Pakistan Market Strategy

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STRATEGY

Elections preview: The captain's turn to bat

Figure 1: Three possible scenarios can emerge after the polls

Election scenarios	Economic/ market implications	Stock winners/losers
PTI-led coalition with MQM, PSP and others (Probability: 60%)	**Positive:** Improved investment flows due to likelihood of tax reforms, curbing SOE losses and plugging energy sector loopholes	**Beneficiaries:** EFERT, FFC, LUCKY, UBL, NML, HUBCO, PSO. **Losers:** INDU, PSMC, HCAR
PTI-led setup with PPP, MQM, PSP and others (Probability: 15%)	**Negative:** Unclear economic policies, questions on sustainability of coalition and compromises on tax reforms and privatisation	**Beneficiaries:** EFERT, FFC, HUBCO, PSO. **Losers:** INDU, PSMC, HCAR, DGKC, LUCKY
PML-N led alliance with PPP, religious parties and independent candidates (Probability: 25%)	**Neutral to positive:** Pro-business policies to continue with emphasis on infrastructure and energy sectors. Slow progress on tax reforms and privatisation due to lack of consensus	**Beneficiaries:** MCB, NML, DGKC, LUCKY, ENGRO, HUBCO and PSO. **Losers:** FFC, INDU, PSMC, HCAR

Source: Credit Suisse estimates

With Pakistan heading to the polls on 25-July, we assess the possible electoral outcomes and their implications on the market in this report.

- **PTI to edge ahead of the PML-N.** While no single party looks to be in a position to attain a majority, the electoral prospects of the PTI (led by former cricket-team captain Imran Khan) have brightened since the ousting of the PML-N leader Nawaz Sharif and his subsequent sentencing (link). We expect the PTI to bag 92 seats (34%) in the National Assembly and eye a 60% probability of the party forming a coalition government. Imran Khan may have to look towards the PPP to shore up the numbers, but the odds of this are low (15%). That said, the PML-N can secure 73 seats (27%) on our assessment; and in the event that the PTI fails to stitch together an alliance, can put forward its own coalition (25% probability).
- **Rising possibility of an IMF bailout.** Forex reserves have dissipated to ~2 months of import cover with the current account deficit at record highs (11M FY18 US$15.9 bn; +43% YoY). A knock on the IMF's doors is very likely, in our view, with a Stand-By Arrangement (similar to 2008) being a possible option. Pakistan would need funds of at least 3-5x its quota (US$9-14 bn) to provide an adequate buffer to the external account.
- **Market to welcome a healthy PTI mandate.** In the event of our base case scenario materialising, we see a rally of 8-10% post elections. Beyond this, the PTI would need to take concrete measures on taxation and institutional reforms in the first 100 days of its tenure, to maintain the confidence of markets. We expect the PTI to usher in relief measures for the agricultural space, grant incentives for exporters and inject funds in the energy sector. We keep our year-end index target of 47,000 points intact implying 20% upside. Top picks are MCB, EFERT, ENGRO, LUCKY and UBL. **Key risks** are a hung parliament and street agitation leading to a delay in elections.

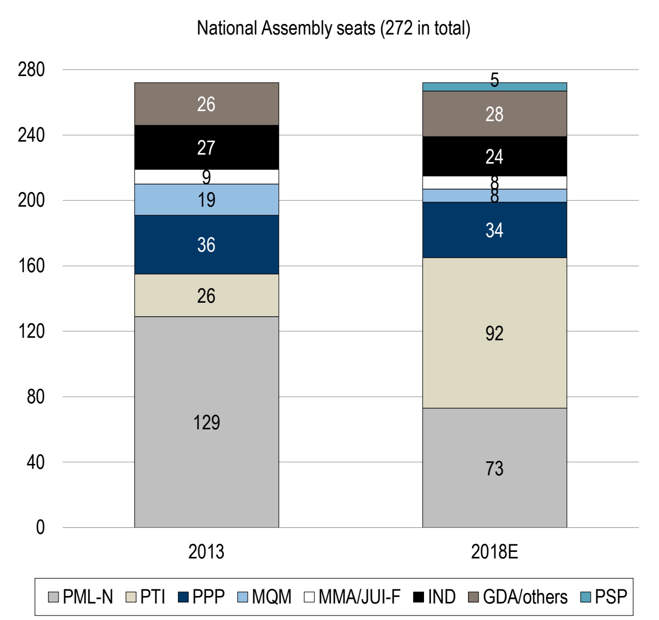
Focus charts and tables

Figure 2: Snapshot of main political parties, their leadership and policies

Party	Political leanings	Leader	History and policies
Pakistan Muslim League (Nawaz)	Centre Right	Nawaz Sharif / Shahbaz Sharif	• Nawaz is three-time PM with a strong vote bank in Punjab and an experienced team • Preference for infrastructure development, mass-transport projects and energy uplift schemes • Amenable policies towards export-oriented sectors but lacking on tax reforms • Historically has had a troubled relationship with the military • Will improve ties with China/GCC countries while maintaining a balanced approach with US
Pakistan Tehreek-e-Insaf	Centrist	Imran Khan	• One of the leading contenders to form the government despite experience limited to provincial level • Strong proponent of institutional reforms, fiscal discipline and agricultural uplift schemes • Will increase resource allocation towards education, health care and housing sectors • Decent relations with religious parties but unlikely to form a coalition with the PPP and PML-N • Holds hawkish views on the US and will tilt more towards China and Muslim-majority countries
Pakistan People's Party	Centre Left	Bilawal Bhutto / Asif Zardari	• The oldest party in Pakistan and arguably the most mature. • Holds a loyal vote bank in the Sindh province but lacks popularity elsewhere. • Poor track record on running the economy in 2008-13 but has a strong leaning towards agriculture • Staunchly against privatsation and unlikely to make concrete efforts to broaden the tax net. • Good history of coalition politics and power sharing with the army. Will also seek better ties with the US

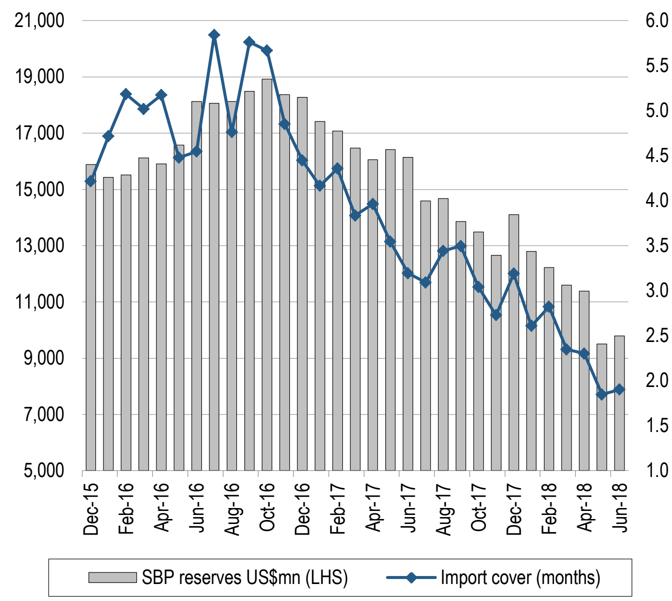
Source: Credit Suisse research

Figure 3: We expect PTI to bag 92 seats (34%) in the National Assembly and become the largest party



Source: ECP, Credit Suisse estimates

Figure 4: Reserves have shrunk to below two months of import cover amidst a record C/A deficit



Source: SBP, PBS

Figure 5: Credit Suisse – Pakistan top picks

Name of company	Ticker	Price (PRs)	Rat	TP (PRs)	M. cap (US$ bn)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)		P/B (x)		ROE (%)		EPS growth (%)	
						18E	19E	18E	19E	18E	19E	18E	19E	18E	19E	18E	19E
MCB Bank Ltd	MCB.KA	191	O	245	1.86	9.3	8.1	NM	NM	8.2%	8.9%	1.4	1.4	14.5%	15.9%	4%	14%
Engro Fertilizers	ENGR.KA	73	O	84	0.81	8.7	8.4	5.5	4.9	11.4%	11.8%	2.3	2.3	26.4%	27.4%	1%	4%
Engro Corporation	EGCH.KA	297	O	355	1.28	10.9	9.7	6.7	6.0	7.4%	7.4%	1.1	1.1	10.4%	11.4%	51%	13%
Lucky Cement	LUKC.KA	468	O	790	1.25	10.4	9.9	6.3	6.6	4.9%	4.1%	1.7	1.6	16.8%	15.9%	6%	5%
United Bank Ltd	UBL.KA	154	O	220	1.55	7.3	6.8	NM	NM	8.5%	8.5%	1.2	1.1	16.1%	15.9%	2%	7%

Source: Reuters, Credit Suisse estimates

Elections preview: The captain's turn to bat

Pakistan is heading to the polls on 25 July after the Pakistan Muslim League-Nawaz (PML-N) became the second party to have completed its mandated term of five years.

Advantage PTI in a close fight with the PML-N

The PTI has a 60% chance to form a coalition government

In case the PTI fails, the PML-N can piece together a coalition with the PPP

The 2018 elections appear to be a close fight between the Centre Right and outgoing ruling party, PML-N and Centrist, PTI. We do not see either side gaining a simple majority, however, we expect the PTI to edge ahead. In our **base case scenario (60% probability)**, we eye a PTI-led coalition forming the government with support from parties in Karachi and Balochistan and collaboration with independent candidates. We also **see a 15% chance** that Imran Khan may need to enter into an alliance with the PPP to shore up the numbers in case the first scenario wavers. However, this would pose long-term challenges, including sustainability of the setup due to PTI's skepticism on the PPP's top leadership. In the event that Imran Khan is unable to cross the magic number of 137 seats, the PML-N could step forward with its own coalition comprising the PPP, a few smaller parties and independent candidates **(25% probability)**. This alliance may be stable if the PML-N and PPP stick to governing in their own backyard provinces (Punjab and Sindh respectively).

What could the parties bring to the table?

Institutional reforms, revenue mobilisation and crackdown on corruption are pillars of the PTI agenda

The **PTI** is a strong proponent of institutional reforms, crackdown on corruption and revenue mobilisation. We expect higher allocations towards education, health care and housing sectors. On foreign policy, Imran Khan has hawkish views towards the US and will lean more towards China and Muslim-majority countries, while domestically it will stay on the same page as the military establishment. The **PML-N's** operating model will be development-focused but will lag on SOE and tax reforms. Elsewhere, the **PPP** has a poor track record on economic management and is firmly opposed to privatisation.

Macro situation is reminiscent of 2013

Reserves have dropped below two months and the IMF program is looking increasingly likely

75-100 bp rate hike in the next 6-9 months

Amidst a record high current account deficit (11M FY18 US$ 15.9 bn: +43% YoY) and eroding forex reserves (US$9.8 bn; 1.9 months of import cover), we see a rising need for a bailout package from the IMF. Similar to 2008, a Stand-By Arrangement can be sought with upfront disbursements to alleviate the stress. Pakistan would need to secure funding of at least 3-5x its quota (amounting to US$9-14 bn) in our view. Alongside, we expect the Fund to attach strict conditions on exchange rate flexibility, a firm roadmap towards tax revenue mobilisation, restructuring of SOE's and energy sector reforms. Monetary tightening is also anticipated to continue with another 75-100 bp hike likely in the next 6-9 months as second round impact of oil prices and currency adjustment filter through to CPI.

Equities to welcome a strong mandate

PTI-led administration will be positive for fertilizers, textiles, energy and financials

Expect 8-10% rally post elections if the PTI comes to power

Key risk for stability is a hung parliament

We expect the market to cheer a strong PTI or PML-N showing with a 10-15% rally as a decisive mandate is essential to implement much needed economic reforms to restore macroeconomic stability. Fertilizers, energy, banks and textiles should benefit. A split mandate resulting in a hung Parliament remains a key risk leading to further political turmoil and making it difficult for the new government to take adjusting measures. We see the market correcting a further 10-15% in such a case. **Our base case scenario remains a PTI led coalition and we see an 8-10% rally post elections**. Beyond this, the PTI would need to take concrete measures on taxation and institutional reforms in the first 100 days of its tenure to maintain the confidence of markets. We expect the party to introduce relief measures for the agricultural space, grant incentives for exporters and inject funds in the energy sector. We keep our year-end index target of 47,000 points intact implying 20% upside. Our top picks are MCB, EFERT, ENGRO, LUCKY and UBL. Key risks are worsening security situation and street agitation leading to a delay in holding elections.

Advantage PTI in a close fight with the PML-N

60% probability of a PTI-led government

15% chance of the PTI including the PPP in its coalition arrangement

25% probability of the PML-N and PPP collaborating to form a coalition government

The 2018 elections appears to be a straight fight between the Centre Right and outgoing ruling party, PML-N and the main opposition, Centrist party PTI. We do not expect a simple majority on either side; however, we expect the PTI to edge ahead. In our **base case scenario (60% probability)**, we eye a PTI-led coalition forming the government with support from parties in Karachi and Balochistan and collaboration with independents. This would provide the PTI an ideal platform to implement its reform agenda. We also **see a 15% chance** that Imran Khan may need to enter into an alliance with the PPP in order to shore up the numbers in case the first scenario wavers. However this would pose challenges to sustainability of the setup due to friction with the PPP leader, Asif Zardari. In the event that Imran Khan is unable to cross the magic number of 137 seats and exhausts his 'first right to form the government', the PML-N could step forward with a coalition comprising the PPP and a few smaller parties and independent candidates **(25% probability)**. This alliance may be stable if the PML-N and PPP stick to governing in their own backyards (Punjab and Sindh respectively) while maintaining cohesion at the center.

