Tellimer

Developing markets, connected.

tellimer.com

CONFIDENTIAL

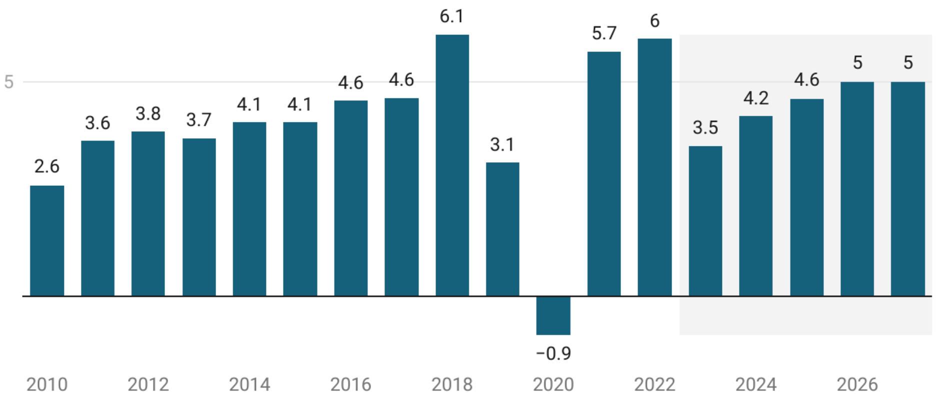
Pakistan Macro Overview

Patrick Curran

21 September 2022

Real GDP growth (%yoy)

Real GDP growth has been nearly 6% over the past 2 years versus potential growth closer to 4.5-5%, resulting in overheating of economy. Growth is projected to moderate this year on a tighter policy stance and impact from the floods before rising towards 5% over the medium-term



**Year corresponds to fiscal year (eg 2022 = FY 21/22)*

Chart: Patrick Curran • Source: IMF WEO, Tellimer Research • Created with Datawrapper

Policy rate versus inflation (%)

Inflation has risen to 27.25% on the back of higher food and fuel prices, pushing the policy rate to -12.25% despite 800bps of rate hikes by the SBP over the past year

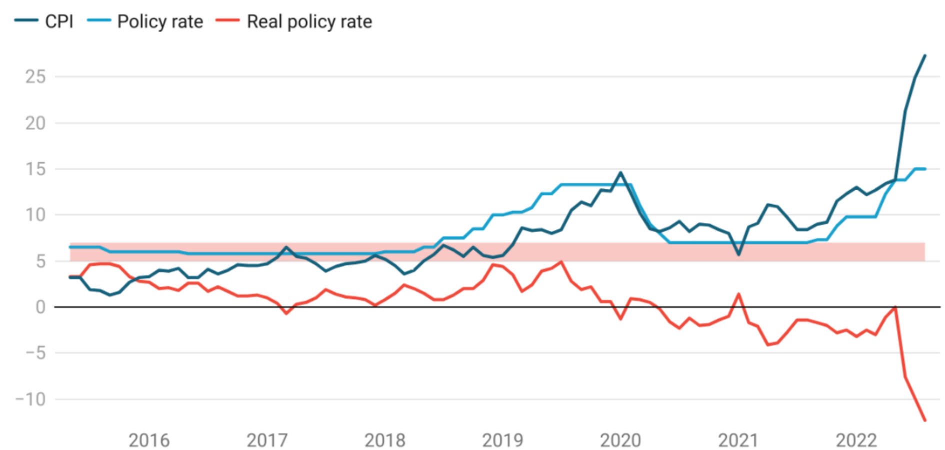
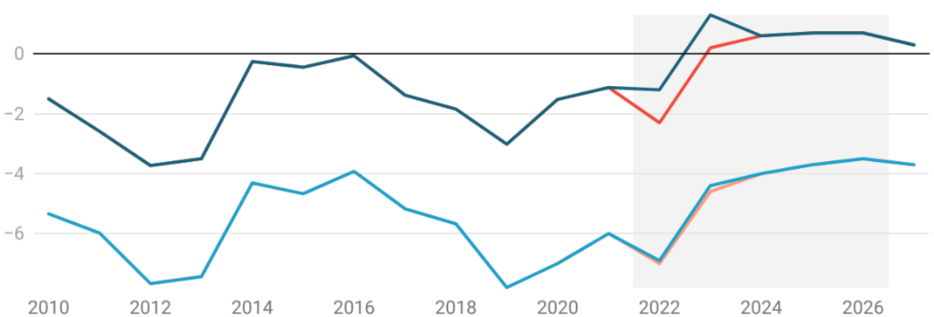


Chart: Patrick Curran • Source: Haver, Tellimer Research • Created with Datawrapper

Budget and primary balances (% of GDP)

Primary deficit came in at 2.3% of GDP in FY 21/22 versus 1.2% target, but is projected to contract by 2.5pp (or 2pp excluding one-off transactions) in FY 22/23 to reach a 0.2% surplus. Consolidation will be driven by 0.6pp of new revenue measures and 1.2pp of subsidy cuts

Primary balance (original target) Primary balance (revised target) Budget balance (original target)
Budget balance (revised target)



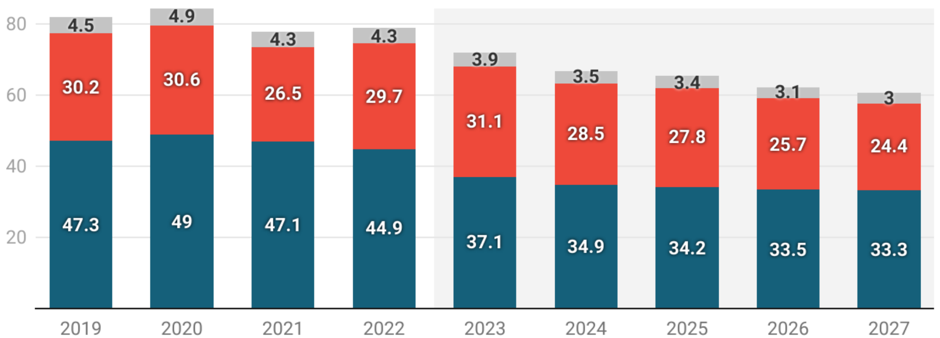
Year corresponds to fiscal year (eg 2022 = FY 22/23)

Chart: Patrick Curran • Source: IMF WEO, Tellimer Research • Created with Datawrapper

General government debt (% of GDP)

Government government and government-guaranteed debt is projected to decline from 78.9% of GDP in FY 21/22 to 60.7% by FY 26/27, but interest absorbed c40% of government revenue in FY 21/22 and external debt service is projected to be c50% of exports in FY 22/23

Domestic debt External debt Government-guaranteed debt



Year corresponds to fiscal year (eg 2022 = FY 22/23)

Chart: Patrick Curran • Source: IMF WEO, Tellimer Research • Created with Datawrapper

Tellimer

Current account balance (US$ mn, NSA)

The CAD fell fo US$0.7bn in the 3 months to Apr from US$2.1bn in the 3 months through Jan, but has widened back out to US$1.6bn in the 3 months to Jul on higher fuel imports. It is projected by the IMF to fall from 4.7% of GDP in FY 21/22 to 2.5% in FY 22/23

