Faysal AssetManagement

Research Note – Elections 2013, The Verdict

May 13, 2013

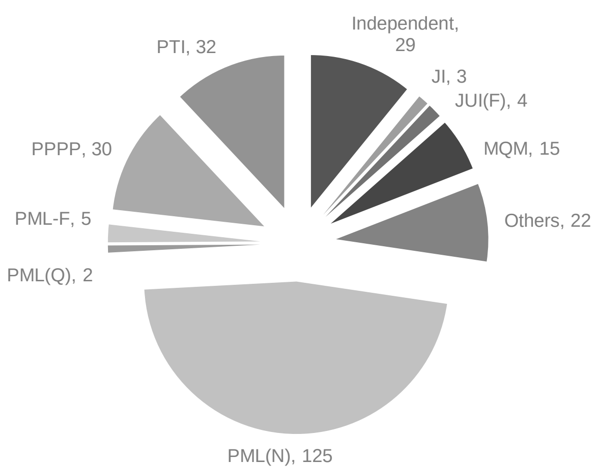
The Results are in

On May 11, 2013 millions of enthusiastic voters came out to choose their beloved leaders – a right which majority had not exercised in their lifetime. It was the first time for many and the turnout was expected to set a new record for Pakistan. With increased awareness and utmost dissatisfaction on the previous coalition Government's performance, voters all across Pakistan were taking a lot of interest in the General Election 2013 –. This led to a lot of speculation on which party would form the next Government. Would it be the Punjab's lion, the cricketer's tsunami, BB's clan or other small political wings. Furthermore, the previous Government must be lauded to have ensured to play an important role in completing its 5 year tenure and transferring the office – a political milestone in Pakistan's history.

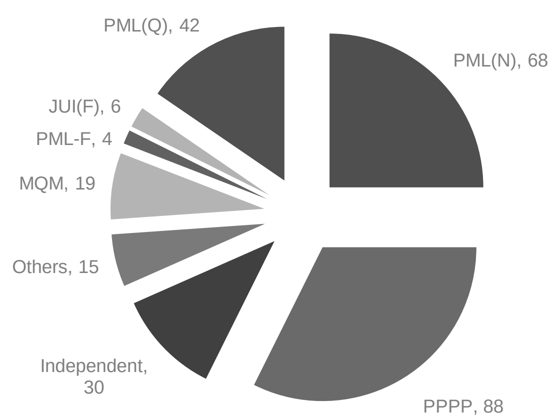
The high voter turnout led by the strong anti –incumbency sentiment resulted in the Pakistan Muslim League – Nawaz group to dominate the elections against the Pakistan Tehreek-e-Insaf threat of the tsunami led by the populist leader Imran Khan. Leading in 125 seats at the center so far, the PML-N is in a very strong position to form the government with little support from coalition partners. The higher than expected seats in favor of the PML-N has dashed any chances of a weak coalition government as previously expected in run-up to the elections. With Nawaz Sharif poised to become Prime Minister for the third time, the focus of the government is towards bolstering the economy and overcoming energy shortages.

The incoming government faces tough challenges including weakening balance of payments position, dwindling foreign reserves, acute energy crisis and high fiscal deficits. While the IMF program may be not be unavoidable in the near term, the new government will also focus towards key reforms already hinted by the IMF including privatization of key loss making entities, taxation reform and big energy and infrastructure projects.

Natioanl Assembly 2013



Natioanal Assembly 2008



The unofficial results now represent significant clarity on the outcome as the cloud of political uncertainty on the prospect of election and smooth transaction of power dissolves. PML-N has taken the instrumental position to form the coalition government to achieve simple majority. Affirmation of anticipated outcome has already excited the investors and driven the local bourse to its new highs with added foreign interest last week.