Figure 6: Party-wise seats in the National Assembly—2013 vs 2018E

Party name	2013	*% of total*	2018E	*% of total*
Pakistan Muslim League – Nawaz (PML-N)	129	*48%*	73	*27%*
Pakistan Tehreek-e-Insaf (PTI)	26	*10%*	92	*34%*
Pakistan People's Party (PPP)	36	*13%*	34	*13%*
Muttahida Quami Movement (MQM)	19	*7%*	8	*3%*
Pak Sarzameen Party (PSP)	0	*0%*	5	*2%*
Jamiat-e-Ulema Islam (Fazal) – JUI-F	9	*3%*	8	*3%*
Independent candidates	27	*10%*	24	*9%*
Grand Democratic Alliance (GDA)/other parties	26	*9%*	28	*10%*
Total number of seats	**272**	***100%***	**272**	***100%***

Source: ECP, Credit Suisse estimates

Figure 7: Three possible scenarios to forming the federal government

Scenario 1: PTI-led coalition – base case expectation	Probability: 60%
PTI	92
MQM	8
PSP	5
Independents and others	39
Total number of seats	**144**
Majority percentage in lower house	*53%*
Scenario 2: PTI-led coalition with PPP in case Scenario 1 fails	**Probability: 15%**
PTI	92
PPP	34
MQM	8
PSP	5
Independents and others	32
Total number of seats	**171**
Majority percentage in lower house	*63%*
Scenario 3: PML-N led coalition with PPP in case both Scenario 1 and Scenario 2 fail	**Probability: 25%**
PML-N	73
PPP	34
JUI-F	8
MQM	8
Independents and others	19
Total number of seats	**142**
Majority percentage in lower house	*52%*

Source: Credit Suisse research

Adverse verdict against Nawaz Sharif to benefit PTI

Imprisonment and fines imposed on the ex-PM and his family in corruption cases

After completion of proceedings in the reference pertaining to the Avenfield Apartments in London, the accountability court issued a major verdict on Friday (6 July). The trial was linked to corruption charges and alleged possession of assets beyond known sources of income. The ex-PM Nawaz Sharif was handed a prison sentence of ten years and fined £8 mn. His daughter, Maryam Nawaz, was given a jail term of seven years along with a penalty of £2 mn, while her husband Captain Safdar was sentenced to one year in prison. The verdict also declared Maryam Nawaz and Captain Safdar ineligible to contest elections for 10 years. The decision comes after intense hearings held in the accountability court in the past 9-10 months. Mr. Sharif, who along with his daughter, is currently in London attending to his ailing wife, has struck a defiant tone and announced to return to Pakistan on 13-July and appeal against the verdict in the High Court.

While PTI can capitalize on this, the PML-N can also aim to start a wave of sympathy among voters

The verdict is likely to negatively impact the PML-N's election momentum, in our view, with the biggest beneficiary being Imran Khan who has campaigned aggressively on tackling corruption, stemming money laundering and curbing tax evasion. The only scenario where PML-N could benefit from the verdict would be if Mr. Sharif is able to galvanise supporters at the time of his arrest and lead the last leg of his party's campaign after obtaining bail.

Figure 8: Timeline of cases against ex-PM Nawaz Sharif and his family

Date	Details of event
Apr-16	The leakage of Panama Papers from the International Consortium of Investigative Journalists (ICIJ) reveals Nawaz Sharif and his family owning luxurious apartments in London through a web of offshore companies
May-Oct 2016	The opposition calls on Nawaz Sharif to explain sources of wealth and raises allegations of money laundering, corruption and tax evasion in purchase of the properties
Oct-16	Opposition leader, Imran Khan decides to launch a country-wide agitation and announces a march towards the federal capital to force Nawaz Sharif to resign on corruption allegations
Nov-16	After the filing of multiple petitions, the Supreme Court (SC) forms a five member bench to commence hearings on the Panama Papers case
Feb-17	After four months of proceedings, the SC reserves its verdict in the case
Apr-17	3-2 split judgement given by the SC. 3 judges decide to constitute a Joint Investigation Team (JIT) to further probe the matter while 2 dissenting judges declare Nawaz Sharif to be disqualified from holding the PM office
May-Jul 2017	6-member JIT comprising of officials from the Central Bank, intelligence agencies, National Accountability Bureau (NAB) and Securities and Exchange Commission conduct investigations and submit a report to the SC
Jul-17	In a unanimous decision (5-0), the SC disqualifies Nawaz Sharif from holding the PM office on dishonesty and directs NAB to file 3 references against the ex-PM and his family in accountability court on corruption.
Oct-17	The accountability court begins hearing cases on a regular basis
Mar-18	After the six month deadline lapses, a two month extension is given by the SC
May-18	Another extension of one month is granted by the SC
Jun-18	A third extension of one month is granted by the SC
Jul-18	**Mr. Sharif is sentenced to a 10-year jail term along with a fine of £8 mn.** **His daughter, Maryam is to serve 7 years in jail with a fine of £2 mn while her husband has a jail term of 1 year. Both husband and wife are also declared to be ineligible to contest elections for 10 years.**

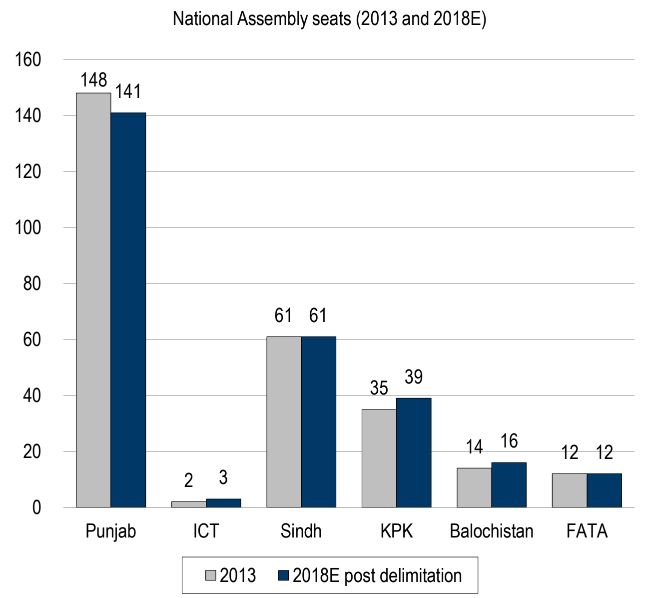
Source: Company data, Credit Suisse estimates

Minor changes to provincial representations at the center after fresh demarcation of constituencies

Punjab's share has dropped while KPK has gained in the new delimitation of constituencies

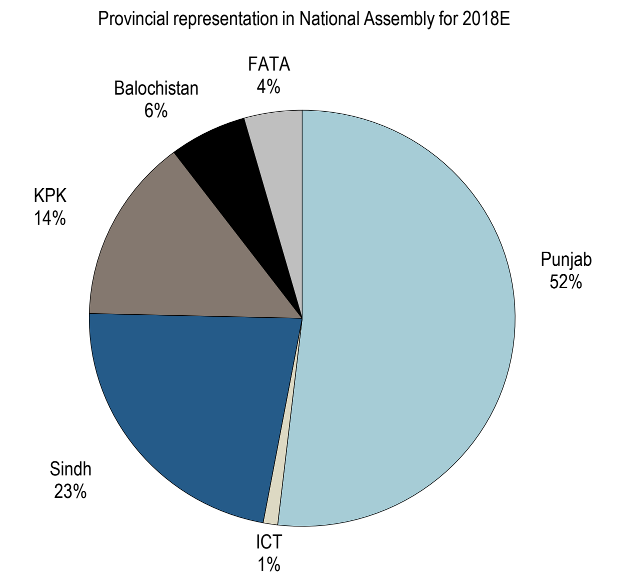
Post completion of population census in 2017 and notification of preliminary results, the Election Commission of Pakistan (ECP) has charted out fresh constituencies across the country while keeping the overall elected seats in the National Assembly unchanged at 272. Punjab has seen its representation drop by 7 seats to 141 seats while KPK and Balochistan have gained 4 seats and 2 seats respectively taking their tally to 39 seats and 16 seats. The share of Sindh is unchanged at 61 seats, however, the provincial capital (Karachi) has seen one seat added in the Malir district. We also note an additional seat allocated to the federal capital (Islamabad). On the revised delimitation, Punjab still holds the lion's share at 52% of the National Assembly followed by Sindh (23%) and KPK (14%).

Figure 9: Punjab has seen a decline of 7 seats in the new delimitation while KPK has gained the most



Source: ECP

Figure 10: However, Punjab is still the battle-ground province with 52% representation at the center



Source: ECP

Battle of Punjab: PML-N and PTI are neck-to-neck

Seats from Punjab still account for 52% of the National Assembly

With 141 seats (52%) out of 272 directly elected seats in the National Assembly (NA), Punjab remains by far the most important province in the country and has always had an import bearing on federal government formation. Barring the 2002 general elections under the military regime of General Pervez Musharraf, PML-N has dominated the province since the 1990s with consistently strong showings in the Central and Northern parts of Punjab (which have a higher concentration of urban centers) as compared to the South. The party swept to victory in the 2013 elections bagging 121 out of 148 elected seats.

We forecast the PML-N to bag 67 seats and the PTI to secure 57 seats

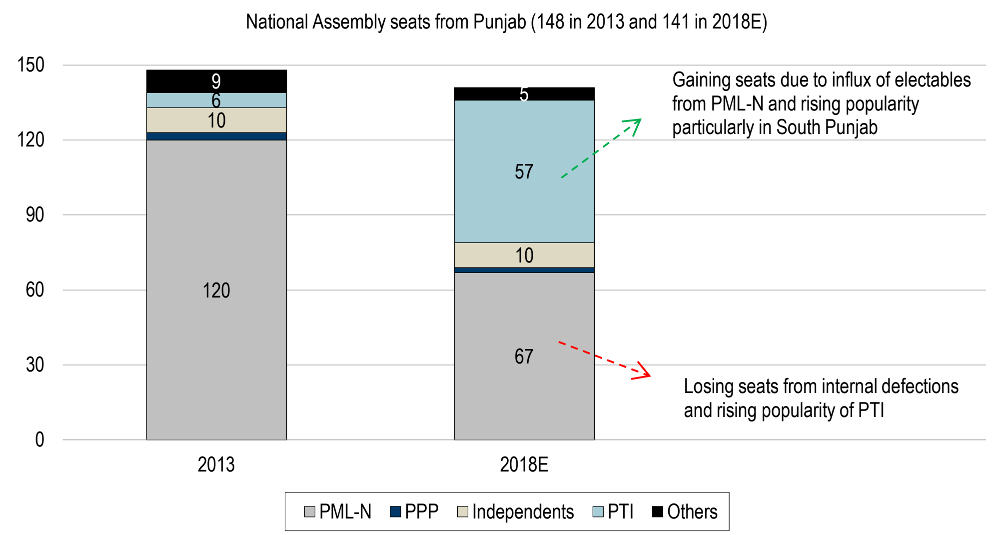
PTI has benefited from multiple challenges faced by the PML-N

In contrast to 2013, we expect a much closer contest between PML-N and PTI in 2018. The former has weakened considerably due to the (1) lifetime disqualification of Nawaz Sharif from contesting elections, (2) defections of a large number of lawmakers to the PTI from the Southern party of Punjab and (3) flexible stance being adopted by PML-N workers to contest independently rather than under the party's umbrella.

PML-N will remain the largest party in Punjab but lead is expected to shrink substantially with PTI a close second

We have conducted a comprehensive seat-wise analysis on the basis of background of candidates contesting each seat, historical track record in elections and political/social lineage. Our analysis still points to the PML-N remaining the single largest party in the province albeit with a lower tally of 67 seats (48%), with PTI a close second at 57 seats (40%) marking a significant progress after a poor result in 2013 (6 seats). Representation from other parties and independent candidates in Punjab can be limited to 17 seats, in our view (down from 22 seats in the previous election), however, these representatives can serve as king-makers at the time of negotiations for a coalition government.

Figure 11: PTI is expected to make rapid inroads in Punjab and secure 57 seats out of 141. The PML-N can maintain leadership at 67 seats but lower than before



Source: ECP, Credit Suisse estimates

PML-N to stay ahead in the North and Center; PTI to gain in the South

Under the new demarcations, seats in North and Central Punjab have declined while South Punjab has seen an increase

We have further bifurcated our analysis into the three regions of Punjab (North, Central and South). As discussed previously, the reduction of 7 National Assembly seats in Punjab (from 148 to 141) has come at the expense of the Northern (-4) and Central (-6) regions with gains being seen for the South (+3). Under the new delimitation, 30% of the province's seats are now associated with the North, 37% with the Center and 33% with the South. Figure 13 illustrates that PML-N is likely to garner substantial support in the North and Center and stay ahead of the PTI with 21 and 34 seats, respectively (16 and 17 for PTI). However, the latter can turn the tables in the South and emerge victorious on 24 seats as compared to 12 for the PML-N in our view.

