TAURUS SECURITIES LIMITED
A Subsidiary of National Bank of Pakistan

Pakistan Strategy 2014

1st Jan'14

Taurus Securities Limited

TSL Research
+9221 35216403
UAN: 111-828787

research@taurus.com.pk

Taurus research is available on Bloomberg under TAUR & on Capital IQ

Click on the sector tab for navigation

Politics takes centre stage as the market banks on PML-N to deliver

- CY13 was a monumental year for Pakistan's politics with smooth Political (the biggest catalyst of CY13's re-rating), Military and Judicial transition being the key reasons for index making a new high, despite issues on the economic front remaining to be tackled.
- Another decisive factor which has boosted KSE, in our view, was PML-N's success in gaining a majority in National Assembly (better than our expectation) and again in Punjab. It now has a clear cut mandate to follow its economic manifesto of restructuring and privatization which was witnessed in their previous tenures. The market and business community at large has shown confidence in their ability to revive economic growth.
- The current government has a clear cut mandate for five years (lasting up to CY18), and with its majority, it is now in a position to better negotiate and deliver on terms set with USA, IMF & to augment the economic growth. As a start, PML-N has undertaken the painful economic reforms which were absent in the previous government's tenure. While electricity tariffs have been raised reluctantly, other measures such as gas tariff hike and SOE's restructuring/privatization are on the agenda for CY14.
- Precarious forex reserve position ensures that Pakistan will have to abide by IMF's economic prescription, which will ensure much needed fiscal and structural reforms.
- Relations with the army/international community over Musharraf trial and with USA over NATO supply/drone attacks are likely to be the litmus test for the government's foreign policy in CY14. With Afghanistan's end game approaching, we do not expect any breakdown of relationship with USA, but the carrot and stick policy is likely to continue. Any progress on Pakistan-India peace talks, as envisioned by the current government is likely to be a bonus, but no major breakthrough is expected on this front due to India's election in CY14.

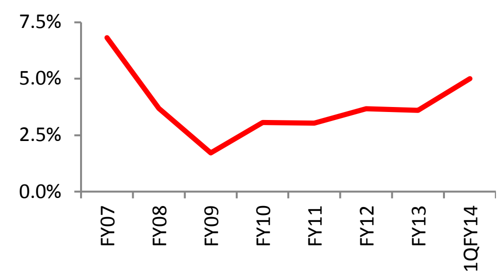
Reforms hold the key

- CY13 is the epitome of how a strong pro business party can transform an economy. The economic wheel has finally started turning with 1QFY14 GDP growth clocking in at 5%, while LSM is up by 6% in the 4MFY14. The much touted circular debt has been significantly reduced to a large extent and politically painful decision of ~50% electricity tariff hike was finally taken. Further reforms of Discos are needed if the government intends to do away with this menace. In a phased manner, tax base is set to increase with gradual elimination of SROs amounting to around PKR500bn.

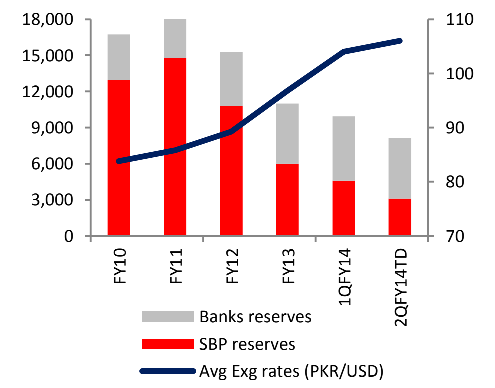
- Since the start of May, KSE-100 index has risen by 34% while the CDS spread also witnessed a decline despite SBP's forex reserves touching a twelve year trough in CY13. Optimism runs high with expectation on this government to revive economic growth, but painful reforms are a prerequisite.

- ***Fiscal Deficit:*** In 1QFY14, fiscal deficit stood at 1.1% compared to CPLY's deficit of 1.2%, which is impressive given the absence of any CSF inflow during the quarter. Looking at historical spending pattern of 2HFY, it will be an uphill task to keep the deficit at the budgeted figure due to revenue slippages and rising debt servicing cost. PSDP allocation will likely face the axe due to stringent deficit reduction requirement of IMF.

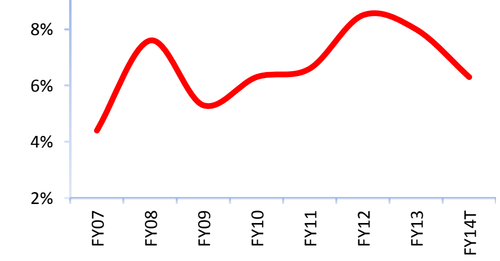
GDP growth rate revives



Reserves breakup (USD mn) and PKR/USD trend



Fiscal deficit as % of GDP



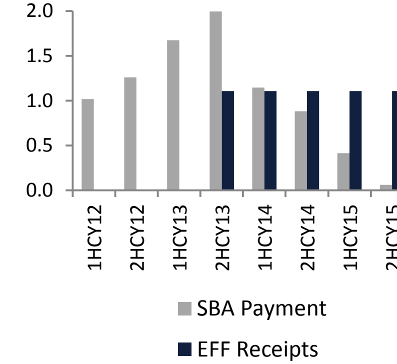
The worst is mostly over on the external side.....

- ***External:*** 5MFY14 current account deficit numbers stood at USD1.9bn as opposed to USD0.7bn witnessed in the CPLY. Limited CSF inflows and burgeoning trade shortfall widened the current account deficit in FY14TD. Improvement in financial account, which stood at positive USD0.7bn versus a negative USD0.3bn in the CPLY has provided respite to the balance of payment position, thanks to higher bilateral financing. We expect FY14 CAD of ~USD4bn which will be higher than last year, but in GDP terms it is well below the norm, and can easily be financed going forward by higher multilateral funding.

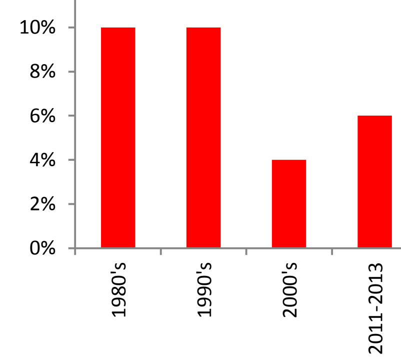
- IMF's nod was critical for reviving the assistance from multilateral agencies, which is now visible and project based lending from World Bank and ADB is expected to be ramped up from CY14 onwards. The good thing is that bulk of repayments to IMF from the previous SBA loan has been made, and in CY14, receipts from current EFF loan will more than cover the projected repayments. If the government is able to fulfill its reforms commitment with IMF, the size of EFF loan will likely be enhanced as well. Nonetheless, we expect the gradual PKR devaluation to continue until the structural trade deficit is reduced.

- Multiple counters are being pursued by the government to augment the reserve position which will materialize in 1HCY14. These include 3G auction, international bond offering, banks GDR, US Aid/CSF etc. These steps are expected to fetch around USD3bn, while a business friendly government image can also revive FDI, going forward.

Worst is over from the IMF side (USD bn)



PKR devaluation versus USD



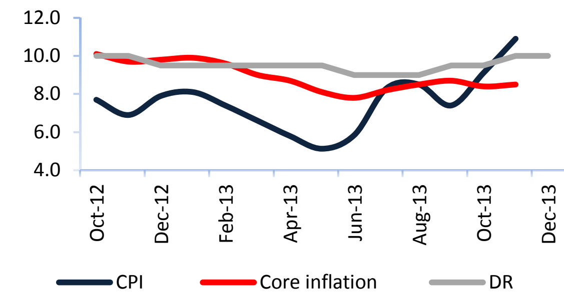
.... and will be over from inflation side in 2HCY14

- **Inflation/Interest rates:** After hitting a multiyear trough of 5% in May, CPI again moved up swiftly to 11% in November due to reversal of low base effect, subsidy reduction and overall rise in food prices. However, an equally swift decline in food prices has brought about a significant MoM decline in December. A lower CPI reading in December, consideration of no hike in domestic gas tariff and positive external side news flow will give ample reasons to the central bank to raise policy rate by only 50bps (our base case) in this month's policy rate meeting, although decision of status quo is also possible.

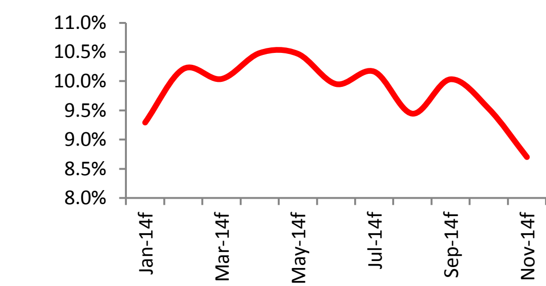
- We expect the DR to touch 11% by May-14, after which the decline in CPI will likely keep the policy rate stable. Carrying out fiscal reforms remain critical for the economy and will be the key factor in determining the banking sector liquidity issues and money market yields. As per the IMF conditions, quantum of government borrowing from SBP are to be gradually reduced, which will only be possible if the deficit is reduced. For this to happen, timely receipt of CSF and 3G auction in 1HCY14 are critical, if the government is to achieve its non-tax revenue target.

- In the medium term, if government is able to bring down the fiscal deficit at an acceptable level of 4% (of GDP), and diversify its funding base, inflationary pressures and money market yields will automatically subside. This step can further boost economic growth and reduce the private sector crowding out which has been going on since the last few years.

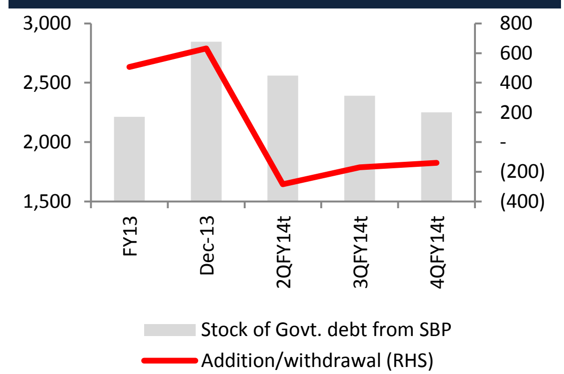
DR vs. Inflation measures



CPI expected to decline in 2HCY14

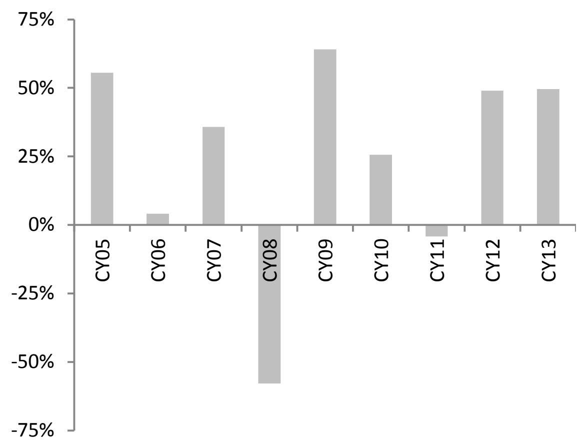


Ceiling on net Govt borrowing from SBP under IMF program (PKR bn)

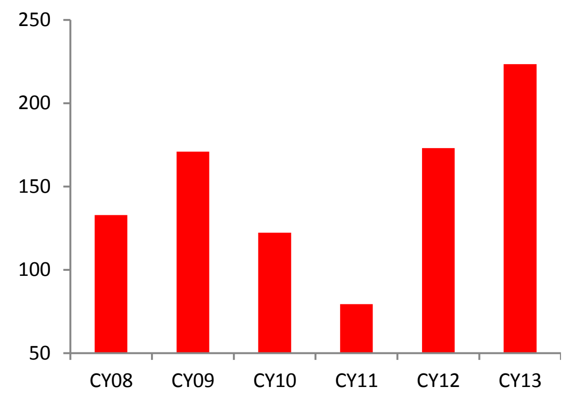


CY13 Recap

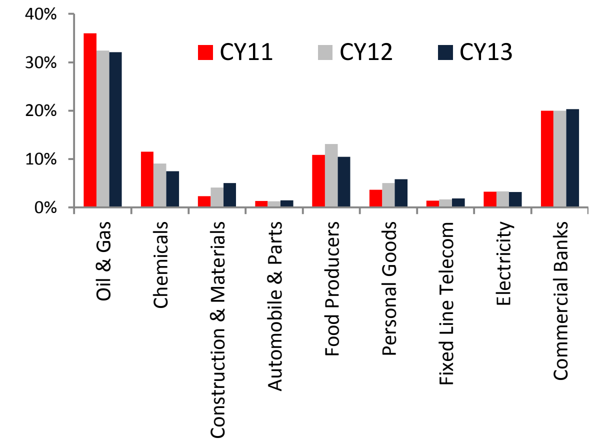
KSE-100 Index yearly return



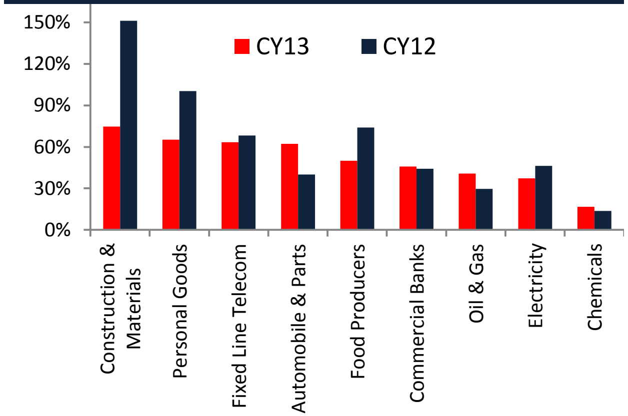
KSE All Share turnover (mn)



