JS Research

January 20, 2009

Pakistan Market

Distress selling and cheap valuation

MORNING BRIEFING

KSE100 Index Closing 5280.75 ↓ (-231.18)

Liquidity drives the market. That is why we are seeing continuous fall in share prices at Pakistan's exchange though market average PE is now 4.9x. With gradual buying by NIT managed US$250mn fund relatively to aggressive selling mainly by foreigners and banks after investors failed to deposit margins, equity values have plummeted 10% so far this year this is in addition to 58% (67% in US$) fall witnessed in 2008.

Right now the major problem with the market is lack of funds to absorb this desperate selling. Politics, economy, corporate earnings, etc. are not the major factors behind the recent slide. In fact we are seeing some improvement in key economic indicators like inflation, revenue collection, trade deficit, forex reserves, etc.

Foreigners share increasing, now 25% of volumes

Banks have been selling shares of those investors who are not fulfilling margins after the steep fall in share prices. But the main factor has been selling by offshore investors. This is not a surprise. This was expected after the unjustified closure of market for more than 100 days that also resulted in exclusion of Pakistan from widely followed MSCI EM index. Moreover, the global financial meltdown has caused funds outflow from all leading markets.

On an average ever since the lifting of price floor, net foreign selling is US$3.7mn per trading session. This offshore activity is and will create an impact as foreigners share in total volume has risen sharply to 25% in cash market post lifting of floor rule. With average settlement of 67% of total volume, foreigners (who hardly do intra day trades) share in settlement has jumped to more than 35%.

As mentioned in our recently issued note on Market Strategy dated January 14, 2008 we expect foreigners can sell shares worth US$300-400mn (out of their total holing of close to US$1bn) in next few months. In the 23 trading days after floor they have already sold shares (net of buying) of US$85mn.

Fund buying is slow and gradual

As observed in the last few trading sessions that NIT-led fund has bought 8 state owned shares. But that buying has been slow and not matching the overall selling trend especially supply coming from banks and foreigners. According to news reports, NIT has bought shares valuing Rs2bn (10% of fund size). This has caused the market to erode 13% in last 3 sessions. Yesterday there were offers on lower limit of only Rs230mn in 8 stocks that NIT has planned to buy. This is nothing considering the Rs18bn still lying with NIT.

Many stocks with 20% dividend yield & PE of 3x

Pakistan market has seen average PE of less than 5x three times in 1998, 2002 and 2003. In fact in 2002 at one pint in time PE was lower than 4x. But as mentioned earlier markets issue right now is not valuation but supply. Investors investing at current levels may earn decent returns but they should be patient as it will take few months before this selling I absorbed effectively. Following are top dividend yield and PE stocks.

Table 1: Top 5 dividend yield companies

Company Name	FY09E
Oil & Gas Development Company	22.3%
Fauji Fertilizer Company	20.5%
Pakistan Oilfields	19.4%
Hub Power Company	18.7%
Pakistan Petroleum	17.9%

Source: JS Research

Table 2: Top 5 companies in terms of lowest PE

Company Name	FY09E
Pakistan Oilfields	2.8
National Refinery	3.0
Nishat Mills	3.2
Attock Petroleum	3.2
ICI Pakistan	3.3

Source: JS Research

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Also in focus

Cumulative cotton arrivals marginally up by 3.5%

According to the latest numbers released by Pakistan Cotton Ginners Association (PCGA), cotton arrivals stood at 10.3mn bales as of Jan 15 2009, translating into a marginal growth of 3.5%. While overall arrivals show some improvement from last year, the growth has slowed considerably as arrivals in the last fortnight i.e. Jan 1 to Jan 15 2008 stood at 0.58mn bales, down 32% from 0.86mn bales recorded in the corresponding period last year. This is the fourth consecutive fortnight to witness a YoY decline in cotton arrivals this season. We expect cotton arrivals for FY09 to be close to 12mn bales, marginally lower than government's revised target of 12.1mn bales.

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