

# PAKISTAN STRATEGY

# REP-019 MARKET VISTA

## September of stalemates marks 1.8%MoM slip

- Despite the first few steps towards policy formation including the announcement of a mini budget and hike in gas tariff for industry and households, lack of concrete, long term details to tackle the 'twin deficits' led the bourse to a dismal show, with the KSE-100 index falling 1.8%MoM to 40,998.59pts.
- In Saturday's MPS, the SBP increased its policy rate by 100bps to 8.5% (in line with expectations marking 275bps rise CYTD) as a proactive step to fend-off price pressures, a widening external imbalance, and deteriorating fiscal position.
- Developments on the macro front are likely to dictate market moves in the month ahead, where crystallization of the GoP's plans to attract financing flows (diaspora bonds, bilateral arrangements, third country inclusion in CPEC projects) and initiation of formal negotiations with the IMF for another funding arrangement are the key flashpoints.
- We continue to recommend exposure to sectors (i.e. Banks and E&Ps) that benefit from macro themes (i.e. monetary tightening & currency depreciation). Our top picks include MCB, ABL, OGDC, PPL, and HUBC.

**Market Review:** Sep'18 saw the incumbent government taking its first few steps towards long term policy formation including the announcement of a mini budget and hike in gas rates, though still remaining short of a clear long term direction. In this regard, the benchmark index fell 1.8%MoM to close at 40,998.59pts, with depressed average traded volumes at 137.8mn shares as compared with CYTD average of 185.03mn shares. Negative performance across the board was largely attributable to a ~30% hike in gas rates for industrial customers (barring 5 export oriented sectors) where amongst the coverage universe, Engineering sector dipped the most (-11.9%MoM) as annual results also disappointed largely due to the incorporation of GIDC, followed by Automobile & Parts (-7.0%) on the back of uncertainty over the imposition/removal of ban on non-filers. Investors also factored in expectations of rate hike by the Central Bank (announcement of a 100bps hike over the last weekend of Sep'18) taking toll on Cements/Chemicals (down 6.8%/3.4%MoM).

**Lack of participation:** Tepid volumes prevailed where the KSE-100/All-Shares indices witnessed total average volumes decline of 29.6/34.4%MoM (down 56/73%YoY) marking receding investor participation. From a quarterly standpoint, during 1QFY19 KSE-100/KSE All-share average daily turnover declined 3.9/2.8%QoQ, commensurate with relatively steady activity in sector-heavy banks and E&Ps. Additionally, the share of KSE100 volume in total shares traded at the exchange averaged 54.2% for 1QFY19 vs. 48.7% during 1QFY18, taking the 9MCY18 average to 50.0% vs. 45.0% for CY17, marking a flight to blue chip stocks as opposed to the wider all-shares space. Foreigners continued to off-load their equity stakes, with Sep'18 net outflow of US\$57.94mn. On the local side, Insurance and M. funds combined amassed US\$50.4mn worth of equities.

**SBP to continue its hawkish stance:** In its latest MPS, SBP increased the policy rate by 100bps to 8.5% (cumulative 275bps in CYTD) as a proactive step to curb price pressures, widening external imbalance, and deteriorating fiscal space. We expect SBP to continue maintaining hawkish stance in the context of inflationary pressures due to higher international oil prices, gas rate hike and passed through impact from FX swings. In this regard, we expect another cumulative 175bps hike in FY19F with policy rate to settle at 10.25%. Under this scenario, Banking sector is likely to lead market performance with current valuations at an undemanding ~1.0x P/B vs. 1.39x (CY13-16). On the flip side, leveraged sectors (Cements, Fertilizers, & Steel) should see near term weakness.

**Outlook:** Happenings on the macro front are likely to dictate the market performance in the month ahead. In this regard, GoP's guidance on an arrangement of financing inflows is the key checkpoint. Macro developments such as aggressive rate hikes by the central bank (cumulative 275bps CYTD) and fiscal tightening (i.e. cut in PSDP & further RD on imports) point to likely entry into an IMF program, in our view. Any potential announcement or clarity on the same could trigger a minor relief rally. We continue to recommend exposure to sectors (i.e. Banks and E&Ps) that benefit from macro themes (i.e. monetary tightening & currency depreciation).

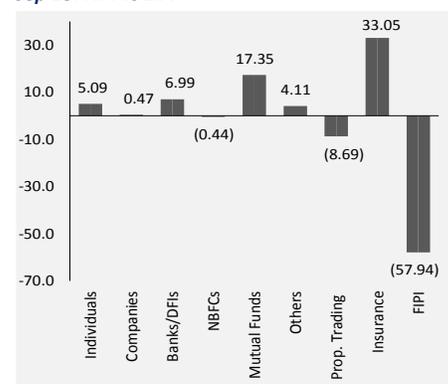
Umer Farooq & M. Daniyal Kanani  
research@akdsecurities.net  
111-253-111 Ext:639

### Key highlights of the month:

|        |                                                                             |
|--------|-----------------------------------------------------------------------------|
| Sep 05 | US State Secretary Mike Pompeo visits Pakistan to discuss regional strategy |
| Sep 17 | ECC approves hike in gas prices in the range of 10-143%                     |
| Sep 18 | GoP announces mini-budget to scale down fiscal deficit                      |
| Sep 18 | PM Imran Khan visits Saudi Arabia                                           |
| Sep 19 | IHC overturns NAB court verdict & orders release of Nawaz Sharif            |
| Sep 28 | An IMF team arrives in Pakistan for Article IV consultations                |
| Sep 29 | MPC raises policy rate by 100bps                                            |

Source: News Reports & AKD Research

### Sep'18: FIPI vs LIPI



Source: NCCPL & AKD Research

### Sep'18: Sector Performance

| Sector               | MoM    |
|----------------------|--------|
| Textile              | -0.4%  |
| Banks                | -0.5%  |
| Electricity          | -2.4%  |
| Oil and Gas          | -2.7%  |
| Chemicals            | -3.4%  |
| Pharma               | -5.6%  |
| Cement               | -6.8%  |
| Automobile and Parts | -7.0%  |
| Engineering          | -11.9% |

Source: PSX & AKD Research



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### New Rating Definitions

|         |                                                |
|---------|------------------------------------------------|
| Buy     | > 16% expected total return (Rf: 10% + Rp: 6%) |
| Neutral | > 10% to < 16% expected total return           |
| Sell    | < 10% expected total return (Rf: 10%)          |

### 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 |

## Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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