

## Pakistan Equity Strategy

# Exchange rate weakness & KSE-100 earnings

KSE100 Index: Closing 23,088.49 ↓ (551.48)

- Despite the precarious Balance of Payments position in FY13, Pak Rupee (PKR) exchange rate held up reasonably well, losing 4.8% vs. the US Dollar (USD), vis-à-vis 30-year average annual Rupee devaluation of 7.2%.
- FY14-to-date, has been a different story altogether where despite greater reassurance on the external account post joining the IMF program, the PKR is already down 7.4% vs. the USD.
- We maintain our view that the Pak Rupee will start to stabilize post 1QFY14 but believe uncertain currency outlook is likely to play on equity investor minds, given risk of (1) macro slippages; (2) risk of lowering KSE attraction for foreign investors and (3) lower corporate earnings.

## Currency stability in FY13 despite BoP concerns...

Despite the precarious Balance of Payments (BoP) position in FY13 - which depleted foreign exchange (FX) reserves from US\$15.29bn to US\$11.02bn - Pak Rupee (PKR) exchange rate held up considerably well last year. The PKR lost 4.8% of its value against the US Dollar (USD) in FY13, a reasonable enough performance as compared to previous 30-year average annual Rupee devaluation of 7.2%. The same was despite the fact that in FY13, State Bank of Pakistan (SBP) reserves dropped from US\$10.80bn (almost 3-months import cover) to US\$6.00bn (about 6-weeks import cover), which ignited concerns of a bull-blown BoP crisis.

## ...but YTD FY14 depicts sharp deterioration

FY14-to-date, has been a different story altogether. While the risk of a BoP crisis has been averted by Pakistan's re-entry into the IMF program (September 2013); Pak Rupee exchange rate has deteriorated considerably post July 2013. YTD FY14, the Pak Rupee has shed ~7.4% of its value vs. the greenback (Jan 2013-to-date Pak Rupee is down 9.4% vs. the USD). The same can partly be dubbed a late 'catch-up' play vis-à-vis the rout in regional FX markets (see table adjacent). That said, recent Pak Rupee slide also ties up to the IMF's requirement that the SBP (1) purchase US\$125mn from the FX spot market (prior action completed 5-days before IMF's Board Meeting on Sep 04, 2013); (2) limit interventions in the market to those consistent with the program; & (3) increase its net foreign reserves by US\$347mn by Dec-2013. With limited US Dollar liquidity, speculative activity also picked pace with USD crossing an all time high of Rs108/US\$ in the open market.

## Outlook and KSE implications

Recall last week we raised our Pak Rupee exchange rate outlook for June 2014 to Rs107.5/US\$ (from Rs105.5/US\$), where we flagged that currency pressure is likely to subside post 1QFY14. We maintain this view but believe a weak/uncertain currency outlook is likely to play on equity investor minds, given risk of (1) macro slippages - inflation, fiscal account; (2) lowering KSE attraction for foreign investors, where FY14-to-date deval has already pared Dollar returns at the KSE to 2.5% (9.9% Rupee denominated return) and (3) lower corporate earnings. On the latter, we see a relatively timid impact on KSE earnings where heavyweight sectors are either positively correlated to or immune to PKR exchange rate weakness.

## MORNING BRIEFING

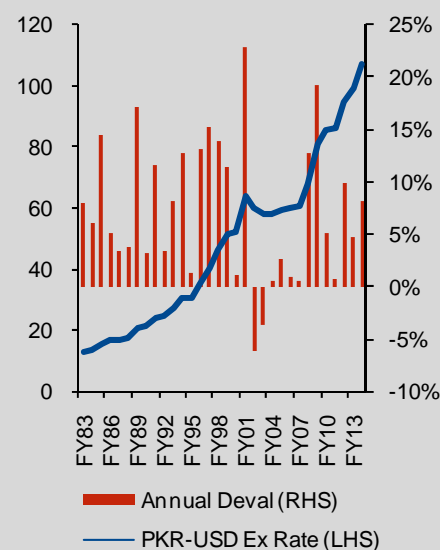
JS Research  
js.research@js.com  
+ 9221 111-574-111