Contesting Parties	National Assembly	Sindh	Punjab	KPK	Balochistan
PML(N)	125	1	206	10	5
PTI	32	1	22	25	0
PPPP	30	44	5	2	0
Independent	29	0	39	10	4
Others	22	0	0	0	3
MQM	15	8	0	0	0
PML-F	5	3	1	5	1
JUI(F)	4	2	0	9	0
JI	3	0	1	7	0
PML(Q)	2	0	7	0	1
Summary	**267/272**	**68/130**	**288/297**	**76/99**	**19/51**

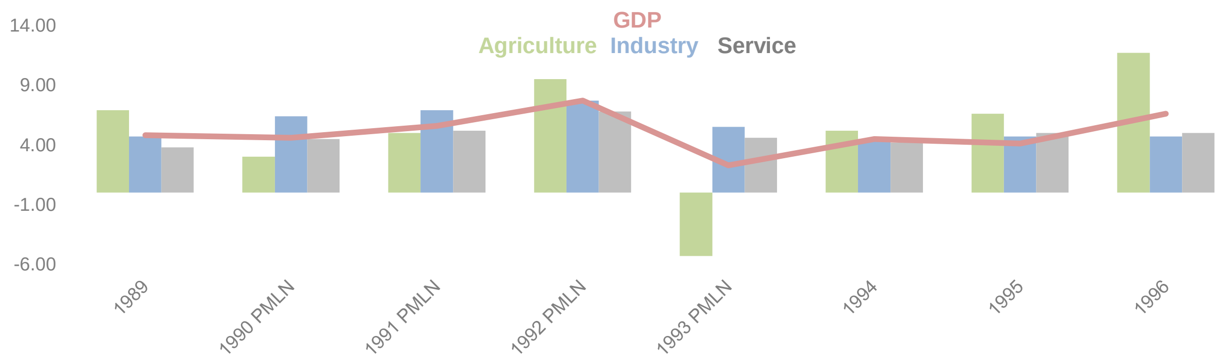
Economy: A detailed Picture

In order to comment on the prospect of economic revival as outlined in PML-N Manifesto 2013, a glimpse on their past performance would give a reality check to the Pre-Election promises.

Glimpse into 1990-1993

As a devoted capitalist and having suffered the nationalization of large industrial enterprises during Bhutto's regime (1971-77) Nawaz Sharif's initial task after holding office was to promote private industrial and commercial entrepreneurship. Under the development policy restriction on establishing new industries was lifted and investments were encouraged at massive levels.

In an effort to support the smooth functionality of industries Mian Nawaz Sharif launched the construction of a superhighway project – amounting US$1 billion. Moreover, he set upon a fundamental liberalization of the foreign exchange regime In 1992 the government also allowed Pakistani residents to hold foreign exchange in designated accounts if the funds were received from overseas. However, due to decline in the inflow of home remittances and increase in other invisible payments the current account balance of payments deficit stood at $1.85 billion against the original target of $1.33 billion. In an effort to further lure the business class massive tax cuts for big business and wealthy individuals were introduced in 1990 which slashed the quantum of tax collection and widened the disequilibrium in the society (a common criticism on philosophy of capitalism). Tax-to-GDP of 14.3% in FY90 ended up at 13.3% of GDP in FY93.



Glimpse into 1997-1999

In the second term as Prime Minister, Mian Nawaz Sharif had two success mantras. One pertaining to efforts to bequeath Nuclear Strength to Pakistan and second was voiced as 'Qarz Utaro Mulk Sanwaro' (translation: Pay off your debt to make country prosper). Unfortunately, Large-scale manufacturing contracted for the first time in over 50 years, while agriculture, which is the backbone of the economy collapsed in the aforementioned tenor. Pakistan's worsening international trade performance is among the most visible symbols of economic depression. Furthermore, the then elected Government of Nawaz Sharif could not tackle with the economic crisis under the strict pressure from IMF in response to which incremental taxes with imposed.

Head Count Ratio of Poverty in Pakistan			
Year	Total	Rural	Urban
1964	40.24	38.94	44.53
1967	44.50	45.62	40.96
1970	46.53	49.11	38.76
1979	30.68	32.51	25.94
1985	24.47	25.87	21.17
1988	17.32	18.32	14.99
1991	22.10	23.59	18.64
1993	22.40	23.35	15.50
1997	31.00	32.00	27.00
1999	32.60	34.80	25.90

Source: Amjad and Kemal Research

Nawaz Government was under extreme pressure from IMF yet the Government rehashed its previous tax reduction strategy to please the business class. Moreover, it was only under his leadership, that the nuclear program became vital part of Pakistan's economic policy in 1998. After the nuclear test all foreign currency accounts in Pakistani banks were frozen in order to minimize the effects of economic sanctions. Thus honoring Pakistan with the title of being the 1st Muslim country to have gained Nuclear Power.

