Alfalah CLSA

Pakistan Strategy 2024

Bull is here to stay

Economic recovery through structural reform

Annual Strategy

December 2023

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PPL - BUY 23
MARI - BUY 24
BAHL - BUY 25
MEBL - BUY 26
HMB- BUY 27
PSO – BUY 28
LUCK – BUY 29
FCCL - BUY 30
EFERT - BUY 31
ILP – BUY 32

Economic recovery through structural reform

IMF led structural reforms along with easing external pressures will unlock true valuations of Pakistan's equity market. 2022 and major part of 2023 was marred by structural risks, both political and economic, necessitating significantly higher risk premiums to Pakistan in general and equities in particular. However, muted political noise along with wide breadth economic reforms both on macro and micro levels have uplifted Pakistan's outlook. Inflation is expected to remain contained at 25.3%/14.8% in FY24/FY25. Moreover, 2ppts real interest rates are likely to contain spending and growth. PKR depreciation is expected to normalize at 8-9% per annum. Even after 57.9% market rally FY24TD, Pakistan is still trading at a PER of 3.2x which is expected to gradually unwind to our target PER of 4.28x by Dec'24. The unwinding will be more profound when the upcoming elected government will re-affirm the continuity of reform process – Pakistan is a must 'BUY'.

Monetary tightening has ended, all eyes on first rate cut

Record PKR depreciation and commodity super cycle is behind us. Balanced current account and prospective refinancing of maturing loans, will alleviate stress from PKR which is expected to depreciate at a normalized 8-9% p.a. hereon. Inflation is expected to decelerate swiftly, with Nov'24 inflation expected to hit a low of 14%. Therefore, the period of all time high interest rates is soon to be over, where we expect the first rate cut of 100bps in Mar'24 followed by consistent easing till 17% in Oct'24.

Export and remittances led growth

Pakistan's pivot from debt led growth to sustainable growth is expected to take some time to recalibrate. Spending growth is expected to pick up gradually as exports and remittances recover. We see major upside emanating from agriculture as crop yields improve substantially in the 3 years following a major flood (in 2022). Corporates moving towards efficiency to capitalize restricted imports and major export potential in newly opened central Asian markets may revive LSM growth. We see GDP growth to pace up by 2.6%/3.5% in FY24/FY25.

Politics to remain muted; we see elections in Feb-24 in our base case

Since the takeover of the interim government, political chaos has largely subsided with calmness across all parties. Though the noise may emerge as elections approach, we believe they will be limited on a constituency level. Restricted media coverage of any agitating elements is also helping keep the chaos at bay. Though PTI still leads in popularity amongst majority polls, however with the resignation of Imran khan from party chairmanship and lack of electable candidates in play, PML-M seems to be the strongest contender to form government in the upcoming elections.

Delay in elections only possible with IMF nod

Talks of further delay in elections are dim but do exist. Pakistan needs a long-term IMF program after the conclusion of the current SBA which coincides with the end of the interim government's tenure. Therefore, any new IMF program will probably be negotiated with the elected setup to ensure buy-in of the parties involved in implementing IMF mandated benchmarks.

Buy all dips!

At PE of 3.2x, KSE100 is trading at a historic discount of 68/79% to MSCI-FM/MSCI-AP. On an absolute basis, market is trading at 64% discount to its 10yr mean PE of 9.2x. That said, the first leg of value discovery has ended in our view, where we see the market to unlock its true potential from Mar'24 onwards after negotiation of a new IMF program by the elected government. This will also coincide with the beginning of monetary easing cycle. We recommend i) Energy chain - unwinding cash flows due to restricted circular debt, ii) Mid-tier high growth Banks with potential to increase payouts iii) Cement sector - high margins and immense potential for growth and iv) Fertilizers – Sustainable yields far outpacing even current interest rates. Buy **PPL, MARI, BAHL, MEBL, HMB, PSO, LUCK, FCCL, EFERT and ILP.**

Economy: Cycle is shifting in favour

Declining international commodity prices, decelerating inflation, balanced external account and a relatively stable currency will uplift economic output in 2024. Inflation and interest rates have peaked with easing cycle expected to begin in Mar'24. Seamless external repayments/ rollovers have significantly reduced the default risk of the country.

Figure 1

Key economic forecasts

	2022	2023	2024E	2025E
PKR/USD year End (CY)	204.85	285.9	319.1	346.6
Inflation average (FY)	12.1%	29.1%	25.3%	14.8%
Inflation average (CY)	19.7%	30.9%	18.7%	14.0%
Inflation end (CY)	24.5%	30.1%	14.3%	13.1%
Policy Rate year-end (CY)	16.0%	22.0%	17.0%	15.0%
Real GDP growth rate (FY)	6.1%	-0.2%	2.6%	3.50%

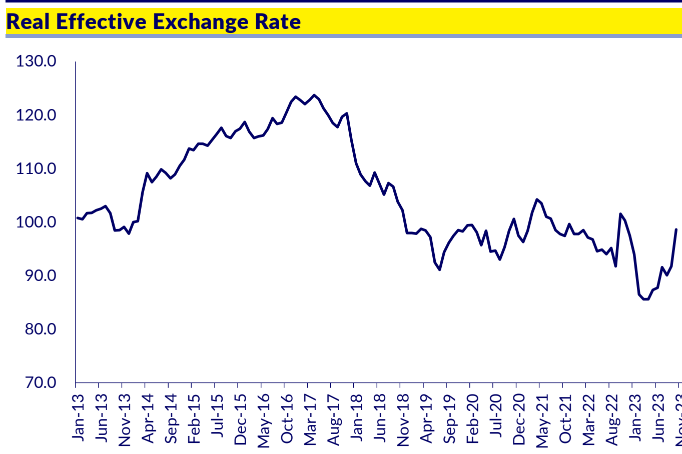
Source: Alfalah CLSA Research

Massive currency devaluation over

The backlog of currency pressure cleared in the past 2 years, we expect currency to now run its normal course and depreciate at the rate of 8-9% per annum. REER is currently trading at 98.6. Current account deficit, a key pressure on currency, has declined 64%YoY to USD1.2bn in 5MFY24. SBP reserves stand at USD7.0bn as of 8th Dec-2023 (import cover of 1.50 months).

Figure 2

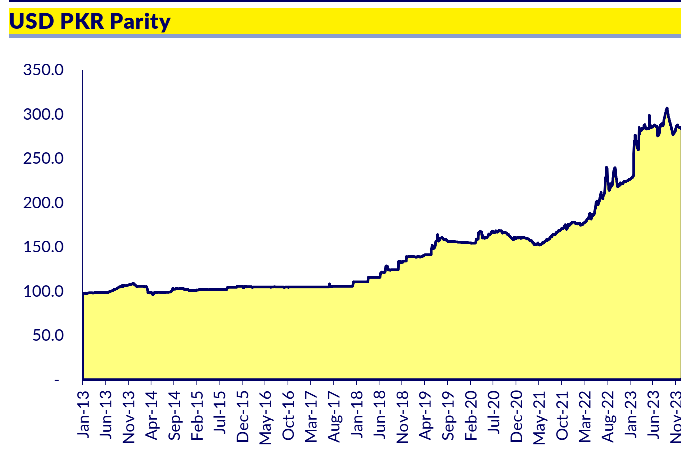
Real Effective Exchange Rate



Source: SBP, Alfalah CLSA Research

Figure 3

USD PKR Parity



Source: SBP, Alfalah CLSA Research

Current account to remain largely balanced

Pakistan's burgeoning current account deficit has remained a key concern for the past 7 years given currency controls and massive fiscal spending. We expect the current account deficit to be limited in the range of USD2.5-4bn, as exports are rising due to reforms and imports are weak due to demand destruction following significant inflation burden in the last 2 years. Remittances have recently started picking pace since PKR stabilized and crackdown on illegal flows was initiated. BOP position however will remain tough for the upcoming 2 years, though manageable, especially given a successful experiment in putting administrative measures on imports to control current account whenever needed to fund the BOP.

Figure 4

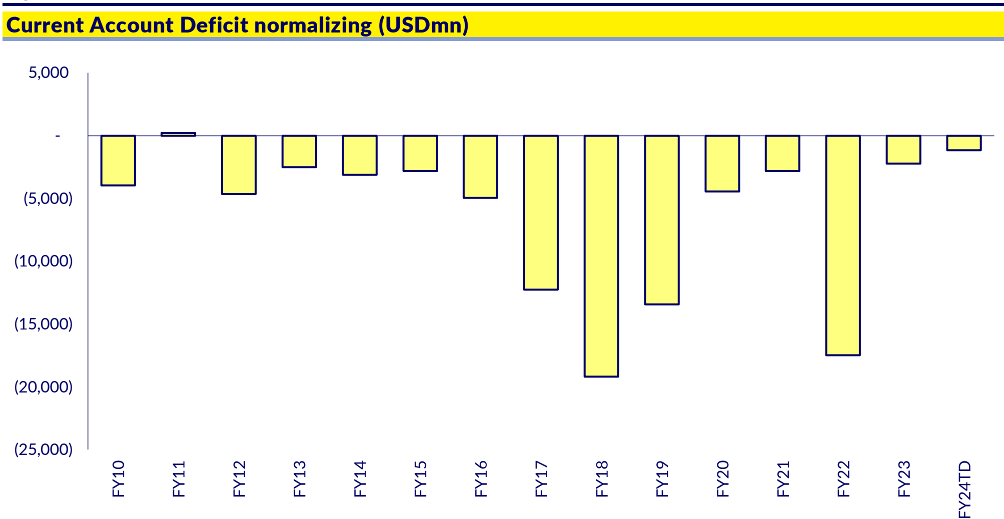
Pakistan Current Account (USDbn)

	FY22	FY23	FY24E	FY25E
Imports	84.5	60.4	57.8	61.3
Exports	39.6	35.5	29.5	31.0
Trade deficit	-39.1	-24.0	-28.3	-30.3
Services deficit	-5.8	-1.0	-3.2	-3.4
Remittances	31.3	27.3	28.5	29.9
Current Account	-17.5	-2.2	-3.0	-3.8

Source: SBP, Alfalah CLSA Research

Figure 5

Current Account Deficit normalizing (USDmn)



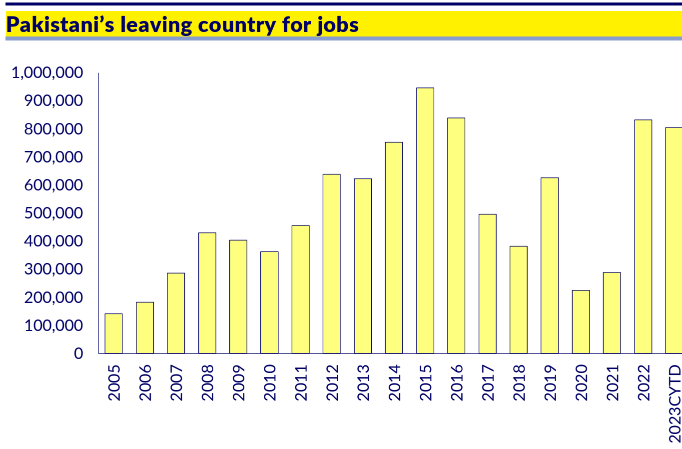
Source: SBP, Alfalah CLSA Research

Remittances to be a life saver

Worker remittances have started improving lately as confidence increased after PKR was devalued and curbs on informal channels were strengthened. Worker remittances in Nov 2023 were recorded at US$2.25mn (+4% YoY). However, 5MFY24 remittances are still 10% below the number recorded in the same period last year. The Middle East remained the largest outbound destination for overseas employment.