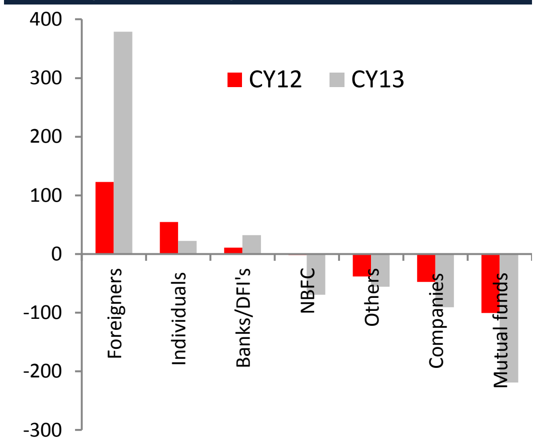
Market weight of key sectors



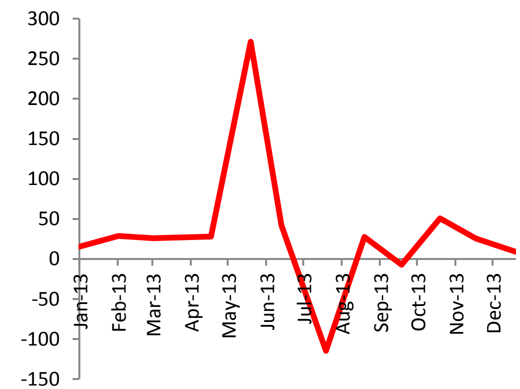
Key sectors return in CY12 & CY13



Participants activity in CY12 & CY13 (USDmn)



Net monthly FIPI in CY13 (USD mn)



Privatization/restructuring to keep the rerating theme alive in CY14

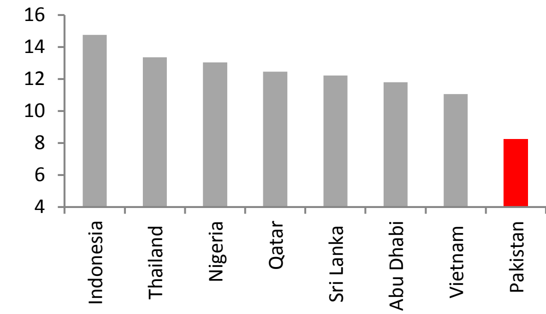
- After two years of extraordinary performance by KSE-100 index, it is a tough call to make a view on the direction of the market. Smooth Political (the biggest catalyst of CY13), Military and Judicial transition were the key reasons for the index making a new high, despite issues on the economic front remaining to be tackled.

- We are optimistic on the macro picture in CY14 and feel that government's ability to implement its economic agenda which includes deficit reduction and offloading of state owned enterprises through SPO/GDR and management stake sales hold the key for above normal return. If circular debt alone is fully tackled in CY14, it will unlock further value in Oil & Gas and Electricity sector (having a combined weight of 35%).

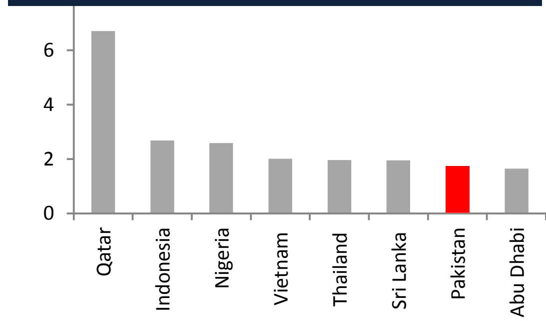
- Having said that, the downside is also limited in our view since KSE is mostly a cash market, thus absence of leverage hedges against any major drop. However, upside will largely be determined by how well the government accomplishes its goals.

- 1HCY14 will likely witness SPO/GDR of UBL and ABL which can easily be sold to sponsors as well. Appetite wise (especially from foreigners perspective), a further stake sale by government in OGDC, PPL & HBL will be welcomed. While PIA's privatization may be the biggest challenge among the listed entities for government in CY14, any further stake sale/privatization of PNSC and PSO are more feasible in our view.

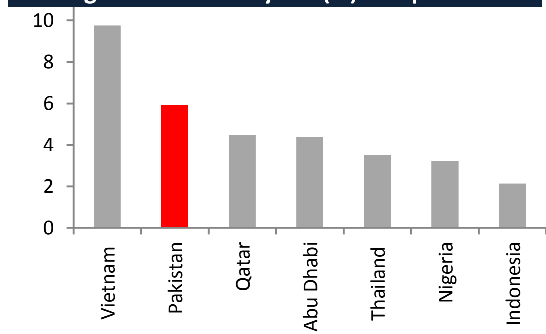
Regional P/E comparison



Regional P/B comparison



Regional Dividend yield (%) comparison



Liquidity also an important factor to keep track of

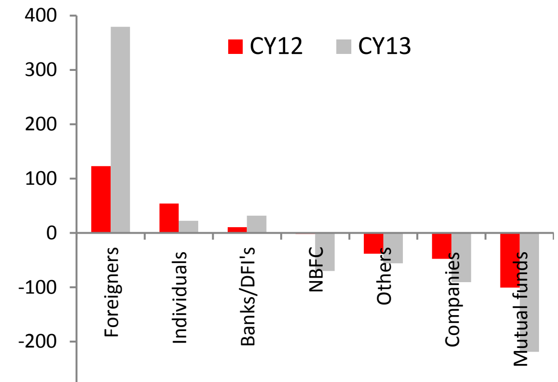
- While economic growth is yet to fully play its part in propelling the market, liquidity provided by the foreigners in the last two years has largely determined the market direction. With Fed tapering, this flow may reduce going forward, so locals may have to step forward now to lead the market.

- ***Key positive events in terms of flows for CY14 are:*** 1) Rise of Pakistan's weight in MSCI Frontier market from May 2014, as Qatar and UAE will be upgraded to MSCI Emerging market, and 2) improved sentiments from locals/HNWI as economic wheel shows an uptick, and possible resurgence of retailers to cash in on the SPO theme of government.

- ***Key negative events in terms of flows for CY14 are:*** 1) The scheme announced by previous government to not ask about the source of income invested in the market, is set to expire in June 2014, and 2) start of Fed tapering, though impact on Pakistan will likely be muted.

- **We feel that likelihood of KSE-100 going beyond 30k is bright, provided the government sticks to its reform agenda which would keep Pakistan on foreign investor's radar. Another crucial factor would be if the SOE's stake sales through the Stock Exchange is done gradually, ideally through GDR, so that the liquidity within the market doesn't decrease and the USD inflow stream increases for the government from this end.**

Participants activity in CY12 & CY13 (USD mn)



TSL universe valuation

	FY13	FY14	FY15
P/E	10.3	8.1	7.0
Div. yield	4.7%	5.8%	6.8%
P/B	2.7	2.3	2.0

Sector wise stance

- Dollar return denominated companies are our preferred exposure choice as they provide a good hedge in the wake of continued PKR devaluation. We also advocate keeping the portfolio tilted towards liquid stocks so that exit can be easily made in case the aforesaid reforms are delayed or if foreign liquidity declines.

Sector	Stance	Top picks	Catalyst
Banks	Neutral	BAFL & BAHL	DR hike & NPL slowdown (+ve), appreciation in big 5 makes mid tier banks more appealing
OMC's	Positive	PSO	Margin revision, volumetric growth, circular debt resolution
Fertilizer	Neutral	EFert & Fatima	Gas cost hike (-ve), Engro concessionary gas decision
Textile	Neutral to Positive	NML	GSP plus & PKR deval (+ve), China's yarn import decline (-ve)
Cement	Positive	DGKC, FCCL & Lucky	Cement price hike & cartel sustenance (+ve), gas price hike (-ve)
E&P	Positive	POL	Production addition, PKR deval
Power	Neutral	NPL	PKR deval, circular debt resolution
Autos	Neutral	PSMC	Yen depreciation impact (+ve), GST hike on Tractor (-ve)
Chemical	Neutral	EPCL	Volumetric addition, PKR deval
FMCG	Negative		Earnings growth uncertainty and lofty valuations (-ve), low float (+ve)

Rainy days are over; policy rate hike in coming periods to auger well for the industry

- Banking industry has come under the heels of SBP during the previous 2 years. Sector spreads have contracted amid declining interest rate environment and adverse regulatory changes by SBP. Reduction in policy rate has lowered the average lending rate, while hike in MDR from 5% to 6% last year, followed by change in calculation methodology and lastly the recent decision of SBP which links MDR to repo rate has effectively raised the cost of funding for the banking sector. Consequently, 11MCY13 spreads averaged 6.26% compared to 7.07% in SPLY. However, with the re-pricing of loan book of the industry amid recent DR hike and further rate hike expected in future, profitability of the industry should see improvement in coming periods.

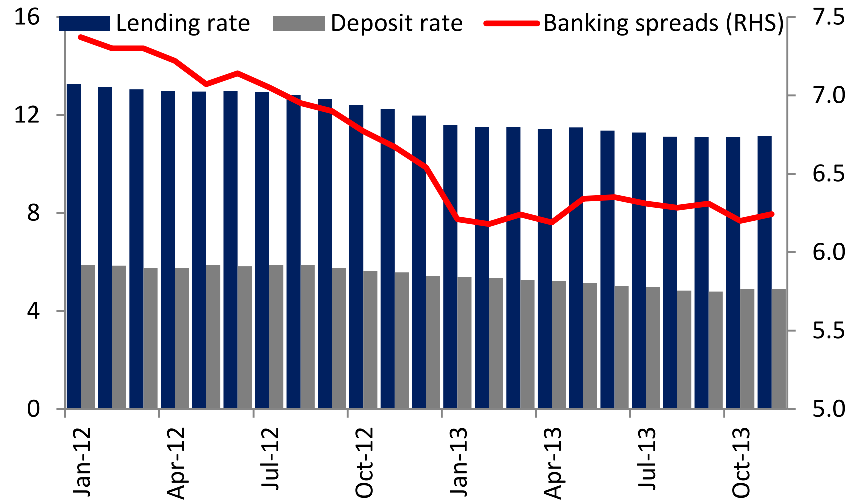
- As modest recovery of 5.7% was witnessed in LSM during July-Oct, a similar improvement in private sector loans was also seen, primarily from textile sector. Although part of this credit demand is seasonal, but genuine demand of credit from textile sector in the wake of GSP+ status for capacity enhancement / betterments, opting for alternative fuels is also present. Recovery in private sector loans has also resulted in uptick in ADR of the banking industry in recent months.

- Significant reduction in credit losses due to prudent lending policies of the banks and inclination towards risk free government papers has also benefitted the banking sector in terms of improvement in asset quality of the industry. Provision coverage ratio has improved from 66.7% in June'12 to 76.5% in Sept'13, while net NPL ratio has shrunk to 3.80% in Sept'13 after peaking at 5.99% in June'12.