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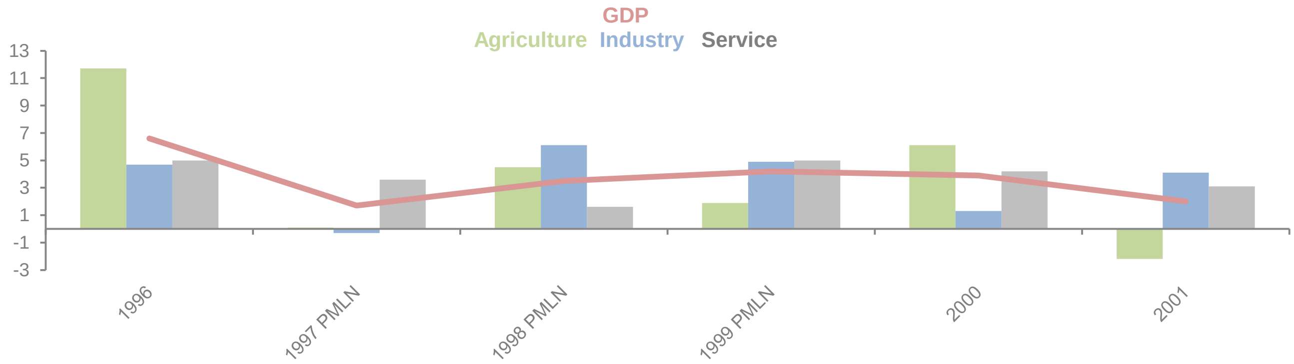
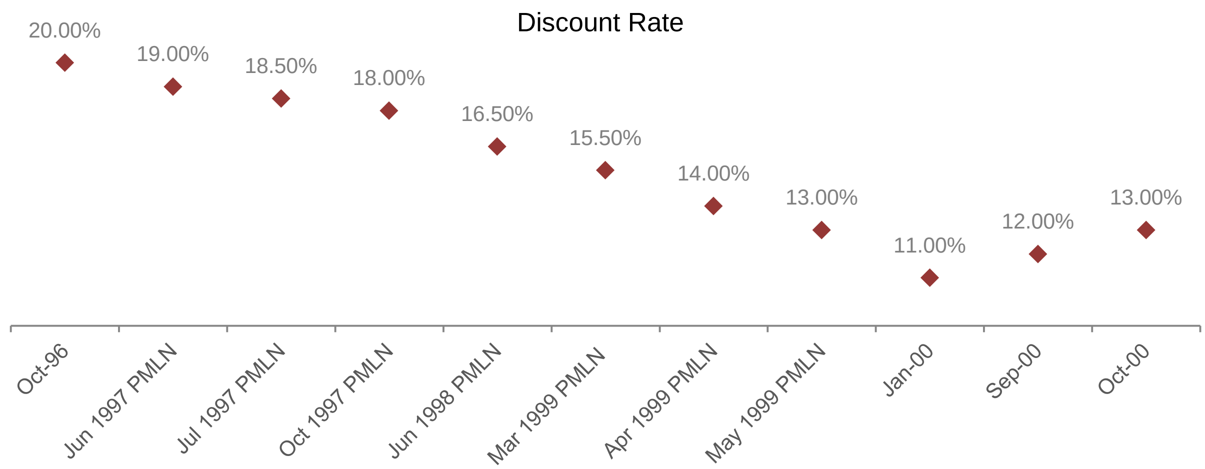




Going forward: Do the promises hold any REALITY

With the pressing issue of IMF repayment and depleting foreign reserves the country faces serious economic challenges with the new Government will have to answer. The Manifesto 2013 talks about following concerns:

Steps for economic Revival

1. Budget deficit will be brought down to 4%.Overly Optimistic
   Action 1: Increase in revenues. Tax to GDP ratio to increase from 9% at present to 15% by the end of 2018. PML-N have had the history of reducing taxes in order to entice the business community. So there are serious reservations on the implementation of the promised action.
   Action 2: One-third reduction in current expenditures other than salaries, allowances and pensions. Approximately 30% to 40% of the current expenditure constitutes servicing of debt (foreign and domestic) and defense expenditure. Curtailing either of the major items of current expenditure seems highly doubtful.
   Action 3: Losses from State Enterprises amounting to approx. PKR 400 billion will be reduced through revamping / privatizing these institutions. Past years suggest that PML-N holds strong to the concept of privatization and may expedite the process once they come into power – thus relieving budget deficit to carry loss making PSE (Public Sector Enterprise).