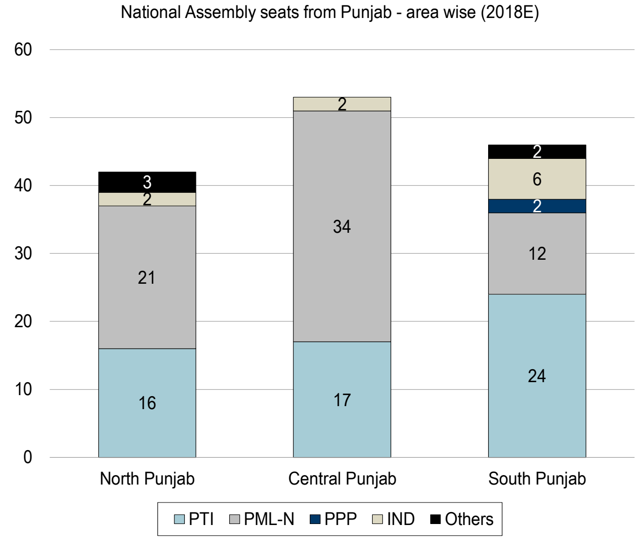
PML-N to lead in the Northern and Central areas of the province…

…while PTI can gain in the South due to wide-spread defections

Apart from rising popularity of the PTI, key factors driving the overall improvement in PTI's representation is the flight of electable candidates. One example was the formation of the JPSM (Junoobi Punjab Suba Mahaz), which comprises a group of MNA's that have parted ways with the PML-N with the aim of carving out a new South Punjab province. This group has now merged with the PTI. Moreover, internal rifts within the PML-N have also played to the PTI's advantage as several party members have not supported the aggressive stance adopted by Nawaz Sharif towards state institutions after his ouster.

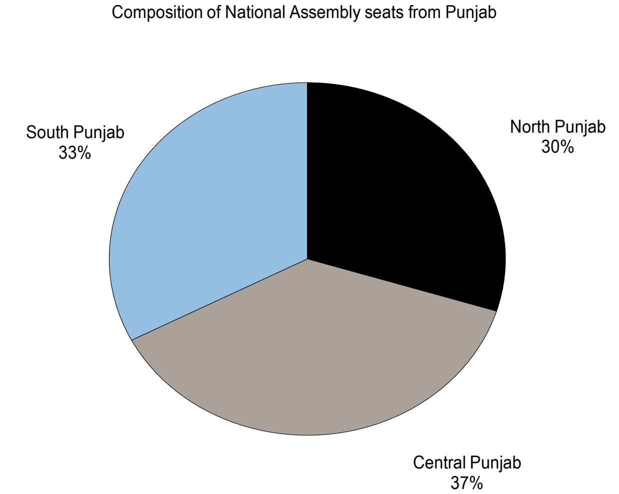
Having said that, the PML-N still holds a robust vote bank in Punjab. It drew the largest electorate in the 2013 elections (14.8 mn voters) which was almost double that of the PTI (7.7 mn voters). Moreover, the party has broadly delivered on its election promises to invest heavily in infrastructure and has also completed mega transportation projects (Orange Line Metro Train in Lahore and Metro Bus in Multan). Performance on electricity generation has also been commendable as a coal IPP in Sahiwal (1,200 MW) has been set up along with three LNG-based plants in Punjab (combined capacity of 3,600 MW).

Figure 12: PML-N to fetch more seats in the North and Center of Punjab while PTI dominates the South



Source: Credit Suisse estimates

Figure 13: PML-N strongholds in the North and Central parts of Punjab are 67% of total seats



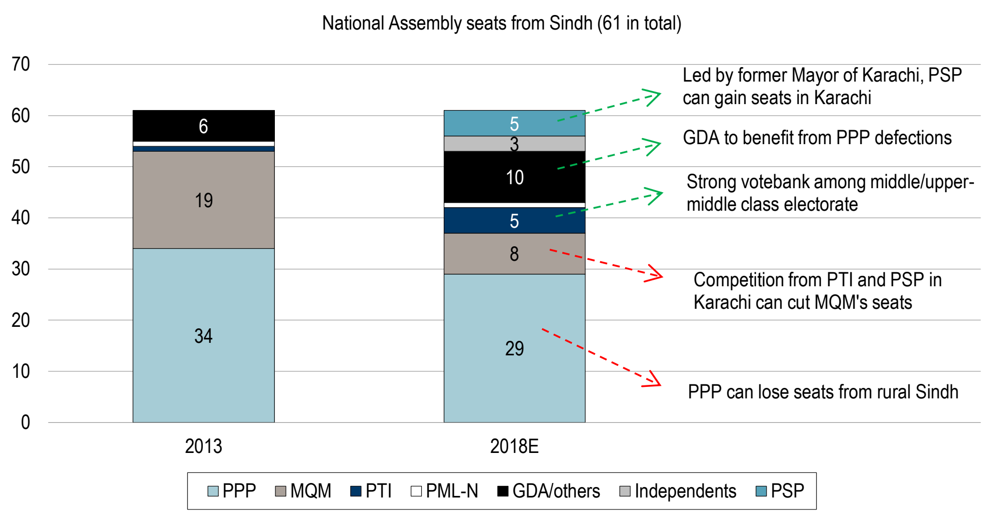
Source: ECP

Sindh: PPP and MQM to lose seats to PTI and PSP

PPP and MQM's representation in Sindh can shrink due to tough competition from PTI, PSP and GDA

Sindh is the second largest province with 61 seats (23%) in the National Assembly. The province has remained a stronghold of the PPP which has ruled for two consecutive terms (2008-13 and 2013-18). Our seat-wise analysis indicates that the PPP can potentially lose 7 seats from the rural areas and gain 2 seats from Karachi, bringing its total tally to 29 seats (34 in 2013). Defections of couple of senior leaders along with consolidation of anti-PPP parties under the Grand Democratic Alliance (GDA), can raise competition. Besides this, the MQM has seen its grip on Karachi erode since 2013 (when it won 17 out of 20 seats in the city). We expect the PTI to improve its footing due to weakening of the MQM and also due to the PTI's ability to draw votes from the middle and upper class societies. The newly formed PSP (Pak Sarzameen Party) under the leadership of ex-Karachi Mayor, Mustafa Kamal can also bag 4 seats from Karachi (5 in total from Sindh).

Figure 14: PPP and MQM can see losses while PTI, PSP and GDA can gain



Source: ECP, Credit Suisse estimates

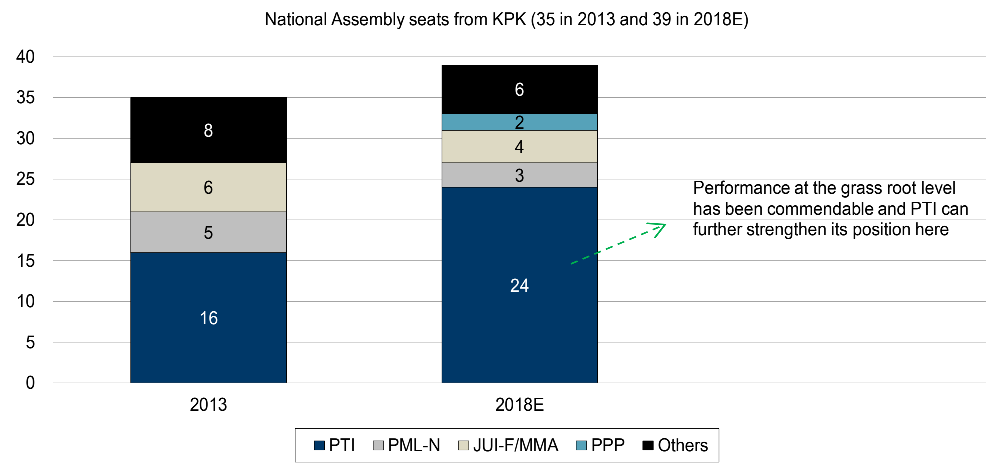
PTI to further solidify its position in KPK province

KPK province has seen its number of seats in the National Assembly rise by 4 to 39 seats

PTI to improve its position and gain 8 more seats to reach 24

Khyber Pakhtunkhwa (KPK) is the third largest province with 39 seats (14%) in the National Assembly. It was a key beneficiary of the delimitation exercise post the 2017 census with the addition of four seats. PTI emerged as the largest party in the 2013 elections when it secured 16 seats (46% of total) and ran the provincial government in a coalition for five years (its first ever shot at governance). The party looks to have performed well during this course with most opinion polls indicating it has strengthened its footing in the province. We expect it to gain more ground in the 2018 elections and anticipate a victory on 24 seats (62%) at the expense of regional parties such as the JUI-F and ANP.

Figure 15: PTI is deemed to have fared well since 2013 and can improve in 2018

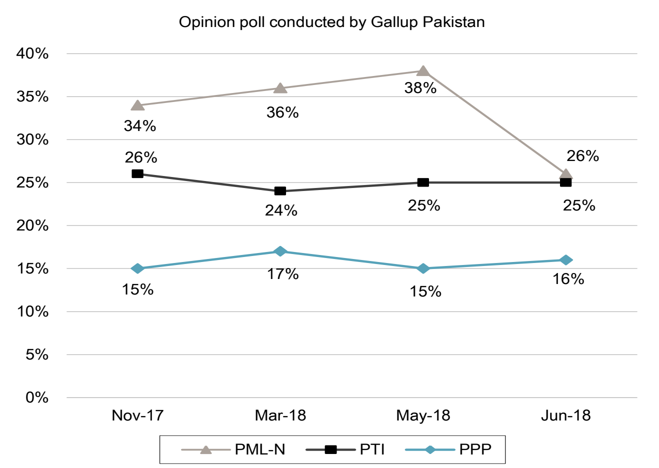


Source: ECP, Credit Suisse estimates

Latest opinion polls show a close overall race

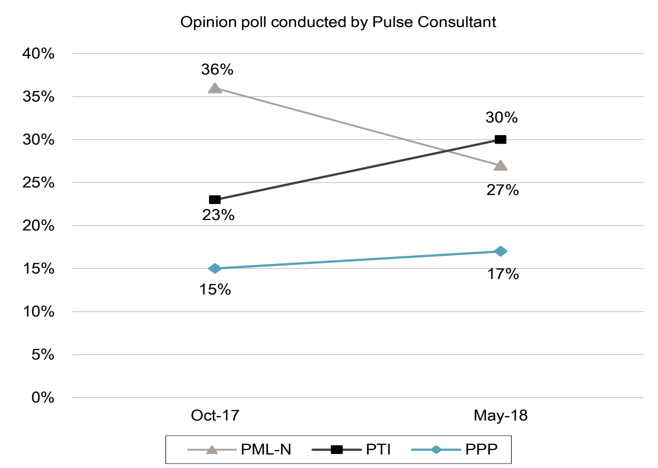
The recent poll conducted by Gallup Pakistan in June 2018 saw a neck and neck tie between the PML-N (26%) and PTI (25%). As per the results of the survey, the PML-N's popularity has dropped sharply from May levels when the party polled at 38%. In another poll conducted by the Pulse Consultant, the results illustrated that PTI has surpassed PML-N by garnering 30% of voters relative to 27% for PML-N. Both surveys were uniform in assigning a 15-17% popularity to the PPP keeping the party in third place.

Figure 16: PML-N and PTI at par



Source: Gallup Pakistan

Figure 17: Another poll places the PTI ahead



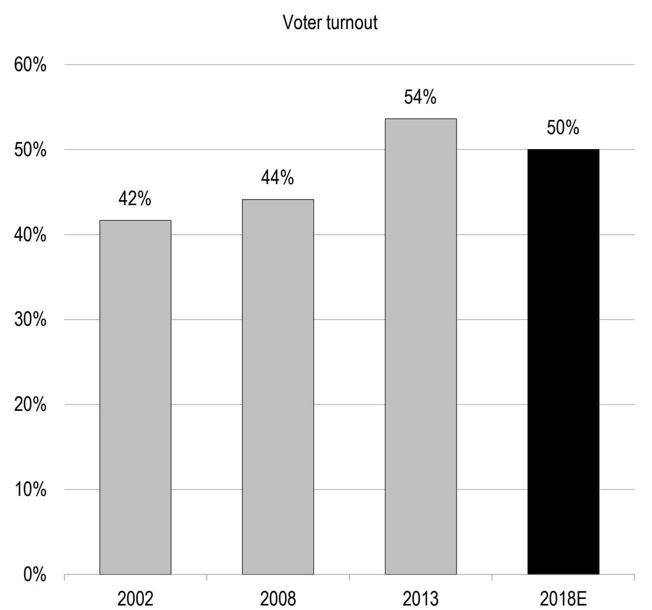
Source: Pulse Consultant

Swing factors in the elections

Voter turnout

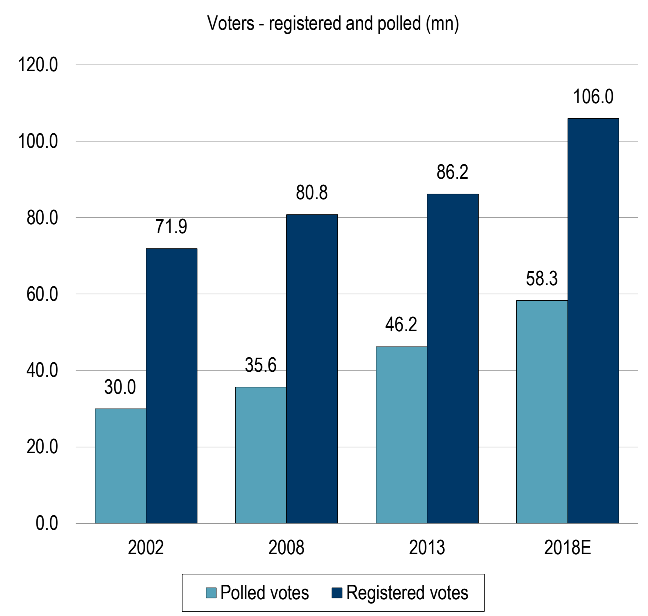
Elections in Pakistan have historically been marred by low turnouts and little participation from the youth and the educated class. Allegations of rigging and bogus voting have further deterred eligible voters to cast their ballot. Participation improved in the last three polls (42% in 2002, 44% in 2008 and up to 54% in 2013) but we expect turnout to drop this year (to 50%) due to a hotter weather condition and likely demoralisation of PML-N workers. The PTI has also seen its appeal dial down among the educated, middle and upper class voters (as compared to 2013). Having said that, any surge in voter turnout due more participation from the youth and first time voters can the benefit PTI, in our view.