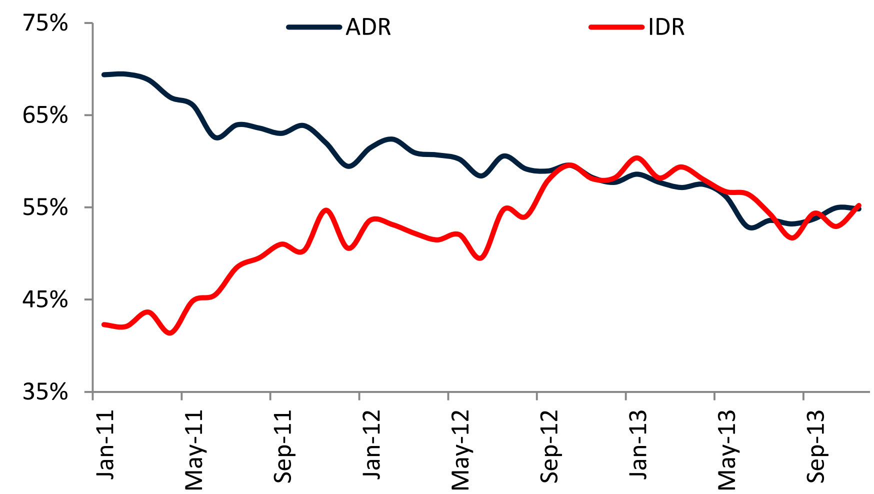
- **Recommendation:** Despite tough times faced by the industry during the last couple of years, the banking industry has fared well against the benchmark index, therefore, value among the sector is not ubiquitous. However, we our preference remains with the mid cap banking stocks such as BAHL and BAFL. Though, not in our active coverage, FABL has also strong appeal, owing to its improving fundamentals and considerable discount to its PB value.

Sector highlights

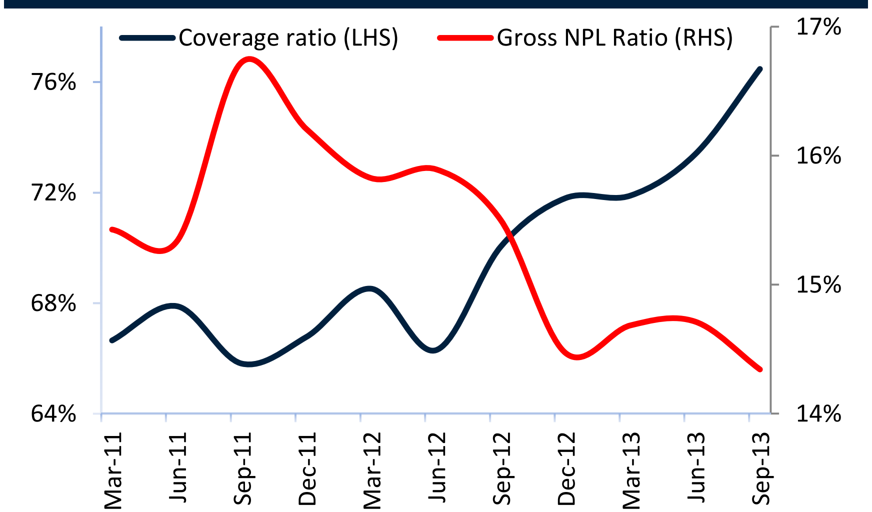
Stabilizing banking sector spreads (%age)



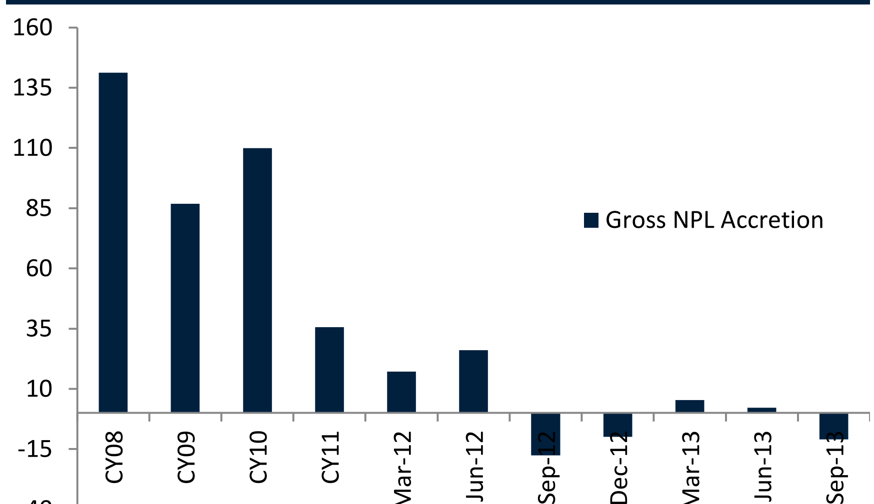
Uptick in ADR due to recovery in private sector credit



Tapering off NPL ratio with improving coverage ratio



NPLs accretion has hit snags due to prudent lending(in PKR bn)



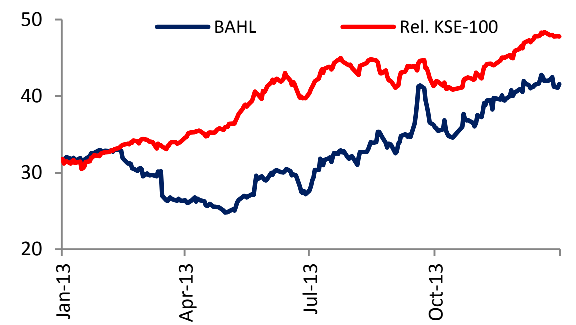
Bank Al Habib

The cream of the crop

- Bank Al Habib (BAHL) remains our preferred choice in the banking sector. Although earnings of the bank are projected to decline in CY13 by 10%, we expect strong rebound of 30% in CY14 earnings driven by further rise in policy rate expected going forward.
- The bank has significantly improved its deposit mix since CY12. From CASA of 59% at CY11 end, it has improved the mix to 73% by 3QCY13 end, with focus on CA which constitutes around 41% of deposits. More importantly, non-remunerative CA form around 31% of deposits, which will help the bank to keep its funding costs low and thereby aiding in NIM expansion.
- Impact of variable MDR will be limited on BAHL, as the bank already provides competitive rates on its savings accounts.
- Asset quality ratio of the bank remains pristine, with gross infection ratio significantly below industry average and coverage ratio more than adequate, requiring limited provisioning expense in coming periods.
- **Recommendation:** BAHL is trading at CY14 PE and PB of 6.5x and 1.4x respectively. At current price it offers 26.9% discount to our Dec'14 target price of PKR52.7/share. We maintain our Buy stance.

BAHL PA	BUY
Stock price	41.6
Target price (Dec'14)	**52.7**
Current upside/(downside)	26.9%
Outstanding shares (mn)	1,010
Market Cap (PKR bn)	42
Free float	55%
3M Avg. daily value traded (PKRm)	25.8
3M Avg. daily volume (m)	0.9
12M High	42.8
12M Low	24.8

Price performance



	CY12A	CY13F	CY14F	CY15F
EPS	5.45	4.93	6.41	7.62
DPS	3.00	2.50	3.00	3.50
BVPS	23.8	26.0	29.3	33.9
P/E (x)	7.6	8.4	6.5	5.5
P/BV (x)	1.7	1.6	1.4	1.2
Dividend Yield	7%	6%	7%	8%
Earnings growth	21%	-10%	30%	19%
ROA	1.3%	1.1%	1.3%	1.4%
ROE	25%	20%	23%	24%
NIM	4.1%	3.5%	4.2%	4.3%

Materialization of Warid deal to further add value

- Bank Alfalah remains our second preferred choice in the banking industry. The company is expected to report flat earnings, unlike other banks which are expected to see their earnings decline, during the current year aided by pre-tax buyback gain of PKR245mn on Wateen in 4Q.

- Sale of Warid remains a key trigger for the bank as it holds 319mn shares of Warid, which have been completely written down. With Warid deal price expected at USD650-700mn, BAFL will report onetime gain of around PKR5.7bn in CY14. Deployment of funds generated from sale will further augment earnings of the bank and may warrant revision in our TP, as we have not incorporated any impact of Warid deal so far.

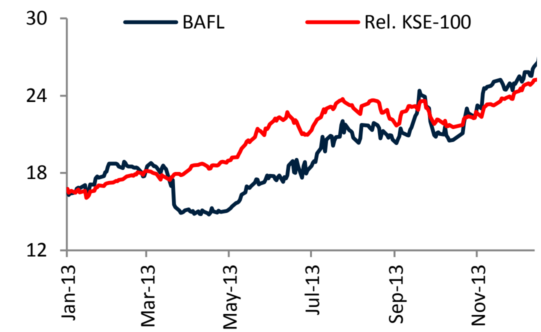
- BAFL has focused heavily on cheaper deposit mobilization in recent years, which is manifested in its CASA improvement. From 56% CASA ratio at end of CY11, the present CASA ratio of the bank stands at 74.4%, while current accounts constitute around 35% of total deposits.

- The bank has materially improved its asset quality, aided by sizeable recoveries of delinquent loans. Coverage ratio of the bank has improved to 68.2% during 3QFY13, with net NPL ratio declining to 2.9%. FSV benefit of the bank has also regressed over time, indicating relatively muted provision expenses in coming periods.

- **Recommendation:** The scrip is trading at CY14E PE and PB of 6.0x and 1.0x respectively, and provides an upside potential of 7.4% to our Dec'14 TP of 28.6/share. We maintain our Hold rating on the scrip.

BAFL PA	HOLD
Stock price	26.7
Target price (Dec'14)	**28.6**
Current upside/(downside)	7.4%
Outstanding shares (mn)	1,349
Market Cap (PKR bn)	36.0
Free float	52.5%
3M Avg. daily value traded (PKR mn)	117.5
3M Avg. daily volume (mn)	4.8
12M High	28.1
12M Low	14.8

Price performance



	CY12A	CY13F	CY14F	CY15F
EPS	3.38	3.46	4.46	4.94
DPS	2.00	1.50	2.00	2.25
BVPS	22.4	24.1	26.8	30.1
P/E (x)	7.9	7.7	6.0	5.4
P/BV (x)	1.2	1.1	1.0	0.9
Dividend Yield	7.5%	5.6%	7.5%	8.4%
Earnings growth	30%	2%	29%	11%
ROA	1%	1%	1%	1%
ROE	16%	15%	18%	17%
NIM	4.4%	3.7%	4.3%	4.1%

Expected margin revision with growth in POL sales after a long hiatus to benefit OMCs

- Oil Marketing Sector is a semi regulated sector and therefore, the companies do not have complete control over pricing or margins of their key products under the current framework. For regulated products the commissions remain fixed, taxes are determined by the government and IFEM continues to remain in place despite recommendations to the contrary. While, FO and jet fuels are completely deregulated with each company determining their own rate with margins determined by mutual consent.

- After years of moribund sales, consumption of POL products is poised to grow in the current year. Volumetric sales of POL products have grown by 13% thus far in 5MFY14, which will bolster the profitability of the OMC sector.

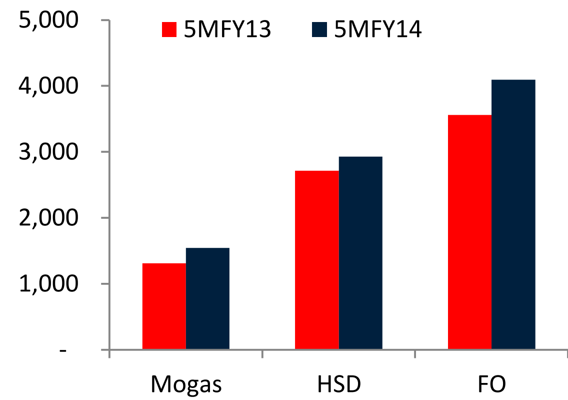
- Growth in volumetric sales was mainly led by 18% YoY growth in Mogas sales amid acute shortage of CNG for transportation sector, 15% YoY rise in consumption of FO after government injected massive liquidity in the energy chain to cut short hours of power outages. Moreover, prospects of HSD also look promising which has grown by 8% YoY during this fiscal year.

- Margin revision for regulated products remains a key catalyst for OMC sector in the near term. PIDE, entrusted with the responsibility to determine margins of OMCs and dealers has submitted its recommendation of margin hike to the government.

- Various news reports indicate that circular debt is again on the rise. It is important to note that much of the quoted amount pertains to the previous fiscal year and accumulation during the current fiscal year has remained relatively subdued.

- **Recommendation**: PSO remains our top pick of the lot. Based on last closing price, the scrip is trading around FY14E PE multiple of 4.2x, the lowest in our TSL universe.