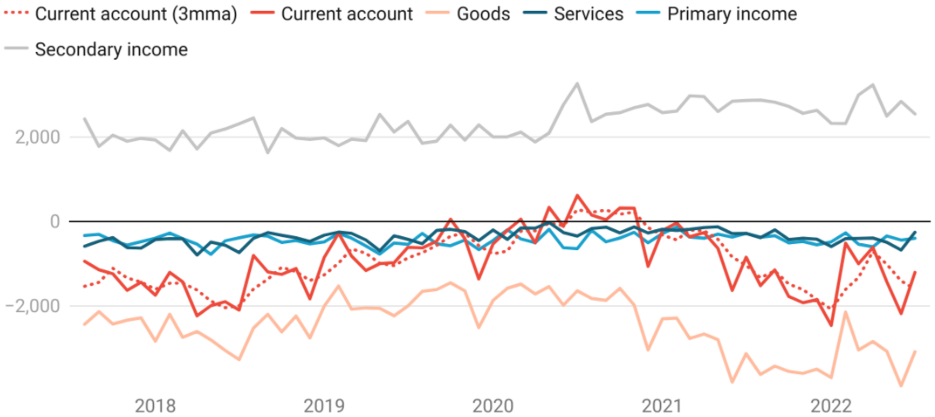


Chart: Patrick Curran • Source: Haver, Tellimer Research • Created with Datawrapper

Balance of payments (US$ mn)

Pakistan has relied on "other investment" inflows to funds it's current account deficit given weak FDI and portfolio flows, resulting in consistent pressure on reserves

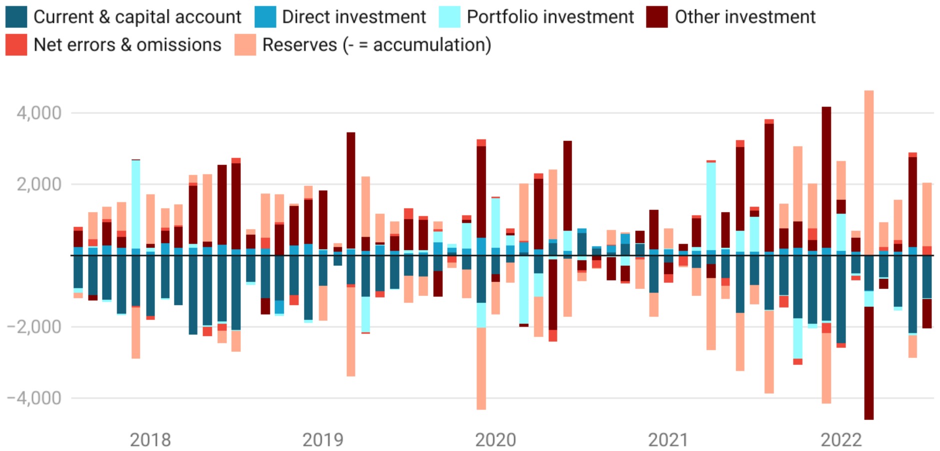


Chart: Patrick Curran • Source: Haver, Tellimer Research • Created with Datawrapper

Tellimer

Liquid FX reserves with SBP (US$ bn)

FX reserves jumped after the IMF's US$1.16bn disbursement at the end of August but remain alarmingly low c1.5 months of goods & services imports c25% of GEFR

Chart: Patrick Curran • Source: Haver, Tellimer Research • Created with Datawrapper

Gross external financing requirement (% of FX reserves)

Projected US$30.8bn GEFR in FY 22/23 to be covered by US$31bn external financing pipeline. US$2.2bn of FDI, and US$3.8bn of IMF disbursements, pushing reserves to over US$16bn

Chart: Patrick Curran • Source: Haver, Tellimer Research • Created with Datawrapper

Tellimer

PKSTAN 7 ⅜ 04/08/2031 (mid price)

Pakistan's eurobonds have plummeted over the past year, with the '31s trading below US$50 versus an estimated recovery value of US$53-71 at a 12% exit yield

Chart: Patrick Curran • Source: Bloomberg, Tellimer Research • Created with Datawrapper

PKR spot and non-deliverable forward rates

The PKR has depreciated by nearly 30% over the past year and 10% over the past month, with forwards pricing in another 18% of depreciation over the next 12 months

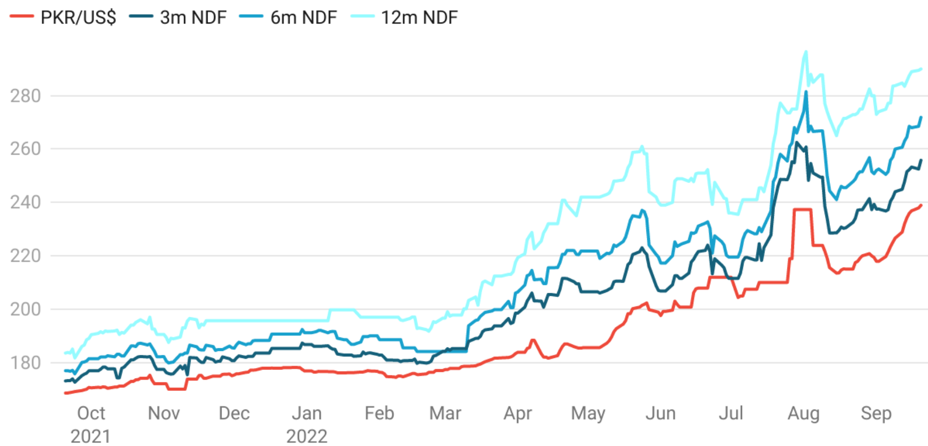


Chart: Patrick Curran • Source: Bloomberg, SBP, Tellimer Research • Created with Datawrapper

Tellimer

INTERMARKET SECURITIES LTD

Risk & Reward

The Investment Case for Pakistan

Raza Jafri, CFA
Head of Equities

Wajid Rizvi
Head of Research

Pakistan partners of:

Tellimer

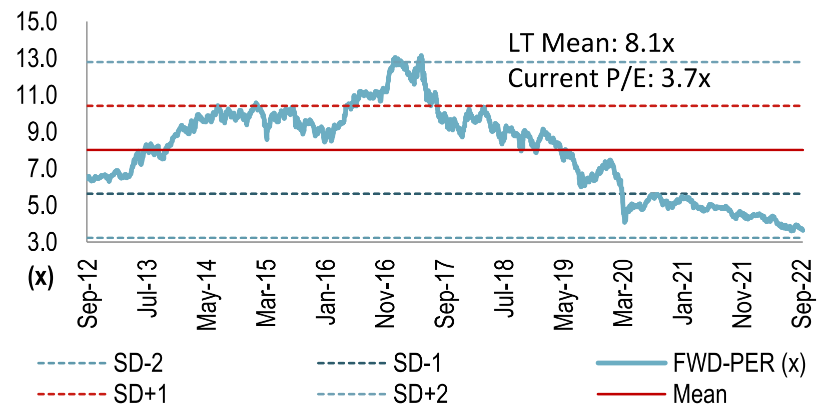
Valuations are ultra-cheap

Pakistan's P/E has usually been 6-12x. It is less than 4x now. Mean reversion = 100%+ upside