Figure 18: Expecting decline in participation rate …



Source: ECP

Figure 19: … but polled votes can rise 22%



Source: ECP

Street agitation against Nawaz Sharif's sentencing

Wave of sympathy for the PML-N cannot be ruled out after Nawaz Sharif's sentencing

With Nawaz Sharif expected to return to the country on 13 July, concerns of street agitation are present despite the PML-N not having a history of confrontational politics. Any calls for protests in the aftermath of the sentencing could raise the risk of timely conduction of polls. Similarly, a larger-than-expected voter turnout may also be seen on election day in solidarity with the party leader if the father-daughter duo are imprisoned in the coming days. Note that Captain Safdar (Maryam Nawaz's husband) has already been arrested by the National Accountability Bureau and is expected to be sent to jail.

Law and order situation

Law and order remains a critical factor which could have a bearing in the outcome of the elections. Apart from their poor governance in 2008-13, one of the reasons for the poor showing of PPP and ANP, the two leftist parties in the 2013 elections, was a hostile campaign environment with continuous threats and attacks on their candidates from militants. While the law and order situation has improved many folds since then, any untoward incident in the run up to elections can possibly deter the middle class/upper class voters in the urban areas from coming out to cast their vote which would particularly impact the electoral performance of PTI as it draws support from the said segments.

What could each party bring to the table?

The **PTI** is a strong proponent of institutional reforms, crackdown on corruption and revenue mobilisation. We expect higher allocations towards education, health care and housing sectors. On foreign policy, Imran Khan has hawkish views towards the US and will lean more towards China and Muslim-majority countries, while domestically it will stay on the same page as the military establishment. The **PML-N's** operating model will be development-focused but will lag on SOE and tax reforms. Elsewhere, the **PPP** has a poor track record on economic management and is firmly opposed to privatisation.

Figure 20: Snapshot of main political parties, leadership and policies

Party	Political leanings	Leaders	History and policies
Pakistan Muslim League (Nawaz)	Centre Right	Nawaz Sharif / Shahbaz Sharif	• Nawaz is a three-time PM with a strong vote bank in Punjab and an experienced team • Preference for infrastructure development, mass-transport projects and energy uplift schemes • Amenable policies towards export-oriented sectors but lacking on tax reforms • Historically has had a troubled relationship with the military • Will improve ties with China/GCC countries while maintaining a balanced approach with US
Pakistan Tehreek-e-Insaf	Centrist	Imran Khan	• One of the leading contenders to form the government despite experience limited to provincial level • Strong proponent of institutional reforms, fiscal discipline and agricultural uplift • Emphasis on education, health care and housing sectors • Can assemble a strong economic team • Decent relations with religious parties but unlikely to form a coalition with the PPP and the PML-N • Holds hawkish views on the US and will tilt more towards China and Muslim-majority countries
Pakistan Peoples Party	Centre Left	Bilawal Bhutto / Asif Zardari	• The oldest party in Pakistan and arguably the most mature • Holds a loyal vote bank in the Sindh province but lacks popularity elsewhere • Poor track record on running the economy in 2008-13 but populist agricultural packages likely • Strongly against privatization and unlikely to make concrete efforts to broaden the tax net. • The PPP has a good history of forming coalitions with political parties and will share space with the military while also fostering better relations with the US

Source: Credit Suisse research

PTI: Social uplift efforts, strengthening institutions and tax collection

PTI is viewed as a Centrist party

Major emphasis on institutional reforms and revenue collection More leanings towards China and Muslim-majority countries

PTI has a strong focus on institutional reforms, implementation of the law and de politicisation of security agencies. The party is likely to launch an aggressive drive towards eliminating corruption and improving bureaucratic efficiency. It has laid a strong emphasis on reforming the tax authorities, widening the tax net and rationalizing current expenditures. In tandem, the PTI seeks to allocate more resources towards social areas and prioritizes education, health care and water. From an economic stand point, the party is expected to aggressively tackle the energy crisis through reforming loss making distribution companies and plugging electricity theft and pilferages. While infrastructure development such as roads and highways is also on the agenda, the focus is lower than the PML-N. On foreign policy, the PTI is likely to adopt a more hawkish approach towards the US and increase its leaning towards China and other Muslim-majority states. On defence matters, the party is likely to be on the same page with the military establishment.

PML-N: Development-driven growth agenda

Development-driven model but lagging on tax reform and institutional building

With a pro-business and pro-development mindset, the PML-N will look to focus on mega infrastructure and transportation projects along with heavy investments in the energy sector. During its previous tenure, the PML-N had fallen short of tax reforms and chances of faring better on this count are still low in our view. The party has also advocated judicial reforms after friction emerged with the ousting of Nawaz Sharif. On foreign policy, tilt towards China will be pursued while a hawkish stance towards the US will not be adopted. Given the civil-military tussles in its previous tenure, the PML-N (under the new leadership of Shahbaz Sharif) is expected to adopt a more conciliatory and collaborative approach on matters of defence and foreign policy and allow space-sharing with the military.

PPP: Socio-agricultural tilt but weak on overall economic management

Poor track record of economic management in its previous tenure

May introduce pro-agri measures but will fall short on tax reforms and privatizations

Having spent multiple tenures in office, the PPP is considered as a mature political party with reconciliation and consensus on tackling issues being a key hallmark in its 2008-13 term. The party is likely to give space to the military in shaping up foreign policy and defense and can adopt a neutral approach to the US while attempting to increase its reliance on China. With a strong rural vote-bank, agriculture will be prioritised under a PPP government. Emphasis on infrastructure development will be lower and efforts to implement institutional reforms, and improve the functioning of government are likely to fall short. Moreover, PPP is a staunch opposition of privatisation and loss-making performance of state-run companies can worsen, in our view. During its tenure of 2008-13, the PPP fared poorly on economic management amidst high allegations on corruption in bureaucracy and failure to mobilise resources. New fixed capital formation is likely to witness a slowdown and corporate expansions will likely be reconsidered in a PPP-government.

PML-N has previously performed better than the PPP

While the PTI has not experienced running a federal government, we compare the main economic indicators seen during the PPP tenure (FY09-13) and the recently concluded PML-N term (FY14-18). Across the main heads, PML-N has fared better than its competitor with GDP growth averaging 4.8% over its term (2.8% for PPP). Fiscal position also shows better management with deficit at 5.4% (vs 6.6% for PPP) and tax-to-GDP at 11.7% (9.7% for PPP). Other variables like inflation and policy rate are also better in the PML-N's term however these have mainly been driven by exogenous variables like oil.

Figure 21: Macro-economic indicators during PPP and PML-N tenures. PML-N fared better on most counts

	PPP government						PML-N government					
	FY09	FY10	FY11	FY12	FY13	Average	FY14	FY15	FY16	FY17	FY18	Average
GDP growth	0.4%	2.6%	3.7%	3.8%	3.7%	2.8%	4.1%	4.1%	4.5%	5.4%	5.8%	4.8%
Agriculture	3.5%	0.2%	2.0%	3.6%	2.7%	2.4%	2.5%	2.1%	0.3%	2.1%	3.5%	2.1%
Manufacturing	-4.2%	1.4%	2.5%	2.1%	4.6%	1.3%	4.5%	3.9%	3.7%	5.4%	5.5%	4.6%
Services Sector	1.3%	3.2%	3.9%	4.4%	5.1%	3.6%	4.5%	4.4%	5.6%	6.5%	6.4%	5.5%
CPI – average	17.0%	10.1%	13.7%	11.0%	7.4%	11.8%	8.6%	4.6%	2.9%	4.2%	5.3%	5.1%
C/A deficit as % of GDP	-5.5%	-2.2%	0.1%	-2.1%	-1.1%	-2.2%	-1.3%	-0.8%	-1.7%	-4.0%	-5.5%	-2.7%
Tax-to-GDP ratio	9.1%	9.9%	9.3%	10.2%	9.8%	9.7%	10.2%	11.0%	12.4%	12.5%	12.5%	11.7%
Fiscal deficit	5.2%	6.2%	6.5%	6.8%	8.2%	6.6%	5.5%	5.3%	4.6%	5.8%	5.7%	5.4%
Policy rate - average	14.0%	12.8%	13.6%	12.4%	10.0%	12.6%	9.8%	9.0%	6.0%	5.8%	6.1%	7.3%
Trade deficit (US$ bn)	(12.6)	(11.5)	(10.5)	(15.7)	(15.4)	(13.1)	(16.6)	(17.1)	(19.3)	(26.9)	(30.3)	(22.0)
FDI (US$ bn)	3.7	2.2	1.6	0.8	1.5	2.0	1.7	0.9	1.9	2.3	2.8	1.9

Source: PBS, SBP

Macro situation is reminiscent of 2013

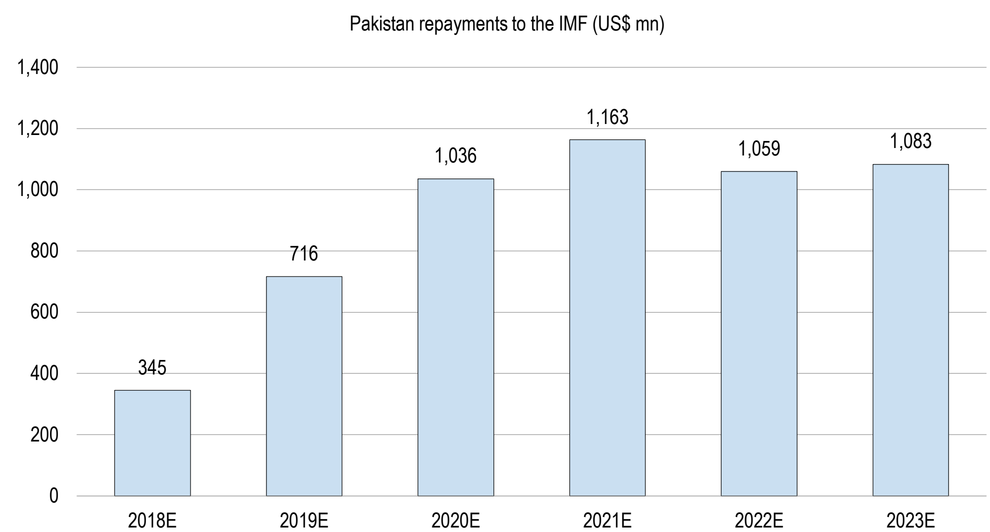
Amidst a record high current account deficit (11M FY18 US$ 15.9 bn: +43% YoY) and eroding forex reserves (US$9.8 bn; 1.9 months of import cover), we see a rising need for a bailout package from the IMF. Similar to 2008, a Stand-By Arrangement can be sought with upfront disbursements to alleviate the stress. Pakistan would need to secure funding of at least 3-5x its quota (amounting to US$9-14 bn) in our view. Alongside, we expect the Fund to attach strict conditions on exchange rate flexibility, a firm roadmap towards tax revenue mobilization, restructuring of SOE's and energy sector reforms. Monetary tightening is also anticipated to continue with another 75-100 bp hike likely in the next 6-9 months as second round impact of oil prices and currency adjustment filter through to CPI.

Odds stacked in favor of an IMF program

Annual repayments to the IMF are expected to cross US$1 bn per year from 2020E onwards

We see rising risks of the new government seeking a support package from the IMF in 4Q18 to manage balance of payments stress despite the move being politically unpopular. Pakistan's repayment of IMF funds stands at US$345 mn in 2018E which will rapidly rise to US$716 mn and US$1,036 mn in 2019/20E. In its Post Program Monitoring Report, the Fund has already cautioned that risks to Pakistan's medium-term capacity to repay the fund have increased and can further rise if external imbalances are not addressed timely. The IMF also foresees gross external financing needs rising from US$24.5 bn in 2018E to US$36 bn by 2021E and expects reserve drawdowns to persist in the medium term. Mobilisation of financing at accommodative rates will also be challenging in the wake of higher funding needs and tightening interest rates globally.