Improving volumetric sales ('000 MTs)



Impact of 10 paisa margin hike

	SHEL	PSO	APL
HSD	1.46	1.24	0.8
Mogas	1.13	0.69	0.29
Total	2.59	1.93	1.09

Pakistan State Oil

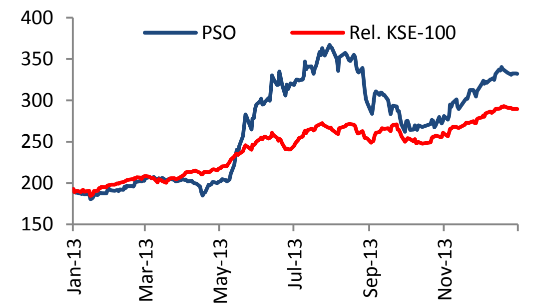
Liquidity woes have eased off to some extent

- Pakistan State Oil, the largest oil marketing company, with market share of around 63.8% in Sept'13, remains our top pick in OMC space as we remain upbeat about desired outcome of the power sector reforms.
- Valuations of the company are cheap due to its erstwhile cash flow woes and subdued cash payout. With improving cash recoveries from Hubco and Kapco and slow down in the accumulation of receivables from Gencos after tariff hike, liquidity woes of PSO have eased off to some extent.
- PSO reported colossal earnings of PKR31.57/share during 1QFY14 results which were mainly driven by huge late payment income of PKR8.2bn from Hubco. The company still has net un-booked income of PKR28bn. Any future receipt of late payment charges from Hubco or Kapco can again positively surprise the market.
- Improvement in regulated margins also remains a positive trigger for PSO. It is important to note that every PKR0.1/liter hike in HSD and Mogas will raise EPS of PSO by PKR1.24/share and PKR0.69/share respectively.
- **Recommendation:** Although the stock has outperformed the broader market during the past 1 year, the stock is still trading at attractive valuations. With FY14E PE of 4.2x, and slowdown in accumulation of circular debt with higher expected payout going forward, we maintain our Buy stance with June'14 TP of 411.9/share.

	FY13A	FY14F	FY15F	FY15F
EPS	50.84	75.83	62.68	72.05
DPS	4.58	10.00	15.00	20.00
BVPS	250.6	321.8	374.5	431.5
P/Ex	6.3	4.2	5.1	4.5
P/BVx	1.3	1.0	0.9	0.7
Dividend Yield	1.4%	3.1%	4.7%	6.2%
Earnings growth	39%	49%	-17%	15%
ROA	4%	6%	4%	5%
ROE	22%	26%	18%	18%
Net debt/Equity	19%	24%	-12%	-34%

PSO PA	BUY
Stock price	322.2
Target price (June'14)	**411.9**
Current upside/(downside)	27.8%
Outstanding shares (mn)	247
Market Cap (PKR bn)	79.6
Free float	54%
3M Avg. daily value traded (PKR mn)	709.0
3M Avg. daily volume (mn)	2.7
12M High	367.1
12M Low	180.7

Price performance



GSAs and Gas tariff hike- keeping the local manufacturers on their toes

- After three continuous years of YoY decline, CY13 marked decent recovery in the industry offtake levels of Urea especially for the local manufactures. Urea offtake of local manufacturers was up 34% YoY during 11MCY13, largely due to improved operating environment as a result of incremental gas supply to Engro together with low levels of imports for a greater part of the year. While Urea imports made up 21% of the total offtake in CY12, the contribution of Urea imports in 11MCY13 offtake numbers reduced to 17%.

- Two key risks, i.e the gas cost hike and the Gas Sale Agreements (GSAs), emerging in the latter part of CY13, however, did raise serious doubts over the longevity of the improved performance of this sector. Recent news flow suggests that the Oil and Gas Regulatory Authority (OGRA) is expected to give its decision on the gas tariff hike on the 16^{th} and 24^{th} of January. In line with the proposed gas price increases, we believe that the companies would require a minimum PKR255/bag price rise in order to tone down the decline in their margins. Moreover, the gas levy due to be imposed under IMF agreements keeps up local industry players wary of the risks to their margins.

- If the government decides to grant feed gas to Engro Fertilizer at the concessionary rate of USD0.7/mmbtu, possible only at the expense of a urea price decrease, this subsidy together with the gas tariff hike, will prove to be a double whammy for all manufacturers except Engro Fertilizer and FATIMA.

- The GSAs remain the key factor for stable production and profitability levels for the Four Fertilizer Manufacturers (FFM) on the SNGPL network. CY13TD has shown the turnaround in ENGRO as a result of improved gas supplies ensuring operation of both plants. An inability to successfully implement the GSAs will bring back ENGRO to square one, creating potential of CY12 repeating itself all over again.

- **FATIMA** is expected to emerge as the key beneficiary in the case that the gas hike is followed by a increase in the Urea prices. The ability of the producers to pass on the price increase as a result of the gas tariff hike has been enhanced by the of late growth in the international prices of Urea.

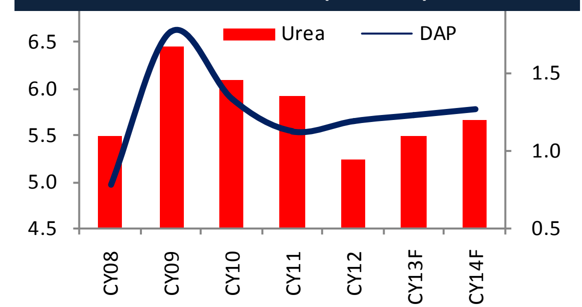
CY14-EPS (Post proposed gas hike)				
	PKR/bag Price increase			
	Proposed	150.00	200.00	250.00
FFC	11.70	15.02	16.13	17.24
Engro	1.68	3.89	4.63	5.36
FFBL	5.05	5.58	5.76	5.94
FATIMA	4.08	4.96	5.25	5.53

	EPS-CY14E	P/E-CY14E
Fauji Fertilizer Co.	16.07	7.00
Engro Corporation	19.14	8.31
Engro Fertilizer*	3.55	7.96
Fauji Fertilizer Bin Qasim	6.27	7.01
Fatima Fertilzer	4.17	6.86
Dawood Hercules Corporation	10.33	5.43

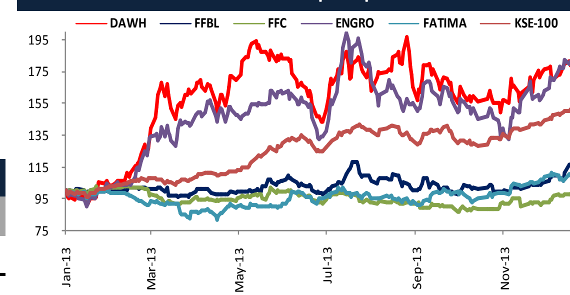
Source: TSL Research

*Price for Engro Fertilizer is taken as the strike price of PKR28.25/-

Offtake levels (mn tons)



TSL Fertilizer universe price performance



Banking on GSAs and Concessionary rate to continue the growth

- After witnessing the worst of periods in CY12, the fortunes of Engro Fertilizer changed drastically after it successfully managed to operate its Enven plant on low BTU Mari gas. The company managed to make the most out of the temporary gas from Guddu, augmenting its Urea offtake by 112% YoY during 11MCY13. This enabled the company to clock in an all time high production level in CY13. With cash flows improving and debt restructuring concluding in CY13, another positive boost came in the shape of its successful IPO. Oversubscription by 3.9x in its book building process clearly reflects the investor appetite for the company.

- The company has been working aggressively towards long term gas supply arrangements to avoid any future lapse in its production levels. An inability to operate its both plants (unsuccessful implementation of the GSA pertaining to the KPD gas pipeline would limit the operations to a single plant) will dent its production and profitability levels.

- An ideal case for Engro Fertilizers can emerge if the government starts to provide the feed gas at a subsidized rate of US$0.7/mmbtu, as promised under the Fertilizer Policy 2001. This concession would only come about at the expense of a urea price decrease, limiting Engro's downside from the gas tariff hike, enabling it to gain at the expense of its competitors.

- While we maintain our bullish stance on the stock, the indecisiveness of the ECC on the ratification of GSAs creates considerable uncertainty. The greater the time lag between the final decision of ECC and the delay in the capex of the KPD gas pipeline, the longer the dry patch in production after the gas diverted from Guddu is withdrawn (expected in 2QCY14).Nonetheless, the government's intention in making up for the early disadvantages faced by Engro creates considerable buoyancy that there is more good to come from the company in the near term. We roll forward our model, with Dec-14 target price of **PKR37.41/share**.

Key Metrics	CY12A	CY13F	CY14F	CY15F
EPS	(2.40)	4.20	3.55	6.26
DPS	-	-	-	-
P/Ex	-	8.9	10.5	6.0
P/BVx	3.1	2.2	1.8	1.4
Dividend Yield	0.0%	0.0%	0.0%	0.0%
ROA	-3%	5%	5%	9%
ROE	-19%	23%	16%	22%
Net Debt/Equity	406%	232%	153%	83%

Engro Fertilizer	BUY
Strike Price	28.25
Target price (Dec-14)	**37.41**
Current upside/(downside)	32%
Outstanding shares (mn) - Post IPO	1,298
Market Cap (PKR bn)	36.7
Free float- Post IPO	8.1%

CY15 EPS		
	Base case	Ideal case*
Both plants	6.26	9.48
One plant	3.58	7.37

**Price of Engro Feedstock=USD0.7/mmbtu*

Fatima Fertilizer Ltd

Fixed gas cost keeps upside from urea price hike intact

- Being on the Mari network, Fatima has remained aloof from almost all the risks underlying the Fertilizer sector for quite some time. The company has shown decent performance in CY13 with 45% YoY growth in 9MCY13 earnings. Moreover, we expect the company to club in decent 4Q results amid product mix changes.
- Despite being a fundamentally strong company, FATIMA has not been the top performer in the industry forming considerable skepticism among investors. However, CY14 may turn out to be the year where FATIMA emerges out as the winner as a result of the gas tariff hike.
- With the much awaited decision on the gas tariff hike expected to be announced next month, as per news reports, FATIMA could emerge out as a key winner as a result of its fixed feed gas rate of US$0.7/mmbtu, thereby shielding its margins. A proposed PKR132/mmbtu rise in the feed and fuel gas is expected to shrink the margins for FATIMA's competitors, calling for a price rise making FATIMA better off as compared to its competitors.
- We roll forward our valuations, with a Dec-14 TP of PKR32.2/share. Changing industry dynamics, however, as a result of gas tariff rationalization and subsequent urea price increase, making **FATIMA** the safest best in the sector, is expected to upscale the EPS and TP estimates going forward.

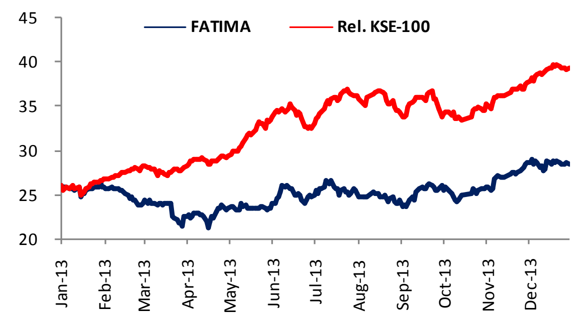
Post Gas Tariff Rationalization- Sensitivity

	Urea PKR/Bag Price Increase		
	Base Case	150.00	250.00
CY14- EPS	4.10	4.97	5.54
TP	32.06	40.73	46.61

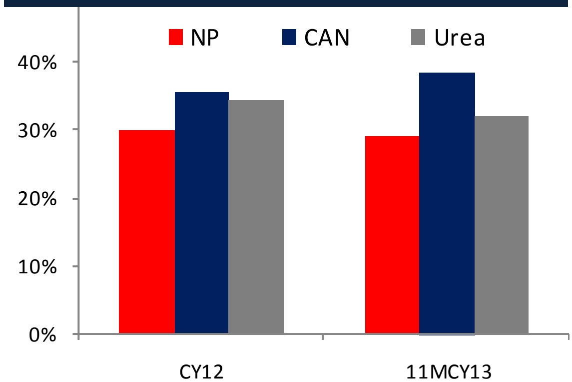
	CY12A	CY13F	CY14F	CY15F
EPS	2.91	3.90	4.10	4.77
DPS	2.00	2.00	2.50	3.00
BVPS	13.8	15.7	17.3	19.1
P/Ex	9.9	7.4	7.0	6.0
P/BVx	2.1	1.8	1.7	1.5
Dividend Yield	6.9%	6.9%	8.7%	10.4%
Earnings growth	48%	34%	5%	16%
ROA	8%	11%	11%	13%
ROE	21%	25%	24%	25%
Net debt/Equity	125%	82%	51%	23%