- Inflation will be brought down to single digit in the range of 7-8%. Achievable. Apt to add here are the efforts of the previous macroeconomic managers to have curbed the inflationary pressure since the start of FY13. Going forward inflation can be managed well-under 9%.
  Action 1: Lower interest rates through effective monetary policy. IMF will exert immense pressure from further curtailing DR from current levels. Since current macroeconomic dynamics don't leave room for further monetary easing.
- Large scale manufacturing will grow by 7-8% annually. Would require resolution of energy crisis.
- Investment-to-GDP ratio will rise to 20%. Would require stability in Geo Political Situation.

The need to request IMF for a new bailout package is inevitable and even though Nawaz Sharif asserts to make domestic resources sufficient for economic revival yet the eminent crisis is huge and requires international support. However, the interesting aspect would be to ascertain the negotiation with the International body on the conditionality before extending new loan. Moreover, the PML-N would also try to ensure prevalence of single digit discount rate which further highlights and endorses a case of positive real returns to continue.

Uplifting the Economy

With the deteriorating position of Balance of Payment positions, it seems fairly obvious that Pakistan will enter into an IMF program sooner rather than later with PML-N's chief and incoming PM Mian Nawaz Sharif has already indicated the possibility to seek another bailout package in order to avoid an impending Balance of Payment crisis. However, time and again ex-chief minister Punjab Mian Shahbaz Sharif has rejected the idea of foreign aid.

Bearing in mind PML-N's history it is expected that PML-N will work on major infrastructure projects, restructuring of Public Sector Enterprises and Privatization amongst implementing other policies. In its earlier tenures PML-N has a proven track record of good governance and efficient administration which when combined with the policies mentioned in its manifesto, will have a positive impact on our economy. This time around, with a targeted economic manifesto chained with broad action plans, PML-N should face no hurdles in implementing even toughest of decisions needed to undo deep economic dents.

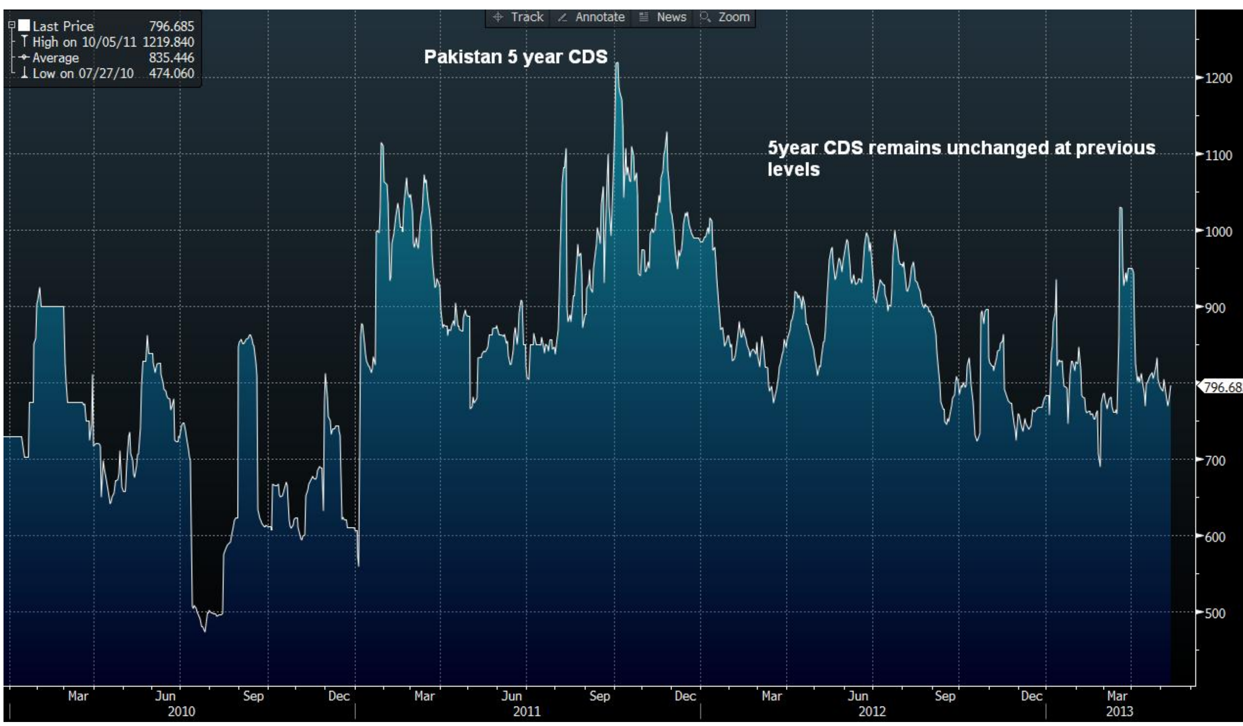
The Two P's: Privatization leading to Prosperity