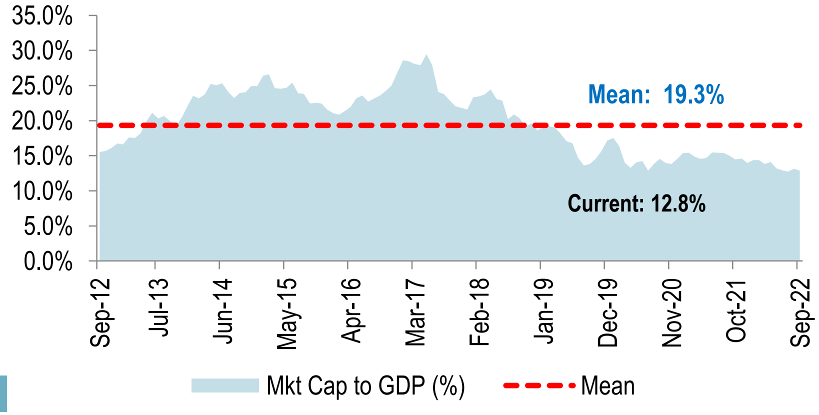
Mkt Cap to GDP is 1sd below mean. All-time high was 47% in 2007

Discount to peer markets is a wide 60%, double the historical discount

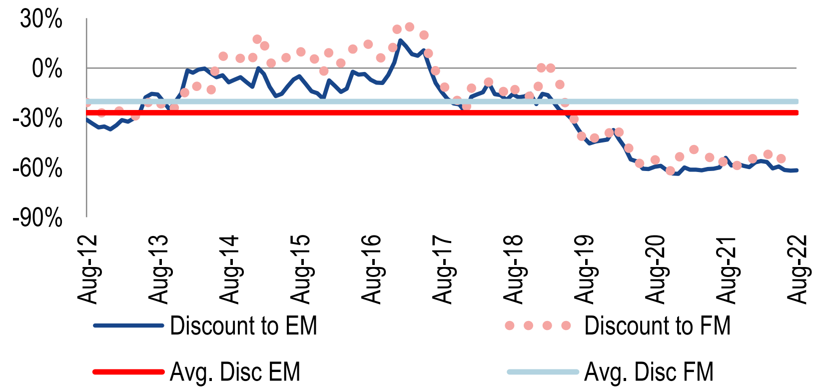
P/E is much below usual trough levels



Market Cap to GDP is near Covid & GFC lows



The cheapest we have seen Pakistan vs. peers



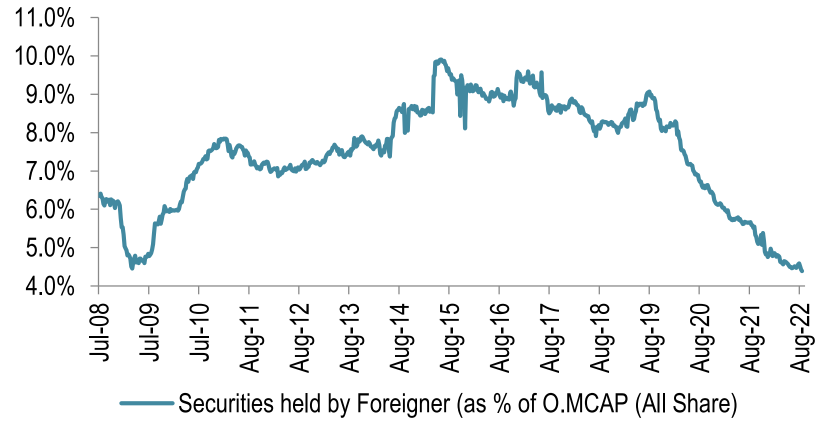
Rotation into fixed income appears complete

FIs now own less than 5% of the market. FI selling has slowed in 2022

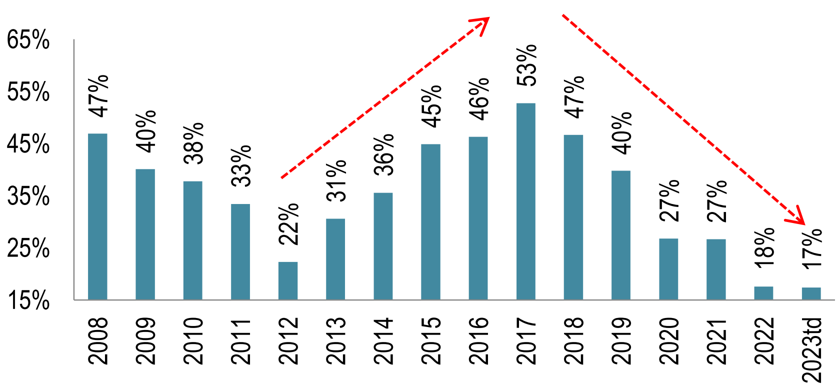
Local AUMs dedicated to equities are the lowest on record

Local Individuals have kept buying. State-owned entities can join if pushed

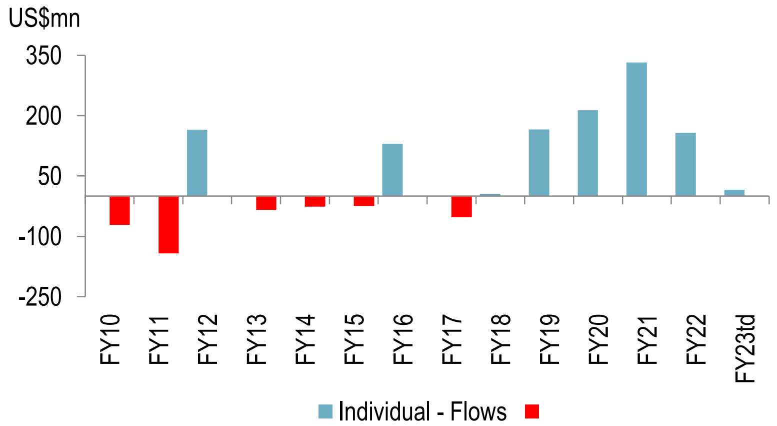
Foreign selling has slowed, and Foreign holdings are the lowest since GFC