Figure 6

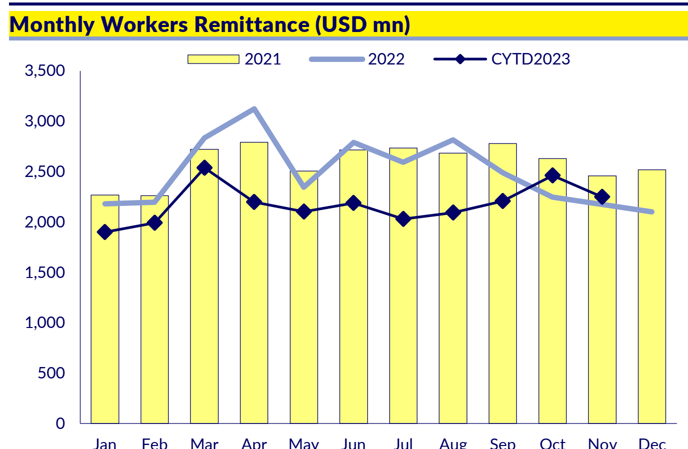
Pakistani's leaving country for jobs



Source: GoP, Alfalah CLSA Research

Figure 7

Monthly Workers Remittance (USD mn)



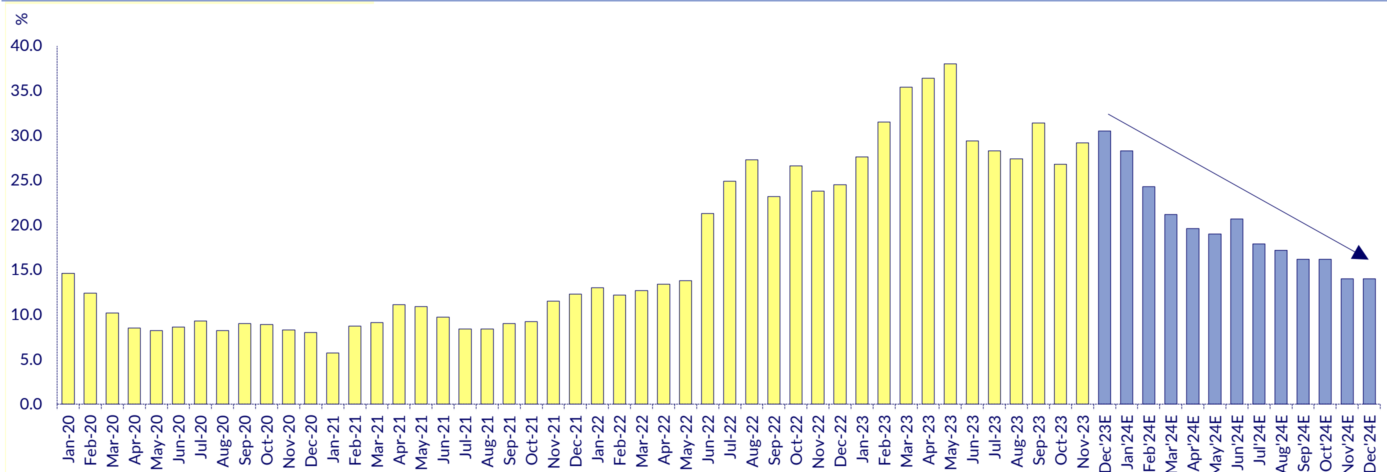
Source: SBP, Alfalah CLSA Research

Inflation has peaked!

Commodity super cycle in FY22 followed by rampant currency depreciation in 2023 kept inflation high, marking a peak of 38%YoY in May 2023. Going forward, inflation is expected to continue its downward trajectory, especially in the second half of the current fiscal year. We expect Jan-Dec 2024 average inflation to settle at 18.6%, with the lowest reading expected of 14% in Nov 2024. While acknowledging the upside risks to inflation targets due to rise in local gas tariffs and sustained food inflation; declining international commodity prices and limited PKR depreciation will provide support in bringing inflation down to our target.

Figure 8

CPI (base year 2015-16)

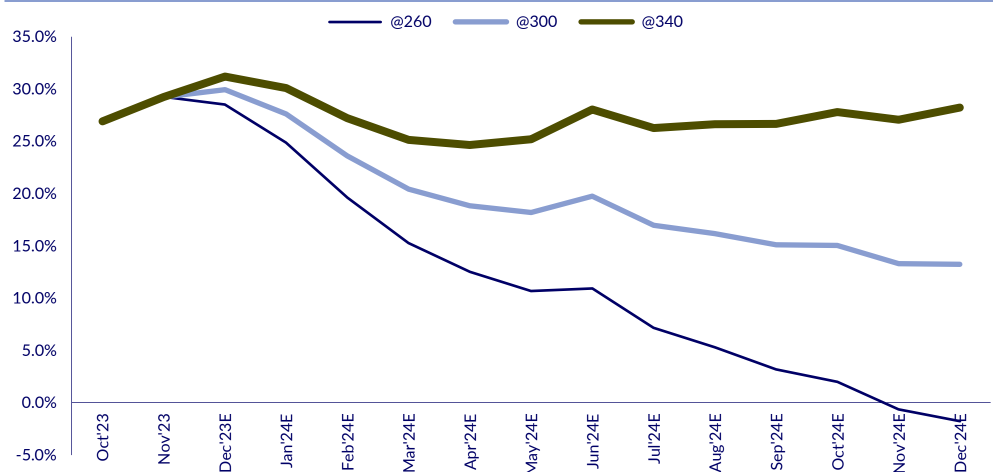


Source: PBS, Alfalah CLSA Research

Inflation is highly sensitive to USD/PKR parity and a risk to our estimates

Figure 9

Inflation Sensitivity to USD/PKR Parity



Source: SBP, Alfalah CLSA Research

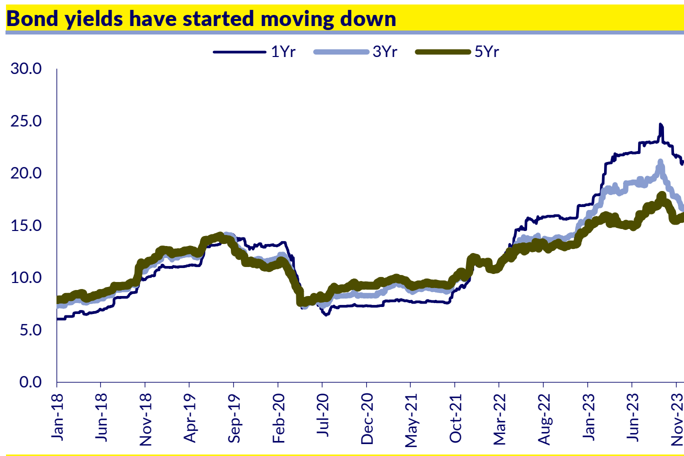
Interest rate easing cycle to begin in CY24

After touching highest ever interest rates in Pakistan, the intended objectives to cool down demand and control the current account deficit were achieved. In response to tapering inflation, we expect the State Bank of Pakistan (SBP) to initiate its first rate cut in the beginning of CY24, then onwards, the real rates will be in a substantially positive territory. We expect policy rate to fall to 20% by FY24-end.

Bond markets are clearly reflecting broad based rate cut expectation in the upcoming year, with short term bills trading below policy rate after 3 years.

Figure 10

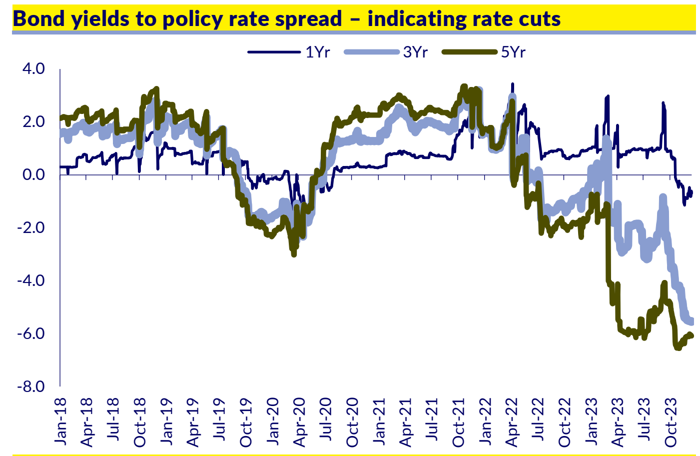
Bond yields have started moving down



Source: Mufap, Alfalah CLSA Research

Figure 11

Bond yields to policy rate spread – indicating rate cuts



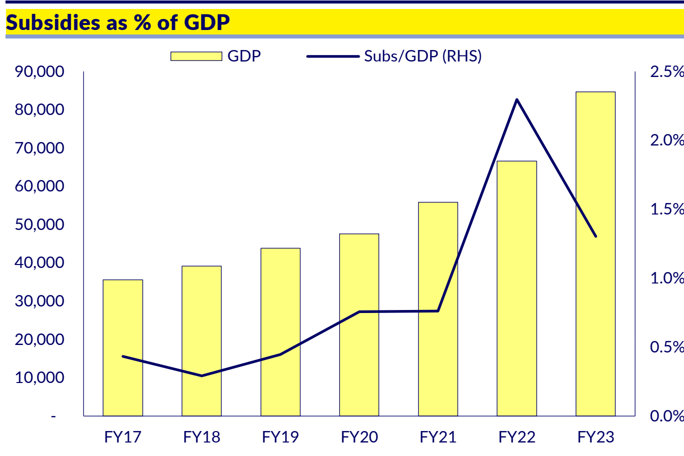
Source: SBP, Mufap, Alfalah CLSA Research

Fiscal consolidation to continue

IMF has mandated Pakistan to increase revenues and reduce subsidies & discretionary spending to bring primary surplus to 0.4% of GDP in FY24. Pakistan is on track to achieve the IMF mandated target, with 1Q primary budget surplus clocking in at 0.4% of GDP. Taxing the untaxed is the theme for future, wherein the FBR (revenue collection authority) has unveiled an ambitious plan to the IMF to bring 1.5mn (35% growth) new taxpayers into the net by FY24 end. In addition, it has been proposed to bring Agriculture and Retailers under the tax net which contribute ~42% to the GDP.

Figure 12

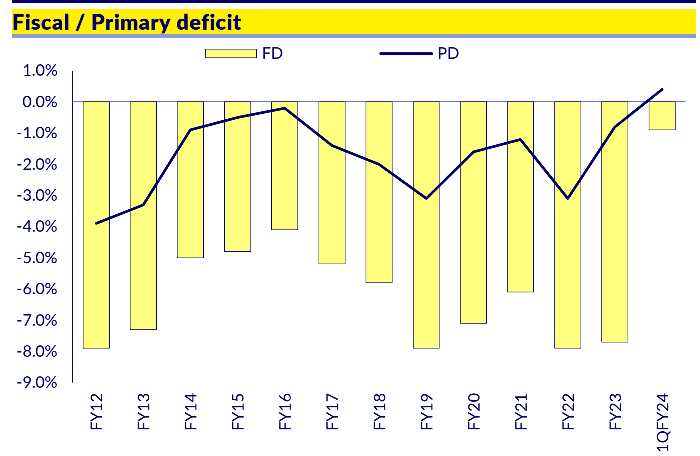
Subsidies as % of GDP



Source: Economic Survey, MoF, Alfalah CLSA Research

Figure 13

Fiscal / Primary deficit



Source: Economic Survey, MoF, Alfalah CLSA Research

Figure 14

Reform snapshot

What has been done	Yet to be done
Power tariff increased to reduce subsidy	Bring 1.5mn new taxpayers into the net by FY24 end
Anti power theft campaign launched	Tax Agriculture and Retailers contributing ~42% to GDP
Increase in gas prices to stop all flow of circular debt	Privatize loss making SOEs
Free float currency	Respond resolutely if near-term price pressures reemerge
Subsidies reduction in a gradual manner	Address undercapitalized financial institutions
Crackdown on grey market to curb smuggling and outflow of dollars	Timely disbursement of committed external support
Repatriation of illegal foreign residents	Increase SBP FX reserves to USD10.4bn by FY24-end
Surpassed tax collection and primary budget surplus targets	Maintain power circular debt stock at FY23-end levels

Source: IMF, Alfalah CLSA Research

Bottom up and top down; Both strategies in play

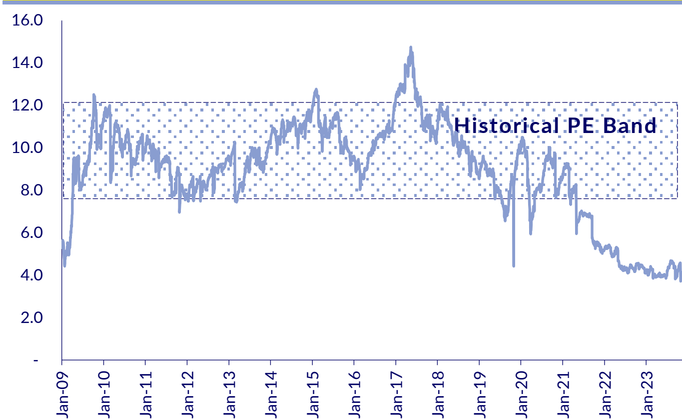
Strategy

BUY ALL DIPS!

