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Index	Points	CYTD%
KSE-100	12,267.33	-1.3%

KSE Market Cap

PkR3,098bn (US$35.68bn)

CYTD KSE-100 High/Low
12,681.94 / 10,842.26

CYTD Avg. Daily Traded Value
PkR3,781.12mn (US$43.55mn)

Pakistan's economic recovery in our view is more of a factor of unleashing pent-up domestic demand and we believe that its economic fortunes in the near term will remain relatively un-levered to the global economic slowdown

Key Macro Estimates

(US$bn	FY11	FY12F	FY13F
GDP Growth (%)	2.40	3.60	4.50
Avg CPI (%)	13.9	12.1	12.0
Imports	40.4	41.5	43.0
Exports	25.17	26.5	28.0
Remittances	11.2	12.5	13.8
CA as % of GDP	0.2	(1.3)	(1.4)
Fiscal Bal as % of GDP	(6.6)	(5.8)	(5.5)

Source: AKD Research & SBP

Assessing the Balance of Payments Profile

Despite the positive signals generated by resumption of monetary easing, FY12 is shaping to be another challenging year for Pakistan. With greater than anticipated weakness in US and EU economic activity compounded by swelling domestic challenges, we downward revise Pakistan's FY12 GDP growth estimate to 3.50%-3.75% vs. the 4.2% estimated by the GoP. We also increase our FY12 Current Account deficit estimate to US$3bn up from US$1.5bn previously, as Pakistan faces the joint prospects of decelerating exports, a sticky import bill and slower external inflows. If it becomes entrenched, this trend would likely see foreign exchange reserves depletion over the near to medium term, and a potential return to IMF ala 2008. Unlike 2008 however, when high commodity prices eroded corporate profitability, we expect Pakistan's corporate earnings to remain relatively shielded this time around. This should lead to relative insulation for the KSE-100 Index, which is down 1.3%CYTD vs. a decline of 12.26%CYTD by MSCI Emerging Market Index. However, investors could potentially attach a higher risk premium to Pakistan equities (particularly Banks which have high GoP exposure) which may stall rerating impetus provided by monetary easing.

Pakistan & the Global Economy: In contrast to historical 'dislocation' arguments, the Pakistan Economy does appear to be correlated with global economic slowdowns, albeit with a lag. Although we do see incremental pressure on the Current Account and concede the persistence of structural deficiencies (e.g. chronic high fiscal deficit), we believe the Pakistan Economy stands on firmer ground relative to 2008. The Balance of Payments profile appears comfortable over FY12 even after IMF/Paris Club repayments commencing from Feb'12. Beyond the near-term however, failure to implement fiscal reforms (see our previous Economic Focus for details) remains the key risk to reserves buildup.

Trimming Estimates: Following Sindh floods (estimated cotton crop damage of 2.2mn bales), agriculture growth may again remain subdued while continued energy shortages are likely to constrain manufacturing potential. As a result, we revise our FY12 GDP growth estimate to 3.50%-3.75% from 4.10% previously. At the same time, with lower cotton prices likely to stall export performance and with Arab Light price upward sticky, we now expect the CA deficit to register at US$3bn in FY12, up from our previous estimate of US$1.5bn. We expect the FY12 trade deficit to register at US$15bn (exports: US$26.5bn, imports: US$41.5bn) and remittances to clock in at US$12.5bn. Despite improvement (1QFY12 tax collection up 24%YoY to PkR366bn) a single digit tax to GDP ratio leads us to retain a fiscal deficit of >5% of GDP.

Financing Gap & the KSE: We anticipate consistent reserves erosion over the near to medium term, which could potentially lead to a return to IMF ala 2008. That said, we believe there are clear differences between now and 2008 where the latter was defined by the commodity price boom that led to a spike in the cost of production, squeezed margins and a decline in corporate sector profitability. In this case, we see underlying corporate sector profitability and the KSE-100 Index remaining relatively shielded. However, investors could potentially attach a higher risk premium to Pakistan equities (particularly Banks which have high GoP exposure) which may stall rerating impetus provided by monetary easing.

Balance of Payments: Manageable, but only in the short run

While stock of foreign exchange reserves appears enough for the next year, medium term reserves erosion could see a return to IMF ala 2008.