FATIMA PA	BUY
Stock price	28.6
Target price (Dec-14)	**32.2**
Current upside/(downside)	12%
Outstanding shares (m)	2,100
Market Cap (PKR bn)	60.1
Free float	15%
3M Avg. daily turnover (PKRm)	40.6
3M Avg. daily volume (m)	1.5
3M High	29.0
3M Low	24.3

Price performance



Volumetric Product mix



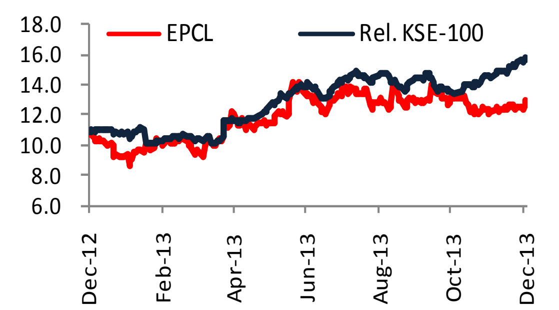
Engro Polymer & Chemicals Limited

Stable VCM production & PVC debottlenecking will keep earnings growth robust

- 9MCY13 financials witnessed the change in fortunes on the basis of growth in volumetric sales due to successful streamlining of VCM production which brought the company back in profit. Resultantly, it earned consolidated EPS from core earnings of PKR0.55/share (total consolidated EPS of 9MCY13 PKR0.85 inclusive of dividend from subsidiary of PKR0.30/share) as compared to PKR0.09/share in the CPLY. Moreover, enhancement of PVC capacity from 150KT p.a. to 156KT p.a. in 3QCY13 will be visible in 4q. We expect stable VCM production and thus forecast CY13 EPS of PKR1.11/share as compared to an EPS of PKR0.07/share of CY12.
- PVC debottlenecking plans will further augment the total capacity to 179KT p.a. in 1HCY15. This will provide an overall 19% volumetric boost to the company's PVC capacity.
- Mitsubishi Corporation (a related party- main supplier of raw material) also has extended the terms of credit from 120 days to 180-360 days which provided a vital support in controlling the short term borrowing/ payment of finance cost at a time when cash flows of the company were under severe stress.
- Being a growth oriented company the dividend yield is on the lower side, but EPCL does offer the highest earnings CAGR (during the next three years) in our TSL universe. At current price, the stock is trading at an enticing CY15 PE of 3.3x (when PVC expansion comes online) and offers an upside of 37%.

EPCL PA	BUY
Stock price	13.4
Target price (Dec-14)	**18.4**
Current upside/(downside)	37%
Outstanding shares (m)	663
Market Cap (PKR bn)	8.9
Free float	19%
3M Avg. daily turnover (PKRm)	14.0
3M Avg. daily volume (m)	1.1
3M High	14.0
3M Low	12.1

EPCL Price vs KSE Relative Index



Key Metrics	CY12A	CY13F	CY14F	CY15F
EPS	0.07	1.11	1.59	4.04
DPS	-	-	1.00	2.00
BVPS	9.3	10.4	12.0	15.1
P/Ex	178.9	12.1	8.4	3.3
P/BVx	1.44	1.28	1.11	0.89
Dividend Yield	0.0%	0.0%	7.5%	14.9%
ROA	0%	3%	4%	10%
ROE	1%	11%	13%	27%

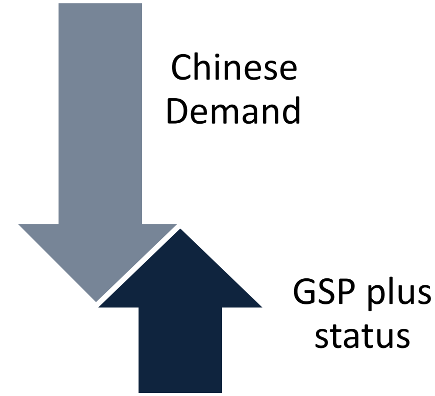
GSP plus status; A new era for the textile industry

- FY13 proved to be a year of strong performance for the yarn dominated textile industry. Chinese demand elicited strong bottom line growth for local manufacturers in the outgoing year. CY14 may well bring an end to the honeymoon period with China limiting its yarn imports. However, with Pakistan being granted the GSP plus status, positive ambiance surrounds the future prospects.

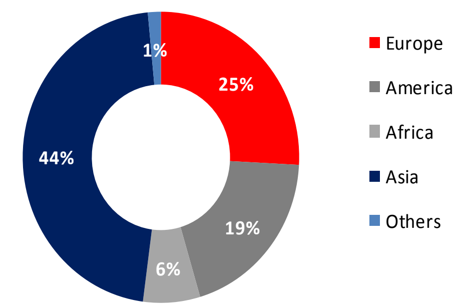
- Absence of a final expression on the Chinese cotton policy alongside the recent news flow of harvest affected by an early frost has kept optimists believing that the growth in spinning segment exports will continue. However, 37% YoY decline in the cotton imported by China during the 3 months of marketing year '14 (Sep-Nov'13) is a silent signal of the change in gears of the Chinese demand.

- The local industry has thus far lagged behind its direct competitors (e.g Bangladesh) as a result of less favorable trade policies. Nonetheless, the attainment of GSP plus status (effective from Jan-14), alongside the migration of China and India outside the GSP and GSP plus criterion pertaining to the textile industry, have created significant room for the textile industry of Pakistan to cover up the lost ground in the past.

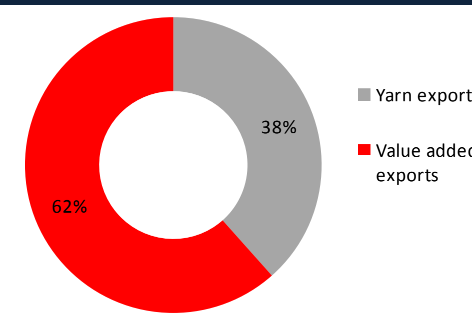
- GSP plus status will provide a significant upside to local manufacturers with diversified product lines titled towards value added segments. However, the government needs to keep a check on the prevailing energy crisis to make the best out of the GSP plus status. Nishat Mills Limited, with its significant exposure in value added segment and European markets, remains our **top pick** in the sector. We maintain a ***Hold*** stance on Nishat Chunian Limited, despite its tremendous growth in FY13, because of its increased vulnerability to the Chinese cotton policy. Moreover, we also expect players like Gul Ahmed Textiles, Azgard Nine Limited and Artistic Denim to derive decent benefit from the GSP plus status.



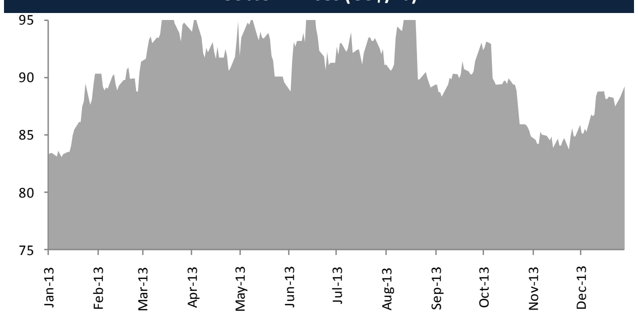
Geographical Distribution of Exports (FY13)



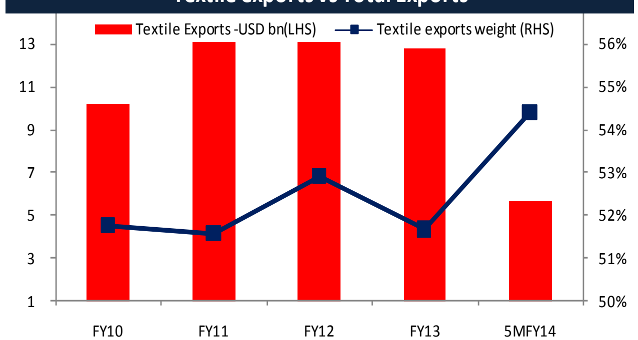
Textile Exports (FY13)



Cotton Prices (US$/lb)



Textile exports vs Total Exports



Nishat Mills Limited

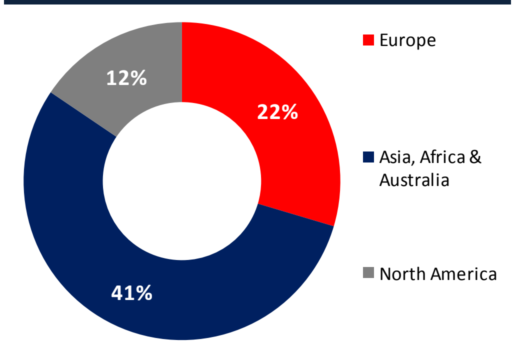
The key beneficiary of GSP plus status

- FY13 saw the company recover from a bad patch in FY12, with its bottom line growing by 66% YoY. Operating in a spinning dominated industry; NML is one of the few players having strong exposure in the value added segment. As a result, the company made a strong start to the year capturing the advantages of high PKR depreciation making up for the lag in volumetric growth.
- Going forward, the company is well poised to take the greatest advantage of the GSP plus status. An increased exposure in the value added segment and reduced reliance on the spinning segment is expected to counter the steadily regressing Chinese demand.
- Going forward, a stable dividend income alongside decent uptick in core operations owing to GSP plus status coming into play from Jan-14, we expect the company to post decent growth in the latter part of FY14 before completely extracting the best out of the GSP plus status FY15 onwards.
- NML has been very aggressive in taking initiatives to boost its value added segment with 25% rise in the value added production capacity expected to be in place in 2HFY14. Moreover, installation of low cost fuel plants is also reflective of the company's efforts to minimize its fuel costs.
- We expect NML to report an EPS of PKR18.27/share in FY14, 10% YoY. The company remains our top pick in the sector, providing an upside potential of 14%.

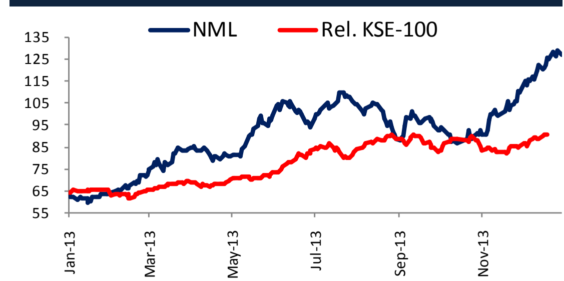
NML PA	BUY
Stock price	127.2
Target price (Jun-14)	**144.8**
Current upside/(downside)	14%
Outstanding shares (m)	352
Market Cap (PKR bn)	44.7
Free float	53%
3M Avg. daily turnover (PKRm)	395
3M Avg. daily volume (m)	3.8
3M High	128.8
3M Low	86.4

Target Price break up	
Core Value	57.9
Portfolio Value	87.0
	144.9

Exports- Geographical distribution

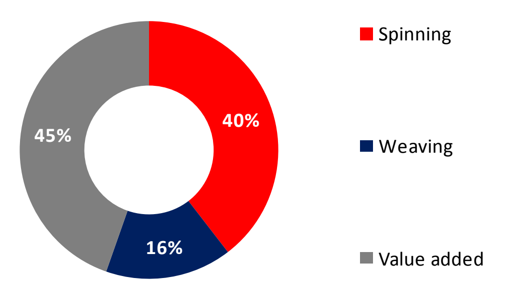


Price Performance



	FY13A	FY14F	FY15F	FY16F
EPS	16.63	18.27	20.01	21.28
DPS	4.00	6.00	7.00	7.00
BVPS	167.6	181.6	195.6	209.9
P/Ex	7.52	6.85	6.25	5.88
P/BVx	0.75	0.69	0.64	0.60
Dividend Yield	3%	5%	6%	6%
Earnings growth	66%	10%	10%	6%
ROA	7%	8%	8%	8%
ROE	10%	10%	10%	10%
Debt/Equity	28%	20%	17%	14%

Segment-wise revenue break up (FY13)



Growth contingent on pricing arrangement - Overweight

- After considerable rise of 21% YoY in FY12, cement prices settled down and recorded a decent growth of 8% in FY13 against SPLY. Moreover, since budget announcement, avg. cement prices have again jumped by 6% and are hovering around PKR513/bag (FYTD average price ~PKR501/bag). We opine that cement prices are likely to maintain its momentum during remaining half of FY14, keeping industry margins lofty.