Equity allocations for mutual funds at lows

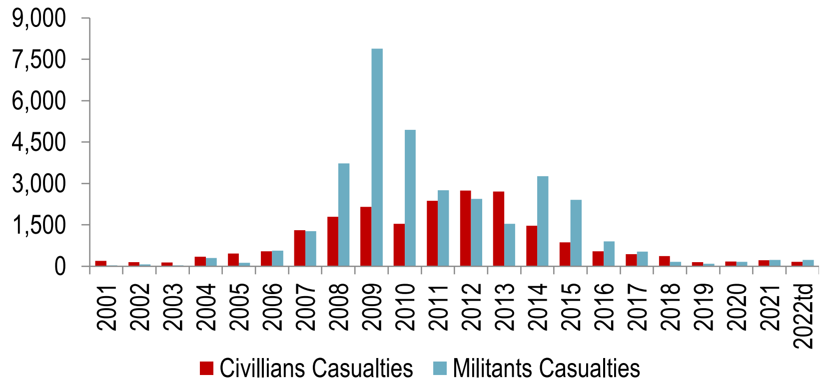


Local individuals have kept buying

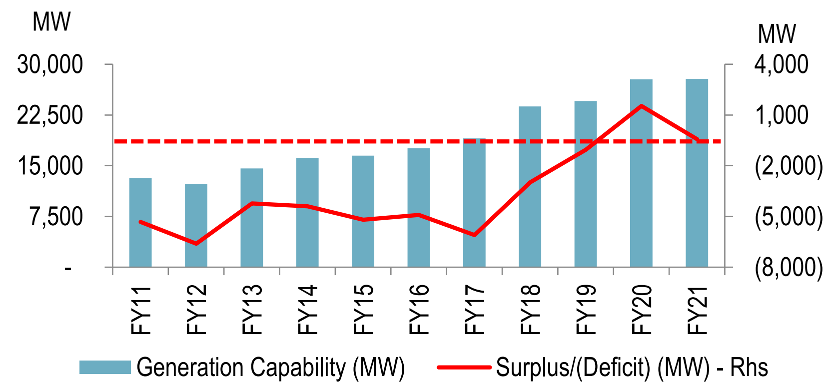


Pakistan has got some things right

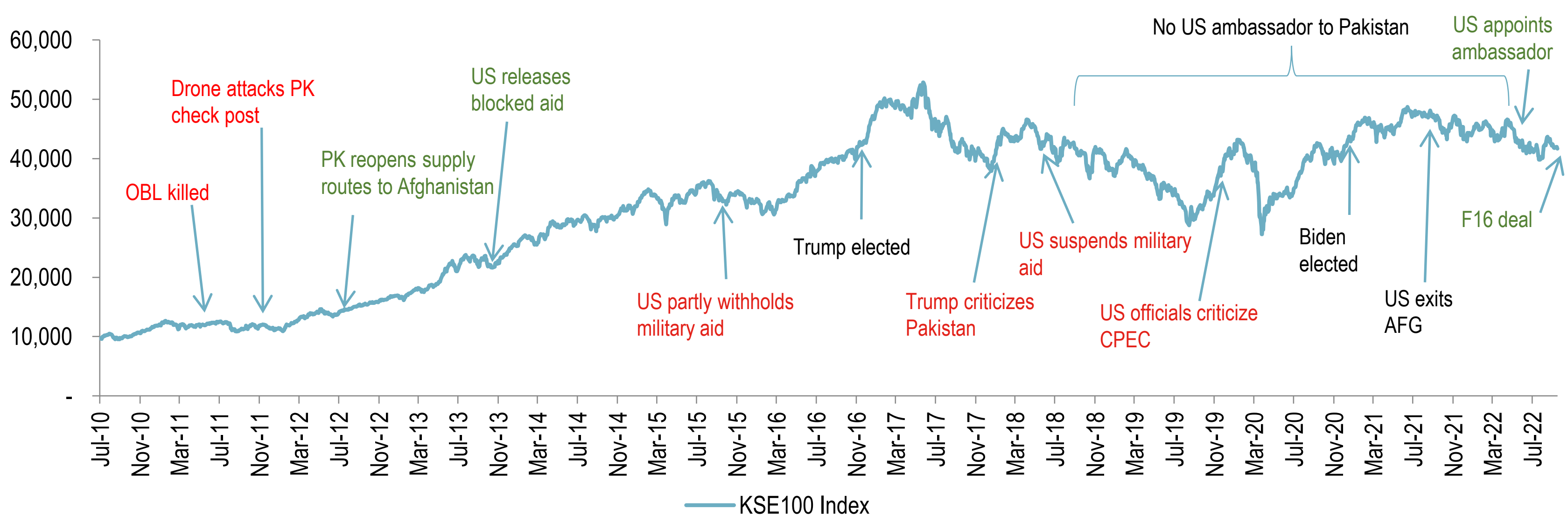
Significant improvement in security conditions



Blackouts have reduced

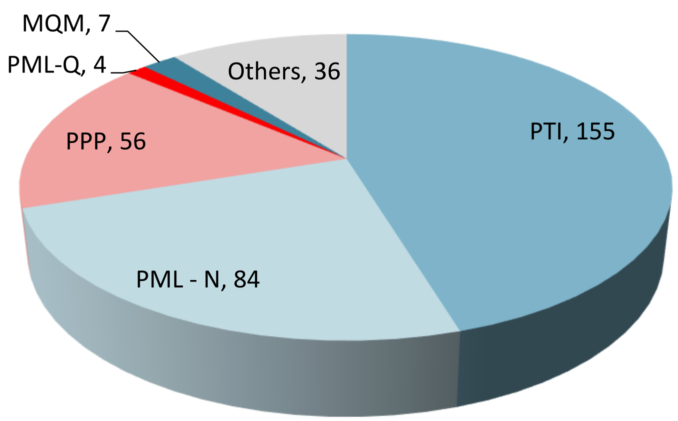


Improving relations with the US (gradually)

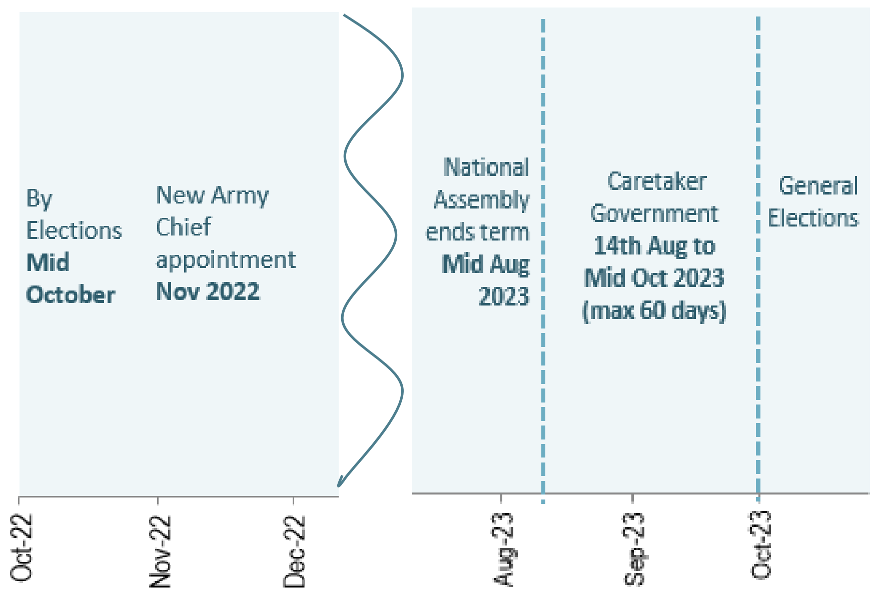


Politics is already priced in

National Assembly Composition (pre VONC)



Politics Timeline



Important political events, that will set the stage for the medium-term, will happen within the next 12 months. These include the appointment of the new Army Chief and General Elections.

