KSE100 Remarkable Journey; 110,000 is the Magic Number

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EXECUTIVE SUMMARY

Investors and analysts are constantly seeking insights into the stock market's performance, especially when major milestones are achieved. This report provides a detailed comparison of the KSE-100 index's performance in May 2017 and May 2024.

It aims to address the concerns and curiosity of investors regarding the recent surge in the index, reaching an all-time high of 75,000 in May 2024, as investors are questioning the sustainability of this rally, considering the market's previous stagnation over five years.

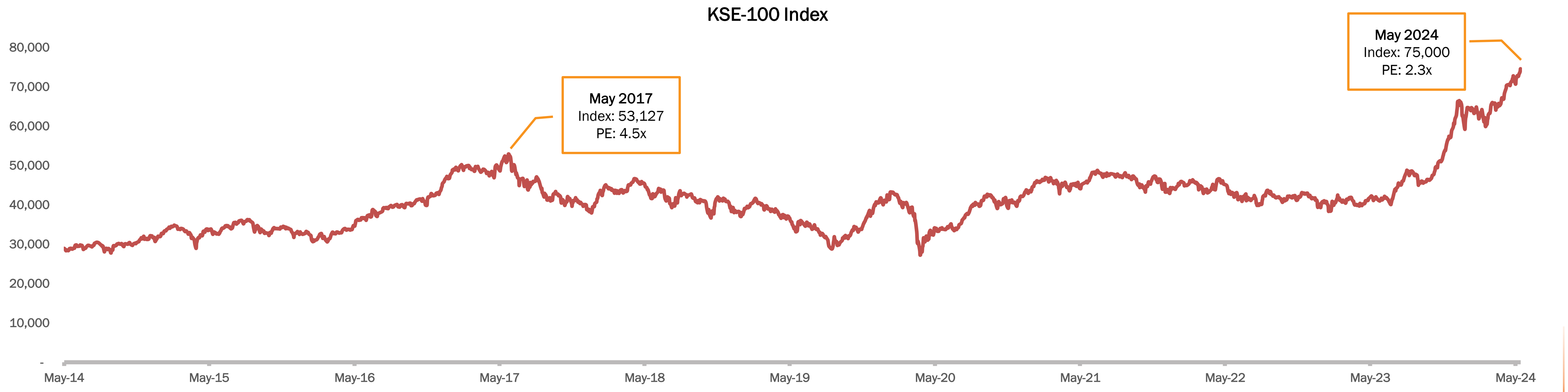
The report analyzes key factors such as market triggers, historical performance, and valuation metrics to provide a comprehensive view of the market's current state and future outlook.

It also explains why 110,000 is a magic number and why we're betting big on the KSE-100 hitting that jackpot soon.

KSE-100 Remarkable Journey; 110,000 is the Magic Number

Picture this: May 2017, KSE-100 index hits a record high of 53,127, fueled by the excitement surrounding the China-Pakistan Economic Corridor (CPEC) and Pakistan's inclusion in the MSCI Emerging Markets index. Investors were on cloud nine with a year-to-date (FYTD) return of 40%. Fast forward to May 2024, and the KSE-100 index is rewriting history once again, smashing through its previous record to reach an incredible 75,000, with an even stronger FYTD return of 80%. What's powering this surge? A mix of political stability, optimism over the upcoming IMF program, foreign investment, steady exchange rates, decreasing inflation, and the buzz around imminent monetary easing by year-end.

But wait, why are investors raising eyebrows? Well, let's rewind a bit. Except for a brief surge in FY21 due to supportive interest rates during the pandemic, the market had been in a five-year slump. Since June 2022, the interest rate has stubbornly stayed at 22%, with a tightening monetary policy since January 2018. This prolonged tightening, coupled with persistent inflation, kept the market undervalued for about six years. Resultantly, investors had grown accustomed to the stagnant and underperforming market over this extended period. Therefore, many investors are finding it hard to digest this recent rally.



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Now, here's where it gets really interesting. With inflation finally on the decline and whispers of an easing cycle, investors are seeing a light at the end of the tunnel. It's like the market is saying, "Enough with the gloom, let's get back to growth!" After years of being undervalued, the market is now playing catch-up, normalizing its multiples.

Is 75,000 Really High?