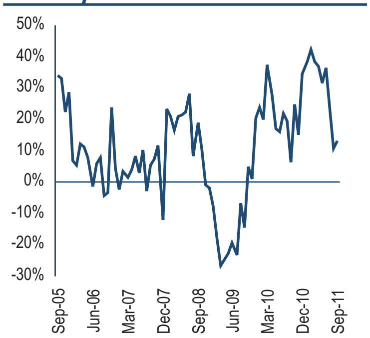
Pakistan's Balance of Payment profile has seen much improvement after the 2008 commodity crisis, but the recovery could be fleeting. In this regard, Pakistan's Current Account posted a surplus of US$437mn in FY11 (0.2% of GDP) due to 1) strong exports (high cotton prices) and robust remittances. As a result, foreign exchange reserves remained stable and the PkR depreciated by a contained 2% vs. the US$ in FY11. In the new fiscal year however, the 1QFY12 Current Account deficit at US$1.2bn is up 2xYoY, indicating clear risks to the Balance of Payments profile. Within the backdrop of continuing energy shortages and security challenges, Pakistan's exports have to contend with an environment of lower cotton prices while the import bill may remain upward sticky as Arab Light price is still above the FY11 average of US$93.3/bbl. Accordingly, we lower our FY12 export estimates to US$26.5bn, keep our import bill estimates unchanged at US$41.5bn and expand our trade deficit projections to US$15bn. This should translate into a Current Account deficit of US$2.5 bn in FY12, as remittances remain strong (we view Sep'11 remittances of US$890mn as a temporary blip). While our CA projections appear manageable, overall macroeconomic management remains challenging in view of 1) a chronic high fiscal deficit, 2) exit from the IMF SBA program and subsequent repayments, 3) continued decline in FDI and 4) ongoing Pakistan-USA tension/slowdown in aid. Considering global financial conditions remain weak (which effectively rules out prospects for privatization proceeds), foreign exchange reserves rundown going forward remains a realistic possibility. Based on the Purchasing Power Parity approach, we expect the exchange rate to depreciate to PkR91.5/US$ by FY12 end. A return to IMF in the near to medium term remains a tangible possibility.

We expect the PkR/US$ parity to depreciate to PkR91.5 by Jun'12. However, speculative pressure could rise as reserves run down.

Exports facing headwinds

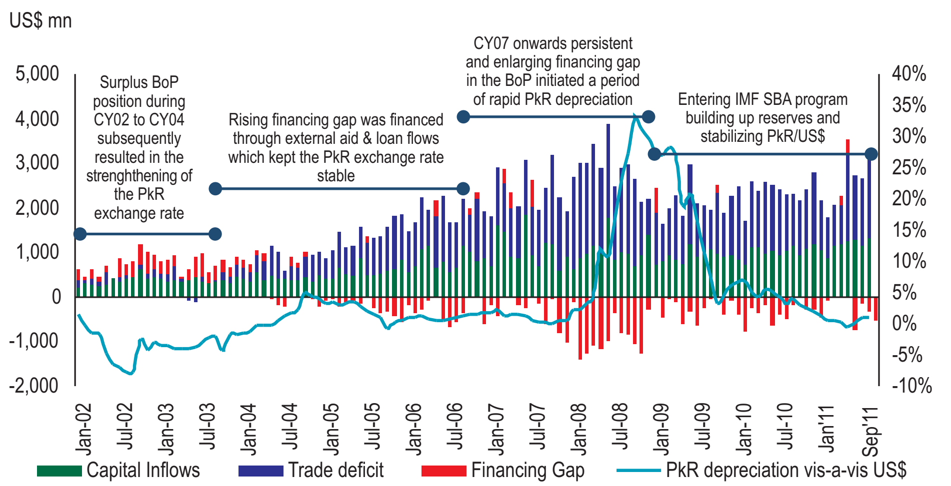
Pakistan's total exports registered at US$25bn in FY11, up 30%YoY, where textile exports contributed US$13bn (53% share). Robust textile exports were primarily due to higher cotton prices as volumes broadly remained flat. Even as internal challenges remain (deteriorating law & order, power shortages, Sindh floods), external factors now provide severe headwinds as well with risks emanating from potential double-dip recession/sharp growth slowdown in the US (16% share in exports) and EU (11% share in exports). Accordingly, we now expect overall FY12 exports to clock in at US$26.5bn, up a contained 5%YoY.