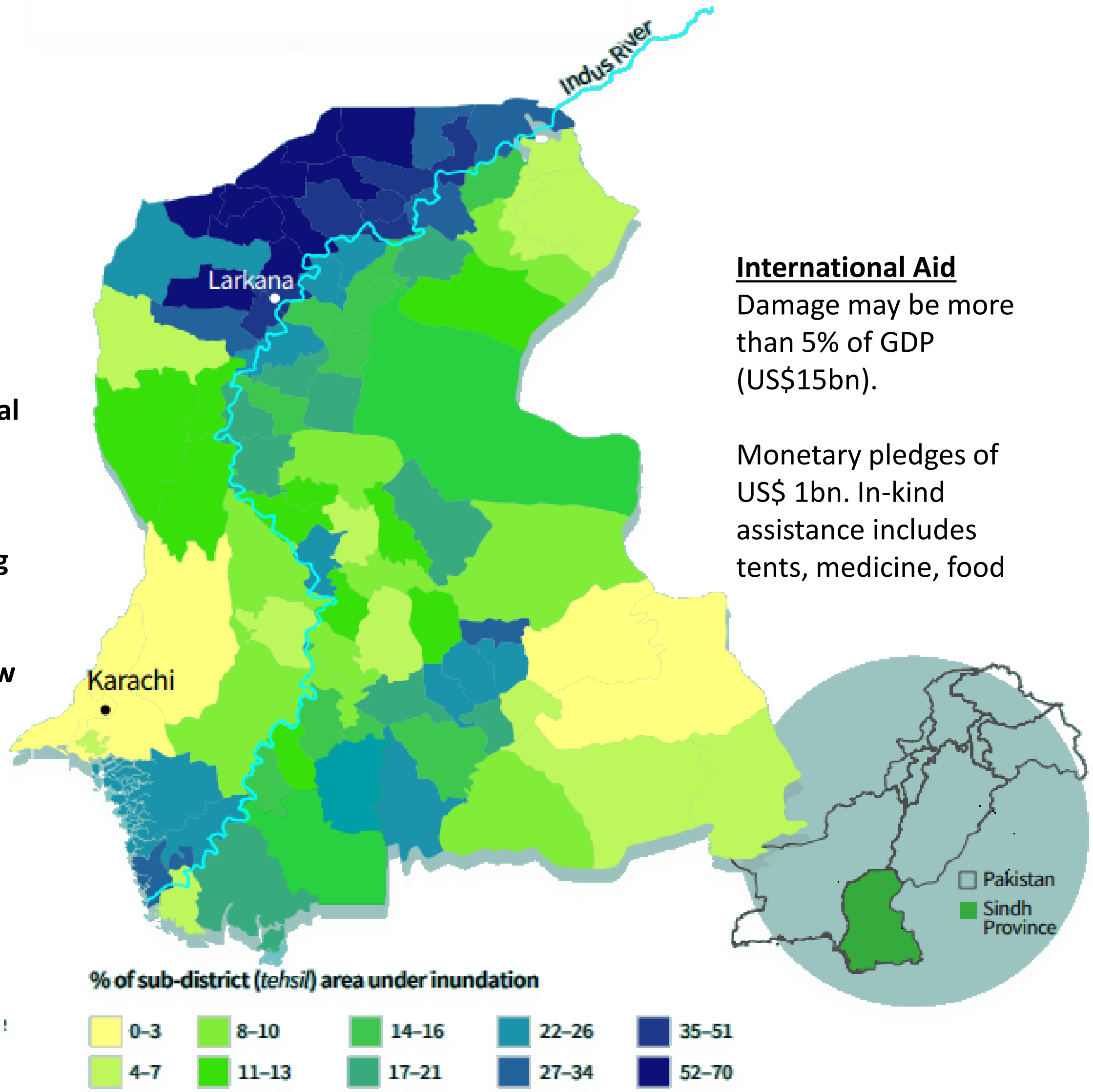
Within the next 1yr, Pakistan should have a government with a fresh 5yr mandate. There is a risk that the political environment remains as polarized as it is now, but it should not get worse.

FY22 Floods – A human tragedy

2022 monsoons bring 5x usual rain

30mn+ people displaced (c15% of total population)

More than 1,500 deaths. Disease is a big follow-on risk but trickle down impact may be limited to a few sectors only



International Aid
Damage may be more than 5% of GDP (US$15bn).

Monetary pledges of US$ 1bn. In-kind assistance includes tents, medicine, food

Agriculture
35% of cotton lost = US$1.5bn

Rice and Sugarcane are also affected.

1-2% of Livestock population lost.

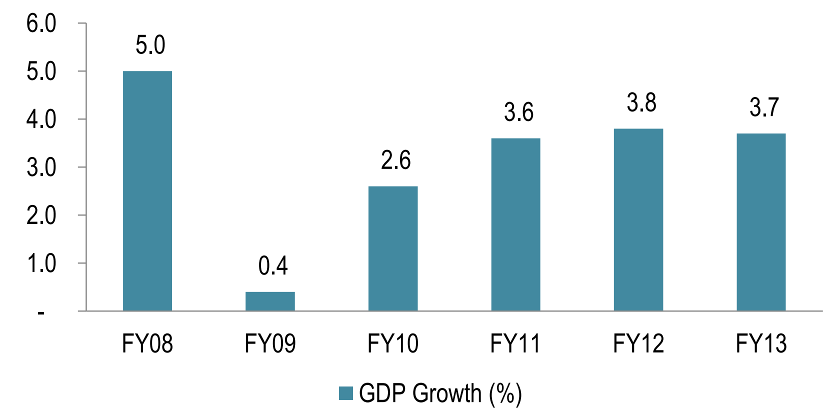
Infrastructure
2mn houses affected (5% of total)