Equities have started pricing in the optimism surrounding Pakistan's economic revival based on structural reform and tapering inflation. KSE-100 has touched new highs, with index posting a phenomenal return of 57.9% FY24YTD. However, the market is still trading at a forward multiple of 3.2x, a significant discount of 64% to its 10yr mean multiples of 9.2x. As monetary easing begins, we expect the market to re-rate at a much quicker pace. We recommend i) Energy chain - unwinding cash flows due to restricted circular debt flow, ii) Mid-tier high growth Banks with potential to increase payouts, iii) Cement sector - high margins and immense potential for growth and iv) Fertilizers – Sustainable yields far outpacing even current interest rates. **PPL, MARI, BAHL, MEBL, HMB, PSO, LUCK, FCCL, EFERT and ILP- 'BUY'.**

Figure 15

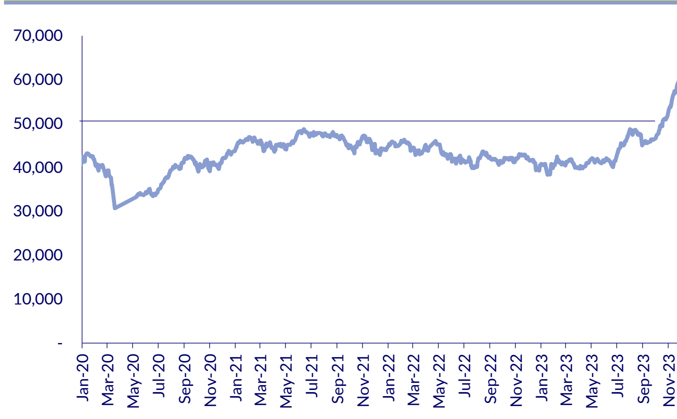
Pakistan historical PER trend



Source: Bloomberg, Alfalah CLSA Research

Figure 16

Kse-100 touching new highs

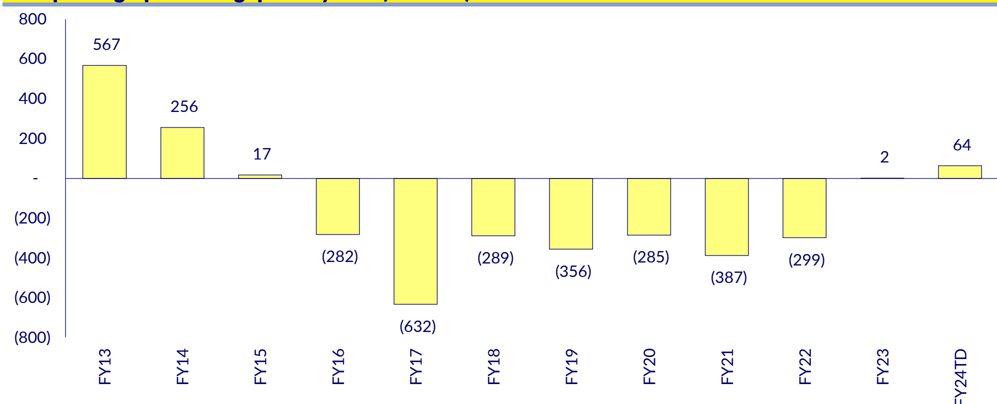


Source: PSX, Alfalah CLSA Research

Foreign buying witnessed after a long time: The ongoing unprecedented market rally is still just the beginning of a cyclical recovery Pakistan has now entered. In our opinion, equities so far have just shrugged the excess risk premium assigned due to volatile political climate and default risk in the past two years. Therefore, the real re-rating is yet to occur amid massive earnings growth of companies despite moderate growth and difficult economic landscape. Therefore, foreigners were net buyers of USD63.6mn in FY24TD.

Figure 17

FIPI picking up after a gap of 8 years (USDmn)



Source: SBP, Alfalah CLSA Research

Corporate focus shifting to efficiency to boost exports: A paradigm shift is being witnessed, though in its nascent stage at the moment, where corporations are working to improve cost efficiencies rather than just carrying rent seeking expansions. This is in response to eroding subsidies and dull demand in Pakistan, compelling corporates to explore export market for growth. Legacy export sectors are also witnessing capital re-allocation towards high value added (garment) products from traditional low margin energy intensive yarn spinning.

Index Target	
TP mapping	94,109
Earnings and DY yield	86,552
Index Target	**90,330**

Source: Alfalah CLSA Research

Index Target at 90,330

We believe the market has now entered a multi-year bull run with economic, political and sustainability risks reducing at a swift pace. For 2024, we expect KSE-100 to stay on a consistent bullish trend with majority of the return for the year unlocking with Pakistan's entry into a long-term IMF plan possibly coinciding with the beginning of the interest rate easing cycle. We target the KSE-100 index at 90,330 points for Dec'24, offering a return of 38% inclusive of 12.6% dividend yield.

Figure 18

Justified PER	
Growth	2.60%
Rf (a)	17.00%
Risk Premium (b)	7.00%
Ke (a+b)	24.00%
Justified PER (x)	**4.28**
Trailing PER (x)	3.65
Re-rating	17.20%

Source: Alfalah CLSA Research

Figure 19

Earnings and DY yield	
Earnings growth	14.00%
Dividend yield	12.60%
Re-rating	17.20%
Total return	**43.80%**

Source: Alfalah CLSA Research

Our index target is a factor of 14%YoY earnings growth, 12.6% dividend yields and re-rating of the market by 17.2% to 4.28x. The re-rating originates from 500bps reduction in benchmark interest rates. Earnings growth is expected to be led by OMCs, Fertilizers and Cements, which are expected to grow by ~79/37/34% respectively.

Figure 20

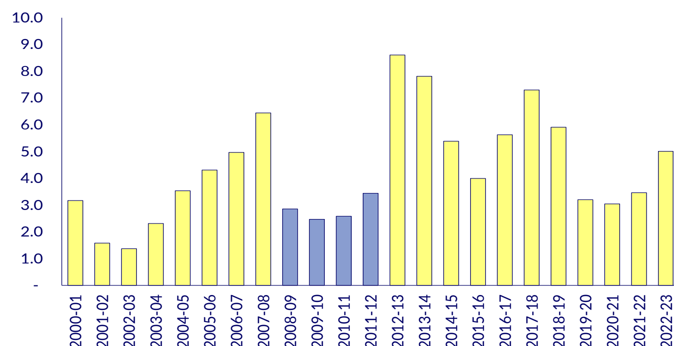
Earnings growth Break-up CY24	
OMCs	79%
Fertilizer	37%
Cements	34%
Banks	13%
E&P	0%
AFS Universe	14%

Source: Alfalah CLSA Research

A fresh perspective to market valuation

Figure 21

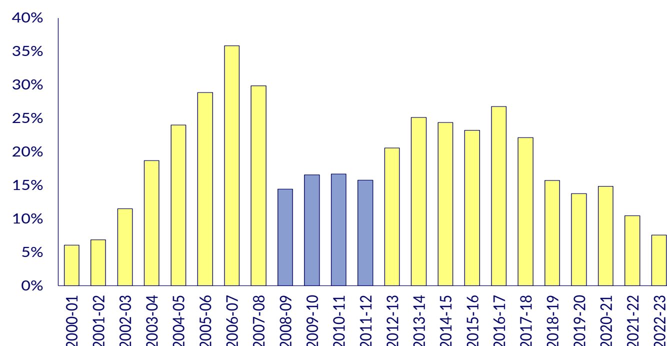
FX Reserves to MCAP (x)



Source: SBP, PSX, Alfalah CLSA Research

Figure 22

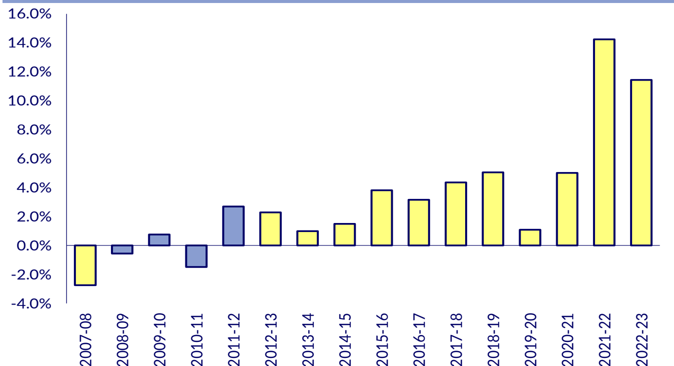
MCAP to GDP (%)



Source: PSX, SBP, Alfalah CLSA Research

Figure 23

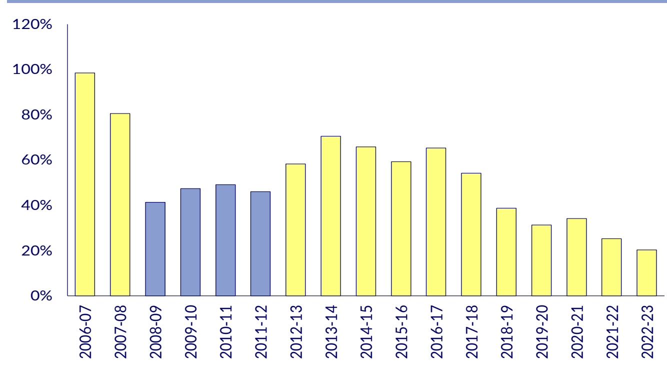
Earnings yield spread to 1yr KIBOR (%)



Source: SBP, Alfalah CLSA Research

Figure 24

MCAP to M2 (%)



Source: SBP, PSX, Alfalah CLSA Research

Figure 25

Comparative economic indicators in a similar era

USDbn	2009-2012	2024E
FX Reserves	11.92	10
GDP Growth	2.4%	2.6%
1yr Kibor	13.5%	17.0%
Fiscal balance	-6.5%	-7.6%
Primary balance	-2.1%	0.4%

Source: SBP, PSX, Alfalah CLSA Research

Figure 26

Index valuation from economic variables – Benchmark years 2009-2012

USDbn	Benchmark factor - old	Benchmark factor - Current	Benchmark ratio	Index target
FX Reserves to MCAP	11.9	10.0	**2.8**	55,949
MCAP to GDP	209.9	301.9	15.8%	94,302
Earnings to 1yr Kibor	13.5%	17.0%	0.4%	113,260
MCAP to M2	72.3	114.4	45.9%	103,626
Average				**91,784**

Source: SBP, Economic Survey, PSX, Alfalah CLSA Research

Comment: Since Pakistan's economy has touched its nadir and is on its way towards mean revision, we have used the long-term valuation indictors based on key economic variables. As reference we have used FY09-FY12 where Pakistan had similar economic variables (GDP growth, interest rates and reserve levels). In conclusion, these metrices give an average index target of 91,784 for CY24, which will be lifted in CY25 as all benchmark indicators as expected to improve even further.

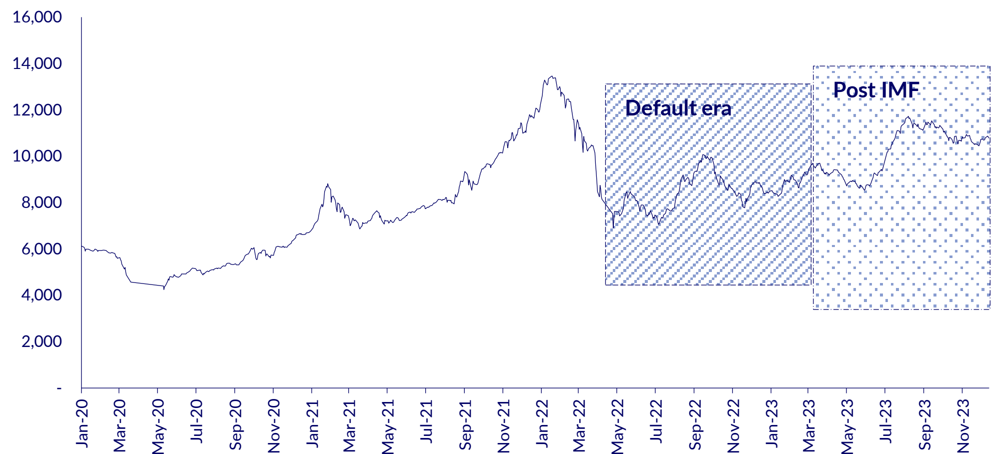
Drawing Parallels with Sri Lanka

Pakistan is in a similar situation as Sri Lanka. However, Pakistan's ability to manage finances has been much better than Sri Lanka, which defaulted on its debt in 2022, while taking almost a year to get an IMF deal. The country also failed its first review under the new EFF due to significant shortfall in tax collection. Pakistan has successfully averted default/restructuring with implementation of IMF plan, meeting all quantitative targets set by the authority. Broader economic and structural reform measures are also moving at a swift pace. Interestingly, Pakistan and Sri Lanka's markets had similar performance (in nominal terms) until June'21. However, significant divergence emerged post that amid sour political landscape of Pakistan followed by massive floods wreaking havoc on the economy. However, Pakistan's economic resilience and reform pace has proved much better than that of Sri Lanka, warranting re-rating for Pakistan. Pakistan is trading at 52% discount to Sri Lanka, with a dividend yield differential of 8.4ppts.

Sri Lanka witnessed significant re-rating post IMF Program

Figure 27

Sri Lanka index performance

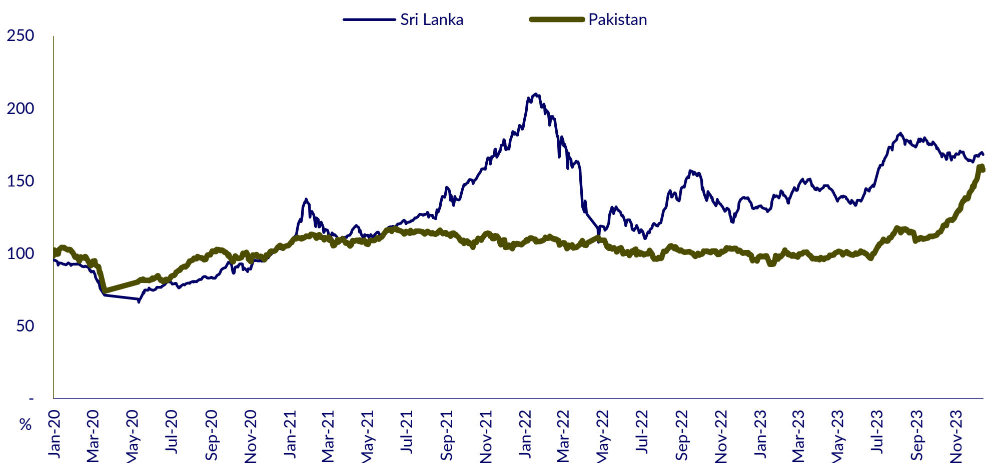


Source: Bloomberg, Alfalah CLSA Research

KSE-100 and CSE-ALL have historically moved in tandem.