YoY Exports Growth



Source: SBP & AKD Research

Financing Gap expected to widen



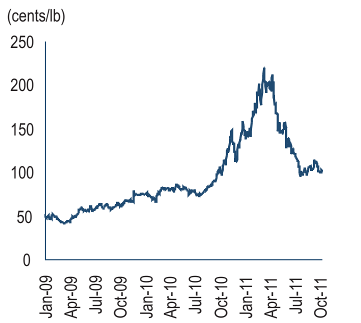
Source: SBP & AKD Research

1QFY12 YoY Textile Growth

Textile Group	**25.0%**
Raw Cotton	292.7%
Cotton Yarn	45.8%
Cotton Cloth	30.5%
Cotton Carded or Combed	62.2%
Yarn Other than Cotton Yarn	224.8%
Knitwear	8.0%
Bed Wear	14.6%
Towels	9.2%
Tents,Canvas & Tarpulin	42.8%
Readymade Garments	42.1%
Art,Silk & Synthetic Textile	49.7%
Madeup Articles(incl.Other Tex	22.1%
Other Textile Materials	-1.6%

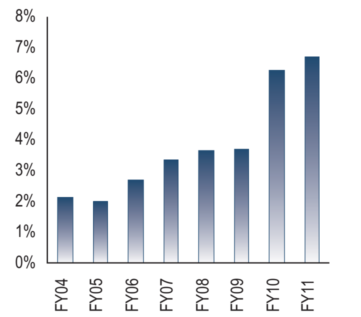
Source: SBP & AKD Research

Cotton Price Trend



Source: SBP & AKD Research

Share of China in Pak Exports



Source: SBP & AKD Research

Lower cotton price to impact textile exports: Although 1QFY12 textile exports rose by 25%YoY to US$3.4bn, full-year textile exports are expected to decline this year due to sharply lower cotton prices. While anticipated PkR depreciation should provide an opportunity to undercut global competitors, we expect FY12 textile exports to range between ~US$11.5bn-US$12.5bn. Below we have provided our textile export sensitivity to cotton prices based on regression of textile exports with cotton price. Our forecasting methodology is based on 1) assumed int'l cotton prices average of approximately US$1/lb in FY12F against an average of US$1.56/lb in FY11, domestic cotton production of 12.5mn bales (vs. 11.5mn bales last year) and an average US$/PkR exchange rate of 90. Selected textile players like NML (TP: PkR80.25/share; Buy) may still benefit considering 1) their focus on high value added products whose margins expand in times of lower cotton prices and 2) anticipated weaker PkR.

Pakistan Textile Export Sensitivity to Cotton Prices

Cotton Prices UScents/lb	225	200	175	150	125	100	75	50
Textile Exports	15,453	14,668	13,884	13,099	12,315	11,531	10,746	9,962

Source: SBP & AKD Research

External headwinds: Considering Pakistan's exports are primarily geared towards developed economies, a global economic slowdown stands to further stall export growth. In this regard, we have carried out an export sensitivity analysis in order to assess the impact of a decline in US consumption growth on Pakistan's exports and trade deficit. Our analysis shows that a 1.0% change in US consumption growth leads to a 0.6% change in Pakistan's export growth. The following table shows the estimates for export growth and trade deficit for three different U.S. consumption growth scenarios that will depend on how serious the U.S slowdown is .The correlation between US consumption and Pakistan exports is 0.58 and we believe the impact comes after a lag.

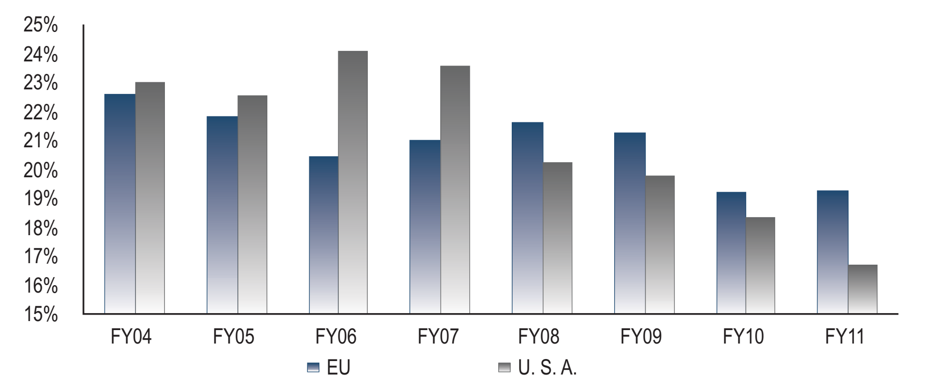
Pakistan Export Sensitivity to US Consumption (US$bn)

		fall in US consumption		
CORREL=0.6	FY12	1%	2%	3%
Export	26.50	26.34	26.18	26.02
Imports	41.50	41.50	41.50	41.50
Trade deficit	(15.00)	(15.16)	(15.32)	(15.48)

