dividend payouts to increase given adequate CAR (MCB/ABL: 17.0/17.3%) and profitability growth (CY19/20F: MCB 10.0/34.0% and ABL 17.8/39.4%) whereas NBP's dividend payout remains dependent on the outcome of review of pension case judgement. Similarly, POL and APL are likely to witness increase in dividend payouts in the medium run given increase in oil prices and lower debt on their balance sheet. Further, clearance of circular debt through PkR200bn sukuk issuance with an additional PkR200bn sukuk in the pipeline could jump start dividend payouts in the power sector (KAPCO/HUBC skipped dividend in the last quarter under stress from weak liquidity position). On the flip side, cash flow of Fertilizer sector could be affected on the adjustment of GIDC hampering their ability to increase dividend payout in the near-term. Similarly, INDU is unlikely to increase its dividend particularly with pressure on earnings on the near-term horizon.

Outlook: The relative resilience of D/Y plays and theirs ability to withstand a bearish spell is reflected in the average beta (relative to KSE-100) of the top dividend yield plays amounting to 0.74x (2017-2019TD) during the current bearish spell vs. 0.77x in a wider bull market (2013-2016). However, as highlighted above, lower volumes in recent times are believed to be due to systematic factors as well as attractive risk-free returns on other asset classes. To highlight, special saving certificates currently offers 11.4% one year risk-free return similar to CY19F avg. dividend yield of our investment universe. Succinctly put, investors are not being compensated for equity risk premiums, and hence are shunning attractive payouts. With current D/Ys on offer being rather insipid considering Saving returns, we believe stock selection should focus on thematic plays offering a mix of a strong fundamental story in tandem with yield. In this context, we believe scrips with lucrative planned expansions (HUBC), adherence to macro-hedge credentials (OGDC) and themes better placed to thrive under a constrained macro outlook (MEBL, NML) are bets to take.

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Buy	**> 19% expected total return (Rf: 13% + Rp: 6%)**
Neutral	**> 13% to < 19% expected total return**
Sell	**< 13% expected total return (Rf: 13%)**

Old Rating Definitions (Discontinued)	
Buy	**> 20% upside potential**
Accumulate	**> 5% to < 20% upside potential**
Neutral	**< 5% to > -5% potential**
Reduce	**< -5% to > -20% downside potential**
Sell	**< -20% downside potential**
Not Rated	**No investment opinion or recommendation**

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