As evident from its previous reigns and possessing an industrialist background, we expect the policies of privatization to resume in this reign as well. In its first tenure as Prime Minister, Nawaz Sharif privatized MCB and ABL amongst others and this time around we expect him to kick-start the privatization program to achieve space for long- term development spending and overall fiscal consolidation while providing currency stability. Moreover, we expect an inflow of private sector investment in public sector projects as well as privatizing SOEs (State Owned Enterprise). However, this time around these measures need to be taken quickly keeping in mind the worsening BoP position.

Energy issue: The top Priority

Over the last 5 years, Punjab has suffered the most in terms of energy with load-shedding on a high during PPP's reign. We expect that it will be the top most priority for the incoming government led by PML-N to resolve the circular debt and load shedding issues.

At present, circular debt stands at PKR 400bn and is ever-increasing at a rate of PKR 15-20bn per month primarily accountable to subsidies, inefficiencies and non-recoveries from various state organizations. With a strong mandate in hand, it is expected that PML-N will take bold and drastic step or raising the power tariff in the long term. However, immediate short-term measure could constitute of restructuring outstanding cash flows as medium- term debt instruments backed by the GoP, coupled with power dispatch as per plant efficiency. Moreover, off- loading sizeable stakes in selected state owned enterprises can eliminate the outstanding stock of circular debt over the long term and provide support on twin deficits.



Positivity on the cards

The local bourse achieved a new high level of 19,916 that indicates a welcoming note on PML-N taking the front running party to the government office as the expected winner. With much clarity on hand and given a strong and experienced economic team at their disposal coupled with past record of business friendly policies, the capital markets will welcome the PML-N government with a likely rerating of the market valuations to P/E of 9x from current levels P/E of 7.5, due to lower political risk and business friendly policies, setting a short term index target of 21,400 for December-13 and long term index target of 25,000 index points. Expansion of earnings dictates the case as policies and framework from the pro-business government would highly improve the outlook going forward. Investor interest is likely to drive up on the fact that the performance oriented forthcoming government would likely lay its focus on infrastructure products and exports oriented industries which would be positive for cements, construction, textile, steel and allied industries while resolution of the mounting circular debt would help improve the outlook for energy. Taking into account past rallies following the elections, the average post 6 month equity return is 25%, making our target of 21,400 a very achievable target in the near term.

Election Date	Winning Party	6-MonthsPost Elections
24th October 1990	PML-N	12.87%
6th October 1993	PPP	80.2%
3rd February 1997	PML-N	25%
10th October 2002	PML-Q	35.7%
18th February 2008	PPP	-25%
Average Return		**25.75%**

The KSE-100 index has sharply caught up to the S&P500 index which has had a phenomenal run this calendar year up 14.5%. However in terms of price earnings multiples, the KSE has underperformed the rally with earning differentials rising to as high as 7x between the two indices against the historical average of 6x. We expect the differential to fall back to 6x taking the KSE index to record high index target level of 21,400 points in the near term.

Sectorial Impact

Fertilizer: Urea imports could be curtailed post IMF program. Companies with low-priced gas agreements to benefit the most coupled with implementation of long-term gas plan to follow. SNGPL based fertilizer manufacturers may still face load shedding. Top pick: ENGRO, DAWH, FATIMA

Telecom: 3G spectrum auction likely to take place generating USD 800mn. Middle East based Telecom management to feel relaxed under PMLN regime. Recovery of PTCL privatization proceeds amounting to USD 800mn from Etilisalat.