Source: SBP & AKD Research

From a broader perspective, Pakistan has managed to diversify its exports away from developed economies over the last five years. In this regard, exports to China now have a 7% share in Pakistan's exports, up from 3% five years ago. In our view, this illustrates Pakistan's focus on growing exports to markets within its immediate proximity - case in point is recent talk to grant MFN status to India. Most significant from Pakistan's

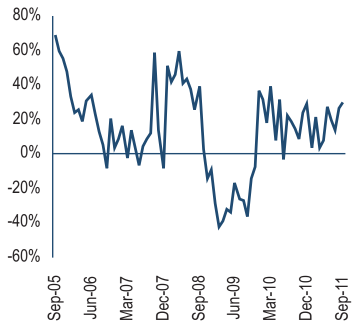
Pakistan has diversified its export destinations over last 5 yrs



Source: SBP & AKD Research

EU and US together account for 36% of Pakistan's exports, down from 46% of exports in FY04.

YoY Imports Growth



Source: SBP & AKD Research

Any dip in oil prices (Arab-light) should be a positive for Pakistan

perspective in potentially granting MFN status to India is India's recent decision to drop its objections at the WTO regarding EU's trade concessions to Pakistan. Recall that EU had earlier promised to reduce tariffs on 75 goods for 3 yrs but the move stalled after India raised objections at the WTO. That said, execution risks concerning MFN to India remain with potential resistance from the Opposition and some sections of the business community.

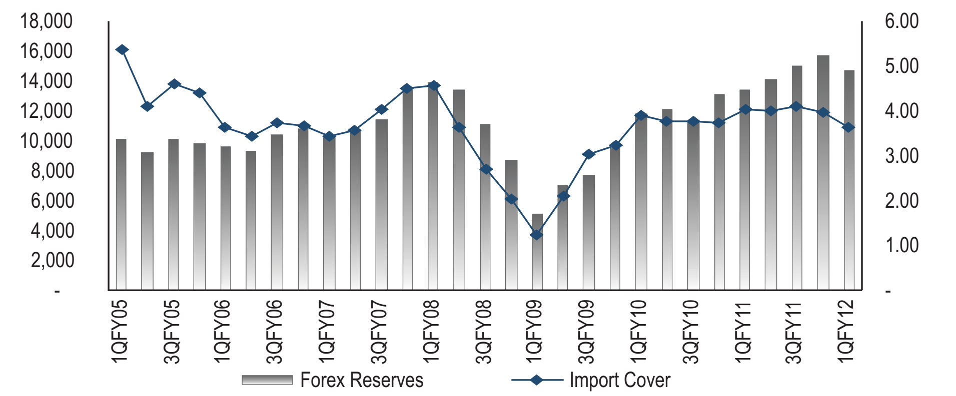
Pakistan's Exports Mix to Different Countries

Country	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
EU	23%	22%	20%	21%	22%	21%	19%	19%
U. S. A.	23%	23%	24%	24%	20%	20%	18%	17%
Afghanistan	3%	5%	5%	4%	6%	5%	6%	8%
U.A.E	9%	8%	8%	8%	9%	8%	8%	8%
China	2%	2%	3%	3%	4%	4%	6%	7%
U. K.	7%	7%	6%	6%	6%	5%	6%	5%
Bangladesh	1%	1%	1%	2%	2%	2%	2%	4%
Turkey	2%	2%	2%	2%	2%	2%	2%	3%
Hong Kong	5%	5%	5%	5%	4%	3%	3%	3%
Others	24%	25%	25%	26%	26%	29%	29%	27%

Imports appear stable despite weaker PkR

Pakistan's total imports registered at US$40bn in FY11, up17%YoY, due to increased oil import (35% share in total imports). We forecast the FY12 import bill to register at US$41.5bn,up 4%YoY as Arab Light price remains upward sticky. So far, 1QFY12 imports have totaled US$11bn, up 23%YoY, with oil imports registering at US$3.8bn. Other than the bellwether oil, machinery imports fell by 14%YoY to US$1.1bn in 1QFY12 which in itself is not an encouraging sign.