Figure 28

KSE-100 vs Sri Lanka index performance



Source: Bloomberg, PSX, Alfalah CLSA Research

Figure 29

Indicators Snapshot

	Pakistan	Sri Lanka
Economy		
GDP growth (2024) *	2.5%	1.8%
1yr Yield- Spot	21.3%	14.0%
Inflation CYTD	31.0%	22.0%
Inflation - Nov'23	29.2%	3.4%
Current Account FY23 - USDbn	-2.2	0.9
Current Account 4MFY24 - USDbn	-1.1	N/A
Reserves (Central Bank) - USDbn	7.0	3.6
Reserves (Total) - USDbn	12.2	8.7
Import cover (months)	1.5	2.6
Currency	283.12	326.7
REER – Oct 2023	98.6	70.28
Fiscal Balance (2024 target) *	-7.60%	-9.10%
Primary budget Balance (2024 target) *	0.40%	-0.60%
External Debt to GDP	38.40%	42.00%
Total Debt to GDP	86.00%	101.90%
Market		
P/E	3.2	6.7
Dividend yield	12.60%	4.20%
MCAP (USDbn)	33.2	13.1
MCAP/GDP	11.49%	16.12%

Source: SBP, PBS, Central Bank Sri Lanka, Bloomberg, Alfalah CLSA Research
*IMF estimates

Valuation sheet

Company	Current Price	Price Target	% Upside	Recommendation	EPS(PKR)			DPS(PKR)			PER (x)			Dividend Yield (%)			P/BV (x)			Outs. Shares	Year End
	PKR	PKR			2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	2023	2024	2025	mn	
Banks											**2.9**	**2.6**	**3.0**	**15.3%**	**17.9%**	**16.6%**	**0.8**	**0.7**	**0.6**		
MEBL	160.8	221.4	37.7%	Buy	46.50	48.35	42.40	16.8	16.9	19.1	3.5	3.3	3.8	10.5%	10.5%	11.9%	1.5	1.2	1.0	1,791	Dec
MCB	185.4	201.0	8.4%	Buy	57.13	55.95	48.21	29.5	30.8	29.0	3.2	3.3	3.8	15.9%	16.6%	15.6%	1.0	0.9	0.8	1,185	Dec
HBL	123.3	138.5	12.3%	Buy	45.30	53.94	44.86	8.7	13.5	17.9	2.7	2.3	2.7	7.1%	10.9%	14.5%	0.5	0.4	0.4	1,467	Dec
UBL	179.4	180.0	0.3%	Buy	49.16	61.17	50.88	45.5	55.0	40.8	3.6	2.9	3.5	25.4%	30.7%	22.7%	0.9	0.9	0.8	1,224	Dec
BAHL	82.8	145.0	75.1%	Buy	38.51	45.74	40.92	17.0	20.5	18.5	2.2	1.8	2.0	20.5%	24.7%	22.3%	0.8	0.6	0.5	1,111	Dec
HMB	57.1	78.0	36.5%	Buy	26.06	29.53	25.67	11.0	14.0	12.5	2.2	1.9	2.2	19.3%	24.5%	21.9%	0.7	0.6	0.5	1,048	Dec
AKBL	24.6	UR	UR	UR	0.00	0.00	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0	0.0	0.0	1,449	Dec
BIPL	22.0	23.5	6.8%	Buy	10.66	9.83	8.31	3.8	4.0	3.3	2.1	2.2	2.6	17.0%	18.2%	14.8%	0.7	0.6	0.5	1,109	Dec
ABL	87.0	122.4	40.7%	Buy	36.40	45.78	39.93	11.5	14.0	14.0	2.4	1.9	2.2	13.2%	16.1%	16.1%	0.6	0.5	0.4	1,145	Dec
FABL	33.3	42.0	26.2%	Buy	13.19	14.79	11.01	5.0	6.0	5.0	2.5	2.3	3.0	15.0%	18.0%	15.0%	0.6	0.5	0.5	1,518	Dec
E&P											**3.1**	**3.2**	**3.0**	**6.7%**	**11.7%**	**13.7%**	**0.7**	**0.6**	**0.5**		
OGDC	125.0	170.0	36.0%	Buy	52.23	46.48	48.11	8.6	13.9	16.8	2.4	2.7	2.6	6.8%	11.2%	13.5%	0.5	0.4	0.4	4,301	Jun
MARI	2,114.3	3,100.0	46.6%	Buy	420.75	492.28	540.00	147.0	295.3	324.0	5.0	4.3	3.9	7.0%	14.0%	15.3%	1.7	1.5	1.3	133	Jun
PPL	120.8	150.0	24.2%	Buy	35.99	38.00	39.90	2.5	7.5	12.0	3.4	3.2	3.0	2.1%	6.2%	9.9%	0.6	0.5	0.5	2,721	Jun
POL	450.4	520.0	15.5%	Buy	128.42	122.00	109.80	80.0	103.7	93.3	3.5	3.7	4.1	17.8%	23.0%	20.7%	2.0	1.8	1.7	284	Jun
OMCs											**8.0**	**3.5**	**2.3**	**4.8%**	**7.4%**	**7.6%**	**0.6**	**0.5**	**0.4**		
PSO	204.5	319.1	56.0%	Buy	12.06	63.87	108.65	7.5	10.0	10.0	17.0	3.2	1.9	3.7%	4.9%	4.9%	0.4	0.4	0.3	469	Jun
APL	396.6	544.3	37.2%	Buy	100.15	94.20	99.85	27.5	48.3	51.5	4.0	4.2	4.0	6.9%	12.2%	13.0%	1.1	1.0	0.9	124	Jun
Cement											**6.8**	**4.2**	**3.6**	**1.3%**	**2.4%**	**3.7%**	**0.9**	**0.8**	**0.7**		
LUCK	812.8	1,077.2	32.5%	Buy	155.59	213.60	227.50	18.0	30.0	35.0	5.2	3.8	3.6	2.2%	3.7%	4.3%	1.0	0.9	0.7	313	Jun
MLCF	41.2	61.2	48.5%	Buy	5.38	7.97	12.60	0.0	0.0	4.0	7.7	5.2	3.3	0.0%	0.0%	9.7%	0.9	0.8	0.7	1,073	Jun
DGKC	80.3	136.7	70.2%	Buy	(8.30)	12.00	18.66	0.0	3.5	5.5	N/A	6.7	4.3	0.0%	4.4%	6.8%	0.5	0.5	0.5	438	Jun
KOHC	224.6	331.4	47.5%	Buy	29.72	50.38	60.64	0.0	0.0	0.0	7.6	4.5	3.7	0.0%	0.0%	0.0%	1.3	1.1	0.8	196	Jun
FCCL	19.9	31.4	58.1%	Buy	3.03	5.27	7.34	0.0	0.0	0.0	6.5	3.8	2.7	0.0%	0.0%	0.0%	0.7	0.6	0.5	2,453	Jun
PIOC	115.4	170.4	47.6%	Buy	11.50	24.45	35.97	0.0	0.0	7.3	10.0	4.7	3.2	0.0%	0.0%	6.3%	0.8	0.6	0.5	227	Jun
CHCC	167.6	215.9	28.8%	Buy	22.67	39.11	47.16	4.5	5.0	0.0	7.4	4.3	3.6	2.7%	3.0%	0.0%	1.6	1.1	0.9	194	Jun
Fertilizer											**5.2**	**3.4**	**3.1**	**14.6%**	**21.0%**	**23.9%**	**2.4**	**1.8**	**1.5**		
FFC	118.7	156.3	31.7%	Buy	26.44	34.88	38.70	17.3	22.8	29.0	4.5	3.4	3.1	14.5%	19.2%	24.4%	2.3	1.8	1.5	1,272	Dec
EFERT	111.4	143.1	28.5%	Buy	19.95	32.48	35.21	20.5	29.0	29.5	5.6	3.4	3.2	18.4%	26.0%	26.5%	3.1	2.3	2.1	1,335	Dec
FFBL	29.0	35.5	22.5%	Buy	3.69	8.01	9.06	0.0	2.5	3.3	7.9	3.6	3.2	0.0%	8.6%	11.2%	1.4	1.0	0.8	1,291	Dec
Textile																					
ILP	70.9	110.0	55.2%	Buy	14.39	16.68	22.38	4.0	7.0	9.8	4.9	4.2	3.2	5.6%	9.9%	13.8%	2.3	1.6	1.2	1,401	Jun
Engineering											**7.6**	**7.1**	**3.9**	**3.2%**	**3.5%**	**5.5%**	**0.8**	**0.7**	**0.6**		
AGHA	15.6	25.5	63.5%	Buy	1.50	1.57	4.23	0.0	0.0	0.0	10.4	9.9	3.7	0.0%	0.0%	0.0%	0.6	0.5	0.5	605	Jun
MUGHAL	71.4	78.0	9.3%	Hold	10.37	11.13	18.13	3.20	3.5	5.5	6.9	6.4	3.9	4.5%	4.9%	7.7%	1.0	0.8	0.7	336	Jun
Autos																					
INDU	1,268.0	UR	UR	UR	0.00	0.00	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0	0.0	0.0	79	Jun
MTL	617.3	UR	UR	UR	0.00	0.00	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0	0.0	0.0	192	Jun
HCAR	202.6	UR	UR	UR	0.00	0.00	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0	0.0	0.0	143	Mar
PSMC	545.9	UR	UR	UR	0.00	0.00	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0%	0.0%	0.0%	0.0	0.0	0.0	82	Dec
Chemical											**7.9**	**9.3**	**6.9**	**10.8%**	**6.7%**	**10.0%**	**1.8**	**1.6**	**1.4**		
EPCL	50.0	44.5	-11.0%	Sell	5.54	3.91	6.25	6.3	3.5	5.8	9.0	12.8	8.0	12.5%	7.0%	11.5%	1.6	1.6	1.5	909	Dec
LOTCHEM	28.0	30.0	7.1%	Hold	3.24	3.92	4.66	2.5	1.8	2.3	8.6	7.1	6.0	8.9%	6.2%	8.0%	1.9	1.6	1.3	1,514	Dec
Insurance																					
AICL	36.3	55.0	51.7%	Buy	8.03	7.97	8.70	2.40	3.0	3.0	4.5	4.6	4.2	0.5%	8.3%	8.3%	0.6	0.6	0.5	350	Dec
Techonology																					
SYS	453.0	568.2	25.4%	Buy	33.39	40.07	45.62	2.40	7.0	8.0	13.6	11.3	9.9	0.5%	1.5%	1.8%	2.3	2.0	1.7	291	Dec
AFS Universe											**3.7**	**3.2**	**3.2**	**9.3%**	**12.6%**	**13.5%**	**0.9**	**0.7**	**0.7**		

Prices as of 14th Dec 2023

Sector Views

Exploration and Production (Overweight)

The energy sector had been one of the prime burdens on Pakistan's economic progress amid abnormally high line losses (due to inefficient infrastructure), low recovery rates (due to theft) and a broken pricing mechanism resulting in massive cost gaps. The tide has now shifted with widespread reform across all verticals, especially adjustments in front end consumer prices (both gas and power) to stop the flow of circular debt. The IMF has pinned energy sector reforms as a key benchmark not only for the current SBA but has also set the tone for any future programs.

Circular debt now in control

Two gas price adjustments taken in 2023 and a widepread crackdown on theft and illegal connections has largely put a stop on the flow of circular debt since 1st Nov-2023. Though, the second adjustment was delayed by 4 months, IMF's strict guidance to implement the said measure indicates the authority has now included semi-annual rebasing as a key benchmark in subsequent reviews as well. We therefore believe the upcoming price revision in Jan-2024 (to pass laggard impact of USD/PKR adjustment) will be implemented within the stipulated time frame of 40 days of OGRA's approval.

New regulation in consultation

The federal govt. has instructed the petroelum division to draft a policy proposal to amend OGRA ordinance 2002, to grant the regulator powers to determine and implement the gas prices in future. For context, OGRA has always proposed revision in gas prices on time. However, the governments in power used to defer the decision to protect political capital. Therefore, if such a law is promulgated, it significantly reduces the sustainability risk of future cash flows for the gas chain.

Oil prices expected to remain dull

After touching a peak of USD134.4/bbl in 2022, oil prices have been in a consistent downtrend amid slowing global economy. With benchmark interest rates expected to remain elevated for longer than earlier anticipated, we believe the demand for oil will remain subdued in 2024. Also, re-bounding US shale production has played its part in partially negating the impact of OPEC+ production cuts. Thus, we expect oil to trade in the range of USD65-85/bbl for 2024.

Efforts underway to arrest production decline

All exploration companies are expected to work aggressively in the coming years to uplift their production profiles backed by availability of surplus cash flow ahead. Thus, we expect exploratory efforts to pick pace besides monetization of large ticket finds in the last years.

