HBL ASSET MANAGEMENT

AMC Rating - AM3+ by JCR-VIS

FUND MANAGER'S REPORT
August 2013

August 2013: Research Review

KSE-100 fell by 5% in August 2013 due to several contributing factors, such as disappointing corporate results, delay and confusion around upcoming monetary policy as well as geopolitical tension due to Syria. Emerging markets across Asia also witnessed a sell off on news that US Fed's QE program would be tapered off. Pakistan is still comparatively cheaper on a P/E basis compared to most regional peers but the gap is reducing. Pakistan's weight in the MSCI Frontier Market index was increased to 4.42% from 4.36% and HBL was included in the index.

Banks reported 1H2013 results with the top five banks witnessing YoY reduction in net income. The exception was MCB which saw about 6% growth aided by capital gains from Unilever buyback and provisioning reversals. On a QoQ basis however, profits from HBL, UBL and MCB grew. NBP booked PKR 6bn provisioning expense which hurt its profit.

As per the 'New Energy Policy', increase in electricity tariff by 50% for commercial consumers, 70% for industrial consumers, and 17% for captive power plants (CPPs) will increase cost of production for almost all industries. On the positive front, this will decrease dependence on government's subsidy as per the terms of IMF and help in a speedy recovery of dues from NTDC by IPPs.

New power projects including Thar Coal Power Project, Naindipur Power Project, and Neelum Jhelum Power Project were taken up by the government to increase generation. However, despite efforts there has been increase in transmission and distribution losses by 2.2% and collection touched historic low to 66% from 94% last month. IPPs' earnings for FY13 were below consensus mainly on account of lower generation.

E&P companies posted below expectations results mainly due to higher exploration and 2D/3D seismic activity which led to higher prospecting and exploration expenditure. On the OMC side, PSO reported slightly above expectations EPS, however, lower than expected dividend was a disappointment for the market. Conservative dividend can be attributed to company's expansion plans and re-building of circular debt problem. The scrip also lost approximately 18.5% in price during the month.

PSO's receivables from power sector fell to PKR 59bn at the end of FY13 after liquidity injection from the government,however, at the end of August 2013, the receivables stood at PKR 96bn, a pile up of PKR 37bn within a span of two months. According to different news sources, circular debt stands around PKR 70bn to 90bn.

The recent hike of 17% for CPPs for fertilizer and cement producers will put additional pressure on their margins as their production cost will increase and they may find it challenging to fully pass on this cost impact to consumers. Increase in feed stock price for fertilizer sector decision is still pending. International urea prices fell to $285/ton from $320/ton last month, a decline of around 10%,which significantly narrows the gap betweeninternational and domestic urea prices.

Margin compression concerns emerged for the cement sector due to increase in electricity tariff. Lucky Cement's decision to resign from the APCMA on policy issues further dented investor confidence in the sector.

PSMC and INDU posted above expectations results on account of weaker JPY against PKR during Nov'12-Mar'13 period. INDU and HCAR increased the prices of cars by PKR 20,000 to PKR 50,000, which we see as a potential risk to near term volumetric sales.

Monsoon flooding is expected to trim cotton production for FY14 leading to higher cotton prices resulting in lower margins for textile manufacturers. Moreover, increase in gas tariff for CPPs may also hurt margins. That said, lower international cotton prices and Pak Rupee depreciation may offset the impact.

On the positive front, export of textile and clothing surged by 6.5% MoM which was mainly driven by growth in value-added products and significant shift in orders from Bangladesh.