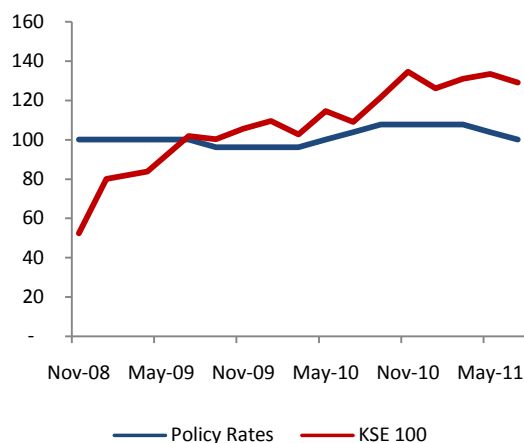


Pakistan

10 October, 2011

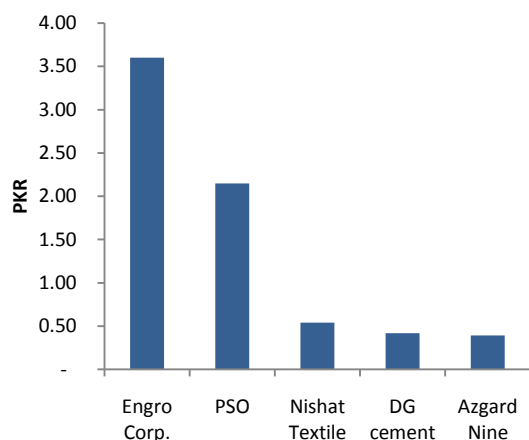
Policy Rate Vs KSE 100 Index



Source: SBP, KSE

Policy Rates and KSE 100 Rebased to 100

Top 5 Gainers (Change in PBT Per Share)



Source: Company Financials, SFA Research

Key Financials

Tickers	Local Floating Loans	Net Income	Annual PBT Saving
ENGRO*	94,438	1,274	1,417
PSO	24,542	14,780	368
NML	12,622	4,845	189
DGKC	12,208	197	183
ANL	11,764	(1,726)	176

* Quarter Ended June, 2011

Source: Company Financials, SFA Research

Monetary Policy

Breath of Fresh air ~ State bank slashed discount rate by 150 bps

Event
The State Bank of Pakistan made a momentous shift in monetary policy by slashing 150 bps to bring policy interest rate to 12%. This was the first monetary policy announcement after GoP decided not to abide by the "Alien" IMF program of USD 11 billion on September 30, 2011

Decision Basis

- Government borrowing is currently at USD 12 Billion, lower than the approved limit of USD 13.22 Billion for the fiscal year 2011-12
- Decline in YoY inflation from 13.3% to 10.5% has been attributed mainly to the change in CPI base year and calculation methodology
- Dismal Loan to Deposit Ratio, which has fallen to 63.5% in August 2011 judged against 72% in the same period last year
- Constricted private credit off-take growth during the past two years, advances have augmented only by 6%, startling situation as it depicts lower future growth

Impact on Banks

Cutting of 150 bps is a sigh of relief for banks operating with high NPLs to Advances ratio. Banks like NIB will now be able to save interest drag on their Non Performing loans. This announcement will also provide inducement to potential defaulters to pay off their loans, thus prospect NPLs will decrease as probability of defaulting will wither. Going forward, we anticipate that this tactical move of SBP will also induce and encourage banks to stimulate private credit off-take in search of higher spreads.

Impact on Stocks

Central banks have many cards to play with to stimulate the real economic activity. Stock indices and policy rates have a close connection with each other; usually they have an inverse relationship. Current cut in policy rate will positively impact stock markets in several ways. Firstly, highly levered up companies shall obtain an interest savings on their existing floating rate loans, increasing their future EPS and hence their fair value. Secondly, lower policy rates translate into lower required returns for the stocks providing support to stock prices.

Top Gainers in our Universe

▪ **Engro Corporation**

Engro Corporation, one of the most celebrated and exalted companies of KSE, currently holds a debt of PKR 94,438 million and associated finance costs of almost PKR 2,501 million as per last quarterly financials. This trimming of interest rate will make Engro as pleased as punch and help them save their finance cost in future years, we anticipate an Annual PBT per share saving of PKR 3.6.

▪ **Pakistan State Oil**

FY 2011 ending balance sheet of PSO's showed an accumulated debt of PKR 24,542 million. Furthermore finance cost incurred by PSO for FY 2011 stood at PKR 11,903 million. Interest rate cut will enable them to save their finance cost up to PKR 368 million, boosting PBT per share by PKR 2.15.

▪ **Nishat Mills**

Nishat Mills reported an EPS of PKR 13.78 for FY2011. During the same period, balance sheet reflected a debt of PKR 12,622 million with accompanied finance cost of PKR 1,393.48 million. We anticipate declining interest burden for Nishat Mills enhancing their PBT by PKR 189 million, translating into an incremental PBT per share of PKR 0.54.

▪ **D.G Khan Cement**

Another highly levered giant that will get an advantage from current interest rate cut. D.G Khan incurred finance cost of PKR 2,051.6 million during FY 2011. A 150 basis points cut in interest rate will undeniably decrease their finance cost as most of their loans are on floating rate. We estimate an increase in annual profit before tax of PKR 183 million.

▪ **Azgard Nine**

Azgard nine, distressed due to high leverage, will get much needed interest saving on its short and long term debt. According to the last reported financials, they incurred finance costs of PKR 2,090 million. Current decline in interest rate will decrease their finance cost by PKR 176 million.