Import cover appears manageable for now...



Source: SBP & AKD Research

Imported Inflation: In general, oil prices have slipped back on the fears that the global economy may be heading for another recession. Lower oil prices would benefit oil-importing countries through downward pressure on imported inflation. Indeed, higher oil prices have been a key factor in inflation rising sharply in the region since the start of the year. While Arab Light price has remained upward sticky, even range-bound oil prices should lower headline inflation, giving room for further cuts in the Discount Rate. In this regard, following inflation rebasing to FY08, we expect CPI inflation to average 12.0% in FY12 vs. 13.7% in FY11. Accordingly, SBP has recently reduced the ben chmark Discount Rate by 200bps (cumulative FYTD) to 12%.

Oil Import Sensitivity: We have carried out a sensitivity analysis between the oil import bill and oil prices (a high correlation of 0.77). At our base-case estimate of Arab Light averaging US$100/bbl in FY12, the oil import bill will register at US$14bn. Further sensitivities are provided in the table on the next page.

Sensitivity analysis of oil price change on import bill

Corral 0.77		Sensitivity analysis of oil price change on import bill			
Oil prices US$/bbl	70	90	100	110	120
	-30%	-10%	0%	10%	20%
	-23%	-8%	0%	8%	15%
Oil Import Bill	10.76	12.92	14.00	15.08	16.16
base case =14 bn					Source: SBP & AKD Research

YoY Growth in Remittances

Source: SBP & AKD Research

Remittances on the up and up

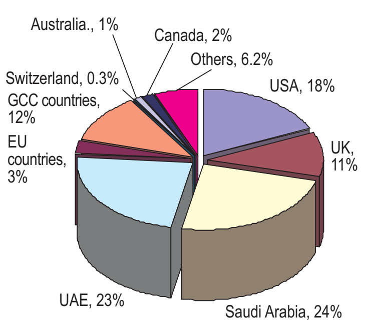
While both global and domestic macroeconomic indicators have depicted volatility over the last five years, the rapid growth in remittances (5yr CAGR: 20%) has been a consistent positive. Remittances have now become the second most important source of foreign exchange after textile exports (53% of the country's exports). The recent rise in remittances has coincided with the crackdown on illegal currency exchange and the commencement of the Pakistan Remittance Initiative. Considering that remittances have been resilient to global economic volatility, we do not foresee an imminent slowdown - 1QFY12 remittances are up 24%YoY.

Remittance/GDP ratio of 5.4% for Pakistan is lower relative to South East Asian average.

The World Bank has ranked Saudi Arabia in second place among the world's largest remittance-sending countries after US

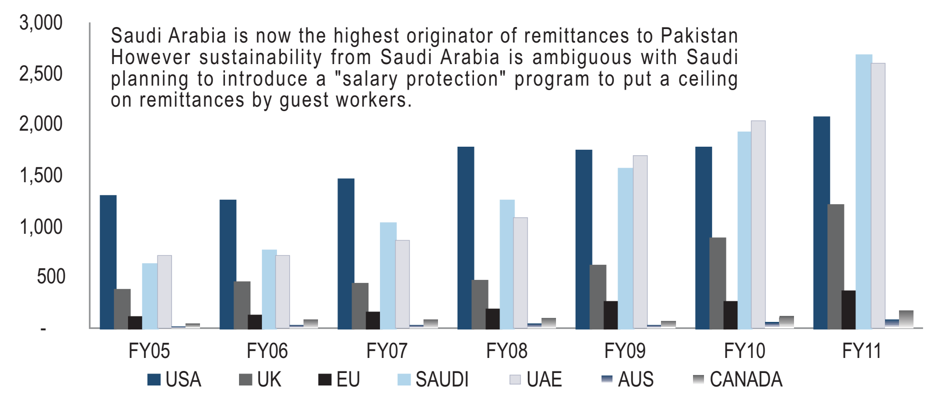
Sustainability of remittances: Being such a substantial source of foreign exchange, questions arise regarding the sustainability of remittances to Pakistan, particularly in the backdrop of a global economic slowdown. In our view, medium term sustainability of remittances depends on whether the rise in labor migration will continue and if the composition of the migrating workforce continues to tilt in favor of highly skilled workers. In this regard, with emerging immigrant destinations (Australia, New Zealand, South Africa) still contributing less than 5% of total remittances, the medium-term outlook for continued remittance growth appears strong. From a longer term perspective, we note that Pakistan's Remittances to GDP ratio is 5.4% vs. 12.3% for Philippines, 3.6% for India, 8.8% for Bangladesh and 8.0% for Sri Lanka. While we have factored in near-term deceleration in remittances growth, any lasting decline in remittances will likely affect the PkR exchange rate as remittances have been shielding the PkR from depreciation (strong correlation of 0.8 between remittances and the REER) which also raises the possibility of the Pakistan economy facing the Dutch disease.