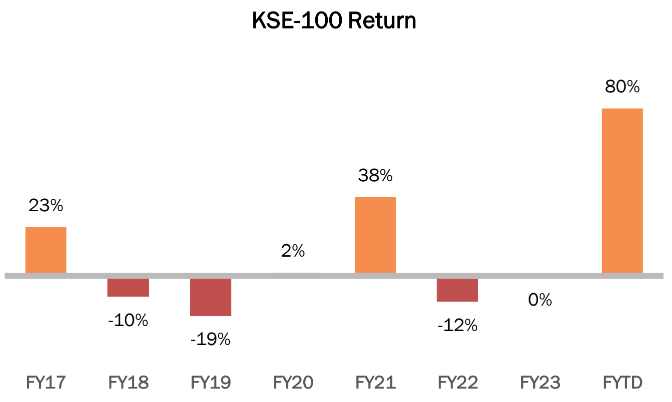
Let's dive into the numbers! Comparing the market capitalization and profitability of KSE-100 constituents between May 2017 and May 2024 reveals the shocking insights. Back in May 2017, the KSE-100 boasted a market cap of Rs 2.8 trillion, generating total profits of Rs 619 billion and a PE multiple of 4.5x. Fast forward to May 2024, and we're looking at a market cap of Rs 3.4 trillion, with total profits soaring to Rs 1.5 trillion, resulting in a PE multiple of a mere 2.3x. Even with the index at 75,000, it's trading at a whopping 48% discount compared to May 2017 levels. To reach the PE multiple of May 2017, the index should be at 110,000, still below the historical average PE of around 8x.

Yes, you read that right—110,000 is the magic number that would justify the multiple of May 2017, when the index sat at just 53,127. The reason behind this is that the profitability of firms has grown nearly 2.3x, but stock prices haven't kept pace, thanks to the macroeconomic factors we've discussed. It's worth noting that the multiple of May 2024 is based on TTM profitability, making the forward multiple even more enticing for potential upside.

The analysis has been done by making the following adjustments:

1. A total of 123 companies were included in the analysis to account for differences in the composition of the KSE-100 index between the two periods.
2. Companies that were listed in May 2017 but are now unlisted in May 2024 were included in the May 2024 analysis using their last traded prices to maintain comparability.
3. Companies that were not listed in May 2017 but are now listed in May 2024 were included in the May 2017 analysis using their first traded prices for comparability.

KSE-100 PE Calculation	May 2017	May 2024
USD/PKR	104.76	278.18
Market Capitalization (USD. Bn)	26	12
Market Capitalization (PKR. Bn)	2,761	3,444
Profit After Taxation (Rs. Bn)	619	1,473
P/E (x)	4.5	2.3
Discount		-48%
Current KSE-100 Value		75,000
Intrinsic KSE-100 Value		**110,668**



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4. Market capitalization for May 2017 was calculated using prices from 25th May 2017 and the free float of shares at that time. The firms' annual profitability for 2017 was used to calculate the price-to-earnings (PE) multiple for May 2017.

5. Market capitalization for May 2024 was calculated using prices from 14th May 2024 and the free float of shares at that time. The firms' trailing twelve months (TTM) profitability as of March 2024 was used to calculate the PE multiple for May 2024.“

6. All cash dividends paid between May 2017 and May 2024 have been added to the prices of 14th May 2024 to ensure comparability with May 2017 prices from an index perspective, as KSE-100 is a total return index.