### Pak ex-rate & market performance vs. region

	Jan-to-date		Jul-to-date	
	Index Return	Ex-rate deval	Index Return	Ex-rate deval
Indonesia	3.3%	17.2%	-7.4%	14.7%
India	2.5%	14.1%	2.7%	5.7%
Japan	41.7%	13.8%	7.7%	-0.5%
Pakistan	36.6%	9.4%	9.9%	7.4%
Philippines	11.2%	5.9%	-0.1%	0.7%
Malaysia	6.1%	5.1%	1.1%	1.7%
Singapore	1.4%	2.7%	1.9%	-1.0%
Thailand	1.9%	2.5%	-2.4%	1.0%
Taiwan	7.8%	1.9%	2.9%	-1.3%
Korea	0.5%	0.7%	7.7%	-6.1%
Hong Kong	2.3%	0.0%	11.4%	0.0%
China	-2.7%	-1.8%	11.5%	-0.3%

Source: Bloomberg

### Pak ex-rate & devaluation history



Source: SBP

# MORNING BRIEFING

	Target Price	Rating	2014E EPS	EPS impact of Rs1/USD higher Ex-rate	Comment
<b>Textile</b>		<b>OW</b>		<b>4.0%</b>	<b>Overall Impact: Positive</b>
Nishat Mills Ltd	118	Buy	17.05	2.0%	With mostly export oriented sales; any PKR depreciation is likely to benefit the entire textile chain.
Nishat Chunian Ltd	65	Hold	15.99	6.0%	
<b>Chemicals</b>		<b>MW</b>		<b>2.5%</b>	<b>Overall Impact: Positive</b>
Lotte Chemical Pak Ltd	6.9	Sell	0.58	2.5%	Weak PKR will increase local PTA prices, which are linked to international prices. Although imported PX cost will also rise, net impact will be positive.
<b>Power Generation</b>		<b>OW</b>		<b>1.3%</b>	<b>Overall Impact: Positive</b>
Hub Power Co	73	Buy	9.41	1.2%	HUBC and KAPCO provide US Dollar based returns via a Dollar based tariff therefore they will benefit from PKR depreciation.
KAPCO	68	Buy	9.28	1.4%	
<b>Oil &amp; Gas Exploration</b>		<b>OW</b>		<b>1.1%</b>	<b>Overall Impact: Positive</b>
Oil & Gas Dev. Co	253	Hold	29.37	1.3%	Pak E&P's benefit from PKR depreciation vis-à-vis USD owing to USD denominated revenues. We flag an avg +1% impact on sector's earnings from Rs1/USD higher Ex. rate
Pakistan Petroleum	220	Buy	33.51	0.7%	
Pakistan Oilfields	550	Buy	66.47	1.4%	
<b>Technology &amp; Comm.</b>		<b>OW</b>		<b>0.5%</b>	<b>Overall Impact: Positive</b>
P.T.C.L.	26	Hold	3.38	0.5%	With international revenues (Post ICH) contributing significantly to total revenue (15%), PTC's earnings are hedged against PKR depreciation.
<b>Fertilizer</b>		<b>OW</b>		<b>0.4%</b>	<b>Overall Impact: Neutral</b>
Fauji Fertilizer Co.	120	Buy	14.91	NM	For fertilizers, PKR deval impact is likely to be neutral. However, ENGRO's earnings are likely to take the brunt due to its foreign denominated loans. For FFBL, it depends on the imported Phos-acid and local DAP price scenario but improvement in primary margin in PKR terms if everything remains constant will positively impact the earnings.
Engro Corporation	166	Buy	18.17	-1.0%	
Fauji Fertilizer Bin Qasim	44	Buy	6.06	1.8%	
Fatima Fertilizer	31	Buy	4.94	NM	
<b>Banks</b>		<b>MW</b>		<b>NM</b>	<b>Overall Impact: Neutral</b>
MCB Bank	300	Hold	22.7	NM	For banks, Pak Rupee depreciation is unlikely to directly affect the bottom line as banks earn commission on their dealings in Foreign Currency. However, banks which have a presence in the international market are likely to report higher bottom line in PKR terms in our view.
Habib Bank Limited	117	Sell	16.52	NM	
United Bank Limited	140	Buy	16.06	NM	
National Bank of Pakistan	57	Buy	7.3	NM	
Allied Bank Limited	83	Hold	10.83	NM	
Bank Al-Falah	26	Buy	3.57	NM	
Askari Bank	16	Hold	1.48	NM	
<b>Cement</b>		<b>OW</b>		<b>-0.3%</b>	<b>Overall Impact: Neutral</b>
Lucky Cement	252	Hold	31.65	0.3%	Impact on the cement sector is largely neutral as export revenues offset the cost of imported coal. LUCK being the biggest exporter of cement is a beneficiary in the case of Rupee depreciation. FCCL is negatively impacted due to relatively lower exports and its foreign currency denominated loan.
DG Khan Cement	97	Buy	14.06	0.0%	
Lafarge Pakistan Cement	8.8	Hold	1.63	0.0%	
Fauji Cement	15.7	Buy	2.18	-1.4%	
<b>Refinery</b>		<b>MW</b>		<b>-1.7%</b>	<b>Overall Impact: Negative</b>
Attock Refinery	190	Sell	32.96	-2.1%	Pak Refineries face exchange losses on account of PKR depreciation from fuel imports.
National Refinery	242	Hold	44.7	-1.3%	
<b>Auto Assembler</b>		<b>MW</b>		<b>-2.3%</b>	<b>Overall Impact: Negative</b>
Indus Motors	341	Hold	50.75	-2.0%	Pak Auto Assemblers face higher cost of production from PKR depreciation vs. USD as they source most of their parts from Japan and Thailand.
Pak Suzuki Motors	159	Hold	26.35	-2.6%	
<b>Oil &amp; Gas Marketing</b>		<b>MW</b>		<b>-4.5%</b>	<b>Overall Impact: Negative</b>
Pakistan State Oil	260	Sell	63.06	-4.5%	We flag incurrence of substantial exchange losses for PSO given its heavy reliance on imports, while APL remains largely immune due to local sourcing of its products.
Attock Petroleum	475	Hold	66.61	NM	