Share of Remittances



Source: SBP & AKD Research

Country wise remittances origin...



Source: SBP & AKD Research

Financing Gap & the KSE

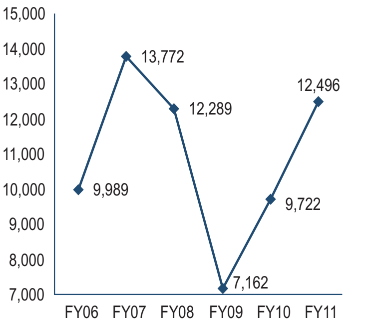
IMF SBA Repayment Schedule (US$bn)

CY12	CY13	CY14	CY15
2.5	4.0	2.2	0.5

Source: IMF & AKD Research

Considering IMF SBA repayments start from Feb'12 and prospects for alternative financing appear bleak (dip in US-Pak relations, stalled privatization program, postponed OGDC exchangeable bonds), we believe reserves' deterioration will be inevitable over the medium-term unless serious structural reforms are put in place. While we believe the stock of foreign exchange reserves will be enough for the next 1 year, the import

KSE-100 Index



Source: AKD Research

Corporate earnings should continue to depict growth,unlike 2008

cover could drop to less than 2 months by mid-CY13 (Pakistan approached the IMF in 2008 when its import cover dropped close to 1 month). Recall that a Balance of Payments crisis in late 2008 led to severe reserves erosion and the KSE-100 Index shedding 69% from its all time high of 15,676 points to its 2009 low of 4,815 points. That said, while a BoP crisis appears to be brewing over the near to medium term, we believe there are clear differences between now and 2008. Specifically, we note that the 2008 crisis was primarily caused by the commodity price boom that led to a spike in the cost of production, squeezed margins and a decline of 5%YoY in corporate sector profitability (based on the AKD Universe which accounts for 73% of the KSE-100's market capitalization). While we do see potential macroeconomic slippages going forward, both underlying corporate sector profitability and the KSE-100 Index should remain relatively shielded. However, investors could potentially attach a higher risk premium to Pakistan equities (particularly Banks which have high GoP exposure). This may stall rerating impetus provided by monetary easing.

AKD Universe Valuations Summary

October 28, 2011	2007A	2008A	2009A	2010A	2011A/F	2012F	2013F
EPS (PkR)	6.55	6.06	6.5	8.1	9.6	10.9	12.25
EPS chg (%)	1.86	(7.5)	6.8	25.1	19.0	13.3	12.1
Price to Earnings (x)	10.2	11.1	10.4	8.3	7.0	6.14	5.5
Price to Book (x)	2.2	2.2	1.9	1.7	1.5	1.3	1.2
Price to CF (x)	27.7	447.0	15.8	17.9	17.7	12.4	12.0
Earnings Yield (%)	9.8	9.0	9.6	12.1	14.4	16.3	18.3
Dividend Yield (%)	5.5	5.1	5.9	6.1	7.4	8.9	10.0
Book Value per Share (PkR)	29.89	31.1	34.7	39.6	45.5	51.3	57.0
Return on Equity (%)	21.9	19.5	18.7	20.4	21.2	21.3	21.5
Return on Assets (%)	4.1	3.4	3.2	3.7	3.9	3.9	4.0
Chg in Sales (%)	28.2	28.1	18.9	14.9	14.7	11.0	10.0
Gross Margin (%)	35.1	33.8	31.0	32.0	31.8	31.9	32.7
Operating Margin (%)	26.1	23.7	20.9	22.2	22.2	22.2	22.8
Net Margin (%)	14.8	10.7	9.6	10.5	10.9	11.1	11.3
Payout (%)	56.8	56.0	61.4	50.7	51.9	54.4	54.7
EV / EBITDA (x)	8.0	7.3	7.1	5.4	4.8	4.2	3.8
Price to sales (x)	1.5	1.19	1.0	0.9	0.8	0.7	0.6

