April 02, 2010

Pakistan Market

MORNING BRIEFING

Constitutional reforms: a value pack for equities

KSE100 Index: Closing 10246.77 ↑ (+68.34)

After electing the Prime Minister unanimously two years ago, another feather in the cap for the democratic setup now is; the political parties agreeing to table the draft of a constitutional reforms package for the 18th amendment in the Parliament. The bill will propose, 1) limitation of the President's powers, including doing away with the authority to dissolve the parliament (Article 58 (2)(b)), 2) transfer the authority to appoint judges of the apex court to the 7-member judicial committee, headed by the Chief justice, 3) selection of the chief election commissioner to be made in consultation with the opposition, and 4) more importantly, the provinces be given more autonomy than before.

The immediate investor reaction to the news of a national consensus on the proposed constitutional reforms has positively impacted the markets; 1) Pakistan's CDS lowered by 87bps to 7ppt, the KSE-100 rose by 68pts or 0.7% and 3) the rupee exchange showed stability against the USD. With this political resolution and the recent assessment by Moody's, we believe Pakistan's political risk premium should contract and help the market converge to its historical discount to the region of 33% from the existing 42% on FY11F PE. Further, resolution of the inter-corporate debt, the successful security operation in South Waziristan and completion of IMF's standby facility, should boost chances of bringing down the historical discount to the all time low level of 25%, as realized on April 13th, 2008. For now, on the basis of the historical average discount of 33% to the region, our first target for the index is 11,800pts. Our top picks include; PPL, POL, PTC, HUBCO, PSO, NML, DGKC, ENGRO and NBP.

18th Constitutional Amendment; a historic event

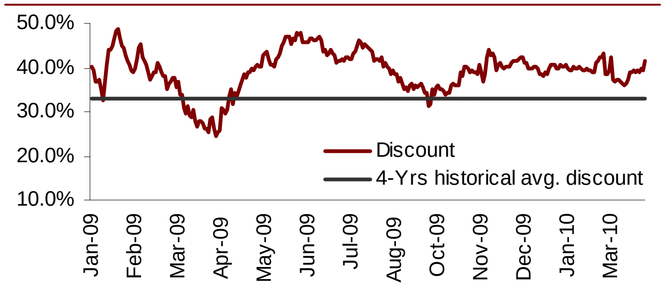
After a hectic round of 79 meetings over a span of 9 months, the Parliamentary Committee on Constitutional Reforms (PCCR) finally achieved a historic consensus on the draft of the 18th Constitutional Amendment Bill, which aims to repeal the tainted 17th Amendment and strike a balance between powers of the key organs of the State. A total of 95 amendments have been proposed, which is almost one fourth of the landmark 1973 Constitution.

We believe agreement on the 18th Amendment Bill marks a new chapter in Pakistan's political history and would play a major role in achieving sustained political stability from hereon.

Political stability to propel Index to 11,800

We expect the local equity market to continue the recent Bull Run (KSE 100 up 9% since Mar 3, 2010) triggered by the political breakthrough on the 18th constitutional amendment and continued improvement in macro fundamentals under the IMF program. Pakistan's political risk premia which had risen substantially in the recent past is likely to contract, thus helping the market to converge towards its historical PE discount of 33% with regional peers.

Pakistan's PE discount relative to Asian EM



Source: Reuters & JS Research

With Pakistan's market trading at a one year forward PE of 7.4x (42% discount to the region), convergence towards the historical average discount would allow the index to reach the 11,800 mark. Increased quantum of foreign inflows (US$143mn in 2010 to date) also indicates renewed confidence of foreigners in Pakistan's equities. Moreover, resolution of the inter-corporate debt, success of the security operation in South Waziristan and completion of IMF's standby facility could even propel the discount to hit an all time low of 25% to region (realized on April 13th, 2008), which would see the index touch a high of 13,200 points.

We remain upbeat on the Oil, Power, Cement, Fertilizer, Textile and Telecom sectors' fundamentals with PPL, POL, PTC, HUBCO, PSO, NML, DGKC, ENGRO and NBP, our preferred plays.

Top Picks snapshot (FY11)

	PE (x)	PBV (x)	Div. Yield (%)	Target Price (Rs)
PPL	6.0	2.0	10.8%	236
POL	5.8	1.5	11.2%	275
PTC	9.9	1.0	8.3%	31
HUBC	6.2	1.4	17.0%	45
PSO	5.1	1.6	7.7%	390
NML	9.1	1.3	4.5%	71
DGKC	8.9	0.4	6.4%	37
ENGRO	10.7	2.2	5.5%	220
NBP	4.8	0.6	9.6%	77

Source: JS Research

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