Oil Marketing Companies (Overweight)

We hold a positive stance for OMC sector, with economy at the cusp of revival, we expect retail fuel offtake to bounce back driven by economic recovery. Amid state action against cross border smuggling of retail fuels and implementation of axle load regime, we expect formal retail fuel demand to get an uplift. Gas circular debt has been one of the pressing issues in the industry putting severe strain on corporate cash flows, mainly PSO. However, IMF has mandated energy sector reforms as one of its structural benchmarks under the program. Another tariff hike in Jan-2024 is set to improve sector cashflows further.

Retail fuel sales volume to improve

The economy's road to recovery and LSM activity picking up, retail fuel sales are set to increase. We expect MS & HSD sales volume to increase by 3% & 9.2% respectively in FY24. Currently, international oil prices are showing a declining trend amid weak global demand and rising U.S inventories. Impending decline in local POL prices will serve to stimulate demand.

Circular debt accumulation to be arrested

With no room to be complacent, the government took the prudent step of increasing gas tariffs by ~35% in Jan-23 followed by a second hike of ~65% in Nov-23 to rationalize gas prices and arrest circular debt accumulation. This is a positive for PSO, as it will prevent further retained earnings from being trapped in receivables which currently stands at PKR 511 Bn (Rs 1090/shr). Another gas tariff hike is expected in Jan-24, to pass on cost pressures of domestic RLNG diversion to industrial and domestic consumers.

Implementation of axle load regime

In light of structural reforms, the government has adopted enforcement of axle load limits on motorways and highways with the applicable weight limit on trucks being reduced to almost half. However, it is pertinent to note that many truckers and tankers in Pakistan use Iranian diesel which is sold at a differential of Rs 25 to 30 from the retail price. The crackdown on smuggling has squeezed supply available for truckers, forcing them to purchase HSD through formal channel. Currently, the transportation sector consumes 88% of the total petroleum products in Pakistan (i.e., both imported and locally). The enforcement of this regime is expected to increase HSD consumption which will translate into higher sales for the OMC sector.

Refinery policy to improve efficiency

The government is in process of onboarding local refineries to uplift their operating efficiencies under the Brownfield Refinery Policy. Upgradation & expansion of local refining capacity will enable both PSO and APL to ramp up local procurement from their respective sister concerns and thereby reducing exposure to foreign creditors.

Rate cuts to reduce cost of doing business

The monetary tightening cycle significantly hindered smaller OMCs ability to fund rising working capital requirements. Therefore, with rate cuts anticipated from Mar'24, we can expect some respite in the cost of doing business enabling companies to pursue strategic growth opportunities. Although the era of very low interest rates is not expected to materialize in the near future, however a decline in financing costs will still be a welcoming move.

To compensate the rising cost of doing business, the ECC approved a 31% hike in OMC margins from Rs 6.00/ltr to Rs 7.88/ltr. Taking FY23 volumes as benchmark, the earnings impact of increase in margins is expected to be Rs 22/shr, Rs 13.1/shr & Rs 7.9/shr for PSO, APL & SHELL respectively.

Banks (Marketweight)

We hold a positive stance on the banking sector based on a blend of growth and impressive dividend yields. As base case, we expect 500bps rate cut in CY24, with the first cut expected in Mar-2024, however, lagged asset repricing and deposit growth shall lead to ~13%YoY earnings growth in CY24. AFSCLSA banking universe trades at 2024E PE/PB of 2.6/0.7x, and offers CY24E dividend yield of 17.9%. We highlight BAHL, HMB and MEBL as our top picks; offering total return of 100/61/48% respectively (dividend yields of 24.7/24.5/10.5% respectively).

Earnings to grow by ~13% YoY in CY24

Despite expected rate cut, banks' earnings are estimated to grow by ~13% in CY24 backed by lagged asset repricing and deposits growth. Specifically, BAHL and MEBL are expected to outpace industry in deposit growth. NII is expected to increase YoY, while non-mark-up income is estimated to decrease due to absence of huge forex income. Operating expenses shall continue to grow in tandem with inflation, which, in our opinion, will gradually trim down.

NPLs to remain in check

NPLs are expected to remain in check as economic recovery kicks-in. In fact, banks have performed exceptionally well on this front as infection ratio clocked-in at 7.6% in 9MCY23 (vs 7.3% at CY22 end) even in a distressed economic situation.

More frequent payouts and decent CAR

Banks have been focusing on paying out larger and more frequent dividends. Thus, the sector offers a CY24E yield of 17.9%, which is higher than our forecasted KIBOR for Dec-24, as rate cuts are anticipated to begin from early next year.

We opine that banks are adequately capitalized (Tier-1 CAR: 16.0, as of Sept 2023) right now. We also believe that they can maintain adequate dividends, while keeping CAR at reasonable levels next year. BAHL has the capacity to increase its payout from current 45% to 65% while maintaining reasonable CAR buffers. HMB and MEBL can also comfortably increase their payouts going forward. We highlight that HBL has a relatively small capital buffer as compared to other banks in AFS Banking Universe while UBL may have to trim down payouts beyond CY25.

Top Picks: We recommend BAHL, HMB and MEBL. BAHL offers a perfect blend of growth and dividends. MEBL is a growth story that can offer higher dividends in future. HMB also offers decent growth, along with high dividend yield.

Key Risks: Some risks to highlight include, 1) Slowdown in deposit growth 2) Higher than expected rate cuts 3) MDR on Islamic banks, 4) application of second phase of Treasury Single Account and 5) tax on retrospective foreign exchange gains (currently stay order taken).

Figure 30

Top Picks

	TP	CY24eEPS	CY24eDPS	P/E(x)	P/B(x)	D/Y (%)
BAHL	145	45.7	20.5	1.8	0.6	24.7
MEBL	221	48.4	16.9	3.3	1.2	10.5
HMB	78	29.5	14.0	1.9	0.6	24.5

Source: Alfalah CLSA Research

Cements (Overweight)

Cement sector's profitability is expected to remain robust given declining international coal prices and pricing consensus among manufacturers. The sector has recently been observed to pass-on even a slight cost increase to end consumers, which we opine will continue in future. Cement price hike post enactment of axle load regulations is testament to that phenomenon where manufacturers increased prices significantly more than hike in cost pressures. Sector has seen some rerating during last quarter as AFSCLSA universe market cap increased by 49.4% QTD. However, significant room to grow still remains as sector is trading at discounted multiples - FY25E P/E, P/B, EV/EBITDA stand at just 3.6 / 0.7 / 2.1 respectively.

Demand recovery to start

We expect demand to start picking up in FY24 after two consecutive yearly declines. Total dispatches are expected to increase to 48.7MT, up 9% YoY. Of which local/export dispatches are likely to increase 3%/60% YoY to 41.3/7.4 MT respectively. However, due to recent expansions, capacity utilization will remain dismal at ~56% despite uptick in exports. This suggests that ample room for growth in dispatches remains in coming years without incurring significant capital expenditure.

Coal prices expected to remain moderate

Normalcy of Australia-China trade relation eliminated trade divergence during the year and has helped keep coal prices in check. To recall, coal imports from Australia were unofficially suspended from April 2022 to Feb 2023. This in conjunction with other favourable developments like 120% YoY surge in Mongolian coal exports to 59.7Mn Tons YTD proved boon for coal users. We are of the opinion that coal prices will remain moderate in coming winter season as 1) temperatures in Northern China particularly Yulin – major coal producing region - have remained above those of yesteryears and 2) prices of other substitute energy sources have trended downward. As coal prices surged, cement manufacturers shifted to Local/Afghan coal in pursuit of cost optimization. Currently, North based manufacturers' reliance on imports through sea ranges between 0% and 25% of overall fuel mix. On energy equivalent basis, Afghan/Local coal is trading at a discount of 3%/24% from imported coal for KPK/Northern Punjab manufactures.

Earnings profile to remain robust

Pricing consensus, positive demand outlook, declining finance cost and declining input costs is expected to translate into earnings CAGR of 21% over next 2 years.

We have LUCK and FCCL as our preferred picks. FCCL trades at a discount to sector multiple and has good cash generation while LUCK has massive cash generation to pursue growth ventures.

Figure 31

EPS & P/E multiple

	FY24E EPS	P/E	FY25E EPS	P/E	FY24E EV/Ton
LUCK	213.6	3.8	227.5	3.6	51
FCCL	5.3	3.8	7.3	2.7	26
CHCC	39.1	4.3	47.2	3.6	23
KOHC	50.4	4.5	60.6	3.7	19
PIOC	24.5	4.7	36.0	3.2	24
MLCF	8.0	5.2	12.6	3.3	24
DGKC	12.0	6.7	18.7	4.3	33

Source: Alfalah CLSA Research

Fertilizer (Marketweight)

Fertilizer manufacturers are exerting pricing power backed by significant discount (~52%) of local prices from import parity. Recent price hikes will keep profitability robust as CY24E P/E stands at 3.4x. Moreover, sector's yield is unmatched at 20.8% since companies to disburse entire cash profits after CAPEX. EFERT boasts highest dividend yield among peers at 25.7% with differential from 1Y/3Y Kibor at 4.5/9.3% respectively. Moreover, any move towards uniform gas pricing will be beneficial for EFERT as it partially relies on petroleum policy for gas needs. Gas price unification will result in incremental EPS of PKR8.4 i.e. 26% of CY24E EPS.

Robust demand and pricing power to persist

Urea demand is expected to remain ~6.7mn tons in CY24. This is premised on healthy farm earnings emanating from bumper cotton output (up 82% YoY YTD), attractive sugar cane price of PKR400/maund (up 66% YoY) and higher rice prices in wake of floor on Indian export prices. Higher farm income serves as an incentive to apply more fertilizer to get better yield, enabling them to earn high profits.

Demand has steadily increased by 0.8 million tons (~13.7%) over the last 5 years. Part of this surge is thought to be due to cross border smuggling as local urea price is half of that dictated by import parity. This has further increased the pricing premium being charged by dealers above suggested MRP as current retail price is around PKR5000/bag.

Urea inventory is expected to plummet to historic lows as demand exceeds supply in the ongoing season. We expect year end urea inventory to fall below 100KT. The supply tightness and discount to import parity leads us to believe that prices will rise further to improve margins at the turn of the year.

EFERT to benefit from gas price unification

We opine that due to pricing power, any gas price hike will be passed-on, rendering it largely immaterial from profitability perspective. This shall be beneficial for EFERT as it also gets gas under petroleum policy. If gas prices are unified, the incremental EPS impact for EFERT is PKR8.4 i.e. 26% of CY24E EPS.

High dividend yields

Fertilizer sector is known for its high dividend yield. CY24 dividend yield for EFERT/FFC/FFBL are expected at 26/19/9% respectively. These yields trump yield on fixed income securities. In this backdrop, we prefer EFERT in fertilizer universe due to its highest dividend yield.

Figure 32

Earnings and dividend estimates

	CY23E	CY24E	CY25E
EPS			
FFC (Un consolidated)	26.4	34.9	38.7
EFERT (Consolidated)	19.9	32.5	35.2
FFBL (Un consolidated)	3.7	8.0	9.1
DPS			
FFC	17.3	23.0	29.0
EFERT	20.5	29.0	29.5
FFBL	0	2.5	3.3
P/E			
FFC	4.5	3.4	3.1
EFERT	5.6	3.4	3.2
FFBL	7.9	3.6	3.2
Dividend Yield			
FFC	14.5%	19.2%	24.4%
EFERT	18.4%	26.0%	26.5%
FFBL	0%	8.6%	11.2%

Source: Company accounts, Alfalah CLSA Research

Textiles (Underweight)

Pakistan's textile sector has shown recovery in volumetric terms, where 4MFY24 exports recovered sharply. However, in value terms, exports fell by ~6% in the same period, reflecting decline in commodity prices globally. Moreover, higher finance costs due to absence of concessionary financing along with reducing subsidies on energy are expected to dent profitability. Thus, we hold under-weight stance on Pakistan's textile sector. We recommend textile companies with high growth and efficiency in the long term. Thus, ILP remains our preferred pick.

Textile volumes have staged a recovery

Textile export volumes have recovered in 4MFY24, as cotton yarn/knitwear/bedwear/towels/garments surged by 64.2/38.4/7.5/20.9/5.5% respectively, albeit on a lower base. Note that knitwear is the only segment that has shown consistent growth in the last 2 years. However, exports have come off by ~6% in USD terms, due to a decline in global commodity prices.

Lack of concessionary financing to keep finance costs elevated

As SBP has abolished all concessionary schemes for textile companies, financing the working capital needs has become quite expensive. However, expected cut in interest rates in the next calendar year can provide some respite.

Higher energy costs not to impact margins materially

Local gas price has been increased by ~91% recently for the export sector, coupled with inclusion of RLNG in the blend. The woes do not end here as another price hike is in offing in January 2024.

Look into side stocks

We recommend evaluating side stocks such as Towellers and Kohinoor Mills, which offer interesting value stories Towellers has considerable cash on its books (PKR178/sh, 88% of the current market price), which it can utilize to either expand or pay out dividends. KML on the other hand, is working on vertical integration. It has already commenced work on a garment unit which is expected to start production in the last quarter FY24; estimated capacity is 5,000 garments/day.