3-5% of Roads and Bridges are affected

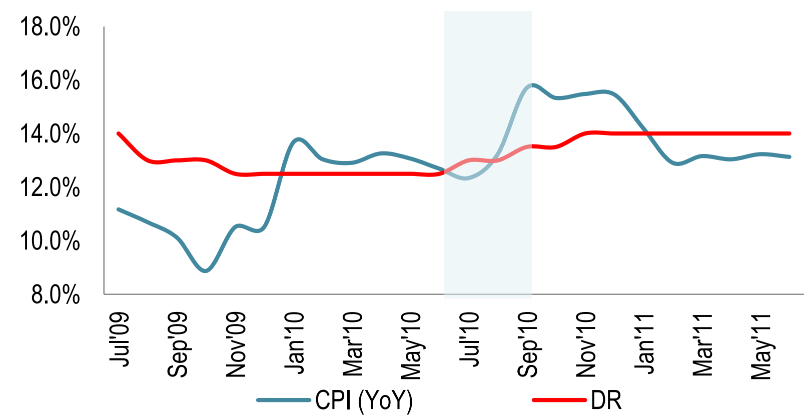
Source: servir.icimod.org

FY11 Floods – Modest impact but thinner buffers now

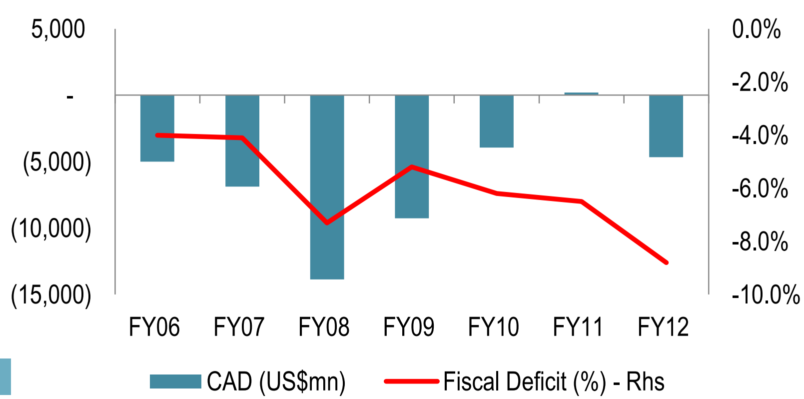
GDP Growth was better than in FY09/10



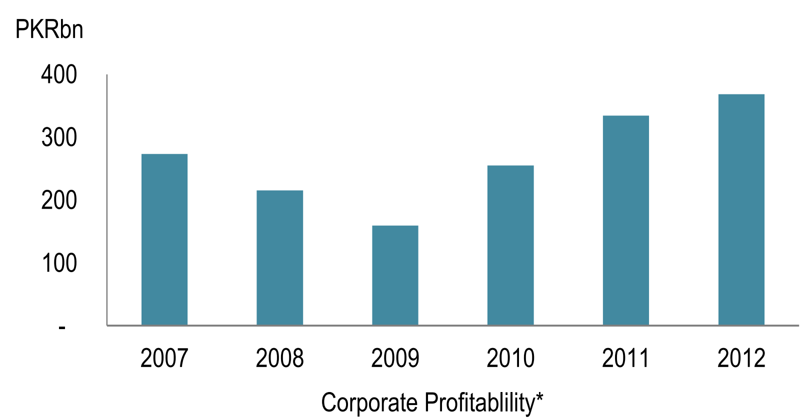
Inflation spiked leading the SBP to tighten



CA showed a rare surplus, but spending for rehabilitation widened the fiscal deficit



Corporate profitability remained unaffected

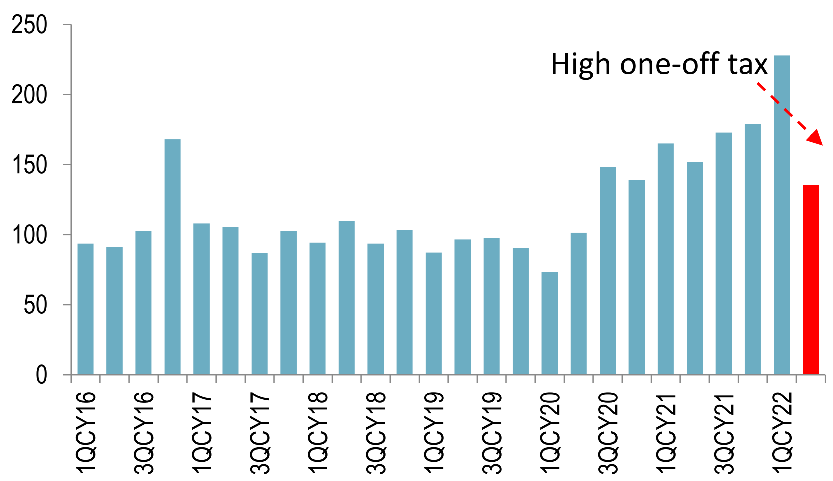


based on 463 companies

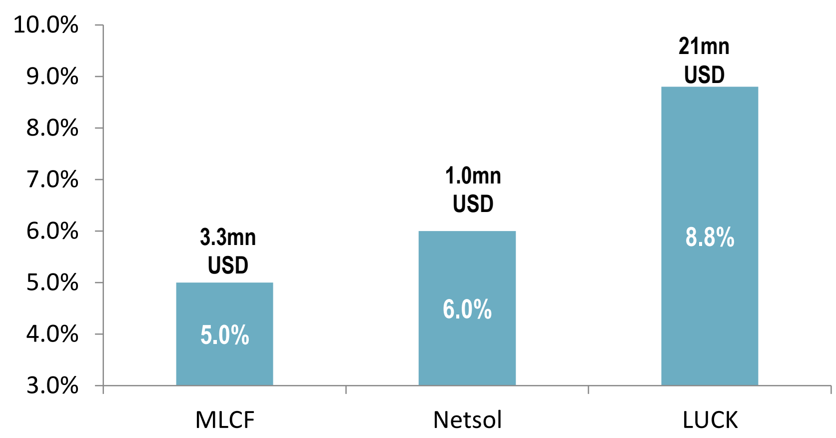
IMS Top Picks

Underlying corporate profits are intact

Corporate profitability trend



Share buybacks have commenced



The government imposed high tax on the corporate sector in the last quarter, to make up for the revenue shortfall

Repeat high taxation is a risk for 2023, due to floods, but medium-term profit trajectory should be unaffected

The last 10yr profit CAGR for the KSE100 is 15%pa

Companies have initiated formal share buybacks this year, a first for Pakistan.

This may morph into a trend, with many companies trading well below replacement cost

Themes we like

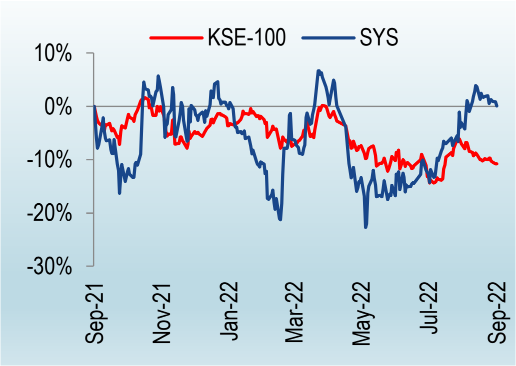
Push on Exports	Exports to GDP has reduced from 12% in FY02 to 8% in FY22. Expect export-friendly policies to continue, especially for IT (growth potential) and Textile (moves the needle)	**Systems** **Interloop**
Climate Change	2022 floods show Pakistan suffers greatly from climate change despite contributing less than 1% of global emissions Expect more focus on small dams and supportive policies for electric vehicles	**Lucky Cement** **Maple Leaf** **Indus Motors**
Economic Reforms	Pakistan is committed to economic reforms under the IMF programme This may lead to more sustainable economic growth compared to the short-lived cycles in the past	**United Bank Ltd**

Top Picks

Systems Ltd

SYS was incorporated in 1977 in Lahore. It is 34.33% owned by current employees and 17.13% by retired employees. Its major markets are US, Middle East, Europe and Pakistan.

