



Equity Research Pakistan

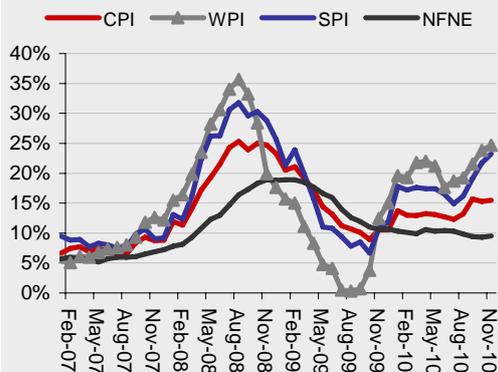
In Focus Strategy

Hamad Aslam, CFA
haslam@bmacapital.com

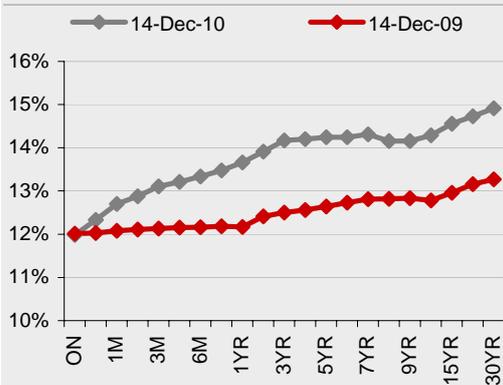
Select Economic Indicators

CPI Inflation	Nov-10 YoY	15.5%
SPI Inflation	Nov-10 YoY	23.2%
NFNE Inflation	Nov-10 YoY	9.5%
Reserves	As 04-Dec-10	USD16.39bn
Remittances	4MFY11	USD3.50bn
Trade Balance	4MFY11	USD(3.72bn)
Current A/c deficit	4MFY11	USD(0.53bn)
6 Month KIBOR	14-Dec-10	13.5%
10 Year PIB	14-Dec-10	14.3%
Discount Rate		14.0%

Inflation (YoY)



Yield Curve



Pakistan Capital Markets Day at LSE: Conference Takeaways

- BMA Capital, in collaboration with LSE and PC, held Pakistan Privatization and Capital Markets Day at LSE on December 10, 2010. The event was attended by global fund managers and analysts covering Pakistan as well as other Emerging and Frontier markets
- PC in its presentation disclosed the privatization agenda for Pakistan and outlined the tentative timelines and targets for convertible bonds and IPOs in the pipeline
- BMA, in its presentation on Pakistan's investment opportunities, highlighted investment themes and sectors such as 1) privatization, 2) agriculture, 3) rich natural resources, 4) infrastructure, 5) geographic position and 6) financials
- Presenting companies from Pakistan's corporate sector included OGDC, PPL, MCB, UBL, ENGRO, HUBC, LUCK, KESC and IESCO; each of which discussed their respective company profiles and future outlook
- Foreign portfolio investment is now estimated to be accounting for 33% of free-float weighted market cap of Pakistan equities. However most of the recent flows have been concentrated in select large cap scrips; we believe that the recent initiative by BMA and its partners should go a long way in introducing other sectors to foreign investors
- Thus we maintain a positive outlook on Pakistan equities and believe that global liquidity should allow increased penetration into Pakistan equities which remain attractive on the grounds of both 1) growth story and 2) compelling valuations

BMA Capital, in collaboration with London Stock Exchange (LSE) and Privatization Commission of Pakistan (PC), held Pakistan Privatization and Capital Markets Day at LSE on December 10, 2010. The event was attended by global fund managers and analysts covering Pakistan as well as other Emerging and Frontier markets.

Listed companies representing Pakistan included Oil and Gas Development Company (OGDC), Pakistan Petroleum (PPL), MCB Bank (MCB), United Bank Limited (UBL), Engro Corporation (ENGRO), Lucky Cement (LUCK), Hub Power (HUBC) and Karachi Electric Supply Corporation (KESC).

Welcome and opening remarks for the forum were given by Rt. Hon. Alderman Michael Bar, Lord Mayor of the City of London, where he highlighted the growth potential in Pakistan and importance of business ties between the two countries. This was followed by presentations by Privatization Commission, BMA and Pakistan's corporate sector while the second half was dedicated to one-on-one meetings between investors and managements of listed companies.