Autos (Underweight)

Pakistan's auto sector continues to face headwinds, although market performance reflects otherwise. LC restrictions have recently eased; however, dismal demand has kept operating levels below par. While PSMC's value was unlocked due to initiation of de-listing process, other auto stocks have performed in anticipation of improvement in sector dynamics.

Import restrictions resulting in plant shut downs

The sector continues to be impacted by plant shut downs. PSMC/INDU/HCAR, all have announced extended shutdowns throughout the ongoing quarter due to shortage of raw material.

Auto volumes have remained dismal

Demand slowdown has been observed in almost all vehicle categories, due to steep increase in car prices and high financing rates. Passenger car volumes are down by ~53% YoY in 5MFY24. Note that majority of the decline was witnessed in 1000cc and above segments. Trucks & buses' sales came off by 45%. Jeeps and pickups also declined by 31% YoY. 2/3 wheelers showcased a relatively better trend, with sales declining by 12.3% YoY in 5MFY24. We highlight that tractor was the only segment which performed well, where sales jumped by 98% YoY (20.8k units).

PKR still a risk

Though, PKR has remained largely stable throughout CY24, REER has crept up to 98.52, necessitating devaluation. Therefore, we expect margins to come under stress again with renewed pressure on demand.

Top Picks

PPL - BUY

The accumulation of gas based circular debt is expected to stop in CY24 as government implements IMF structural reforms. PPL being the worst affected by the ballooning circular debt will be prime beneficiary of improvement in cash flows. In this regard, PPL's outstanding receivables (net of payables) currently stand at PKR437bn (PKR160/sh). Furthermore, the company's revenue being dollar-denominated will act as a counter to declining crude oil prices. First well spud in Abu Dhabi's offshore Block-5 is also targeted in 3QFY24 wherein any major discovery will significantly uplift the company's earnings and its quality.

Energy reforms – PPL the largest beneficiary

PPL, having the largest exposure to circular debt, was worst affected both in terms of cash flows and valuation discount. However, with the IMF's stern stance on resolution of gas-based circular debt through increase in consumer gas tariffs, PPL's cash flow situation is anticipated to drastically improve. In this regard, PPL's receivables (net of payables) stand at PKR437bn (PKR160/sh) on top of PKR74bn (PKR27/sh) cash and equivalents. To note, full translation of earnings into cash flow will also alleviate the valuation discount associated with PPL's earnings.

Another perspective to value receivables

Since the accumulation of circular debt is expected to halt, using Dec'24e net receivables of PKR437bn as a proxy for 5yr interest free bond, the discounted value (@17%) stands at PKR228bn (PKR84/sh). Therefore, even if the resolution of outstanding stock of circular debt is done in a gradual manner, the discounted value of receivables account for ~70% of current market capitlization of the company.

Other ventures for growth

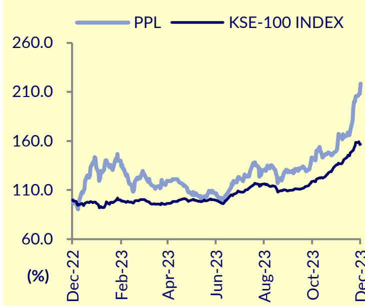
Mineral exploration ramping up: Barytes and Iron ore exploration has picked up significant pace with production jumping by 13%YoY in FY23. For Baryte, Lead and Zinc project, regulatory approvals are awaited to award EPC contracts. Nokkundi iron ore project is progressing well with drilling underway to explore deposits. Also, jigging plant is being installed to upgrade the quality of low grade bartye, reduce waste and increase productivity.

Reko Diq: Following reconstituted Reko Diq Project, PPL holds 8.33% stake in the venture. The project will take 4-6 years to begin commercial operations. Reko Diq holds copper and gold reserves of ~24mn tons and ~42mn ounces respectively, combined valued at a signifcant sum of ~USD300bn. If retained by PPL, this project will assist in generating cash rich long term growth.

Abu Dhabi Offshore Block-5: Planning and preparation for drilling of three appraisal wells during 2024 is underway. First well may be spud as early as 3QFY24. Any material finds in the block will significantly improve the company's earnings profile and its valuation.

Symbol	PPL
Price PKR	120.8
Bloomberg	PPL PA
Reuters	PPL.PSX
Price Target	150.0
Up/downside	4.2%
Mkt. cap USD mn	1,160.1
No. of Shares mn	2,721.0
3M ADV USD mn	3.1

PPL vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 30 June	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (PKR)	19.7	36.0	38.0	39.9	43.1
EPS growth	2.2%	82.9%	5.6%	5.0%	8.0%
P/Ex	6.1	3.4	3.2	3.0	2.8
DPS (PKR)	2.00	2.50	7.50	12.00	13.00
Dividend Yield	1.7%	2.1%	6.2%	9.9%	10.8%
P/BVx	0.76	0.61	0.52	0.47	0.42
BVPS(PKR)	159.82	198.73	229.13	257.06	287.23
ROA	8.6%	12.4%	11.8%	11.4%	11.4%
ROE	13.0%	20.1%	17.8%	16.4%	15.8%

Source: Company Accounts, Alfalah CLSA Research

MARI - BUY

Mari has ramped up its exploratory and development efforts given the incentive of higher gas prices beyond a production threshold of 525mmcfd. Resultantly, Mari is the only company in AFS universe to record a positive 5yr gas production CAGR of 2% compared to the negative -6% CAGR of other listed players. Also, with the long reserve lives of Mari's fields, the earnings quality of MARI far supersedes that of its peers.

PKR hedge

Mari's earnings potential has not been appreciated by the market yet, given current decline in oil prices and uncertainty surrounding the dividend payout policy of the company. Oil prices have increased 10%HoH in 2H2023, leading to 2% upward revision in wellhead gas prices coupled with lagged impact of PKR depreciation of 5%. This shall increase further support the earnings profile of MARI in the latter half of FY24.

Attractive dividend yield

MARI being part of the Fauji group is widely expected to carry a higher payout comparable to other companies. In this regard, we expect the company to maintain a pay-out of 60% paid half-yearly. This provides an attractive yield cover of 14.0%/15.3% for FY24/FY25 as a value protector, providing minimum downside room with market volatility.

Successful exploratory efforts continue

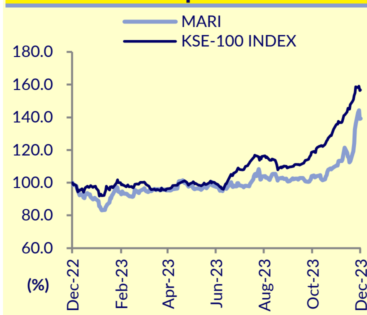
Mari has continued its course of executing succesful drilling with 3 finds FY24TD namely MARI-123H, MARI124H and Ghazinj-2 having cumulative production flows of 48.1 mmcfd. The company also has a well (Miawand-X01) under testing in Block-28 where any significant exploratory discovery will add another production block to MARI's portfolio.

Outlook: FY23 saw some spillover of ballooning circular debt on Mari too with the company's receivables increasing by PKR29.3bn (PKR220/sh). However, with no pile up of receivables expected across the gas chain, MARI's profits will fully translate into cash, assisting in increasing payouts and ramping up growth expenditure. Current cash and ST investment reserve of PKR407/sh, attractive dividend yield of 14.0%, USD indexed revenues, eradication of circular debt pile up and sole E&P with volume growth makes a strong investment case for Mari. At our target price of PKR3,100/sh the company offers a total return of 61%.

Key Risk: We highlight that MARI lease is expiring in early FY25, where a renewal will attract additional 15ppts royalty on production. This shall have a negative impact of PKR110/sh on the company's bottom-line. We seek clarity in regards to additional tax shield available on royalty, which may dilute the negative impact by PKR44/sh.

Symbol	MARI
Price PKR	2,114.3
Bloomberg	MARI PA
Reuters	MGAS.PSX
Price Target	3,100.0
Up/downside	46.6%
Mkt. cap USD mn	995.7
No. of Shares mn	133.4
3M ADV USD mn	0.5

MARI vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 30 June	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (PKR)	247.8	420.7	492.3	540.0	582.4
EPS growth	5.1%	69.8%	17.0%	9.7%	7.7%
P/Ex	8.5	5.0	4.3	3.9	3.6
DPS (PKR)	124.00	147.00	295.25	324.00	349.2
Dividend Yield	5.9%	7.0%	14.0%	15.3%	16.5%
P/BVx	2.16	1.69	1.46	1.27	1.10
BVPS(PKR)	980.93	1,254.68	1,451.59	1,667.59	1,899.8
ROA	17.9%	22.0%	23.4%	23.3%	24.1%
ROE	25.3%	37.6%	36.4%	34.6%	30.6%

Source: Company Accounts, Alfalah CLSA Research

BAHL - BUY

BAHL offers a perfect mix of high growth and impressive dividend yields. We opine that BAHL has room to increase dividend payouts going forward while maintaining its CAR at adequate level. Moreover, the bank has been consistently focusing towards Islamic banking business and is planning to add around 80 branches (+41% of Islamic) next year, most of them being Islamic. BAHL trades at an attractive CY24E PE/PB of 1.8/0.6x, with Dec-24 TP of PKR145/sh offering a total return of ~100%.

Ability to increase dividend payout

Current payout ratio (45%), corresponds to a CY24/25 dividend yield of 24.7/22.3%. We have gradually increased the payout to 55% in the long-run, and conclude that the bank, barring any unforeseen scenario, will maintain CAR well above the regulatory levels. We have also assessed a scenario where BAHL gradually uplifts its payout to 65%; we conclude that even at this level of payout, CAR can be sustained well above regulatory limits.

More reasons to increase payout

We also highlight that unlike larger peers, BAHL is not a part of Domestically Systematically Important banks (DSIB), thus it has more leeway in increasing payouts. Currently, HBL, NBP and UBL are part of DSIB. Another key development is the initiation of quarterly dividend payments. To note, investors usually prefer banks with more frequent payouts.

Eyeing for expansion in Islamic banking business

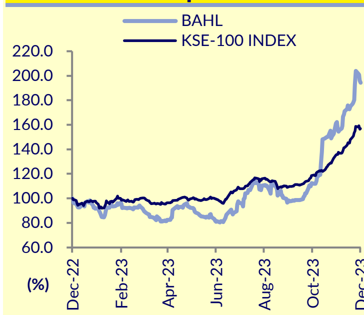
BAHL's Islamic market share has grown consistently from 3.4% in Dec-22 to 3.9% in Sept-23. BAHL aims to open 80 (+41% of Islamic) branches next year, majority of which shall be Islamic. This leads to ~26/3% incremental deposit growth in Islamic/total deposits.

Displaying impressive numbers

The bank has displayed an impressive 2/3/5-year deposit CAGR of 22.6/20.6/20.0% (vs industry CAGR of 15.2/15.9/15.1%), with deposits hitting close to PKR2trn mark. Earnings are expected to grow by ~19% in CY24 (45.7 vs 38.5 in CY23) even though rate decline is on cards. Lagged asset repricing and deposit growth shall lead to incremental earnings, offsetting the impact of rate decline. Note that BAHL commands highest ROE in the AFS Conventional Banking Universe. The bank has an impressive track record of lower infection ratio (1.9% vs industry average of 7.7% as of Sept 2023). Despite of high exposure in textiles (~33%), the bank has managed to maintain its infection ratio at lower levels. Moreover, BAHL has a superior loan coverage ratio of 121% vs industry average of 96% in 3QCY23.

Symbol	BAHL
Price PKR	82.2
Bloomberg	BAHL PA
Reuters	BKEQ.PSX
Price Target	145.0
Up/downside	50.9%
Mkt. cap USD mn	325.0
No. of Shares mn	1,111.4
3M ADV USD mn	0.3

BAHL vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 31 Dec	CY21	CY22	CY23E	CY24E	CY25E
EPS	16.7	15	38.5	45.7	40.9
EPS growth	3.5%	-10.2%	156.4%	18.8%	-10.6%
P/E	5	5.5	2.2	1.8	2
DPS	7	7	17	20.5	18.5
Div. Yield	8.5%	8.5%	20.5%	24.7%	22.3%
P/BV	1	1	0.8	0.6	0.5
BVPS	81.2	86	110.3	135.5	158
ROA	1.1%	0.8%	1.8%	1.8%	1.4%
ROE	21.8%	18.0%	39.2%	37.2%	27.9%

Source: Company Accounts, Alfalah CLSA Research

MEBL - BUY

MEBL has displayed a 5-year deposit CAGR of ~23%, outpacing the banking industry growth of ~15%. It offers the highest ROE in AFSCLSA banking universe (CY23E: 54.8%, industry average 27%). It has the highest total coverage at 171% and one of the lowest infection (1.7% vs 7.7% industry average in 3QCY23), which makes MEBL a safe bet. Moreover, comfortable CAR buffer (Tier-1: 20.6% vs industry CAR of 16.0% in 3QCY23) is expected to support growth and higher payouts in future. We expect MEBL to post earnings of PKR48.4/42.4/sh in CY24/25 respectively. The scrip offers a total return of 48% and is trading at a CY24E PE/PB of 3.3/1.2x respectively.