Price Data	
Price (PKR/sh)	387.13
Target Price (PKR/sh)	660
Upside (%)	70.5
Fwd D/Y (%)	1.8
Total Return (%)	72.3
12m Hi-Low (PKR/sh)	412.8/299.0
6m ADTV - mn sh	409
6m AD Val - USDmn	0.74



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	15.44	24.45	34.03	42.50
EPS Growth (%)	99%	58%	39%	25%
PER (x)	25.1	15.8	11.4	9.1
PBV (x)	8.9	5.7	4.1	3.0
DPS (PKR)	2.5	5.0	7.0	8.5
DY (%)	1%	1%	2%	2%
ROE (%)	43%	44%	42%	38%

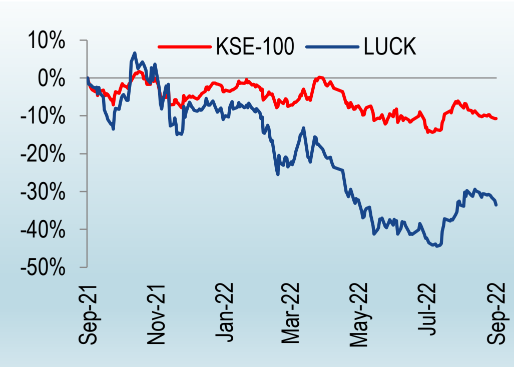
- SYS is one of the largest IT exporters in Pakistan (c.80% of revenue from exports). It provides long-term services with 90% of revenue recurring in nature.
- SYS today is much larger than just a year ago. It has expanded into Europe, the Middle East, Africa and the ASEAN region. It is also diversifying its business lines, going by the recent acquisition of NdcTech (Temenos partner).
- The company is expected to stay on its hyper-growth path. We project next 3yr revenue/profit CAGR at 48%/40%, which justifies premium valuations.

Risks: (i) Difficulty in finding quality HR and high employee turnover, (ii) slowdown in global digitization trends.

Lucky Cement Ltd

LUCK is the largest cement producer in Pakistan with capacity of 12.15mn tpa. It is present in the South and the North. LUCK has evolved into a conglomerate with exposure to the Chemical, Consumer, Auto and Power sectors.

Price Data	
Price (PKR/sh)	492.78
Target Price (PKR/sh)	898
Upside (%)	82.2
Fwd D/Y (%)	-
Total Return (%)	82.2
12m Hi-Low (PKR/sh)	790.3/411.9
6m ADTV - mn sh	571
6m AD Val - USDmn	1.37



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	70.69	91.22	136.24	137.36
EPS Growth (%)	273%	29%	49%	1%
PER (x)	10.3	7.4	3.6	3.6
PBV (x)	1.5	1.1	0.7	0.5
DPS (PKR)	-	-	-	-
DY (%)	0%	0%	0%	0%
ROE (%)	16%	17%	20%	16%

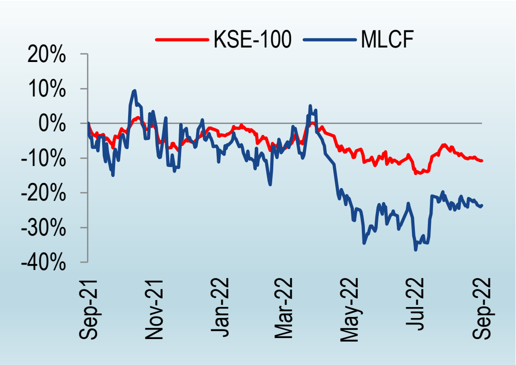
- LUCK is the most cost-efficient cement producer in the industry, largely due to WHR and in-house power generation. This makes LUCK the most profitable cement company in Pakistan.
- LUCK has delivered success in the great majority of its new ventures, including overseas cement exposure and, more recently, the chemical and automotive businesses. We expect LUCK to post 3yr Revenue/profit CAGR of 19%/21%.
- The one-shot exposure to Pakistan that LUCK offers is excellent. A lot of LUCKs businesses are at cyclical troughs and should do very well over the medium to longer term. This includes core cement operations, which should benefit from the potential push to build small dams to protect against flooding going forward.

Risks: (i) Circular debt issue for the power business, (ii) sticky coal prices, and (iii) slower-than-expected demand

Maple Leaf Cement Factory Ltd

MLCF is the fourth largest player in North with the total capacity of 5.7mn tons. This is the single largest cement unit operating in Pakistan. MLCF has announced new expansion which is expected to come online in 1QFY23.

Price Data	
Price (PKR/sh)	27.91
Target Price (PKR/sh)	47
Upside (%)	68.4
Fwd D/Y (%)	-
Total Return (%)	68.4
12m Hi-Low (PKR/sh)	40.0/23.2
6m ADTV - mn sh	4,390
6m AD Val - USDmn	0.66



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	3.57	5.37	3.34	5.12
EPS Growth (%)	-179%	51%	-38%	53%
PER (x)	7.8	5.2	8.4	5.5
PBV (x)	0.8	0.7	0.7	0.6
DPS (PKR)	-	-	-	-
DY (%)	0%	0%	0%	0%
ROE (%)	11%	15%	8%	11%

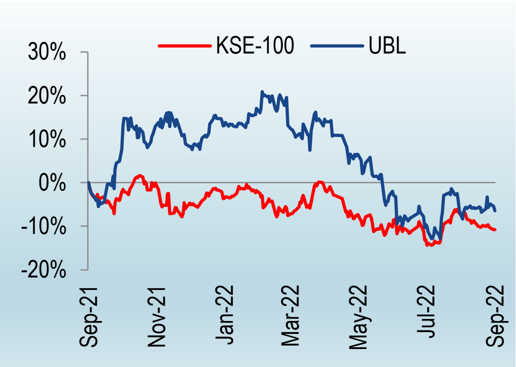
- MLCF is a pure cement play, benefitting from lower production cost compared to peers, as well as access to cheaper financing. As the construction cycle picks up going forward, including from flood-related reconstruction, MLCF should be a key beneficiary.
- MLCF has obtained both SBP TERF and LTFF facilities, availed during Covid. This has helped to finance more than 50% of the new expansion at subsidized rates. As a result, it is less exposed to the higher interest rates.
- About 80% of power requirement is met through its internal generation – which makes MLCF a lower-cost cement producer compared with producers which rely more on grid or FO.

Risks: (i) Prolonged slowdown in construction activity, (ii) pricing pressures in the industry

United Bank Ltd

UBL is the 3rd largest bank in Pakistan by deposits. Its business is concentrated in Pakistan but it has sizeable presence in the GCC also. The Bank is part of the Bestway Group.

Price Data	
Price (PKR/sh)	115.99
Target Price (PKR/sh)	160
Upside (%)	37.9
Fwd D/Y (%)	19.0
Total Return (%)	56.9
12m Hi-Low (PKR/sh)	149.8/108.0
6m ADTV - mn sh	955
6m AD Val - USDmn	0.60



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	24.84	25.45	37.99	38.74
EPS Growth (%)	45%	2%	49%	2%
PER (x)	4.7	4.6	3.1	3.0
PBV (x)	0.6	0.7	0.6	0.5
DPS (PKR)	18.0	19.0	22.0	22.0
DY (%)	16%	16%	19%	19%
ROE (%)	14%	14%	21%	19%

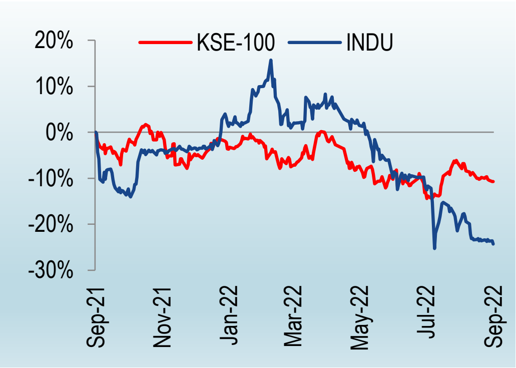
- Legacy asset quality issues in the GCC are over while domestic asset quality remains very strong. The overseas business is profitable for the first time since 2016.
- Assets are better positioned for the higher interest rate environment, which will push swift margin expansion in 2H22 and into 2023. Over the longer-term, UBL has significant room to improve cost efficiency, by reducing its branch network as its digital offerings gain traction.
- With CAR of more than 17%, UBLs capital buffer is the strongest in our coverage. This should help sustain a 60% cash payout ratio. On CY23f, this means a dividend yield of about 20%.