Equity Research Pakistan

In Focus Strategy

Privatization agenda disclosed; Convertible bonds and IPOs for SOEs

Senator Waqar Ahmed Khan, Federal Minister for Privatization, Government of Pakistan, set the stage by introducing the country as a land of opportunities and highlighted the key competitive advantages as strong demographics and geo-strategic location and emphasized upon the recent improvement in economic indicators such as FOREX reserves and home remittances.

He further shed light upon the government's privatization agenda where he disclosed the target amounts and timelines for each of the two convertible bonds in pipeline. According to the laid out plan, OGDC is to issue USD1,081mn worth of bonds in international markets by Mar11 while PPL is to follow suit with USD304mn by Jul11. The Senator also discussed the planned IPO for IESCO (Islamabad Electricity Supply Corp) which stands out amongst the rest of DISCOS by exhibiting the lowest line losses in the country.

Investment Themes for Pakistan

Pakistan continues to be covered by the international media for its various social, political and economic challenges. Without undermining these challenges, Mr. Moazzam Malik, CEO BMA Capital, took the opportunity to talk about how the country has progressed and rose through them. In his presentation on Investment Opportunities in Pakistan, he thus highlighted the key investment themes that the country has to offer.

1. Privatization – Mutual Benefit

The presentation highlighted the existence of a number of SOEs with strong infrastructural setup (such as Pakistan Steel) and natural monopolies (such as DISCOs) that are yet to achieve the full benefits of their business models. The theme thus identified the possible turnaround stories and potential for double digit returns in case private managements take over such entities.

2. Food Reservoir for the Region

Pakistan ranks amongst the top 10 producing countries for wheat, cotton, milk chickpeas and others while almost 25% of its GDP and 45% of employment is contributed by agriculture. Competitive advantages for investment in the sector include nutrient soil, abundant water, subsidized fertilizer, cheap labor force and negligible taxation.

Yet the sector faces structural issues such as lack of farmer education and inappropriate farming methods which involve misapplication of fertilizer and water wastage. Thus agriculture remains one of the key investment themes for Pakistan where sophisticated investors can be invited to establish corporate and livestock farming. Moreover the favorable proximity to Central Asia and the Middle East who rely on food imports for consumption opens up the possibility of filling in the food gap for these large and growing populations.

As the potential food basket of the region, proxy investment through companies like Fauji Fertilizer Bin Qasim (FFBL), Fauji Fertilizer Company (FFC), Engro Corporation (ENGRO) and Millat Tractors (MTL) provide investors with access to



Equity Research Pakistan

In Focus Strategy

market leaders, strong pricing fundamentals, robust demand and brand recognition.

3. Rich Natural Resources – Playing the Global Commodity Cycle

The third investment theme that BMA highlighted remains one of the favorites of both the local and foreign investors and stems from none other but Pakistan's rich natural mineral reserves. In terms of hydrocarbon exploration, the E&P companies have recorded a long term drilling to success ratio of 3:5 and ROEs in excess of 40% while large untapped reserves hint of much more.

Coal reserves, which however remain largely untapped, are estimated at 186bn tons, the 4th largest in the world, depicting reserve to production ratio of 49,000 years! Policy framework for coal exploration and subsequent electricity generation is in its final stages and is envisaged to offer USD guaranteed returns of as high as 21%.

Listed proxies to the theme include ENGRO, OGDC, PPL and Pakistan Oilfields (POL).

4. Infrastructure Deficit an Opportunity

Given Pakistan's population, demand story and economic growth; the next obvious theme stemmed from the infrastructure deficit. Pakistan's economy grew at an average of 5% in the past decade however no major addition was seen in electricity supply and road/railway network during this time period; while no multi-purpose dam has been built since 1976.

As a result, Pakistan's road density and water storage capacity stand at one of the lowest in the world, while the country currently faces electricity shortfall of about 3,500 MW.

Realizing the deficit, the government offers lucrative return profiles in such investment opportunities. For instance, returns for independent power producers are guaranteed at USD based IRR of 15%. Some of the listed power producers include HUBC and Kot Addu Power (KAPCO).

5. The New Silk Route – Pakistan Sits at the Centre of Opportunity

Pakistan's unique geographic position offered the next investment theme for the discussion. On the west lie China and South Asia with a population of 2.6 billion people while on the east lie the world's 54% oil reserves and 40% gas reserves. Not only that, there are six landlocked countries on the north of Pakistan. Thus it would be fair to say that Pakistan sits at the centre of opportunity where strategic investments should allow it to become the next Silk Route of the region.