Cement: Anti-cartel action not likely as the sector grows strong from stable price levels and core margin earnings. PSDP expenditure would lead to volumetric growth for the sector, specifically from post-infrastructure developments post IMF program. Top Picks DGKC, LUCK, KOHC and FCCL

Banks: Banks likely to thrive on better economic prospects amidst strong PMLN support for banking sector. MCB's organic growth plans could go ahead. Sind Bank could be up for scrutiny while BOP may benefit. Increased confidence in the economy should bode well for deposit/loan growth for banks. Top Picks: MCB and BOP

Energy: Revamped energy policy. Improved law and order situation in KPK and Baluchistan would lead to fast track drilling activities. Coal based power projects to be preferred. Conversion of furnace based IPPs into Coal. Foreign investments in alternate energy project i.e. wind and solar. E&Ps sector may offer secondary offerings to finance fiscal deficit. Easing circular debt would weigh in to boost dividend yields and unlock the stock valuations for OMCs. IPPs will continue to attract interest till uncertainty on PKR exchange rate. Cash injections to ease liquidity prospects of the sector. No quick fix for circular debt but leveraging Saudi possible for interim fiscal space. Euro bond /OGDC bonds to resolve circular debt. Sale of inefficient DISCOS, GENCOS to reduce T&D losses and improve energy infrastructure and liquidity. Top picks: PSO, OGDC, POL, PPL, HUBC, KAPCO, NCPL, NPL

Auto: Given yellow cab stigma, less liberal imports likely. Expansion of locally produced taxi/bus schemes. Intra city bus projects. Tractor subsidies will lead to valuation rerating for tractor manufacturers. Top Picks: PSMC, AGTL and MTL .

Textiles: Relief for Textile industry in the form of reduced gas load shedding and export oriented measures to be given. Technological upgrade of the industry will be priority and possible increase in R&D subsidy. Top picks NML, NCL.

Top Performing stocks in the run-up to the Elections 2013							
Security	Last Price	Change	Index Points	Security	Last Price	Change	Index Points
MCB	249.43	+31.53	+235.232	NESTLE	6900.00	+320.0	+13.375
PPL	204.24	+23.15	+145.684	PTC	19.02	+1.10	+11.878
OGDC	211.63	+7.63	+88.875	MUREB	352.30	+62.30	+10.660
POL	487.83	+17.66	+35.179	SCBPL	16.93	+2.62	+9.349
HUBC	56.00	+2.06	+30.758	AICL	84.19	+5.63	+8.986
ENGRO	140.49	+6.25	+29.451	MARI	127.11	+26.16	+8.861
FFC	113.54	+1.81	+23.346	ABL	59.40	+4.39	+8.424
UBL	93.43	+4.06	+22.904	LUCK	177.03	+3.45	+8.226
DAWH	61.77	+7.01	+21.766	HMB	15.70	+.86	+6.644
PSO	211.30	+9.76	+20.419	EFUG	86.28	+4.68	+5.931
NBP	41.39	+2.03	+18.875	KESC	5.54	+.11	+5.599
FCCL	10.18	+1.32	+17.814	PSEL	252.00	+11.50	+5.171
DGKC	71.85	+3.90	+17.323	JDWS	98.50	+8.50	+4.683
BAHL	26.42	+1.63	+16.697	COLG	2000.50	+55.38	+4.450
NML	85.71	+4.67	+15.133	PGF	17.98	+1.04	+4.348
BAFL	16.31	+1.21	+15.046	SHEL	157.11	+13.92	+4.327
PKGS	234.08	+26.58	+14.470	KAPCO	56.17	+1.31	+4.251
HBL	93.85	+5.85	+14.380	CHCC	59.94	+3.69	+4.226
SNBL	7.50	+.91	+13.449	INDU	312.90	+11.03	+3.995

Post Elections

‘Change’ on its Way

With an astonishing turnout ratio at the ballot box (around 60%) following endless queues, the change for Pakistan has finally come through the vote. For the first time in the history of Pakistan has one government managed to complete its tenure and hand over the responsibilities to the other government in a democratic fashion. There were concerns that these elections might not even or in the event of elections it might cause havoc, surprisingly a serene transition was observed. As expected and anticipated by the market it was PML-N that came out victorious with a clear majority followed by PPP and PTI. However, PML-N will be required to join hands with smaller parties and independents in order to form a majority. Moreover, Mian Mohammad Nawaz Sharif is expected to be the Prime Minister for the third time with his younger brother Mian Shahbaz Sharif expected to resume the position of Chief Minister Punjab. With a clear majority PML-N will bring experience and a decent track record to the table coupled with a strong mandate to deliver.