Risks: (i) Greater-than-expected NPLs, (ii) slowdown in fee income, (iii) failure to retain control over costs

Indus Motor Company Ltd

Indus Motors Limited is a JV between the House of Habib and Toyota Motor Corporation Japan for assembling, manufacturing and marketing of Toyota vehicles in Pakistan since July 1990.

Price Data	
Price (PKR/sh)	964.11
Target Price (PKR/sh)	1,339
Upside (%)	38.9
Fwd D/Y (%)	8.4
Total Return (%)	47.3
12m Hi-Low (PKR/sh)	1,473.9/951.4
6m ADTV - mn sh	27
6m AD Val - USDmn	0.15



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	163.21	201.04	174.32	206.20
EPS Growth (%)	152%	23%	-13%	18%
PER (x)	5.9	4.8	5.5	4.7
PBV (x)	1.6	1.4	1.2	1.1
DPS (PKR)	103.5	93.8	81.0	103.0
DY (%)	11%	10%	8%	11%
ROE (%)	29%	31%	23%	24%

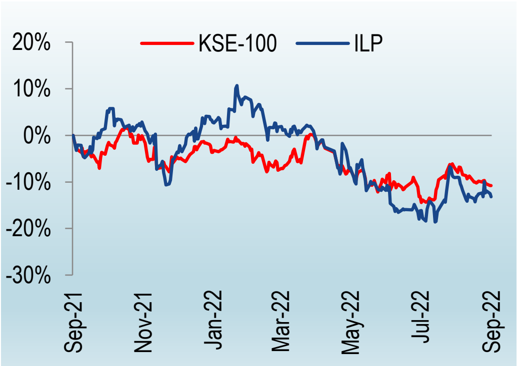
- The auto sector is in a cyclical downturn, with higher interest rates affecting auto finance and the PKR weakness eating into margins. Floods will hurt agriculture income this year – INDU derives c 60% of its sales from rural areas.
- Through the cycle however, INDU has the potential to deliver stellar returns. It is the only auto company that will assemble hybrid electric vehicles. Given the higher fuel prices with the government not giving subsidies anymore, the HEV segment may benefit from a strong demand shift.
- INDU has very strong brand loyalty which grants it better pricing power compared to peers. It also offers strong cash payouts. Sharp stock price correction has opened up valuations to attractive levels.

Risks: (i) Significant PKR depreciation, (ii) higher-for-longer interest rates, (iii) prolonged reduction in purchasing power

Interloop Ltd

Interloop is one of the largest hosiery manufacturers in the world, with a global market share of 3-4%. ILP operates in the hosiery, spinning, denim and apparels segments, with the capacity to produce c.700mn pairs of socks p.a. In FY22, ILP was one of the largest exporters in Pakistan with exports of c.US$400mn

Price Data	
Price (PKR/sh)	63.00
Target Price (PKR/sh)	95
Upside (%)	50.8
Fwd D/Y (%)	6.3
Total Return (%)	57.1
12m Hi-Low (PKR/sh)	80.3/59.1
6m ADTV - mn sh	322
6m AD Val - USDmn	0.10



Key Ratios	2021	2022	2023f	2024f
EPS (PKR)	7.00	13.76	10.38	11.24
EPS Growth (%)	250%	96%	-25%	8%
PER (x)	9.0	4.6	6.1	5.6
PBV (x)	2.8	2.1	1.7	1.4
DPS (PKR)	2.4	4.3	4.0	4.0
DY (%)	4%	7%	6%	6%
ROE (%)	33%	52%	31%	28%

- Imported cotton, to make up for the crops lost during the floods, may eat into textile sector margins in the near-term, but ILP is relatively shielded due to its cotton inventory. Global demand is also expected to soften, but ILP has an orders backlog into the next year.
- ILP has excellent hosiery operations (socks) and has announced a series of expansions slated until FY26 with a total outlay of c.US$300mn. This will entail capacity enhancements in all segments, while adding new product lines in Apparel & Active wear segments and a new Hosiery plant.
- Forward P/E stands at 6.1x, but this contracts sharply to 3.9x when majority of expansion projects come online. ILP is a best-in-class textile name, with good disclosures and corporate governance.

Risks: (i) Higher energy prices, (ii) discontinuation of GSP+ status, and (iii) prolonged global demand slowdown.

Disclosures

This document has been prepared for information purposes only. The information presented herein does not comprise a prospectus of securities for the purposes of EU Directive 2003/71/EC. Any decision to purchase securities in any proposed offering should be made solely on the basis of the information to be contained in the final prospectus published in relation to such offering. This document does not form a fiduciary relationship or constitute advice and is not and should not be construed as an offer, or a solicitation of an offer, or an invitation or inducement to engage in investment activity and cannot be relied upon as a representation that any particular transaction necessarily could have been or can be effected at the stated price.

The information and opinions contained in this document have been derived from sources believed to be reliable and in good faith or constitute Tellimer's judgment as at the date of this document but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness and any opinions are subject to change and may be superseded without notice.

Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by Tellimer with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this document relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this document may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

This document has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This document is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this document. You should always exercise independent judgment in relation to the securities mentioned herein. Neither Tellimer nor any of its members, directors, or employees shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this document or lack of care in this report's preparation or publication, or any losses or damages (whether direct or indirect) which may arise from the use of this document.

Tellimer and/or its members, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Tellimer may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups of Tellimer.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this document may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States. The value of any investment or income from any securities or related financial instruments discussed in this document denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Frontier and Emerging Market laws and regulations governing investments in securities markets may not be sufficiently developed or may be subject to inconsistent or arbitrary interpretation or application. Frontier and Emerging Market securities are often not issued in physical form and registration of ownership may not be subject to a centralised system. Registration of ownership of certain types of securities may not be subject to standardised procedures and may even be effected on an ad hoc basis. The value of investments in Frontier and Emerging Market securities may also be affected by fluctuations in available currency rates and exchange control regulations.

Not all of these or other risks associated with the relevant company, market or instrument which are the subject matter of the document are necessarily considered.

Disclaimer

We, IMS Research Team, certify that the views expressed in the report reflect our personal views about the subject securities. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations made in this report. We further certify that we do not have any beneficial holding of the specific securities that we have recommendations on in this report.

Ratings Guide*	Criteria
Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
Neutral	Total return expectation of > -5% or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Developing markets, connected.

tellimer.com