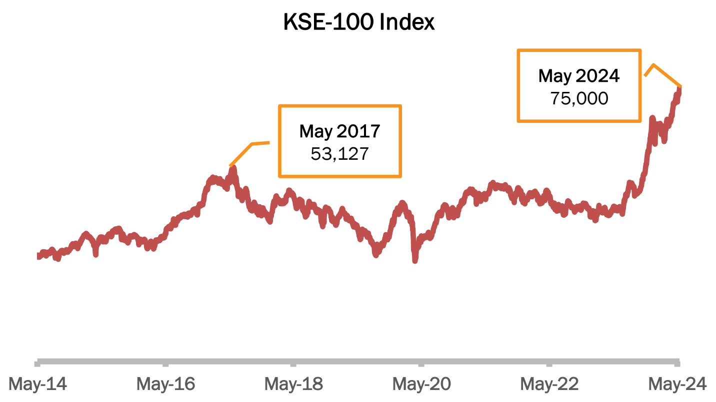
The Exciting Foreign Investor Factor

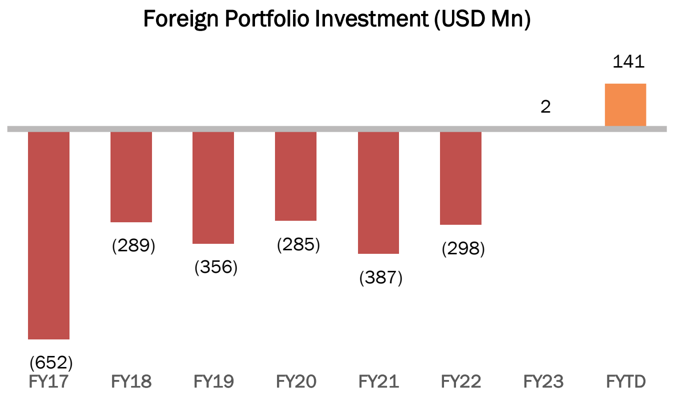
Let's talk about a game-changer in the Pakistani stock market: foreign investors. After years of being on the sidelines, they've suddenly jumped back into the game with gusto. In FYTD alone, they've poured in a staggering $141 million, marking a significant shift in sentiment.

But why the sudden interest? Well, foreign investors are no amateurs. They're savvy players who do their homework before diving in. Their renewed enthusiasm is a strong indicator that they've not only seen the potential but are also confident in the market's future prospects.

Their investments are like votes of confidence, echoing the sentiment that the Pakistani stock market is undervalued and offers attractive multiples. This influx of foreign capital isn't just about the money; it's about validation. It's about the world taking notice of Pakistan's potential as an investment destination.

So, what does this mean for the market? It's like adding fuel to an already blazing fire. The foreign investor factor is adding momentum and excitement to an already thriving market, signaling that the best is yet to come.





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Looking ahead, the political stability, economic recovery, privatization of loss-making public entities, initiatives to promote public private partnerships to attract private investment, expected decline in interest rates, and a potential larger IMF program are all pointing towards continued positive sentiment and a robust stock market. The resurgence of foreign investors, with investments of $141 million in FYTD, is a testament to their confidence in the market's potential.

Let's Analyze the Sectoral Potential

Now that we've established that the KSE-100 is still trading at discounted multiples, let's dive into the exciting world of sector analysis to uncover where the best returns might lie. In our analysis, we've compared the multiples of the top 15 sectors with the highest market cap, which collectively represent around 93% of the KSE-100 index's market cap.

What's truly fascinating is that almost all of these main sectors are currently trading at discounted multiples, presenting a compelling opportunity for investors to earn high returns. **However, our focus and excitement lie particularly with the cement, engineering, chemical, auto, and other main cyclical sectors. The anticipated scenario of declining interest rates and economic growth is expected to propel these sectors the most, making them prime targets for investors seeking substantial returns.**

For those investors looking for high dividend yields and relatively safer options, the fertilizer and banking sectors could be more appealing choices.

It's worth noting some abnormal numbers in our analysis. The IT sector, apart from SYS and AVN, has seen a reduction in profitability, with TRG posting a whopping loss of Rs. 20 billion, turning the profitability of the entire sector negative. This renders the PE of the technology sector incomparable.

In the pharmaceutical sector, with the exception of HINOON, profitability has declined. This has led to the sector trading at a higher multiple than in May 2017.

Sectors	PE 2017	PE 2024	Discount
Technology & Comm.	4.87	(13.80)	-383%
Commercial Banks	4.72	1.52	-68%
Oil & Gas Exploration	2.59	0.96	-63%
Textile Composite	4.84	2.11	-56%
Engineering	9.17	4.63	-50%
Chemical	4.29	2.46	-43%
Refinery	3.10	1.92	-38%
Oil & Gas Marketing	4.67	3.03	-35%
Cement	5.80	4.08	-30%
Inv. Banks	11.85	8.84	-25%
Fertilizer	5.70	4.57	-20%
Food & Personal Care	2.48	2.12	-15%
Pharmaceuticals	7.65	11.76	54%
Automobile Assembler	3.59	13.17	267%
Power Gen. & Dist.	4.41	28.17	539%

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The auto sector, despite trading at a higher multiple, has been recommended as a preferred sector for investment. This is because the profitability used to calculate the multiples is based on TTM, which is not currently encouraging for the auto sector. However, the sector is expected to recover and post good profits in the coming quarters, driven by government and central bank expansionary policies, ultimately leading to higher stock prices.

Lastly, the power sector is showing an abnormally high multiple due to the announcement of extraordinary dividends in recent times. These dividends, resulting from the settlement of pending dues from governments, have been added to the prices of May 2024, inflating the sector's multiple.

Stocks to Watch

Looking ahead, certain stocks are poised to perform well based on key financial indicators. Stocks with high finance costs are expected to be the biggest beneficiaries of the anticipated monetary easing, as reduced interest rates will lower their finance expenses significantly. Additionally, companies demonstrating high sales growth and improved gross and net margins are set to thrive. These criteria suggest strong underlying business performance and operational efficiency, making them attractive investment opportunities.