Figure 22: Sharp increase in IMF repayments in 2019-20E



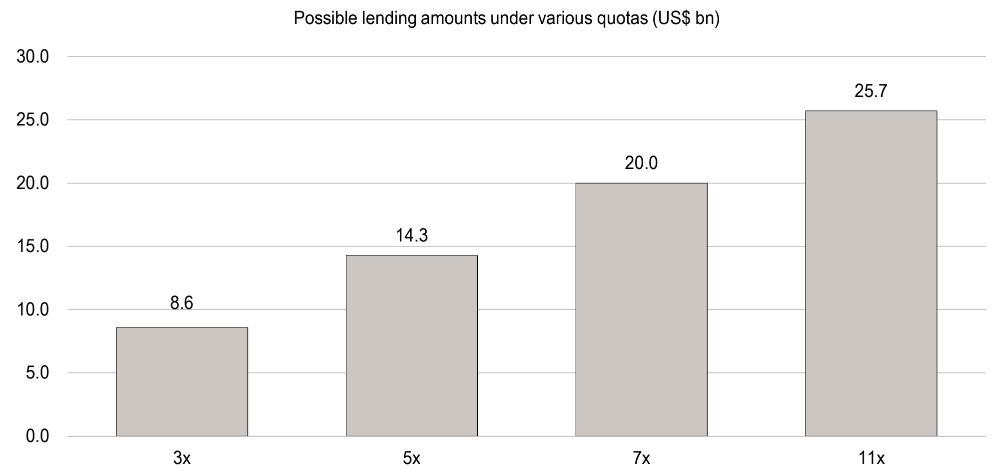
Source: IMF

Stand-By Arrangement is possible; strict conditions to accompany it

Stand-By Arrangement with fast-track disbursements is the possible option

In the event of the new government approaching the IMF for a bailout package, we expect a Stand-By Arrangement to be sought, similar to the one agreed in 2008 with upfront disbursements to alleviate the pressure on forex reserves. As per our understanding, Pakistan has already utilized 2.2x of its IMF quota under the Extended Fund Facility. We believe that fresh borrowings would need to be at least 3-5x of the country's quota in order to provide material respite to the external account. This would imply funds of US$8.6-14.3 bn over a period of three years (88-147% of current reserves). The recent success of Argentina in obtaining a US$50 bn IMF bailout (1110% of its quota) has provided some hope for Pakistan. Having said that, it is unlikely that the IMF will retain a lenient approach in this program. We expect continued advocacy on the Fund's part for greater exchange rate flexibility along with firm conditions on three key areas: (1) revenue mobilisation through tax net expansion, (2) restructuring of major public enterprises and eventual privatisation and (3) power sector reforms with a concrete mechanism to limit accumulation of receivables and reduction in line losses.

Figure 23: Funding of 3-5x of Pakistan's IMF quota will be needed in our view



Source: IMF, Credit Suisse estimates

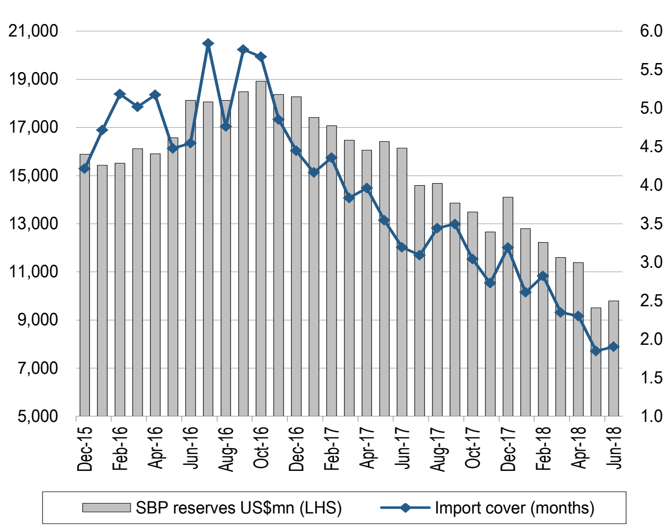
Dwindling forex reserves amid record C/A deficit

Reserves can finance 1.9 months of imports

PKR has fallen by 15.4% in seven months

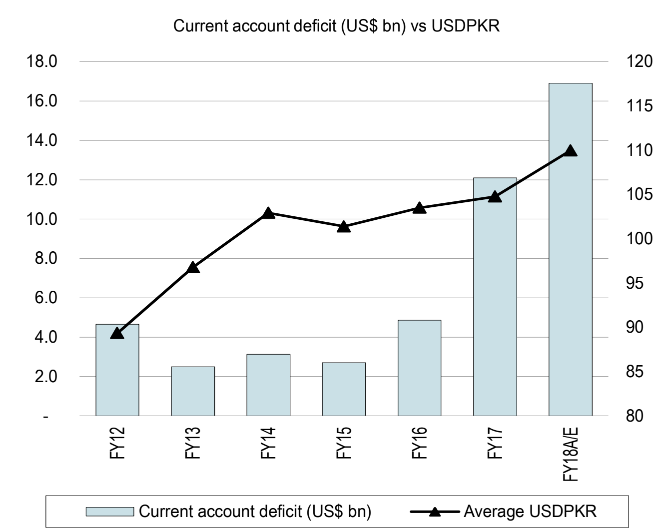
At US$9.8 bn, reserves have dropped to precariously low levels and can cover less than two months of import. The last abrupt currency adjustment of 3.4% was seen on 11-June was the third such instance in the past seven months. Altogether, the PKR has lost 15.4% in seven months. The State Bank of Pakistan (SBP), which is the largest player in the currency market, has opined that the move is a result of supply deficiencies of foreign currency and has supported the adjustment. Alongside, the central bank has shown measured optimism that recent policy measures can serve to reduce aggregate demand and expedite foreign inflows in order to ease external account stress.

Figure 24: Reserve cover is below two months



Source: SBP

Figure 25: C/A deficit at all-time high



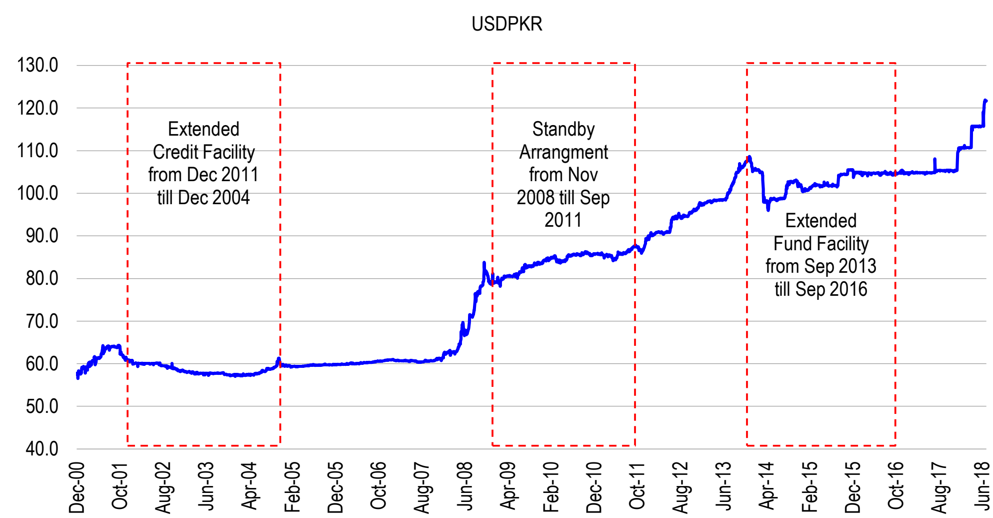
Source: Bloomberg, SBP

Charting the PKR course in the run up to IMF programs

We look at three previous facilities with the Fund (from Dec-2001 onwards) and assess the performance of the currency in the run-up to loan arrangements.

- **Dec-2001 till Dec-2004—Extended Credit Facility:** Pakistan had earlier completed a facility of ~US$600 mn from Nov-2000 till Sep-2001 and during that period, the PKR had depreciated by 11-12%. After the advent of the new Extended Credit Facility in Dec-2001, Pakistan was able to keep the exchange rate relatively stable. Out of the total facility size of US$1.3 bn, only US$1.1 bn was utilised. Recall that that during this period, military and economic aid from the US had picked up substantially and this provided a buffer to foreign exchange reserves.
- **Nov-2008 till Sep-2011—Standby Arrangement:** This was the largest facility negotiated (US$10-11 bn) in the midst of a severe Balance of Payments crisis. In the run-up to the negotiations, the currency lost 26% in six months (Apr-2008 till Oct-2008). The program ultimately ended prematurely and Pakistan was only able to draw US$7-8 bn. During this period the currency fell by another 10-11%.
- **Sep-2013 till Sep-2016—Extended Fund Facility:** Pakistan once again approached the IMF in Sep-2013 to fend off BOP pressures and negotiated a US$6.67 bn program. In the build up to the program and sometime after it commencement, the currency had lost ~10% and reached a USDPKR parity of ~108. However, the government was able to reverse this and strengthen the currency by 7-8%. Overall, if we compare the start and end points of the program, the net currency depreciation was contained at 4-5%.

Figure 26: The PKR adjusts largely in the run-up to IMF programs



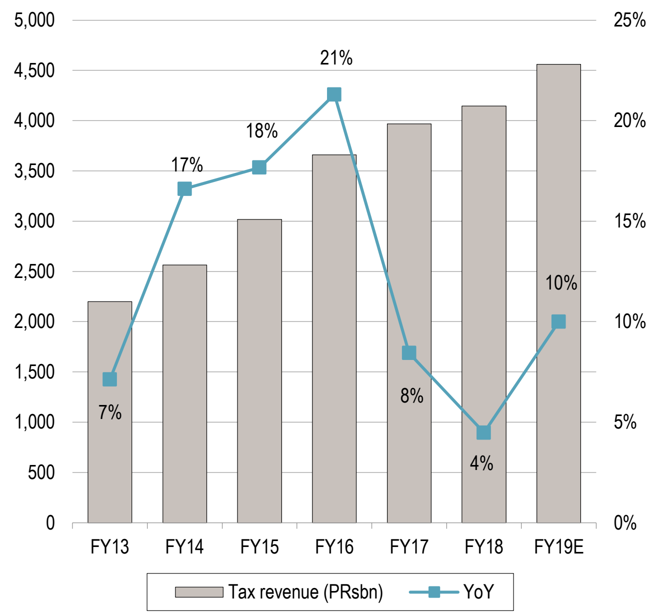
Source: Bloomberg

Budget deficit expected to close above 6% of GDP

Substantial miss on fiscal targets with deficit crossing 6%

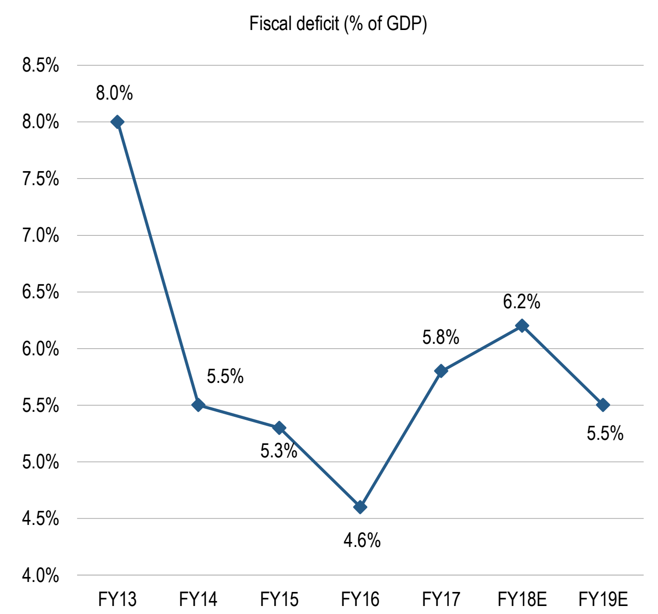
We think that fiscal discipline will be a key area of focus in an IMF program as tax revenue growth has been decelerating in the past two years (+21% in FY16 followed by +8% in FY17 and +4% in FY18). While the outgoing government set a growth target of 13% in FY19E, the Fund is likely to raise this in order to achieve medium-term budget deficit targets of below 4.5% of GDP. News reports (Dawn, Tribune) have reported fiscal deficit crossing 6% of GDP in 11M FY18 which slips beyond our expectations of 5.5-5.7%. In the event of an IMF program, we expect a deficit target of 5.5% in FY19E (excluding potential one-time payment to clear circular debt of 1.5% of GDP). Moreover, a low tax-to-GDP ratio at 11.9% will merit immediate efforts to increase the base of tax filers, withdraw exemptions and strengthen the operations of the tax authorities. The Fund is likely to impose limits on budgetary borrowing to create space for private sector credit.

Figure 27: Tax revenue growth to reverse a slide



Source: MOF, Credit Suisse estimates

Figure 28: Deficit expected to breach 6%

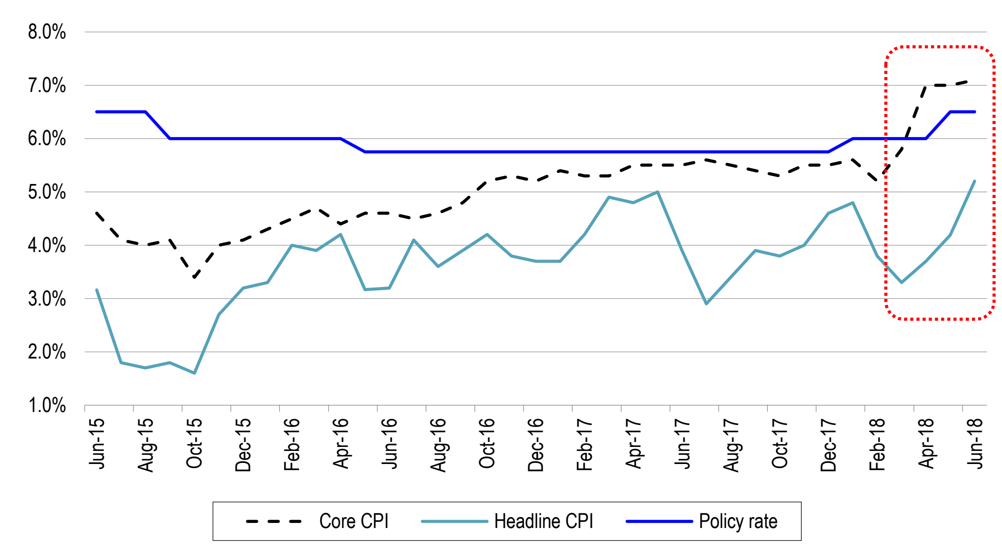


Source: MOF, Credit Suisse estimates

Rates up 75 bp; more hikes of 75-100 bp expected

The Central Bank raised interest rates by 50 bp to 6.5% in May, five months after the first rate hike of 25 bp. This takes real rates to 230 bp. Headline CPI has crept up to 5.2% YoY in June with core inflation rising to 7.1%. Second round impacts of recent PKR adjustment are due to be felt in coming months and double whammy created from oil prices is likely to push up CPI above 6%, in our view. We eye cumulative policy tightening of 75-100 bp in the next 6-9 months with the July policy decision likely to see a hike of 25-50 bp.