Source: JS Research

## MORNING BRIEFING

### Also in Focus

#### Pakistan set to pay another installment to the IMF

Pakistan is expected to pay US\$143mn to IMF on Friday September 27, 2013 on account of the Stand-By-Arrangement (SBA). Note that this is the 20th installment of the SBA and despite various challenges Pakistan has fulfilled its debt obligations. However, Pakistan has entered another IMF program recently which is worth US\$6.6bn in order to build its forex reserves. The country has already received US\$540mn under this new facility in mid September.

#### Pakistan market statistics (Sept 24, 13)

KSE-100 Index	23,088.49
Previous KSE-100 Index	23,639.97
Change from last closing	-551.48
Change from last closing (%)	-2.33%
KSE Market Cap. (Rs. bn)	5,419.92
KSE Market Cap. (US\$ bn)	51.18
Total Volume (Shares mn)	235.88
Traded Value (Rs. bn)	7.97
Traded Value (US\$ mn)	75.26
KSE-30 Index	17,637.25
Change from last closing	-483.32
Change from last closing (%)	-2.67%
KSE Futures Volume (Shares mn)	20.79
KSE Futures Value (Rs. mn)	1,242.42
KSE Futures Spread	10.31%

Source: KSE

#### KSE valuations

	2013E	2014F	2015F
P/E (x)	8.9	7.7	7.2
P/BV (x)	1.9	1.7	1.6
Div. Yield (%)	6%	6%	7%
Earnings growth	7%	16%	7%

Source: JS Research

#### JS Global Capital Limited

6th Floor, Faysal House, Shahrah-e-Faisal, Karachi

##### Research:

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

js.research@js.com

##### Equity Sales:

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

eqsales@js.com