Impressive deposit CAGR

MEBL has displayed a 5-year deposit CAGR of ~23%, outpacing the banking industry growth of ~15%. We highlight that this growth number is lower than overall Islamic banking Industry's growth; MEBL lost its market share (current: 32.6% in 3QCY23, after peaking at 37.0% in CY20) to peer Islamic banks as well as conventional banks' Islamic business. However, MEBL is focused on consistent growth through branch expansions and deposit mobilization.

The bank will continue to benefit from zero cost Current Account deposits, which constitute around 49% of the total deposits as of 3QCY23 (40.2/36.4% as of CY20/CY19). Decent deposit growth combined with low cost (due to absence of minimum deposit rate) puts the bank in a favourable position.

Highest ROE/coverage and contained infection

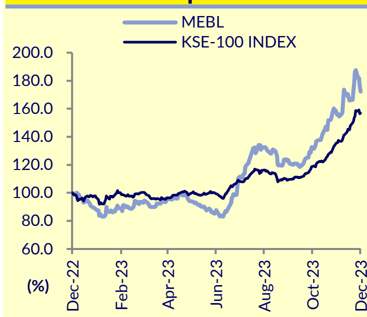
We reiterate that the bank commands the highest ROE in AFSCLSA Banking Universe, CY24E: 40.5% (Average historic 10-year ROE: ~27%). The bank has the highest total coverage ratio (3QCY23: 171%) in the AFSCLSA banking universe, average coverage ratio for the last 10 years stands at 130.5%. MEBL has also managed to maintain one of the lowest infection ratios in the industry - ~1.7% as of 3QCY23 (10-year average: 2.3%).

Enough CAR buffer to increase payouts: The bank currently maintains an elevated Tier1/Total CAR ratio of 20.6/23.4% vs the regulatory requirement of 7.5/11.5%. Thus, the bank can increase payouts in future as well as maintain a considerable CAR buffer.

Risks: Finance minister has recently commented on absence of MDR for Islamic banks, urging SBP to consider its application. We opine that the immediate implementation seems less probable and even if applied, mechanism would be different as compared to Conventional banks. In our view, MDR application is negative, however, incremental deposit mobilization may cushion the decline in earnings.

Symbol	MEBL
Price PKR	160.8
Bloomberg	MEBL PA
Reuters	AMZN.PSX
Price Target	221
Up/downside	37.7%
Mkt. cap USD mn	1,016,7
No. of Shares mn	1,791.3
3M ADV USD mn	1.1

MEBL vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 31 Dec	CY21	CY22	CY23E	CY24E	CY25E
EPS	15.8	25.1	46.5	48.4	42.4
EPS growth	26.0%	59.2%	85.4%	4.0%	-12.3%
P/E	10.2	6.4	3.5	3.3	3.8
DPS	6.0	9.0	16.8	16.9	19.1
Div. Yield	3.7%	5.6%	10.5%	10.5%	11.9%
P/BV	3.23	2.44	1.55	1.19	1.01
BVPS	49.8	65.8	103.8	135.2	158.6
ROA	1.6%	2.0%	3.0%	2.7%	2.1%
ROE	35.0%	43.4%	54.8%	40.5%	28.9%

Source: Company Accounts, Alfalah CLSA Research

HMB- BUY

We have a BUY call on Habib Metropolitan Bank (HMB) with Dec-24 price target of PKR78/sh (total return ~61%), alongside an impressive CY24E dividend yield of 24.5%. We expect the bank to post an EPS of PKR26.1/29.5/25.7 in CY23/24/25. HMB has historically performed well on the NPL (infection) front; infection ratio has come down significantly to as low as 5.2% in 3QCY23 from 12.8/12.3/12.4% in 2014/2015/2016 respectively. We also highlight that HMB pays a half yearly dividend and has the potential to move towards quarterly payouts just like BAHL and FABL. Moreover, its (Tier-1) CAR buffer of 8.4% provides flexibility to increase dividends

Superior dividend yield amidst healthy CAR

HMB fits well with our theme, where it can increase dividend payouts from current levels. Moreover, it can pay out more frequent dividends as BAHL and FABL have initiated. CAR also contains a reasonable buffer (Tier-1 ratio/buffer: 15.9/8.4%). We expect CY24/25 dividend yield to clock-in at 24.5/21.9% at a payout ratio of 47/49%.

Earnings to increase by ~13% in CY24

Earnings are expected to increase by ~13% in CY24 to PKR29.5/sh. NII is estimated to increase by ~20% while non-interest income shall decrease considerably due to absence of massive foreign exchange gains. Note that provisioning expenses (and infection ratio) shall remain around current levels as textile exposure remains high (more than 40% of total advances).

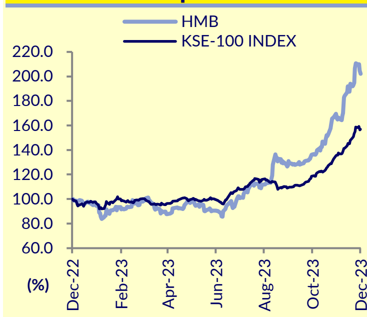
Healthy growth in non-funded income

Non-funded Income has remained high for the bank as the bank surpassed industry in fee income growth. Note that the banking industry's fee income grew at a 5-year CAGR of 14.8%, whereas HMB's fee income grew at an impressive 5-year CAGR of 20.6%.

Improvement in advances quality and NPL Coverage: HMB has managed to significantly bring down its infection ratio from 7.0% to 5.2% from CY18 till date(3QCY23) reflecting a massive improvement in the quality of advances book. Furthermore, the total coverage ratio also remains high at ~105%; therefore, the bank remains adequately covered for any shock on the loan book.

Symbol	**HMB**
Price PKR	57.1
Bloomberg	HMB PA
Reuters	HMB.PSX
Price Target	78.0
Up/downside	36.5%
Mkt. cap USD mn	211.3
No. of Shares mn	1,047.8
3M ADV USD mn	0.1

HMB vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 31 Dec	CY21	CY22	CY23E	CY24E	CY25E
EPS	12.9	13.7	26.1	29.5	25.7
EPS growth	12.2%	6.3%	90.0%	13.3%	-13.1%
P/E	4.4	4.2	2.2	1.9	2.2
DPS	5.0	5.3	11.0	14.0	12.5
Div. Yield	8.8%	9.2%	19.3%	24.5%	21.9%
P/BV	0.94	0.80	0.69	0.58	0.51
BVPS	60.5	71.6	83.0	98.5	111.7
ROA	1.2%	1.1%	1.9%	2.0%	1.6%
ROE	22.3%	20.8%	33.7%	32.5%	24.4%

Source: Company Accounts, Alfalah CLSA Research

PSO – BUY

IMF's structural reforms now being implemented in letter and spirit, circular debt accumulation has effectively halted. This is expected to unlock value for PSO, as future retained earnings will no longer be trapped in receivables giving the company the financial flexibility to pursue strategic growth opportunities. We expect PSO to post earnings of PKR64/109/sh in FY24/25 respectively. The scrip offers an upside potential 52% on the Dec-24 Target Price of Rs 319/sh.

Set to increase its market share in retail fuels

The company has been the market leader in the retail fuel business for a decade. The era of elevated interest rates sets PSO to capture market share lost by smaller competitors that are struggling with their working capital requirements. Moreover, sovereign guarantees for its purchases allows it to bridge any financing gap.

Increased cash flow generation

PSO's loss making LNG segment has been a drag on its operational performance since 2017 evident by its burgeoning receivables owed by SNGPL. However in light of the recent gas tariff hikes and upcoming reforms to the the gas pricing mechanism, price rationalization is now a reality curbing the flow of circular debt. Although, existing circular debt settlement is not expected anytime soon however full realization of core cash flows will be a signifiacnt value driver for PSO.

Attractive valuation

Core earnings (excluding inventory gains and losses) are poised to steadily increase in the next five years. As the economy moves towards recovery, we expect volumetric sales to increase. PSO has ample opportunity to capture market share owing to its retail network and storage capacity. Earnings growth is expected at a CAGR of 30% (FY23-FY28). Moreover as cashflows are set to improve, the company is widely expected to resume its 10% dividend payout.

Potential power vertical integration

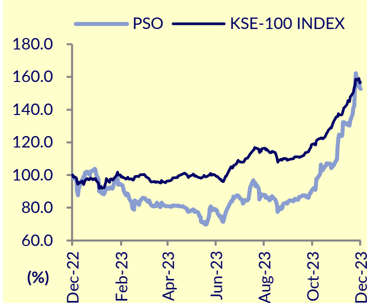
As part of the circular debt management plan, inter-company equity stake arrangements have been put forward as solution to PSO's growing receivables. These include transfer the equity of Guddu and Nandipur power plants or acquisition of GEPCO, which is relatively more efficient than the former. A decisoin in this regard would reduce PSO's opportunity cost stemming from receivables.

Expansion of refining capacity: PSO's refinery subsidiary Pakistan Refinery has inked two land mark agreements for the expansion and upgradation of its refining capacity. PRL has agreed to a USD 1.5 bn investment by United Energy Group to double its refining capacity. As of now, PRL has a refining capacity of 50,000 bpd producing 250,000 tons of MS and 600,000 tons of HSD.

Upon expansion, the refining capacity is expected to increase to 100,000 bpd increasing production of MS and HSD to 1.5 million tons and 2 million tons respectively. Enhancement in PRL's refining capacity would allow PSO to increase its local procurement to bridge the demand-supply gap in a high growth environment without increasing its exposure to foreign currency risk.

Symbol	PSO
Price PKR	204.5
Bloomberg	PSO PA
Reuters	PSO.PSX
Price Target	319.1
Up/downside	56.0%
Mkt. cap USD mn	339.0
No. of Shares mn	469.5
3M ADV USD mn	2.5

PSO vs KSE100 performance



Source: PSX, Bloomberg

Financials snapshot

Year to 30 Jun	FY21	FY22	FY23	FY24	FY25	FY26
EPS (PKR)	62.1	183.7	12.1	63.9	108.7	144.8
DPS (PKR)	10.0	10.0	7.5	10.0	10.0	15.0
BVPS (PKR)	298	459	461	515	614	744
P/Ex	3.30	1.11	16.96	3.20	1.88	1.41
P/BVx	0.69	0.45	0.44	0.40	0.33	0.28
Dividend Yield	4.9%	4.9%	3.7%	4.9%	4.9%	7.3%
Earnings growth	-551.0%	196.0%	-93.0%	430.0%	70.0%	33.0%
ROA	8.1%	13.5%	0.6%	2.9%	4.6%	5.9%
ROE	20.8%	40.0%	2.6%	12.4%	17.7%	19.5%

Source: Company Accounts, Alfalah CLSA Research

LUCK – BUY

LUCK's earnings will expectedly rise to PKR213.6/sh in FY24 and grow at a CAGR of 17% over FY23-26. Earning growth is mainly driven by rebound in domestic cement operations and higher profitability of foreign cement operations. Moreover, company will become more efficient with new solar power facilities in domestic cement manufacturing and new clinker production plant in Samawah. Trading at FY24E P/E of 3.8x we reiterate our BUY call on LUCK. At our June-24 target price of PKR1,077/sh and expected dividend yield of 3.6%, the company provides total upside of 32.5% from last close.

Efficiency projects to uplift profitability margin

Lucky is one of the most efficient cement producers due to low cost power generation. Gross margins for FY23 clocked in at 27% vs industry average of 22%. Company is striving to reduce power cost and, in this lieu, has recently installed 34MW solar power plant in Pezu and another 25MW solar plant in Karachi. Further, 2.5MW solar for Pezu plant and 6.3MW solar and 28.8MW wind power plant are announced for its Karachi plant recently at a cumulative cost of PKR11bn. These projects will reduce reliance on dual fuel power plant and will reduce power cost by ~22% in FY25.

Debt composition makes the company immune to interest rate risk

On standalone basis, all of company's long term debt of PKR15bn is subsidized in nature with markup ranging from 1.5% to 8%. Short term debt of PKR7bn is also subsidized under export refinance facilities. Financial health can also be corroborated from PKR29bn cash and short term investments. Even on consolidated basis, around 84% of company's debt is guaranteed in nature. Hence, company's debt is largely immune to variations in interest rates.

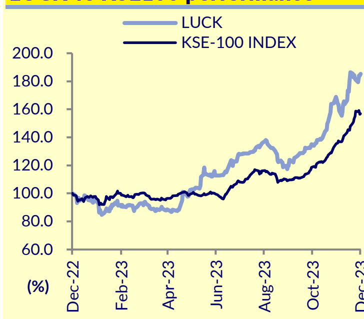
PKR devaluation to increase foreign earnings

Iraq and Congo operations are expected to add PKR 11.6bn to company's bottom line representing around 19% of total profitability. This segment's revenue and profitability are positively linked to PKR depreciation. Hence, providing buffer to company's bottom line as PKR depreciates.