Figure 29: Inflation print has crossed 5% with rates up 75 bp YTD



Source: PBS, SBP

Pakistan economic snapshot

Figure 30: A glance at key economic indicators

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18A/E	FY19E
GDP growth	2.6%	3.7%	3.8%	3.7%	4.1%	4.1%	4.5%	5.4%	5.8%	5.2%
Agriculture growth	0.2%	2.0%	3.6%	2.7%	2.5%	2.1%	0.3%	2.1%	3.8%	2.8%
Manufacturing growth	1.4%	2.5%	2.1%	4.6%	4.5%	3.9%	3.7%	5.4%	5.8%	5.1%
Services growth	3.2%	3.9%	4.4%	5.1%	4.5%	4.4%	5.6%	6.5%	6.4%	6.0%
GDP (US$ bn)	178	214	225	233	250	272	282	306	322	351
Population (mn)	174	177	181	184	188	192	195	198	205	208
CPI	10.1%	13.7%	11.0%	7.4%	8.6%	4.6%	2.9%	4.2%	4.0%	6.8%
Policy rate (avg.)	12.8%	13.6%	12.4%	10.0%	9.8%	9.0%	6.0%	5.8%	6.3%	7.2%
6M KIBOR (interbank rate)	12.2%	13.1%	12.1%	9.7%	9.6%	8.7%	6.5%	6.2%	6.3%	7.3%
M2 growth	12.5%	15.9%	14.1%	15.9%	12.5%	13.2%	13.7%	13.7%	9.5%	13.5%
Fiscal deficit (as % of GDP)	6.2%	6.5%	6.8%	8.2%	5.5%	5.3%	4.6%	5.8%	6.2%	5.5%
Tax revenue % of GDP	9.9%	9.3%	10.2%	9.8%	10.2%	11.0%	12.4%	12.5%	11.9%	12.1%
Exports (US$ bn)	19.7	25.4	24.7	24.8	25.1	24.1	22.0	21.7	24.8	26.8
- Textiles	10.2	13.1	13.1	12.8	13.7	13.5	12.5	11.7	13.3	14.4
Imports (US$ bn)	31.2	35.9	40.4	40.2	41.7	41.3	41.3	48.5	56.1	53.1
- Oil (US$ bn)	10.5	12.3	14.4	14.1	14.8	12.3	8.4	10.6	13.8	15.5
Trade deficit (US$ bn)	(11.5)	(10.5)	(15.7)	(15.4)	(16.6)	(17.1)	(19.3)	(26.9)	(31.3)	(26.3)
Current. account deficit (US$ bn)	3.9	(0.2)	4.7	2.5	3.1	2.7	4.9	12.1	16.9	12.0
Current account (as % of GDP)	-2.2%	0.1%	-2.1%	-1.1%	-1.3%	-0.8%	-1.7%	-4.0%	-5.3%	-3.4%
Remittances (US$ bn)	8.9	11.2	13.2	13.9	15.8	18.7	19.9	19.3	19.6	20.3
- GCC (US$ bn)	5.2	6.6	8.0	8.5	9.7	12.0	12.8	12.1	11.6	11.9
- Non GCC (US$ bn)	3.7	4.6	5.2	5.5	6.1	6.7	7.2	7.2	8.1	8.4
Remittances (as % of GDP)	5.0%	5.2%	5.9%	6.0%	6.3%	6.9%	7.1%	6.3%	6.1%	5.8%
FDI (US$ bn)	2.2	1.6	0.8	1.5	1.7	0.9	1.9	2.3	2.8	3.2
PKR/US$ - average	83.9	85.6	89.4	96.8	102.9	101.4	103.5	104.8	110.0	113.5
PKR YoY	6.3%	2.0%	4.4%	8.3%	6.4%	-1.5%	2.1%	1.2%	5.0%	3.2%
PKR US$ - June end	85.5	85.8	94.7	98.9	98.6	101.8	104.8	105.0	122.5	128.6
Forex reserves (US$ bn)	16.8	18.2	15.0	11.0	14.1	18.7	23.1	21.4	17.2	19.8
- Central bank reserves (US$ bn)	13.0	14.8	10.8	6.0	9.1	13.5	18.4	16.1	10.6	12.7
Import cover (months)	5.0	4.9	3.2	1.8	2.6	3.9	5.4	4.0	2.3	2.9
External debt (US$ bn)	61.6	66.4	65.5	60.9	65.3	65.2	73.9	83.4	94.0	102.0
External debt (as % of GDP)	34.6%	31.1%	29.1%	26.2%	26.1%	24.0%	26.2%	27.3%	29.2%	29.1%
Domestic debt (PRs bn)	4,658	6,092	7,724	9,571	10,907	12,193	13,626	14,849	16,949	18,629
Domestic debt (as % of GDP)	31.8%	33.7%	37.4%	41.8%	42.9%	44.5%	46.0%	46.6%	47.9%	46.8%

Source: PBS, SBP, Economic Survey, Ministry of Finance, Credit Suisse estimates

Equities to welcome a strong mandate

A decisive mandate would be cheered by the market in our view

We expect the market to cheer a strong PTI or PML-N showing with a 10-15% rally as a decisive mandate is essential to implement much needed economic reforms in order to restore macroeconomic stability. Fertilizers, energy, banks and textiles should benefit. A split mandate resulting in a hung Parliament remains a key risk leading to further political turmoil and making it difficult for the new government to adjustment measures. We see the market correcting a further 10-15% in such a case. **Our base case scenario remains a PTI led coalition and we see an 8-10% rally post elections**. Beyond this, the PTI would need to take concrete measures on taxation and institutional reforms in the first 100 days of its tenure to maintain the confidence of markets. We expect the party to introduce relief measures for the agricultural space, grant incentives for exporters and inject funds in the energy sector. We keep our year-end index target of 47,000 points intact implying 17% upside. Top picks are MCB, EFERT, ENGRO, LUCKY and UBL. Key risks are worsening security situation and street agitation leading to a delay in holding elections.

Figure 31: Assessing the impact of various electoral outcomes on the economy and markets

Election scenario	Probability	Economic/ market implications	Winners/Losers
PTI-led coalition with MQM, PSP and other independent candidates	60%	**Positive:** Despite no track record, a strong PTI mandate would result in improve investment flows due to likelihood of tax and energy reforms. Economic management team to have higher credibility	**Beneficiaries:** EFERT, FFC, LUCKY, UBL, NML, HUBCO, PSO. **Losers:** INDU, PSMC, HCAR
PTI-led coalition with PPP, MQM, PSP and other independent candidates	15%	**Negative:** Possible correction of 5-10% due to lack of clarity on economic policies and comprises on key issues like SOE reform and taxation can de-rail the PTI's ambitious agenda	**Beneficiaries:** EFERT, FFC, HUBCO, PSO. **Losers:** INDU, PSMC, HCAR, DGKC, LUCKY
PML-N led coalition with PPP, religious parties and other independent candidates	25%	**Neutral to positive:** Short-term rally due to continuation of PML-N's pro-business policies and development agenda. However, reforms, privatization and accountability drive can take a back seat	**Beneficiaries:** MCB, NML, DGKC, LUCKY, ENGRO, HUBCO and PSO. **Losers:** FFC, INDU, PSMC, HCAR

Source: Credit Suisse research

Scenario 1: PTI-led coalition; buy fertilizers, textiles, banks and energy

This is our base case scenario and should offer the strongest possible government formation in our view. While we expect the market to welcome the results, investors will be closely analysing PTI's cabinet formation and immediate agenda given no prior reference point of governance at the center. PTI's manifesto strongly emphasizes support for the agricultural sector which is likely to come in the shape of lower urea prices/subsidies and incentives for farmers on capital equipment purchases (such as GST relaxations and removal of import duties). EFERT and FFC are key stock ideas on this theme while banks can also come in the limelight due to more allocations of agri-credit and housing finance. Moreover, a more hawkish monetary policy under a probable IMF program will be supportive for banks as well (MCB, UBL). Elsewhere, we think the PTI will make fast track efforts to boost exports and in this vein, disbursement of tax refunds and decrease in electricity costs will positively impact the textile sector (NML). Energy companies (HUBCO and PSO) can also see interest as settlement of circular debt is likely.

Scenario 2: PTI led coalition with PPP; buy fertilizers, energy and banks

Another likely scenario (15% probability) would entail the PTI bringing the PPP on board along with regional parties and independent candidates in case the numerical strength in the first scenario is unable to be achieved. This would be negative for the market due to lack of clarity on economic policies and sustainability of the arrangement for a full term. Moreover, the PTI would have to give concessions to the PPP in areas of accountability and restructuring of PSEs which are a cornerstone of the former's manifesto. Defensive stocks can be preferred and we flag E&Ps (OGDC, PPL and POL) and IPP's (HUBCO) as potential winners. Having said that, both parties do advocate pro-agricultural measures and fertilizer stocks such as FFC and EFERT can benefit in this vein. We also see investor interest coming in high quality names such as LUCKY, ENGRO, MCB and UBL.

Scenario 3: PML-N led coalition; buy banks, cements and energy

In the case of PTI failing to piece together a coalition, the PML-N may join hands with the PPP and form an alliance with the support of smaller parties and independents; similar to what was done after the 2008 elections. While policy continuity would be expected, the weaker mandate of the PML-N as compared to 2013, would imply giving a higher number of concessions to the PPP and other coalition partners in areas such as privatisation (Pakistan Steel Mills, Pakistan International Airlines, electricity generation and distribution companies etc) and taxation. The accountability process may also take a back seat as both mainstream parties have not been in favour of any genuine accountability. Moreover, given the experience from 2008, there will remain questions on the sustainability of the government for a full term. One positive though would be the fact that coalition partners will most likely be governing the two main provinces of Punjab and Sindh which would ensure better cohesion with the center. Likely beneficiaries include cement stocks (LUCK, DGKC) as proxies to infrastructure and housing demand. Banks can rally (MCB and UBL) as business sentiment will stay upbeat and corporate expansions under the CPEC will accelerate. Energy stocks (PSO and HUBCO) may also see some interest as the government will look to clear out the circular debt (similar to the exercise done in 2013).

Hung parliament is the key risk to stability

PML-N and PTI winning 70-80 seats each would suggest a hung parliament which is a major risk for stability

A split mandate or a hung parliament is the biggest risk, in our view. This would imply unstable coalitions, lack of consistency in economic policies and slowdown in reforms. We would define a hung parliament as both the PTI and PML-N securing 70-80 seats each.

How does the index fare in an election year?

In the past five elections, we notice gains of 2-16% in the month immediately preceding polls. And history also suggests that the optimism prevails in the month after elections (positive returns of 4-15%) but tends to get erratic on a three-month horizon.

Figure 32: Short term market performance pre and post general elections

Year of elections	Date	Pre-election market performance		Post-election market performance	
		1M	3M	1M	3M
1993	6th October	5.3%	10.1%	14.9%	64.5%
1997	3rd February	16.0%	9.5%	4.4%	-3.7%
2002	10th October	7.0%	17.0%	6.1%	32.4%
2008	18th February	2.1%	9.5%	5.1%	1.7%
2013	11th May	6.4%	13.5%	12.3%	16.7%

Source: Reuters, Credit Suisse research

Valuations at 7.8x P/E with earnings growth of ~17%

Index-target of 47,000 points suggests 20% upside potential

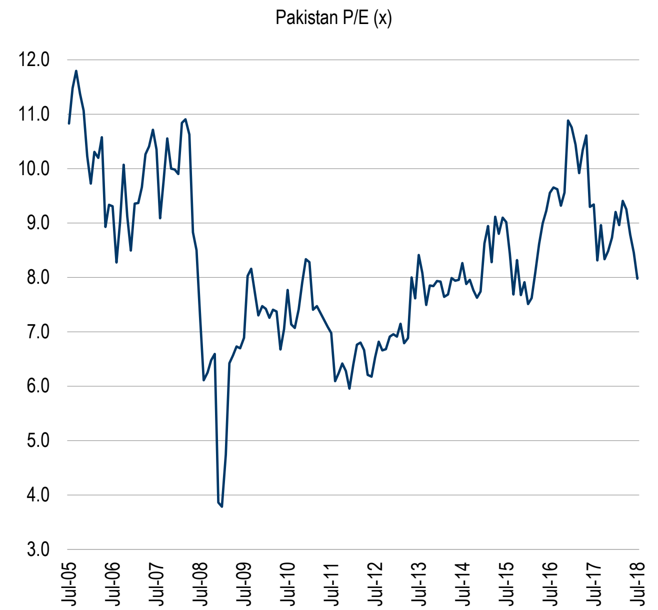
The market is trading at 8.0x 2019E P/E with consensus baking in ~17% EPS growth and dividend yield of 6.8%. 2018E is likely to see a reverse of the four-year slide in ROE's (from 29% in 2014 to 20.5% in 2017). We keep our December index target of 47,000 points intact implying an upside potential of 20% from current levels.