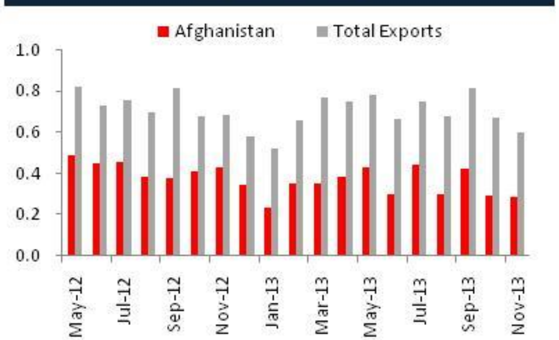
- Export demand is continuously declining since FY10. We see further drop of 2% in FY14, largely due to exports scaling down in Afghanistan. However, local demand will register a slight uptick of 3% because the Govt. has not been able to disburse the funds according to official released mandate so far. Moreover, due to revenue slippages and stringent fiscal deficit benchmark set with IMF, infrastructure spending may be axed which would negatively affect the local cement demand. Resultantly, total growth of the industry is expected to settle at ~2% YoY.

- In order to meet commitment made to IMF, gas tariff hike is on the cards, likely to be implemented from Jan-14 it may hit the margins if industry players do not unite to pass on the cost completely.

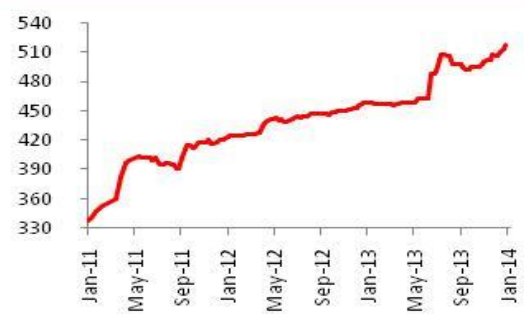
- Due to continuous downtrend in coal prices since Dec-10, cement makers have witnessed significant improvements in their margins and posted phenomenal earnings during FY13. After hovering around ~USD71/ton in Sep-13, coal prices briefly soared to ~USD90/ton in late Oct-13 which have now stabilized at ~USD83/ton. This subdued pricing scenario is expected to continue in the short run while we expect the coal prices to average around ~USD85/ton in FY14.

- **Recommendation:** Currently we have a ***BUY*** stance on our cement universe. However, with muted cement demand and cost pressures, the outlook of the sector is dependent on cartel remaining intact (no expansion) which will keep the pricing power in the hands of the manufacturers.

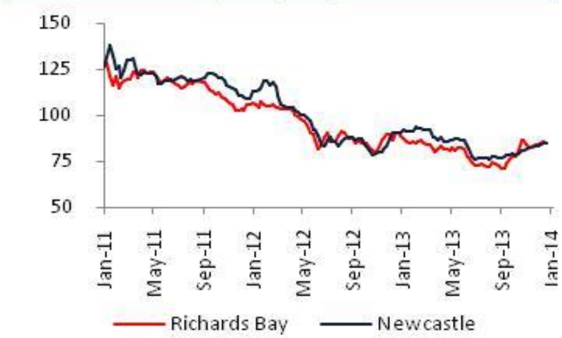
Exports Break-up



Cement prices (PKR/50 kg bag)



Richard's Bay vs. Newcastle coal prices (USD/ton)



D.G Khan Cement

Healthy portfolio + waning leverage + firm margins = Top pick

- Despite witnessing decent price rally following the increase in cement prices in the last two months, near term price performance should continue in our view on account of improved local volumes and cost savings owing to commissioning of WHR plant.
- The company's new WHR plant is likely to be operational in Jan-14, taking its total capacity to 19MW from WHRPs of D.G Khan and Khairpur plant. This new WHR Plant is expected to reduce its reliance on National Grid by 35%, having an annualized EPS impact of ~PKR0.8/share in FY14. Moreover, the company is also investing in alternate fuels to reduce consumption of coal that will further gear up in margins.
- DGKC has sizeable investment in Textile and Financial Sector which hedges it against the possible downside of cement industry dynamics. Improved other income from its investments will further flourish the bottom line, going forward. Market value of DGKC's portfolio stands at PKR68/share, while in our TP it is contributing PKR47/share (due to portfolio discount and taking our MCB TP, which is lower than market price).
- On the back of firm cement pricing outlook and range bound coal prices, DGKC is expected to post another decent year. The scrip is offering an upside of 31% based on our Jun-14 TP of PKR112.0/share. Further, the stock also offers a dividend yield of 6% and trading at a PE of 6.3x. ***BUY***!

Key Metrics	FY13A	FY14F	FY15F	FY16F
EPS	12.56	13.50	15.20	17.04
DPS	3.00	5.00	6.00	9.00
BVPS	75.2	109.6	120.1	130.3
P/Ex	6.83	6.35	5.64	5.03
P/BVx	1.14	0.78	0.71	0.66
Dividend Yield	3%	6%	7%	10%
Earnings growth	34%	7%	13%	12%
ROA	9%	9%	9%	10%
ROE	11%	11%	12%	12%
Net Debt/Equity	23%	13%	8%	2%

DGKC PA	BUY
Stock price	85.7
Target price (June-14)	**112.0**
Current upside/(downside)	31%
Outstanding shares (m)	438.1
Market Cap (PKR bn)	37.6
Free float	55.0%
3M Avg. daily value traded (PKRm)	358.8
3M Avg. daily volume (m)	5.32
3M High	86.0
3M Low	68.3

Price Performance

Fauji Cement Company Limited

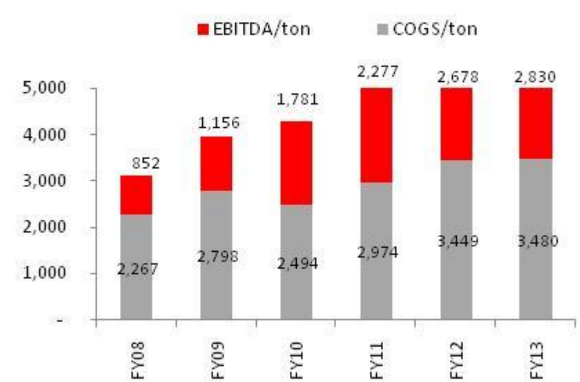
Confidence on high payout & earnings growth will keep FCCL in limelight

- FCCL's capacity utilization in FY13 stood at 73%, compared to industry's capacity utilization level of 75%. We expect the momentum in sales growth to continue in future as capacity utilization of the company catches up with the industry and probable raise in FCCL's quota due to Askari Cement acquisition by Fauji Group as discussed later.
- Owing to healthy cash flow generation, the company retired PKR3.0bn in FY13 that transpired into 61% debt to equity from 110% in FY12. FCCL is further expected to retire PKR1.7bn in FY14 amid strong cash flow generation due to impressive profitability.
- FCCL is installing 10MW WHR plant which will help in reducing its reliance on grid and insulate the company from further cost pressure as the company is heavily dependent on national grid and highly sensitive to electricity cost hike. The WHR plant will be operational during later half of FY16 which will result in cost savings of around PKR500mn.
- Recent acquisition of Askari Cement by Fauji Foundation may indirectly benefit FCCL if it is able to raise its own quota under the group quota head. FCCL being the more efficient plant would likely be the obvious choice for higher capacity utilization for the parent company in this scenario, in our view.
- The scrip is offering an upside of 17% based on our Jun-14 TP of PKR18.7/share. Further, the stock also offers one of the highest dividend yield in cement industry which will be elevated to 13% in FY15 that makes FCCL the preferred choice of investors. ***BUY***!

FCCL PA	BUY
Stock price	16.0
Target price (June-14)	**18.7**
Current upside/(downside)	17%
Outstanding shares (m)	1,331
Market Cap (PKR bn)	21.2
Free float	55%
3M Avg. daily turnover (PKRm)	141
3M Avg. daily volume (m)	11.1
3M High	16.0
3M Low	10.4

Price Performance

Key Metrics	FY13A	FY14F	FY15F	FY16F
EPS	1.42	2.07	2.29	2.82
DPS	1.25	1.50	2.00	2.50
BVPS	12.0	12.8	13.6	14.0
P/Ex	11.3	7.7	7.0	5.7
P/BVx	1.34	1.25	1.18	1.14
Dividend Yield	7.8%	9.4%	12.5%	15.6%
Earnings growth	389%	46%	11%	23%
ROA	6%	9%	10%	12%
ROE	12%	16%	17%	20%
Net Debt/Equity	61%	50%	48%	45%



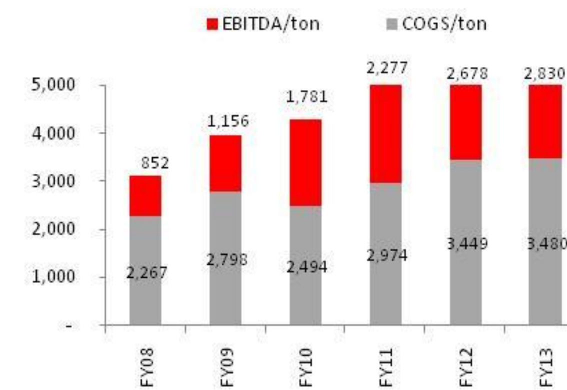
Cash rich balance sheet & lowest production cost to keep Lucky's lead

- In our cement universe, Lucky Cement has successfully maintained its exports, evident from 18% YoY rise during 1HFY14 against 2% YoY decline in industry while local sales, where margins are more lucrative, have been kept steady.
- Owing to lowest COGS/ton in the industry, Lucky Cement benefits the most from any increase in cement prices. As per our calculation, every PKR5.0/bag rise in cement price increase company's earning by PKR0.68/share.
- The company has undertaken multiple energy saving projects including TDF to replace coal while other two 5MW WHR plants are expected to come online in Dec'14 that will reduce its reliance on gas by ~13% which will further buttress the margins.
- The company is negotiating to supply another 20MW to PESCO which will have an annualized EPS impact of PKR1.0/share in FY15.
- Lucky Cement's Iraq project is expected to come online in Jan-14 with an EPS contribution of PKR0.4-1.25/share in FY15 assuming 55-70% utilization levels.
- Healthy cash flow generation along with debt-free balance sheet will enable the company to maintain its dividend paying history and tap other markets.
- We have a ***BUY*** stance on the scrip with Jun-14 TP of PKR338/share, offering an upside potential of 13%. In addition to this, the stock is trading at a P/E of 8.8x and offers a DY of 4%.

Key Metrics	FY13A	FY14F	FY15F	FY16F
EPS	30.04	33.99	37.15	40.17
DPS	8.00	11.00	14.00	17.00
BVPS	126.9	152.9	179.0	205.2
P/Ex	9.91	8.76	8.01	7.41
P/BVx	2.35	1.95	1.66	1.45
Dividend Yield	3%	4%	5%	6%
Earnings growth	43%	13%	9%	8%
ROA	19%	19%	18%	17%
ROE	24%	22%	21%	20%
Net Debt/Equity	-6%	-16%	-25%	-32%

LUCK PA	BUY
Stock price	299.9
Target price (June-14)	**338.4**
Current upside/(downside)	13%
Outstanding shares (m)	323.4
Market Cap (PKRbn)	97.0
Free float	40%
3M Avg. daily turnover (PKRm)	138.8
3M Avg. daily volume (m)	0.5
3M High	301.1
3M Low	228.1

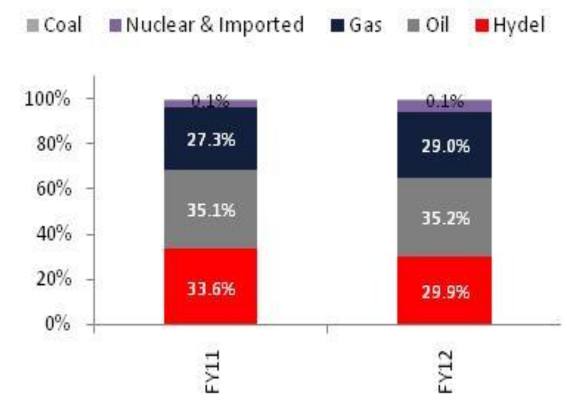
Price Performance



Circular debt resolution holds the key

- Although the name plate capacity of power generation, standing at 22,797MW, exceeds the peak summer demand, which hovers around 18,000MW, de-rating of capacities in Gencos as old plants becomes unable to take load, T&D losses coupled with electricity theft, cyclicality of hydel power generation and circular debt limits the actual generation.
- The circular debt stemmed from disparity between higher generation cost and lower tariffs of electricity and inability of the government to make timely subsidy payments. This issue worsened due to burgeoning cost of FO based power generation and steady rise in thermal power generation.
- Despite recent clearance of circular debt worth PKR480bn in two phases during June and July this year, it has again risen to ~PKR225bn in Dec-13, of which ~PKR120-125bn pertains to last year.
- Although the govt. has raised the power tariffs and significantly phased out the power subsidy in order to curb the circular debt, it has earmarked PKR240-250bn for power subsidies in FY14.
- It is yet to be seen if these reforms meet their intended purpose, but we believe that the power tariff hike coupled with improved recoveries will significantly arrest circular debt build up, and hence improve liquidity situation of power sector companies.
- With fuel, interest and operating cost as pass through item, IPPs thrive on weakening Pak Rupee, however cash flow problems amid spiraling circular debt has often raised red flags on IPPs ability to pay consistent dividends.
- After successful implementation of tariff hike, we have a positive stance on the IPP sector as the pace of rising circular debt has decelerated and we remain upbeat about IPPs liquidity. Our liking also stems from persistent decline in Pak Rupee especially in 1HFY14, and its impact will be fully visible form CY14.