Buybacks and inorganic growth to keep shareholder's return elevated: Company has recently concluded second buyback and has thus reduced outstanding capital by 9.3% to 293mn shares. This will result in higher proportionate earnings for remaining shareholders. Furthermore, company is also acquiring 16% stake in Lucky Core Ventures (LCV) and its chemical subsidiary holds another 51%. LCV is in pursuit to acquire LOTCHEM. Thus, such inorganic growth avenues will likely accrete profitability. Lastly, once power subsidiary starts dividend payment after tariff true-up in FY24, Lucky cement can increase its dividend payout ratio as well.

Symbol	LUCK
Price PKR	812.8
Bloomberg	LUCK PA
Reuters	LUCKY.PSX
Price Target	1,077.2
Up/downside	32.5%
Mkt. cap USD mn	899.2
No. of Shares mn	313.4
3M ADV USD mn	1.5

LUCK vs KSE100 performance



Source: PSX, Bloomberg

Financials

Year to 30 June	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (PKR)	91.2	155.6	213.6	227.5	240.3
DPS (PKR)	0	18	30	35	35
BVPS (PKR)	526	726	938	1159	1364
P/Ex	8.9	5.3	3.8	3.6	3.4
P/BVx	1.5	1.0	0.9	0.7	0.6
Dividend Yield	0%	2%	3%	4%	4%
Earnings growth	31%	68%	39%	7%	6%
ROA	9%	10%	9%	9%	8%
ROE	21%	25%	23%	21%	19%

Source: Company Accounts, Alfalah CLSA Research

FCCL - BUY

FCCL has commissioned its 2.1MTPA Greenfield plant in D.G. Khan and has thus become third largest cement manufacturer of the country with 10.6MTPA capacity. High offtake in proportion to capacity will increase profitability of company by ~17% in FY25. Cash generation of company remains stellar, with FY25 cash generation at around 34% of current market capitalization. Debt, despite of its high absolute level is easily manageable as interest coverage ratio is estimated to be 6.5/9.8/14.3 times in FY25/FY26/FY27 respectively. At our Jun-24 target price of PKR31.4/sh, FCCL offers upside potential of 58.1% from the last close. If sponsor loan is converted, diluted target price is PKR27.1/sh.

Debt level remains comfortable

Company's total debt stock stood at PKR44.9bn at the end of 1QFY24. Long term portion, excluding sponsor support, stand at PKR35.8bn. Of this PKR13.7bn is concessionary in nature utilizing facilities such as TERF, LTFF and renewable energy finance. The weighted average financing rate on this debt component is just 3.1%. Remaining PKR7.4bn is interest free loan provided by parent (Fauji Foundation) to erstwhile Askari cement for Nizampur expansion. Sponsor may convert that amount to equity at any time at par value. For remainder of KIBOR linked debt, impending decline in interest rate will improve interest coverage ratio to 4.9/6.5/9.8/14.3 times in FY24/FY25/FY26/FY27 respectively.

Cash generation can be utilized for dividend payment

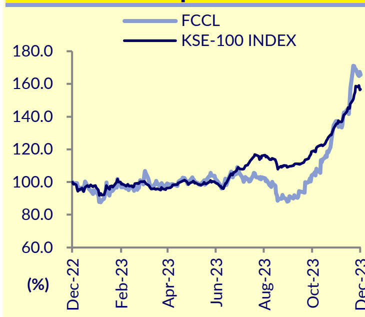
Cash generation of the company is stellar and is enough to retire all debt in 3 years. Current market capitalization is attractive as FCCL trades at 3.4x of FY25 cash generation. Retiring debts that fall due leaves PKR 5.9/14.0/13.3 billion excess profit - excluding depreciation and working capital needs – in FY24/FY25/FY26 which can be disbursed to shareholders. If fully paid out, this can result in dividend of PKR 2.4/5.7/5.4 per share respectively. However, we have remained conservative in our assumptions and have not incorporated this potential dividend until all non-concessionary loan is paid-off by FY26.

Working on energy efficiency: Company is continuously working on in-house power generation and has recently installed 20MW solar power. This along with waste heat recovery plants are capable of meeting 42% of power needs in FY24. If company decides to deploy just FY25 excess cash in energy efficiency projects, then it can procure ~37MW coal power plant without resorting to debt making the company self-reliant in its power needs.

Trading at attractive multiples: Company is currently trading at steep discount to historical multiples. FY24E P/E is 3.8x while P/FCF is at 4.3x. P/B is at distressed level of 0.6x. 5/10 years historic P/E is 6.2x/9.7x, P/FCF is 5.9x/7.5x, while P/B is 0.9x/1.6x. Hence, only partial rerating provides significant upside. EV/Ton also currently stand at USD29, i.e. less than half of replacement cost.

Symbol	FCCL
Price PKR	19.9
Bloomberg	FCCL PA
Reuters	FAUC.PSX
Price Target	31.4
Up/downside	58.1%
Mkt. cap USD mn	172.0
No. of Shares mn	2,452.8
3M ADV USD mn	0.5

FCCL vs KSE100 performance



Source: PSX, Bloomberg

Financials

Year to 30 June	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (PKR)	4.58	3.03	5.27	7.34	9.12
DPS (PKR)	0	0	0	0	4.5
BVPS (PKR)	23.1	26.6	31.8	39.2	43.7
P/Ex	4.4	6.6	3.8	2.7	2.2
P/BVx	0.9	0.8	0.6	0.5	0.4
Dividend Yield	0%	0%	0%	0%	23%
Earnings growth	104%	28%	77%	32%	23%
ROA	10%	6%	9%	11%	11%
ROE	18%	12%	19%	20%	19%

Source: Company Accounts, Alfalah CLSA Research

EFERT - BUY

We have a BUY call on EFERT with a TP of PKR143/sh, offering potential capital upside of 28.5% in addition to dividend yield of 26% in the intervening period. Our liking for the company is mainly premised on EFERT offering highest dividend yield in sector and having resounding earnings outlook. This dividend yield is significantly higher than yield on fixed income securities. Moreover, any upward revision in gas prices as suggested by SNGP in recent submission of revenue requirement will be beneficial for EFERT as it also partially draws gas priced under petroleum policy and fully passes on hike in input costs.

Revision in gas prices to benefit EFERT

In our base case, we have assumed that feed/fuel gas price under fertilizer policy will increase by ~15% in the upcoming year from PKR580/1580 per mmbtu to PKR670/1820 per mmbtu. Such price revisions benefit the company as EFERT relies on petroleum policy for gas needs of its base plant. Therefore. the effective increase in network gas cost is lower compared to competitors. However, the company increases urea price in line with competition which prove to be margin accreting in nature. Following this theme, EFERT's earnings are expected to clock in at PKR32.5/sh in CY24.

Dividend yield like none other

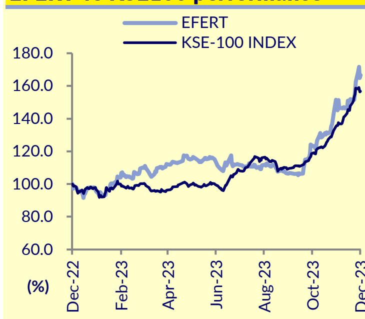
The above mentioned hike in profitability enables the company to significantly increase dividend to PKR29/sh in CY24, even after reducing payout ratio to 90%. This translates into 26% dividend yield, significantly higher than yield on fixed income securities. Company currently accrues and pays for gas at different rates as matter related to provision of concessionary gas is under litigation. We estimate that such arrangement will continue till Feb-2024 and after that payment of gas charges will also increase. Hence, we have declined dividend pay-out ratio from CY24 onwards to more sustainable level of ~90%. However, if outcome of those suits go in favour of EFERT then one-off EPS impact for entire period under contention will be around PKR8.6/sh.

BMR unlocked capacity: Company's production capacity has increased by 170KT during the outgoing year resulting from BMR of base plant with outlay of USD50mn. Incremental earnings from this increase in production capacity amounts to 0.9/sh.

Healthy balance sheet: Company has PKR28bn worth of cash and short term investments as of 3QCY23, of which major chunk is invested in mutual funds and Pakistan Investment bonds. These liquid securities are more than GIDC payable of PKR20bn. Moreover, company's debt profile is quite manageable with D/E and D/A of only 21% and 7% respectively. Thus, company can finance any capex requirement including MARI compressor's project with estimated cost for EFERT of ~PKR20bn through debt.

Symbol	EFERT
Price PKR	111.4
Bloomberg	EFERT PA
Reuters	ENGR.PSX
Price Target	143.1
Up/downside	28.5%
Mkt. cap USD mn	525.0
No. of Shares mn	1,335.3
3M ADV USD mn	0.9

EFERT vs KSE100 performance



Source: PSX, Bloomberg

Financials

Year to 31 Dec	CY21A	CY22A	CY23E	CY24E	CY25E
EPS (PKR)	15.80	11.98	19.95	32.48	35.21
DPS (PKR)	16.5	13.5	20.5	29.0	29.5
BVPS (PKR)	35.1	33.8	36.2	48.2	53.4
P/Ex	7.1	9.4	5.6	3.5	3.2
P/BVx	3.2	3.3	3.1	2.3	2.1
Dividend Yield	15%	12%	18%	26%	26%
Earnings growth	16%	-24%	66%	63%	2%
ROA	16%	12%	18%	27%	25%
ROE	45%	35%	57%	77%	65%

Source: Company Accounts, Alfalah CLSA Research

ILP – BUY

ILP is our preferred textile play. It is pursuing expansions in value added segments; with a capital outlay of USD300mn. The management is eyeing revenues of US$700mn by FY26 through these projects (3yr CAGR of 26%). The company has a sticky customer base, providing benefit when industry exports are on a downturn. Apparel division has achieved profits in pilot phase; a master project of apparels commenced in Nov 2023. New hosiery plant's proposal is currently under review and a final decision is expected by the end of CY23. ILP is also pursuing energy efficiency projects (solar power as well as biomass boilers) to reduce fuel/power cost. We expect FY24/25 EPS at 16.7/22.4 per share. The scrip offers an upside potential of ~59% with Jun-24 PT of PKR110/sh.

One of the world's largest hosiery manufacturers

Interloop Limited, with humble beginnings, has grown into one of the world's largest hosiery manufacturers. The company manufactures ~700 million pairs of socks annually for top international brands and retailers. Consistent improvement in revenue and earnings, sticky customer base and continuous focus on expansions in value-added segments makes ILP our preferred pick. It is interesting to note that the historical 5-year revenue/EPS CAGR has been around ~31/3% respectively.

Expansion projects have started kicking-in

ILP has spent around USD150Mn and recently commenced its master apparel project (after an initial pilot phase). The management projects its revenues to be ~USD125Mn in the next 1-1.5 years. Note that apparel is a higher-margin segment, which shall boost earnings going forward.

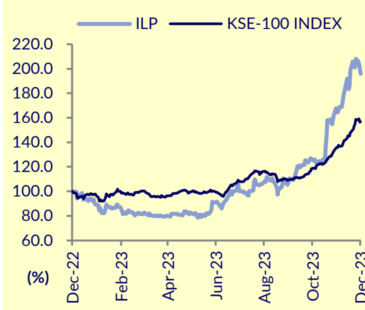
Moreover, new hosiery plant's proposal is currently under review and a final decision is expected by the end of CY23. ILP has also acquired Top Choice, which is US based hosiery manufacturer with a Chinese subsidiary too. Once again, Denim project's further expansion has been put on hold. The next leg of denim expansion could be commissioned, depending on the market conditions. Moreover, ILP also plans to add activewear plant to further enhance ILP's footprint in the value-added sector.

Focus on energy efficiencies: ILP is also pursuing energy efficiency projects (solar power as well as biomass boilers) to reduce fuel/power cost. Currently, ILP is being charged at a blended rate (RLNG/Natural gas: 63/38%). Note that gas prices have increased recently and another gas price hike is in the offing.

Absence of concessionary financing to impact costs: Rates on LTFF and EFS have also been linked to policy rate, which is at decades-high. However, they are expected to go down in the next calendar year and will provide respite to burgeoning finance cost.

Symbol	**ILP**
Price PKR	70.9
Bloomberg	ILP PA
Reuters	INTR.PSX
Price Target	110.0
Up/downside	41.1%
Mkt. cap USD mn	350.6
No. of Shares mn	1,401.4
3M ADV USD mn	0.2

ILP vs KSE100 performance



Source: PSX, Bloomberg

Financials

Year to 30 June	FY22A	FY23A	FY24E	FY25E	FY26E
EPS (PKR)	8.8	14.4	16.7	22.4	27.7
EPS growth	96.4%	63.2%	15.9%	34.2%	23.6%
P/Ex	8.1	4.9	4.3	3.2	2.6
DPS (PKR)	2.6	4.0	7.0	9.8	12.7
Dividend Yield	3.7%	5.6%	9.9%	13.9%	17.9%
P/BVx	3.3	2.3	1.6	1.2	0.9
BVPS(PKR)	21.4	31.3	44.4	58.6	74.8
ROA	12.8%	16.1%	19.0%	23.4%	27.3%
ROE	41.3%	46.0%	37.5%	38.2%	37.0%

Source: Company Accounts, Alfalah CLSA Research

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