Figure 33: Consensus is building in 16-17% market EPS growth in 2018-19E

	2013	2014	2015	2016	2017	2018E	2019E	2020E
EPS growth (%)	4.7%	23.9%	-7.2%	-14.2%	2.2%	16.1%	16.8%	11.5%
P/E (x)	9.8	8.4	9.1	10.6	10.4	8.9	7.8	7.0
ROE (%)	27.5	29.1	25.5	20.1	20.4	21.3	22.1	21.1
Dividend yield (%)	5.3%	5.6%	5.9%	5.7%	5.5%	6.2%	7.0%	7.7%
P/B (x)	2.2	2.2	1.7	1.6	1.5	1.5	1.3	1.2

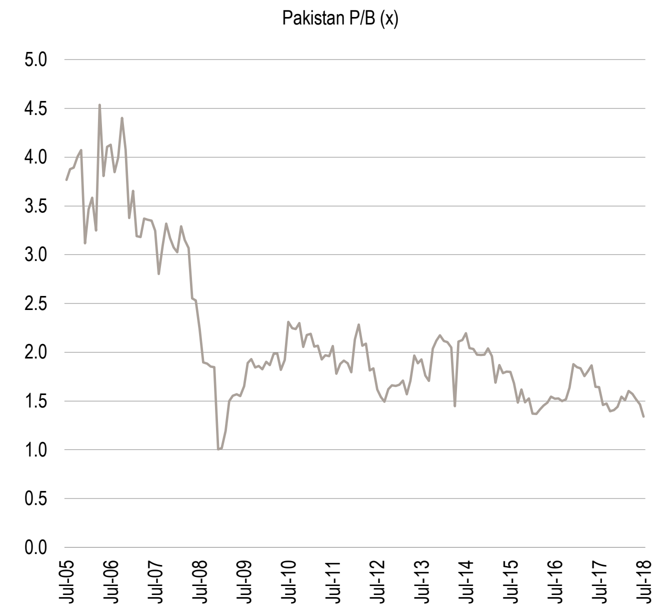
Source: IBES

Figure 34: P/E has de-rated to 8.0x 12MF P/E



Source: IBES

Figure 35: P/B is testing recent troughs



Source: IBES

Figure 36: Credit Suisse – Pakistan universe valuations. Top picks highlighted

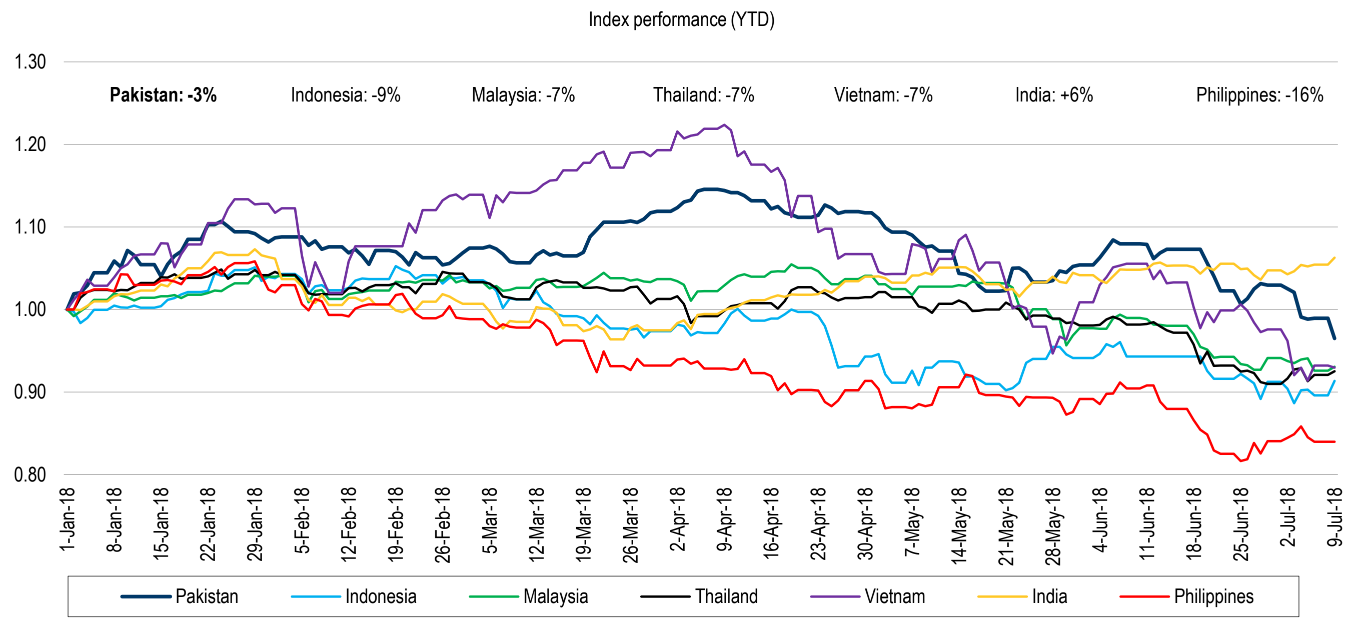
Name of company	Ticker	Price (PRs)	Rat	TP (PRs)	M. cap (US$ bn)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)		P/B (x)		ROE (%)		EPS growth (%)	
						18E	19E	18E	19E	18E	19E	18E	19E	18E	19E	18E	19E
Habib Bank Ltd	HBL.KA	157	N	196	1.89	8.6	6.6	NM	NM	3.2%	6.4%	1.1	1.0	13.0%	15.2%	-17%	32%
MCB Bank Ltd	MCB.KA	191	O	245	1.86	9.3	8.1	NM	NM	8.2%	8.9%	1.4	1.4	14.5%	15.9%	4%	14%
United Bank Ltd	UBL.KA	154	O	220	1.55	7.3	6.8	NM	NM	8.5%	8.5%	1.2	1.1	16.1%	15.9%	2%	7%
Bank Alfalah	BAFL.KA	50	O	56	0.67	8.5	7.4	NM	NM	3.0%	3.5%	1.1	1.0	13.3%	13.7%	14%	15%
Fauji Fertilizer	FAUF.KA	94	U	76	0.99	13.2	12.9	12.7	10.7	6.4%	6.4%	3.9	3.7	29.5%	28.6%	-15%	2%
Engro Fertilizers	ENGR.KA	73	O	84	0.81	8.7	8.4	5.5	4.9	11.4%	11.8%	2.3	2.3	26.4%	27.4%	1%	4%
Engro Corporation	EGCH.KA	297	O	355	1.28	10.9	9.7	6.7	6.0	7.4%	7.4%	1.1	1.1	10.4%	11.4%	51%	13%
Oil and Gas Develop Co	OGDC.KA	147	N	188	5.21	8.9	6.1	5.0	3.5	6.1%	8.8%	1.2	1.1	13.0%	17.5%	11%	46%
Pakistan Petroleum Ltd	PPL.KA	204	N	215	3.31	10.5	7.1	5.1	3.6	4.9%	6.9%	1.7	1.5	16.4%	21.5%	8%	48%
Pakistan Oilfields	PKOL.KA	622	U	620	1.21	23.2	8.2	10.0	4.0	4.3%	11.6%	4.7	4.5	20.2%	55.5%	-34%	184%
Hub Power Company	HPWR.KA	89	N	100	0.84	9.2	9.0	7.8	9.0	7.8%	7.3%	2.9	2.6	31.1%	28.6%	4%	2%
DG Khan Cement	DGKH.KA	103	O	222	0.37	5.0	4.4	5.6	3.7	8.1%	9.0%	0.6	0.5	11.2%	11.4%	14%	12%
Pakistan State Oil	PSO.KA	295	U	330	0.79	5.4	4.5	6.1	5.6	6.4%	8.8%	0.8	0.8	15.6%	16.7%	6%	20%
Lucky Cement	LUKC.KA	468	O	790	1.25	10.4	9.9	6.3	6.6	4.9%	4.1%	1.7	1.6	16.8%	15.9%	6%	5%
Pak Elektron	PKEL.KA	33	N	50	0.13	5.1	4.7	4.8	4.4	8.0%	8.6%	0.6	0.5	11.2%	11.2%	-3%	8%
Honda Atlas Cars	HATC.KA	286	N	335	0.34	6.3	6.6	3.5	4.0	9.4%	5.9%	2.4	2.1	38.0%	31.8%	6%	-5%
Pak Suzuki Motors	PKSU.KA	369	U	330	0.25	8.2	9.6	3.7	3.3	4.9%	4.1%	1.0	0.9	11.6%	9.4%	-4%	-14%
Indus Motors	INDM.KA	1,276	O	1,790	0.83	6.8	7.3	4.4	4.7	10.3%	9.6%	2.8	2.5	41.8%	35.0%	14%	-7%

Source: Reuters, Credit Suisse estimates

Performance relative to the region and stock-wise

On a YTD basis, the KSE-100 is down 3% but has outperformed most Asian markets by 3-13%. While the KSE-100 rallied in the earlier part of the year, deteriorating macros have erased the gains. Moreover, given the PKR's sharp depreciation against the USD (-15% YTD), USD returns of -12% paint a slightly different picture.

Figure 37: Compared to Asian peers, Pakistan has fared better with a nominally positive return YTD

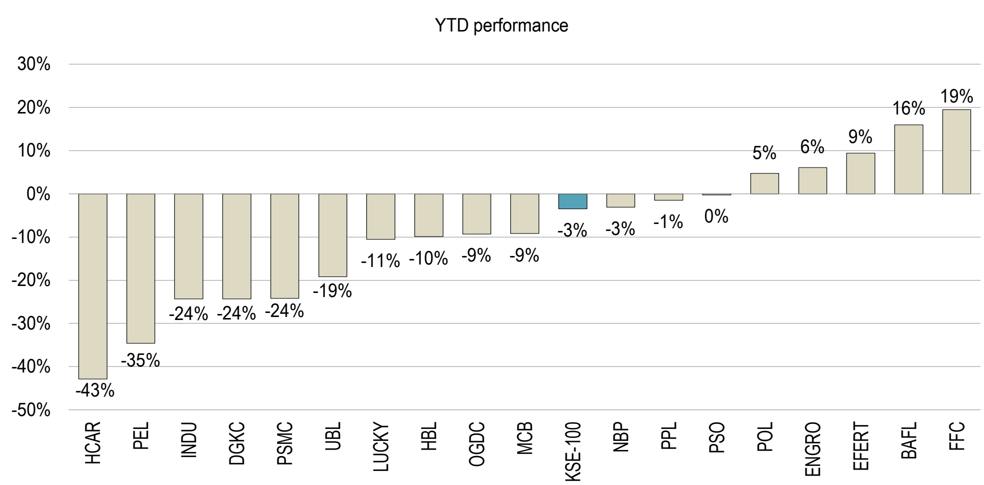


Source: Reuters

Defensives have outperformed cyclicals and commodity stocks YTD

Defensive names such as FFC and EFERT have outperformed YTD along with conglomerate ENGRO. Major losses have been seen in currency-sensitive sectors (autos and capital goods) while banks have yet to react positively to the tightening cycle.