Generation by Source



Higher CFO can augment payout post circular debt resolution

- NPL remains our preferred stock in IPPs space. Earnings of the company are expected to dip slightly during current year before picking up again in FY15 on account of tad higher O&M expenses and diminishing mark-up spread on declining receivables.
- O&M expenses of the company remain relatively lower than envisaged in its tariff, which is resulting in sizeable savings to the company.
- Although reduction in penal mark-up spread seems ominous for the company but in such case, cash earnings of the company improve materially which augurs well for NPL and may pave the way for higher dividends.
- After periods of prolonged distress, cash generation from operations in FY13 stood at PKR12bn. Although the balance turned negative again to PKR1.4bn in 1QFY14, we expect improvement in cash flow generation of the company from 2HFY14, since power tariffs have been raised.
- The scrip is representing an attractive upside potential of 14% based on our Jun-14 TP of PKR34.4/share. Besides this, the stock is expected to pay a total dividend of PKR4.0/share which translates into a dividend yield of 13%.

NPL PA	BUY
Stock price	30.1
Target price (June-14)	**34.4**
Current upside/(downside)	14%
Outstanding shares (mn)	354.1
Market Cap (PKR bn)	10.6
Free float	40%
3M Avg. daily value traded (PKR mn)	24.8
3M Avg. daily volume (mn)	0.8
3M High	31.1
3M Low	28.4

Price Performance

Key Metrics	FY13A	FY14F	FY15F	FY16F
EPS	7.74	7.43	8.18	8.43
DPS	3.00	4.00	5.50	6.50
BVPS	26.01	29.43	32.81	35.2
P/Ex	3.89	4.05	3.68	3.57
P/BVx	1.16	1.02	0.92	0.85
Dividend Yield	10%	13%	18%	21.6%
Earnings growth	34%	-4%	10%	3%
ROA	11%	11%	12%	12%
ROE	33%	27%	26%	25%
Net Debt/Equity	131%	113%	85%	67%

A mixed bag

- Hubco remains our second preferred IPP. Although 1QFY14 earnings remained sub par, and may disappoint investors again in 2QFY14 owing to lower expected generation bonus and relatively inflated O&M cost, improvement in profitability is expected from 2HFY14.
- Although upfront coal tariff for new power plants has been announced, the govt. (Nepra) is yet to announce the tariff for existing power companies which have signed MoUs to convert onto coal. We expect slightly higher incentives for these plants, which will further add value to Hubco, if project is successfully undertaken in due time.
- Although we expect coal conversion of Hubco to be value accretive, raising funds to finance this project has raised alarm bell amongst many investors such as Banks which may have hopped into the company in anticipation of stable dividend stream. The share price may come under pressure, if any of the new sponsor of the company, wary of investing further money in company via right issue, decides to liquidate its stake.
- Based on our Jun-14 TP of PKR64/share, the scrip is offering an upside of 6%. Further, the stock is offering an attractive DY of 12%, comparable to fixed instruments, which is 210bps higher than 6-Month T-Bill.

Key Metrics	FY13A	FY14F	FY15F	FY16F
EPS	8.72	7.96	8.83	10.09
DPS	8.00	7.25	8.00	9.00
BVPS	28.2	29.0	30.6	32.5
P/Ex	6.9	7.5	6.8	5.9
P/BVx	2.1	2.1	2.0	1.8
Dividend Yield	13.4%	12.1%	13.4%	15.0%
Earnings growth	-2%	11%	14%	6%
ROA	9%	6%	7%	8%
ROE	29%	29%	30%	32%
Net debt/Equity	41%	97%	93%	87%

HUBCO PA	HOLD
Stock price	60.7
Target price (June-14)	**64.2**
Current upside/(downside)	5.8%
Outstanding shares (mn)	1,157
Market Cap (PKR bn)	70.3
Free float	60%
3M Avg. daily value (PKR mn)	95.9
3M Avg. daily volume (mn)	1.6
3M High	63.6
3M Low	59.0

Price Performance

Improvement in volumes & reflection of weaker Yen will be the key driver for CY14!

- Auto sales showed a growth of 7% YoY during 5MFY14 due to end of backlog of imported cars. HCAR sales increased by 26% YoY due to low base effect and launch of new Honda Civic 2013 model. Other than above, growth has been observed in PSMC (4%) & in INDU (1%) despite the discontinuation of Alto & Daihatsu Cuore, and ban on company fitted CNG kits.

- Weakening of Yen during FY13, frequent price increases during bouts of Yen appreciation as well as subdued global steel price also bode positively for the margins of local assemblers.

- Threats surrounding auto sales are: 1) persistent price raise considering the overall scenario of PKR devaluation. 2) reversal of government's decision for the reduction in age limit of imported cars from 5 years to 3 years as being lobbied by the dealers association as well as pressure exerted by the competition commission.

- Tractor sales witnessed a decline of 36% YoY during 5MFY14 mainly due to 1) lack of farm mechanization policy at Federal & Provincial level, 2) absence of tractor scheme, and 3) hike in tariffs. We expect subdued tractor sales going forward due to further rise in GST from 10% to 17% w.e.f. January 01 2014.

- **Recommendation:** At current price, we maintain a Buy stance on PSMC & Hold stance on INDU. We downgrade MTL to Sell.

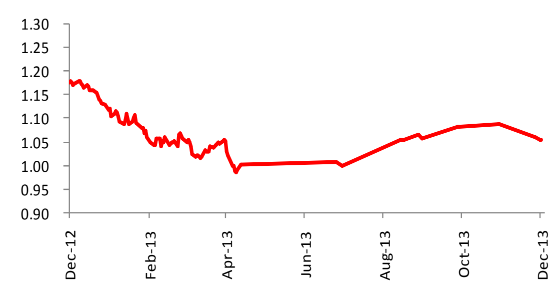
Auto Sales

Cars, Jeeps & Pick-Ups	5MFY14	5MFY13	YoY
PSMC	29,511	28,337	4%
INDU	13,197	13,128	1%
HCAR	9,334	7,429	26%
OTHERS	342	198	73%
Total	**52,384**	**49,092**	**7%**

Tractor Sales

	5MFY14	5MFY13	YoY
AGTL	5,338	8,182	-35%
MTL	7,268	11,669	-38%
Total	**12,606**	**19,851**	**-36%**

PKR / Yen Parity



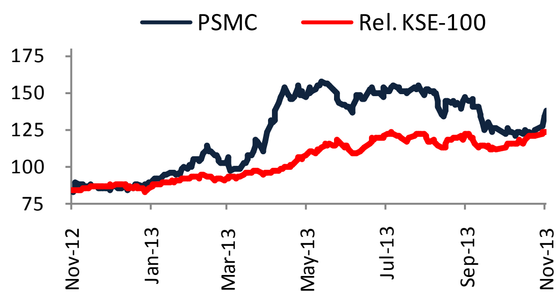
Pak Suzuki Motor Company Limited

Frequent price increase & weaker Yen will keep margins lofty in CY14

- In CY14, we are foreseeing slight growth in volumetric sales despite ban on company fitted CNG kits. We are also anticipating improvement in earnings as compared to CY13 core earnings of PKR24.15/share (total EPS PKR27.48 inclusive of PKR3.33/share against gain on disposal of old motorcycle plant) on the back of frequent price increase made by PSMC during Yen appreciation time period of 2QFY12 till 1QFY13 while not passing on the subsequent benefit during weaker Yen period (major imports of PSMC are Yen based). Additionally, PSMC imports are covered under foreign exchange contracts and the major portion of weaker Yen impact will be visible in CY14.
- We await any positive development from government's side for the implementation of AIDP-II in order to support local auto industry. Within the tariff concession, INDU is lobbying for ~5% reduction in CBUs and CKDs import duty, which bodes well for all local manufactures, if implemented.
- Any replacement of Suzuki Alto (10k units were sold in CY12) as well as launch of Hybrid vehicle (as the same is available in Japan) can boost the volumes as most of the PSMC's customers are from middle class.
- **Recommendation:** Trading at CY14 PE and PB of 6.2x and 0.65x. Based on last closing price, we have a Buy stance on PSMC.

PSMC PA	BUY
Stock price	153.9
Target price (Dec-14)	**184.4**
Current upside/(downside)	20%
Outstanding shares (m)	82.3
Market Cap (PKR bn)	12.7
Free float	27%
3M Avg. daily turnover (PKRm)	5.02
3M Avg. daily volume (m)	0.04
3M High	152.5
3M Low	121.4

PSMC Price vs KSE Relative Index



Key Metrics	CY12A	CY13F	CY14F	CY15F
EPS	11.88	27.48	25.00	21.39
DPS	2.50	5.00	5.00	5.00
P/Ex	12.95	5.60	6.15	7.20
P/BVx	0.80	0.71	0.65	0.61
Dividend Yield	1.6%	3.2%	3.2%	3.2%
ROA	5%	9%	8%	6%
ROE	6%	13%	11%	8%

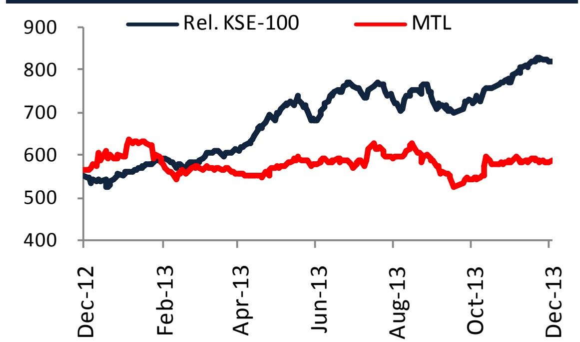
Earnings outlook remains bleak as volumes are expected to dip

- FY13 witnessed stable volumetric sales mainly due to tractor schemes launched by Provincial Government of Punjab (GTS) and Sindh (STS). However, in CY14 we are foreseeing subdued volumetric sales due to upward revision in sales tax rate from 10% to 17% w.e.f. January 01, 2014, absence of subsidies under IMF conditionality of belt tightening as well as hike in tariffs.
- To overcome the aforesaid situation, ensure the food security in the country and to support the tractor industry & their vendors, the PM has constituted Business and Agriculture Advisory Committees to overcome the above challenges being faced by the sector.
- To mitigate the dip on local sales front, MTL has established an offshore subsidiary in Dubai, UAE which would act as a marketing/ trading hub between the foreign buyers & MTL. As Massey Ferguson (AGCOB) has also established a tractor assembly plant in China (for exports to Africa and China), where tractors would be produced from the parts made in MTL factory in Pakistan. This can turn out to be a positive catalyst for future earnings amid depressed local sales.
- **Recommendation:** MTL is trading at FY14 PE and PB of 14.18x and 4.61x. Based on last closing price, we downgrade our stance from Hold to Sell and await any positive trigger of relaxation on the GST front or the launch of any new tractor scheme.