PML-N's first tenure (1990-1993)

- Telecom sector was opened to private investment which led to doubling of telephone connections within two years.
- Deregulation program was implemented to abolish the import licensing system, remove restrictions on the movement of foreign exchange and grant new incentives for local and foreign investment in industries.
- Power Generation capacity was increased from 9,770 MW to 10,600 MW. An agreement was signed with China for the first 300 MW Chashma Nuclear Power Project.
- In the road infrastructure sub-sector, construction of first South-Asian motorway started during this tenure. Moreover, airport construction plans were approved for Karachi and Lahore's airport and construction of Karachi's airport was finalized.
- MCB and ABL were privatized in 1991. In addition, major reforms were introduced to allow 10 new banks and 20 investment companies in the private sector. The PKR was the strongest currency during that time in South Asia.
- Pakistan achieved the highest ever growth rate of 7.7% in 1991-92; the stock market capital quadrupled and the Investment to GDP ratio crossed 20% mark for the first time. Over 200 companies were listed on KSE during that time.

PML-N's Second Tenure (1997-1999)

- Agricultural reforms were introduced in order to benefit the farmers ensuring that the prices paid by farmers were in line with the prices they received for their crops.
- Capital market reforms were announced to convert the outdated Corporate Law Authority into SEC to oversee the modernization of stock exchange and to broaden investors' base.
- Significant reforms were announced in banking and financial sector to turn around sick public sector banks, accelerate the process of financial liberalization, expand reliance on market-based instruments and strengthen the autonomy of the State Bank of Pakistan.
- The system of special import permits was abolished including duty-free import of 3,000 CC vehicles for VIPs.
- Discretionary powers for allocation of textile quotas were abolished, and a transparent system of public auction was introduced resulting in a 450% of increase in revenues.

PML-N's Achievement in Punjab (2008-2012)

- In continuation of Yellow Cab scheme, Rapid Bus transport system was introduced to benefit the people. Similarly flyovers were built throughout Punjab in order to benefit the masses.
- Health was also a priority for Punjab Government. Major reforms were introduced in the health sector making it poor friendly.
- Punjab was the worst affected by the 2010 floods. The PML-N Government ensured that all the affected people are rehabilitated in the shortest possible tenure.
- Special Economic zones and industrial estates have been set up for the promotion of foreign and local investments.
- Pakistan's first 27km Mass Transit Project was launched in Lahore in a record period of 11 months with a cost of PKR 29.7 billion.

PML-N’s Manifesto for this term

Energy

- Generate 10,000 MW additional electricity including 5000 MW new coal fired power plants under IPP mode.
- Mobilize fresh investment of $ 20 billion for power plants and related infrastructures.
- Progressively reducing transmission and distribution losses to 10%.
- Privatization of DISCOs/GENCOs
- Import LNG and ban CNG stations
- Further incentivize Oil & Gas Exploration
- Replace Furnace Oil with Coal and aims to develop Thar coal.

Agriculture & Food Security

- Accelerate agricultural growth to an average of 4% per annum, as an important component of a comprehensive national food security strategy.
- Raise total spending on ‘non pension’ social security from 1% of GDP to 2% by 2018.

Health

- Expenditure on health to be increased from 1% of GDP to 2% by 2018.
- Medical Insurance Card to every family for basic health care at subsidized rates, as a part of comprehensive national Insurance Service.
- Within 5 years, 100% vaccination of children, 50% reduction in maternal and infant mortality and 10% reduction in the rate of population growth.
- Each District will have at least one hospital with diagnostic facilities and required specialists.
- 1000 mobile health units will be launched to provide basic health facilities to remote areas.
- Establishing District Health Authority in each district