Figure 38: Fertilizers leading the rally YTD while autos have faced the brunt



Source: Reuters

Companies Mentioned *(Price as of 10-Jul-2018)*

Bank Alfalah (BAFL.KA, PRs50.41)
DG Khan Cement Co Ltd (DGKH.KA, PRs103.19)
Engro Corporation Ltd (EGCH.KA, PRs297.37, OUTPERFORM, TP PRs355.0)
Engro Fertilizers (ENGR.KA, PRs73.49, OUTPERFORM, TP PRs84.0)
Fauji Fertilizer Company Limited (FAUF.KA, PRs94.44)
Habib Bank Limited (HBL.KA, PRs156.76)
Honda Atlas Cars (HATC.KA, PRs286.19)
Indus Motor Company (INDM.KA, PRs1276.35)
Lucky Cement Co Ltd (LUKC.KA, PRs467.7, OUTPERFORM, TP PRs790.0)
MCB Bank Limited (MCB.KA, PRs190.57, OUTPERFORM, TP PRs245.0)
NCPL (NCPL.KA, PRs25.57)
NPL (NISH.KA, PRs27.02)
National Bank of Pakistan (NBPK.KA, PRs47.05)
Oil & Gas Development Company (OGDC.KA, PRs147.13)
Pak Elektron (PKEL.KA, PRs32.62)
Pak Suzuki Motors (PKSU.KA, PRs369.0)
Pakistan Intl (PIAa.KA, PRs3.98)
Pakistan Oilfields Ltd (PKOL.KA, PRs621.66)
Pakistan Petroleum Limited (PPL.KA, PRs204.06)
Pakistan State Oil (PSO.KA, PRs295.1)
United Bank Limited (UBL.KA, PRs153.53, OUTPERFORM, TP PRs220.0)

Disclosure Appendix

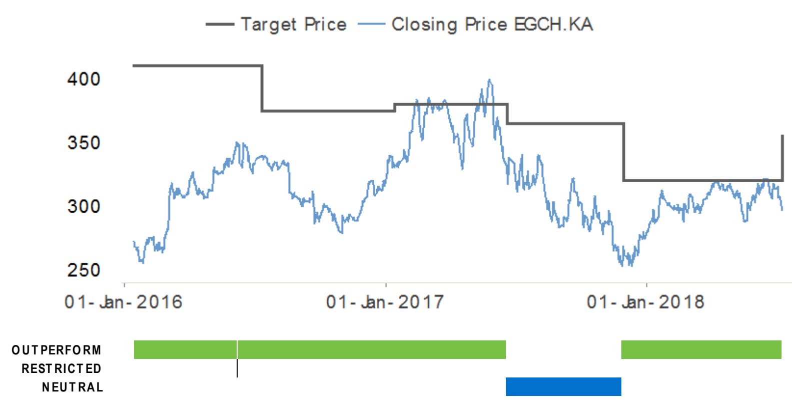
Analyst Certification

Farhan Rizvi, CFA, and Fahd Niaz, CFA, each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Engro Corporation Ltd (EGCH.KA)

EGCH.KA Date	Closing Price (PRs)	Target Price (PRs)	Rating
14-Jan-16	272.23	410.00	O
06-Jun-16	349.86		R
08-Jun-16	347.23	410.00	O
11-Jul-16	339.24	375.00	
13-Jan-17	330.93	380.00	
19-Jun-17	330.52	365.00	N
29-Nov-17	268.51	320.00	O
09-Jul-18	297.37	355.00	

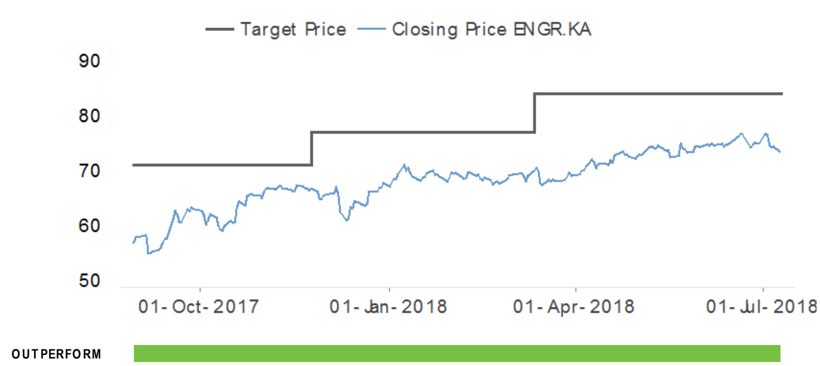
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Engro Fertilizers (ENGR.KA)

ENGR.KA Date	Closing Price (PRs)	Target Price (PRs)	Rating
30-Aug-17	56.90	71.00	O *
24-Nov-17	66.71	77.00	
12-Mar-18	69.95	84.00	

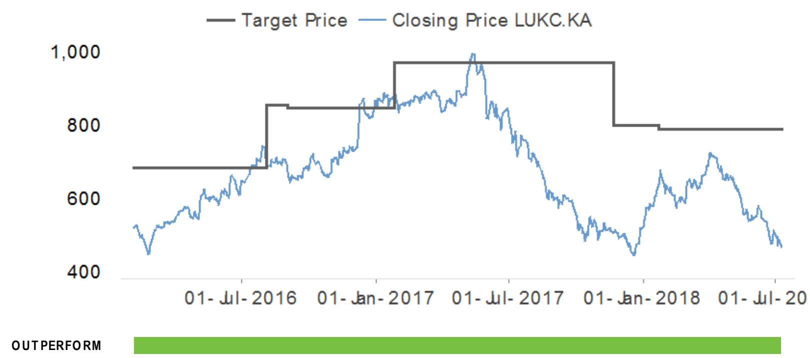
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Lucky Cement Co Ltd (LUKC.KA)

LUKC.KA Date	Closing Price (PRs)	Target Price (PRs)	Rating
04-Feb-16	520.31	685.00	O *
03-Aug-16	705.45	855.00	
02-Sep-16	661.38	848.00	
26-Jan-17	889.18	970.00	
21-Nov-17	506.51	800.00	
22-Jan-18	638.49	790.00	

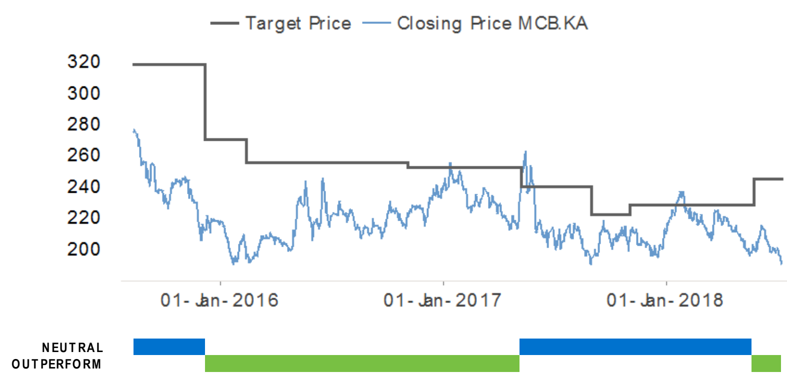
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for MCB Bank Limited (MCB.KA)

MCB.KA Date	Closing Price (PRs)	Target Price (PRs)	Rating
12-Aug-15	274.86	318.00	N
07-Dec-15	211.93	270.00	O
12-Feb-16	194.15	255.00	
03-Nov-16	222.87	252.00	
08-May-17	241.02	240.00	N
31-Aug-17	193.46	222.00	
02-Nov-17	205.95	228.00	
24-May-18	199.42	245.00	O

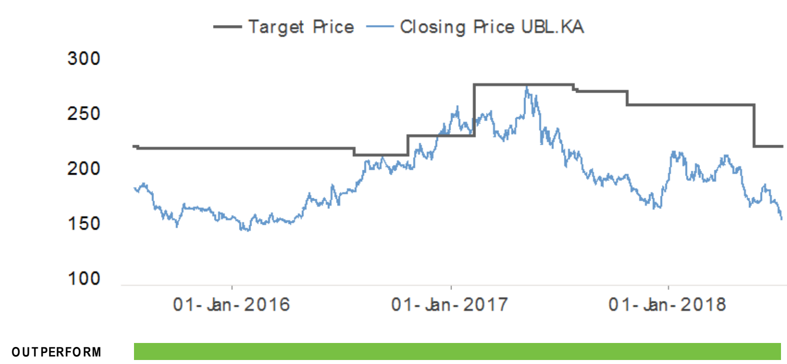
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for United Bank Limited (UBL.KA)

UBL.KA Date	Closing Price (PRs)	Target Price (PRs)	Rating
20-Jul-15	179.02	220.00	O
27-Jul-15	178.93	218.00	
22-Jul-16	179.53	212.00	
21-Oct-16	203.72	230.00	
09-Feb-17	241.37	276.00	
25-Jul-17	214.46	272.00	
01-Aug-17	211.89	270.00	
23-Oct-17	193.99	258.00	
24-May-18	171.27	220.00	

** Asterisk signifies initiation or assumption of coverage.*



As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.
Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.
Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and Asia stocks (excluding Japan and Australia), ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark (India - S&P BSE Sensex Index); prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned where an ETR is greater than or equal to 7.5%; Underperform where an ETR less than or equal to 5%. A Neutral may be assigned where the ETR is between -5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 18 May 2015, ETR ranges for Outperform and Underperform ratings did not overlap with Neutral thresholds between 15% and 7.5%, which was in operation from 7 July 2011.*

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Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.
Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.
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Rating	Versus universe (%)	Of which banking clients (%)
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Underperform/Sell*	13%	(51% banking clients)
Restricted	2%	

**For purposes of the NYSE and FINRA ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Engro Corporation Ltd (EGCH.KA)

Method: Our target price of PRs355 for Engro Corporation Limited is based on a sum-of-the-parts valuation of the company's subsidiaries and joint ventures, namely Engro Fertilizer, Engro Foods, Engro Polymer, Engro Energy, Engro Thar Coal and Engro Vopak using a 25% holding company discount. We have valued the core fertiliser business by using a discounted cash flow (DCF) valuation with projected cash flows for 11 years and a weighted average cost of capital of 9.4%. The valuation of Engro Foods and Engro Polymer is based on a 25% discount to its market price, while we have valued Engro Thar Coal using prescribed IPP agreement and guaranteed US$IRR of 20%. Moreover, the valuation of Engro Vopak and Engro Energy is on DDM with a cost of equity of 15.0%, 15.0% and 14.5%, respectively. Terminal growth is between 2% and 5% across various businesses. We have an OUTPERFORM rating on the company as we believe the company has a strong Balance Sheet and offers a diversified exposure to growth opportunities in Pakistan.

Risk: The major risks to our PRs355 target price and OUTPEFRFORM rating for Engro Corp include gas availability for the urea business, increase in gas prices, interest rates, capital allocation and operational issues with different businesses. Engro is also exposed to exchange rate risks via foreign currency loans, overseas investments and imports of raw material and finished goods for various business. There are also capital allocation risks relating to excess cash ~US$500mn available from recent divestments. Moreover, risk of failure in its new projects such as Thar coal would have a direct impact on the financial health of the company. Further, Engro's driving force has been its top management team and any transition issues for the new management could put the entire philosophy behind the company's expansion strategy in jeopardy.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Engro Fertilizers (ENGR.KA)

Method: We use a Discounted Cash Flow methodology to value Engro Fertilizer. Our forecasts are spread out till 2023E at which time we apply a terminal growth rate of 2%. We use an average WACC of 12.4% over our forecast years. Our TP works out to PRs84 implying a 2018E P/E of 10.0x. EFERT warrants an OUTPERFORM rating as it enjoys concessionary feed gas prices that allow it to enjoy better than peers margins in a tough pricing environment. Moreover the company is on a deleveraging path which should also help in growing dividends

Risk: Risks to our OUTPERFORM rating and TP of PRs84 for EFERT include higher rates of GIDC on feed and fuel gas which have to be absorbed by the company, sluggish urea offtake in the wake of poor agricultural growth, intense competition among manufacturers which leads to price undercutting and higher interest rates.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Lucky Cement Co Ltd (LUKC.KA)

Method: Our target price of PRs790 for Lucky Cement is based on a sum-of-total-parts (SOTP) methodology where we value the core domestic cements business using discounted cash flow (DCF) based on a cost of equity (Ke) of 14.5% and terminal growth of 3%. Moreover, we value the investment in the cement plant in Congo using DCF with a ke of 18.6% and terminal growth of 5%, 660 MW Coal IPP using DCF with cost-to-equity of 13% and investment in grinding facility in Iraq using DCF with Ke of 17% and terminal growth rate of 5%. Lucky's investment in ICI Pakistan limited is valued at market price less 30% portfolio discount broadly in line with market implied discount for other conglomerates. We rate Lucky OUTPERFORM due to robust growth outlook across its core cement business as well as investments in Congo, Iraq, ICI and new venture with Kia in the automobile sector.

Risk: The major risks to our OUTPERFORM rating and target price of PRs790 for Lucky Cement include: (1) a breakdown of the price arrangement between manufacturers; (2) volatility in international coal prices beyond estimates; (3) operational challenges in running the new cement plant in Congo and delays with the 660 MW coal IPP; (4) deterioration in the security situaiton in Iraq and Congo; and (5) a weakening of demand in domestic and export markets

Target Price and Rating
Valuation Methodology and Risks: (12 months) for MCB Bank Limited (MCB.KA)

Method: Our target price of PRs245 for MCB Bank is derived using the Gordon growth model. We have used an average BVPS for 2018E and 2019E and a target P/B multiple of 1.8x based on a sustainable ROE of 18%, COE of 14.1%, and growth internal equity of 7%. COE is based on an RFR of 8.0%, a market premium of 5.8% and beta of 1.05.. We have also applied a 15% premium to derived P/B mutliple due ot MCB's superior asset quality and loan underwriting. We rate MCB as OUTPERFORM as we believe it is best placed to benefit from a rising interest rate scenario due to a very liquid balance sheet and high CASA levels. Moreover, the bank has one of the most stringent lending policies resulting in low infection ratio as well as one of the best NPL recovery rates.

Risk: Potential risks to our target price of PRs245 and OUTPERFORM rating for MCB Bank include regulatory risks including changes in interest rates and/or minimum deposit rate on savings account, future international acquisitions, changes in top management including transition at the top once the influential Chairman plans to retire. Regulatory changes such as structure of interest rates and changes to minimum deposit rates could impact margins and earnings. Moreover, changes in the domestic economic environment could impact asset quality and overall business growth.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for United Bank Limited (UBL.KA)

Method: Our PRs220 target price for United Bank is derived using the Gordon growth model. We have used thae average 2018E and 2019E BVPS and a target P/B multiple of 1.6x based on a sustainable ROE of 17.5%, COE of 14.5% and growth internal equity of 9%. COE is based on an RFR of 8.2%, market premium of 5.8% and beta of 1.05. We rate UBL as OUTPERFORM due to its attractive valuations, strong balance sheet and strong growth momentum from 2019E.

Risk: Potential risks to our OUTPERFORM rating and target price of PRs220 for United Bank include: (1) asset quality deterioration in the bank's corporate and international loan portfolio which would impact earnings and potentially the bank's capital base and (2) political turmoil in the Middle East which could severely impact the international operations of the bank. Industry risks include changes in policy rate and/or the minimum statutory saving deposit rate than currently estimated.

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