A number of listed sectors are already taking advantage of the opportunity; for instance LUCK for which exports now contribute to over 50% of revenues. Pakistan International Container Terminal (PICT) is another example, for which turnover and handling volumes have increased at 5 year CAGR of 31% and 25% respectively.

6. Pakistan Financials – Under Banked, Under Saved, Under Invested

Last in the investment themes was Pakistan Financials, one of the most talked about sectors. It was highlighted that not a single bank had collapsed in Pakistan

Equity Research Pakistan**In Focus**
Strategy

since the global financial crises started. Instead, larger and well established banks in the country have been averaging ROEs of 20% and higher while spreads have remained firm at over 7% - the highest in the region.

Future growth potential remains largely untapped. Credit penetration in Pakistan has been under 30% of GDP; general access to credit is negligible while asset management industry stands at only 5% of deposits, compared to 20% in India and over 100% in US. Similarly, insurance penetration in the country is also one of the lowest in the region, currently standing at just 0.7% of GDP.

A number of well established banks offer the opportunity to take advantage of this under-penetration while offering robust balance sheets and healthy returns. The presentation highlighted UBL and MCB to be the two banking stocks that stood out amongst them.

Crisis is a terrible thing to waste; Pakistan's return profile

The second part of BMA's presentation was delivered by Mr. Muddassar Malik, CEO BMA Funds, who highlighted how Pakistan's capital markets have outperformed almost all other asset classes in the world; had someone invested in times of pessimism such as nuclear blasts of 1998, start of War on Terror in 2001, post stock price floor in 2009 and more recently the devastating floods of 2010.

Corporate Presentations; the E&P giants

The managements of OGDC and PPL, in their presentations, introduced Pakistan's E&P sector. The former also talked about its impressive RRR (reserve to replacement ratio) and aggressive exploration program that had been reaping fruits for the company. Ongoing development projects were also discussed where it was announced that the company expects additional production of 598mmcf of gas and 8,370bpd of oil by Mar12 as projects such as Dakhni, KPD, TAY, Sinjhor, Uch and Jhal Magsi come online.

PPL disclosed its production targets whereby the management expects FY11 to clock production of 188,000boe which is to gradually increase to 191,000boe by FY15.

Corporate Presentations; MCB and UBL

MCB's management discussed the remarkable progress that the group has achieved over the past decade by virtue of which it stands out amongst its peers. UBL was another exciting story from Pakistan's corporate sector where the management also shed light on its future strategy of 1) continued focus on improving margins and reducing operating costs and 2) focus on liability management, acquisition of quality assets, risk management and restructuring of affected assets.

Corporate Presentations; ENGRO expecting COD in Jan11

Apart from the spectacular growth story that ENGRO's management could boast about, they also disclosed that ongoing urea expansion (Enven1.3) is expected to undergo COD in Jan11. The cost overruns due to the delay are estimated at USD50mn which will take the total project cost to USD1.1bn. It was further



Equity Research Pakistan

In Focus Strategy

highlighted that recent bridge financing taken to account for the plant delay will be retired through upcoming IPOs of Engro Foods and Engro Fertilizer.

Broadly speaking, the group remains committed to its announced expansions whereby the energy sector is expected to drive the future growth story for the company. For instance, the management disclosed tentative cost of USD2.5bn for 1,200MW coal fired power plant to be established over the next 5 years.

Foreign investment to continue; the conference is to open up appetite for investment in broader market

After 14 months of continuous foreign portfolio outflows, foreign investors turned positive for the first time in Jun09 – right after Pakistan's inclusion in MSCI Frontier Markets. Since then, Pakistan's equity markets have to date witnessed net portfolio inflows of around USD750mn. In fact, foreign portfolio investment is now estimated to be accounting for a record 33% of free-float weighted market capitalization of KSE.

However most of the recent flows have been concentrated in select large cap scrips such as OGDC, PPL, NBP and MCB. We believe that the recent initiative by BMA and its partners should go a long way in introducing other sectors to foreign investors and should allow flows in broader market including cements, fertilizer, electricity and other financials.

Thus we maintain a positive outlook on Pakistan equities and believe that global liquidity should allow increased penetration into Pakistan which not only trades at over 50% discount to regional markets but offers even higher potential returns given the recent rally in closer peers such as India, Sri Lanka and Bangladesh.