Based on the financials from the recent quarter (March 2024), we have curated a selection of stocks that meet these criteria. Please refer to the table on the right side to see the list of these promising stocks, which are well-positioned for potential growth in the near future.

So, Buckle Up, Investors!

The KSE100 index, currently at 75,000, is a story of resilience and potential. It's not just about the numbers; it's about a market that has weathered the storm and is now ready to soar. So, buckle up, investors, because the ride is just getting started. Short-term bumps? Maybe. But the long-term outlook? Exciting, to say the least.

Recommended Stocks	
Automobile Assembler	**Automobile Parts**
GHNI	ATBA
INDU	LOADS
SAZEW	THALL
Chemical	**Cement**
BIFO	DGKC
NICL	POWER
NRSL	
Food & Personal Care	**Insurance**
QUICE	CSIL
UNITY	UNIC
Oil & Gas Marketing	**Synthetic & Rayon**
HTL	IMAGE
PSO	
Technology	**Cable & Electrical**
PTC	PAEL
Textile Composite	**Tobacco**
NCL	KHTC

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Potential Risks

While the outlook for the KSE100 index is optimistic, investors should remain vigilant about the following risk factors that could impact market performance:

- Political instability could arise if the opposition leads a movement against the sitting government, potentially creating uncertainty and volatility in the market.
- Any delays in securing an IMF deal or the imposition of stringent conditions that hinder economic expansion could dampen investor sentiment.
- A delay in the anticipated monetary easing could slow down economic growth and affect market dynamics.
- The upcoming budget also poses a risk; an unexpected increase in taxation could strain corporate profits and consumer spending.
- The privatization of Pakistan International Airlines (PIA), which is currently the center of focus, if faces failure or halt, could cause negative ripples across the market.
- Any halt in the flow of foreign investment, due to global economic factors or domestic issues, could reduce market liquidity and dampen the recent positive momentum.

Investors should carefully monitor these factors and adjust their strategies accordingly to mitigate potential risks.

FIPI / LIPI SECTOR WISE BREAK UP

(USD' mn) (FYTD)

LIPI Portfolio	Cement	Banks	Fertilizer	Food	E&P	OMC	Power	Tech	Textile	Others	Gross
Banks / DFI	-12.99	-33.73	-26.74	-1.43	-8.80	0.68	-21.26	1.12	-2.18	-18.29	-123.62
Broker Proprietary Trading	-1.97	-1.17	-4.60	-0.53	-0.11	-2.04	-1.07	-2.87	-2.07	-6.29	-22.72
Companies	30.79	-31.72	9.37	-0.14	11.55	-0.62	4.46	-7.11	6.06	4.53	27.18
Individuals	-25.45	-5.91	-1.45	3.75	0.17	-10.75	-0.16	10.41	-2.04	-7.58	-39.01
Insurance Companies	2.31	36.34	35.77	-3.07	16.61	3.67	7.12	1.17	-0.47	2.41	101.87
Mutual Funds	-2.59	-10.56	-13.08	-4.19	-22.77	4.37	5.02	-1.75	0.20	-2.14	-47.50
NBFC	-0.15	-0.02	0.08	-0.33	-0.10	0.04	0.03	-0.03	-0.00	-0.25	-0.73
Other Organization	-2.93	3.66	-18.42	1.14	-4.19	0.09	-5.62	-1.58	-0.23	-8.17	-36.26
LIPI Total	**-12.98**	**-43.09**	**-19.07**	**-4.80**	**-7.63**	**-4.57**	**-11.48**	**-0.64**	**-0.73**	**-35.79**	**-140.79**

FIPI Portfolio	Cement	Banks	Fertilizer	Food	E&P	OMC	Power	Tech	Textile	Others	Gross
Foreign Corporates	13.91	46.93	15.11	7.41	9.43	6.25	8.59	2.95	0.49	37.64	148.71
Foreign Individual	-0.08	-0.20	0.01	0.02	-0.06	-0.03	0.04	1.26	0.03	0.11	1.09
Overseas Pakistani	-0.85	-3.64	3.96	-2.64	-1.73	-1.65	2.85	-3.57	0.22	-1.96	-9.01
FIPI Total	**12.98**	**43.09**	**19.07**	**4.80**	**7.63**	**4.57**	**4.36**	**0.64**	**0.73**	**35.79**	**140.79**

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