Key Metrics	FY13 A	FY14F	FY15F	FY16F
EPS	48.28	34.03	42.18	43.02
DPS (Bonus adj.)	47.5	30.0	35.0	40.0
P/Ex	9.99	14.18	11.44	11.22
P/BVx	4.49	4.61	4.13	4.02
Dividend Yield	9.8%	6.2%	7.3%	8.3%
ROA	21%	19%	19%	18%
ROE	45%	32%	36%	36%

MTL PA	SELL
Stock price	482.5
Target price (June-14)	**419.9**
Current upside/(downside)	-13%
Outstanding shares (m)	44.3
Market Cap (PKRm)	21.4
Free float	36.6%
3M Avg. daily turnover (PKRm)	6.7
3M Avg. daily volume (m)	0.01
3M High	490.5
3M Low	433.7

MTL Price vs KSE Relative Index

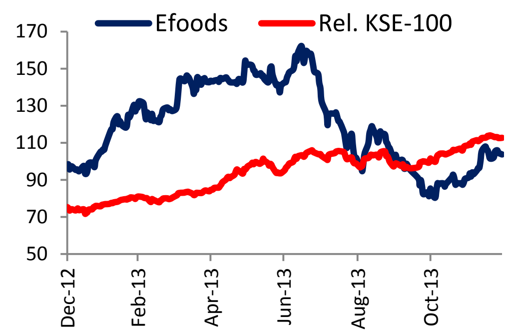


Optimistic only in the medium term

- 9MCY13 showed a decline of 23% YoY. The real cause of concern however was the QoQ result, which saw earnings drop by a massive 72% in 3q. Our earnings expectation for CY13 is PKR 1.73 , a decline of 49% YoY.
- Supply chain issues have largely been addressed and the company does not see logistical issues as the reason for volumes attrition going forward. The company has decided to offer discount on its largest volumetric product (Tarang), in order to bring back the customers lost to loose milk. With these variables, we expect 4q earnings to also remain on the lower side due to Tarang discount.
- The first pilot project of Fresh Dairy milk (Mabrook) has started from November with good response from customers, while the second pilot project of meat business will come online in 1HCY14, as the company is currently developing the meat supply chain. The milk powder plant is also expected to boost earnings in CY14.
- Given the negative margins outlook and towering multiples, we maintain our Sell stance on the script, as it is trading at CY13 P/E of 61x. Low float & lofty valuations of peers will however keep the stock in limelight.

EFOODS PA	SELL
Stock price	104.4
Target price (DEC-14)	**82.2**
Current upside/(downside)	-21%
Outstanding shares (m)	766
Market Cap (PKR bn)	80.1
Free float	15%
3M Avg. daily value traded (PKRm)	364
3M Avg. daily volume (m)	3.0
12M High	162.2
12M Low	80.4

Price Performance



	CY12A	CY13F	CY14F	CY15F
EPS	3.39	1.73	2.72	5.51
DPS	-	-	-	-
BVPS	13.1	14.9	17.6	23.1
P/Ex	26.3	51.6	32.8	16.2
P/BVx	6.8	6.0	5.1	3.9
Dividend Yield	-	-	-	-
Earnings growth	191%	-49%	57%	103%
ROA	13%	6%	8%	15%
ROE	30%	12%	17%	27%

TSL Valuations Guide

KATS	Target price	Closing price	Upside/ (Downside)	Rating	EPS			DPS			P/E x			Dividend Yield			P/BV x		
					FY13E	FY14F	FY15F	FY13E	FY14F	FY15F	FY13E	FY14F	FY15F	FY13E	FY14F	FY15F	FY13E	FY14F	FY15F
BAFL	28.6	27.04	6%	Hold	3.46	4.46	4.94	1.5	2.0	2.3	7.8	6.1	5.5	5.5%	7.4%	8.3%	1.1	1.0	0.9
BAHL	52.7	41.55	27%	Buy	4.93	6.41	7.62	2.5	3.0	3.5	8.4	6.5	5.5	6.0%	7.2%	8.4%	1.6	1.4	1.2
HBL	157.5	166.63	-5%	Hold	16.64	19.31	21.30	8.0	9.0	10.0	10.0	8.6	7.8	4.8%	5.4%	6.0%	1.6	1.5	1.3
MCB	271.6	281.17	-3%	Hold	22.54	25.98	27.90	14.0	14.0	15.0	12.5	10.8	10.1	5.0%	5.0%	5.3%	2.5	2.2	2.0
UBL	140.1	132.55	6%	Hold	14.58	16.86	19.50	8.0	8.5	9.0	9.1	7.9	6.8	6.0%	6.4%	6.8%	1.6	1.4	1.3
Banking Sector			**0%**	**Hold**							**10.3**	**8.8**	**7.9**	**5.2%**	**5.7%**	**6.2%**	**1.8**	**1.6**	**1.5**
CHCC	85.6	63.29	35%	Buy	12.81	14.27	15.74	2.5	4.0	7.0	4.9	4.4	4.0	4.0%	6.3%	11.1%	1.6	1.3	1.0
AKZO	90.6	124.69	-27%	Sell	9.64	8.13	8.23	8.0	8.0	8.0	12.9	15.3	15.2	6.4%	6.4%	6.4%	2.1	2.1	2.1
MLCF	34.1	27.43	24%	Buy	6.11	6.32	7.12	-	-	1.5	4.5	4.3	3.9	0.0%	0.0%	5.5%	2.2	1.5	1.1
DGKC	112.3	85.73	31%	Buy	12.56	13.48	15.19	3.0	5.0	6.0	6.8	6.4	5.6	3.5%	5.8%	7.0%	0.8	0.7	0.7
FCCL	18.7	15.95	17%	Buy	1.42	2.07	2.29	1.3	1.5	2.0	11.3	7.7	7.0	7.8%	9.4%	12.5%	1.3	1.2	1.2
LUCK	338.4	299.87	13%	Buy	30.04	33.99	37.15	8.0	11.0	14.0	10.0	8.8	8.1	2.7%	3.7%	4.7%	2.4	2.0	1.7
Construction & Material			**17%**	**Buy**							**8.3**	**7.4**	**6.7**	**3.4%**	**4.7%**	**6.4%**	**1.5**	**1.3**	**1.2**
HUBC	64.2	60.72	6%	Hold	8.11	7.96	8.83	8.0	7.2	8.1	7.5	7.6	6.9	13.2%	11.9%	13.4%	2.1	2.0	1.9
NPL	34.4	30.06	14%	Buy	7.65	7.43	8.18	5.0	4.0	5.5	3.9	4.0	3.7	16.6%	13.3%	18.3%	1.3	1.0	0.9
KAPCO	61.6	61.75	0%	Hold	8.36	8.58	9.47	8.0	8.2	9.0	7.4	7.2	6.5	13.0%	13.4%	14.6%	2.1	2.0	2.0
Power Sector			**4%**	**Hold**							**7.0**	**7.0**	**6.3**	**13.4%**	**12.6%**	**14.2%**	**2.0**	**1.9**	**1.8**
MTL	419.9	482.5	-13%	Sell	48.28	34.03	42.18	47.5	30.0	35.0	10.0	14.2	11.4	9.8%	6.2%	7.3%	4.5	4.6	4.1
PSMC	184.4	153.89	20%	Buy	27.48	25.00	21.39	5.0	5.0	5.0	5.6	6.2	7.2	3.2%	3.2%	3.2%	0.7	0.6	0.6
INDU	348.0	333	5%	Hold	42.72	37.23	37.45	25.0	22.0	22.0	7.8	8.9	8.9	7.5%	6.6%	6.6%	1.5	1.4	1.3
Auto Sector			**2%**	**Hold**							**7.8**	**9.3**	**9.2**	**7.4%**	**5.8%**	**6.1%**	**1.5**	**1.4**	**1.3**
FFBL	46.4	43.81	6%	Hold	6.10	6.27	5.30	5.5	5.5	5.0	7.2	7.0	8.3	12.6%	12.6%	11.4%	3.1	2.9	2.9
Engro	190.8	158.38	20%	Buy	16.68	19.14	33.39	-	-	6.0	9.5	8.3	4.7	0.0%	0.0%	3.8%	1.7	2.2	3.1
FFC	119.8	111.96	7%	Hold	15.25	16.07	16.40	14.0	15.0	15.5	7.3	7.0	6.8	12.5%	13.4%	13.8%	5.1	4.9	4.7
EFERT	37.4	28.25	32%	Buy	4.20	3.55	6.26	-	-	-	6.7	8.0	4.5	0.0%	0.0%	0.0%	1.5	1.3	1.0
FATIMA	32.3	28.56	13%	Buy	3.90	4.17	4.78	2.0	2.5	3.0	7.3	6.8	6.0	7.0%	8.8%	10.5%	1.8	1.6	1.5
DAWH	73.6	56.12	31%	Buy	7.47	10.33	19.44	1.0	1.5	2.0	7.5	5.4	2.9	1.8%	2.7%	3.6%	0.9	0.8	0.6
EPCL	18.4	13.41	37%	Buy	1.11	1.59	4.04	-	1.0	2.0	12.1	8.4	3.3	0.0%	7.5%	14.9%	1.3	1.1	0.9
LOTCHEM	7.2	7.34	-2%	Hold	(0.11)	0.07	0.33	-	-	0.2	n.a.	109.0	22.4	0.0%	0.0%	3.4%	0.9	0.9	0.9
Chemical Sector			**15%**	**Buy**							**7.9**	**7.3**	**5.6**	**6.8%**	**7.6%**	**9.0%**	**2.1**	**2.1**	**1.9**
APL	506.7	499.69	1%	Hold	47.10	53.61	56.14	37.5	43.0	45.0	10.6	9.3	8.9	7.5%	8.6%	9.0%	3.0	2.8	2.6
PSO	397.9	332.22	20%	Buy	50.84	75.83	62.68	4.6	25.0	30.0	6.5	4.4	5.3	1.4%	7.5%	9.0%	1.3	1.0	0.9
OGDC	297.6	276.36	8%	Hold	21.11	32.63	38.17	8.0	12.0	15.0	13.1	8.5	7.2	2.9%	4.3%	5.4%	3.5	2.8	2.3
POL	588.7	497.71	18%	Buy	45.78	64.63	77.56	45.0	60.0	70.0	10.9	7.7	6.4	9.0%	12.1%	14.1%	3.2	3.1	3.0
PPL	232.3	213.96	9%	Hold	21.28	26.16	31.40	8.8	12.0	14.0	10.1	8.2	6.8	4.1%	5.6%	6.5%	2.7	2.2	1.9
Oil & Gas Sector			**9%**	**Hold**							**11.6**	**8.0**	**7.0**	**3.6%**	**5.4%**	**6.5%**	**3.0**	**2.5**	**2.1**
EFOODS	82.2	104.44	-21%	Sell	1.73	2.72	5.51	-	-	-	60.5	38.4	18.9	0.0%	0.0%	0.0%	7.0	5.9	4.5
NML	144.9	127.24	14%	Buy	16.63	18.27	20.01	4.0	6.0	7.0	7.7	7.0	6.4	3.1%	4.7%	5.5%	0.8	0.7	0.7
NCL	64.0	60.2	6%	Hold	11.37	13.44	11.87	1.8	3.0	4.0	5.3	4.5	5.1	3.0%	5.0%	6.6%	2.6	2.0	1.7
Personal Goods Sector			**12%**	**Buy**							**7.0**	**6.2**	**6.0**	**3.1%**	**4.8%**	**5.7%**	**0.8**	**0.8**	**0.7**
TSL UNIVERSE			**7%**	**Hold**							**10.3**	**8.1**	**7.0**	**4.7%**	**5.8%**	**6.8%**	**2.7**	**2.3**	**2.0**

TSL team

Suite # 604, 6th Floor, Progressive Plaza, Beaumont Road, Karachi, Pakistan. UAN : (021) 111 82 87 87 Fax : (92) 021-3568-6279

Syed Zain Hussain	Chief Executive Officer		zain@taurus.com.pk
Muhammad Asif	Head of Broking	35682690	asifjan@taurus.com.pk

RESEARCH	**Sectors**		
Taha Khan Javed, CFA	Economy, Strategy & E&Ps	35216403	taha@taurus.com.pk
Hassan Raza	Banking & OMCs	Ext: 202	hassan@taurus.com.pk
Hassaan Ghafoor	Power & Cements	Ext: 203	hassaan.ghafoor@taurus.com.pk
Ameet Daulat	Fertilizer & Textile	Ext: 202	ameet.daulat@taurus.com.pk
Asim Zaidi	Autos & Chemicals	Ext: 202	asim.zaidi@taurus.com.pk
Syed Sufyan Subhani	Technicals & FMCG	Ext: 202	sufyan@taurus.com.pk

URL: http://www.taurus.com.pk

E-mail: research@taurus.com.pk