Source: AKD Research

Economic Snapshot

End Month Data	Units	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11
T-bill														
3M	%	12.62	12.80	12.78	13.16	13.47	13.48	13.29	13.25	13.11	13.45	13.50	13.04	13.04
6M	%	12.76	13.08	13.15	13.39	13.56	13.67	13.63	13.63	13.50	13.71	13.75	13.26	13.23
12M	%	12.79	13.22	13.27	13.69	13.87	13.84	13.81	13.83	13.80	13.89	13.91	13.35	13.33
Discount rate	%	13.5	13.5	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	13.5	13.5	12.0
Inflation														
Headline inflation	%	15.7	15.3	15.5	15.5	14.2	12.9	13.2	13.0	13.2	13.1	13.8	11.6	10.5
Core inflation	%	9.4	9.3	9.5	9.5	9.4	9.2	9.5	9.4	10.2	10.4	10.7	10.1	10.6
Food inflation	%	21.2	20.0	20.5	20.4	20.4	17.7	18.0	17.2	15.9	15.7	17.6	13.2	9.7
External Indicators														
Export (SBP)	US$ (mn)	1,776	1,849	1,938	2,078	2,043	2,282	2,508	2,590	2,268	2,643	2,121	2,128	1,892
Import (SBP)	US$ (mn)	2,381	2,615	2,807	3,191	2,796	3,065	3,298	2,906	3,370	3,447	3,171	3,626	3,381
Trade Deficit (SBP)	US$ (mn)	(606)	(765)	(869)	(1,114)	(752)	(783)	(790)	(317)	(1,102)	(804)	(1,049)	(1,498)	(1,489)
Home Remittances	US$ (mn)	922	855	927	863	827	845	1,053	1,030	1,050	1,105	1,096	1,310	890
Banking Sector														
Deposits	PkR (bn)	4,717	4,733	4,824	5,124	5,047	5,051	5,084	5,160	5,294	5,599	5,344	5,365	5,418
Advances	PkR (bn)	3,270	3,338	3,385	3,494	3,485	3,508	3,477	3,388	3,457	3,505	3,418	3,412	3,415
Investments	PkR (bn)	1,820	1,870	1,917	2,102	2,100	2,126	2,202	2,243	2,361	2,548	2,593	2,657	2,764
Weighted avg lending rate	%	13.34	13.32	13.42	13.52	13.62	13.55	13.55	13.55	13.65	13.78	13.76	13.65	n.a.
Weighted avg deposit rate	%	5.77	5.83	5.88	5.91	6.02	6.04	5.97	6.03	6.00	5.92	5.88	6.06	n.a.
Spread	%	7.57	7.49	7.54	7.61	7.60	7.51	7.58	7.52	7.65	7.86	7.88	7.59	n.a.
Public Finance														
Revenue collection	PkR (mn)	116,407	103,547	103,032	161,580	108,413	105,910	144,172	129,686	159,623	248,556	112,275	n.a.	n.a.
Direct taxes	PkR (mn)	51,610	34,218	32,668	78,273	36,860	37,206	66,674	49,635	46,995	124,204	28,996	n.a.	n.a.
Indirect Taxes	PkR (mn)	64,797	69,329	70,364	83,307	71,553	68,704	77,498	80,051	112,628	124,352	83,309	n.a.	n.a.
Currency														
Reserves	US$ (mn)	16,984	16,914	16,744	17,213	17,354	17,505	17,601	17,045	17,069	18,244	18,295	18,066	17,346
USDPkR - Interbank	PkRUSD	85.88	86.01	85.59	85.81	85.72	85.40	85.38	84.71	85.20	85.88	86.05	86.53	87.56

Analyst Certification

We, Anum Dhedhi and Raza Jafri, CFA individually and jointly, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is/or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. We further certify that we do not have any beneficial holding of the specific securities that we have recommendations on in this report.

Rating Definitions

Buy	≥ 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	≤ 5% to ≥ -5% potential
Reduce	≤ -5% to > -20% downside potential
Sell	< -20% downside potential