

Pakistan Economy Remains Resilient Amid Crisis

Despite being at a political crossroads, strong fundamentals keep the economy buoyant

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Article by Dinar Standard

Media coverage of Pakistan has been dominated by its political crisis and the now unfortunately regular spate of suicide attacks including the assassination of the prominent opposition leader Benazir Bhutto.

It would then seemingly defy conventional wisdom that two leading Silicon Valley venture capital firms, ePlanet Ventures and Draper Fisher Jurvetson (DFJ) - funds that helped create companies like Hotmail, Skype and Baidu - would recently invest in a Pakistani Internet company - Naseeb Networks.



Or it would seem unlikely that a new \$158 million private-equity fund, by the JS Group, would close on Dec 31st 2007 to invest solely in Pakistan.

Or that in a year (2007) when the country experienced the highest levels of political turmoil and security breaches, its largest stock exchange, the KSE with 670 companies listed would be up an impressive 40% and that the average dividend yield of its stocks would be 6%.

Undoubtedly, for such investor confidence, the fundamental attractiveness of an economy has to be solid while the impact of any crisis limited. In Pakistan not only does this seem to be true but its potential remains severely untapped -- offering tremendous opportunities to both domestic and foreign businesses.

Domestic demand driving economy

With a large and growing population of 160 million, its real GDP (Gross Domestic Product) has grown at over 7.0% for the last 4 years and is expected to be at 7.2% for 2008. Meanwhile the most recognized indicator of a nation's prosperity – its GDP per capita, is expected to cross US\$1,000 this year – and US\$2,000 by 2014, according to local financial services firm BMA Capital. Similarly, middle class incomes are rapidly growing and consumer spending consequently growing above 10% CAGR for last 3 years.



Image: Emaar Pakistan

Key Economic Indicators		
Year	FY07	FY08
GDP Growth	7.0%	7.2%
GDP (US\$ bill)	145	167
GDP/Capita (US\$)	925	1,043
FDI (US\$ bill)	5.1	4.0
Inflation	7.7%	8.6%

Source: BMA Research

At the same time, a Feb 2008 report by the World Bank points out that Pakistan suffers from a dearth of infrastructure in the water, irrigation, power, and transport sectors. With its water infrastructure in poor condition, the report argues that Pakistan has to invest around US\$1 billion per year in reservoirs and related infrastructure over the next five years. In the energy sector, the country will face severe power shortages of around 6,000 megawatts by 2010. Similarly, inefficiencies in the transport sector cost the economy between 4-5 percent of GDP each year. To overcome these constraints, Pakistan has tripled its annual infrastructure investment from an average of US\$2.5 billion to US\$7.3 billion, but increased involvement of the private sector will be needed to meet the gaps.

BMA Capital is amongst the leading financial groups in Pakistan and was the advisor to Etisalat (the UAE based Telecommunication company) on their successful acquisition of a 26% strategic stake in Pakistan Telecommunications Company Limited (PTCL) for US\$2.6 billion, the largest M&A transaction and foreign direct investment in Pakistan's history. In BMA's 2008 outlook for Pakistan, it highlights the key economic drivers as the role of domestic demand, relative insulation from a US recession, insensitivity to domestic politics, tight monetary policy and high oil and commodity prices. The firm projects earnings growth of Pakistan's publicly listed companies in FY08 at 12.2% and FY09 at 18.0% and projects that the FY09 P/E ratios will move up from the current 9.7x to the historical average of 11.4x.

Recent Foreign Direct Investments '07-'08	
Transaction	Value
Khalifa Refinery Project - IPIC	US\$ 5 bn
Hutchison Port - Gwadar Port Terminal	US\$ 1 bn
SingTel- Warid	US\$ 785 mn
UBL GDR	US\$ 650 mn
Oman Telecom - Worldcall (65%)	US\$ 202 mn
Nomura/Bank Muscat Consortium Saudi Pak Bank (60%)	US\$ 200 mn

Source: BMA Research

BMA is certainly benefiting from its own advice. Speaking to DinarStandard, Mr. Shehryar Ahmed, Senior Vice President & Head of Marketing and Investor Relations at BMA Capital Management commented that, "In 2007, BMA's Pakistan Opportunities Fund, the country's first and only offshore country fund generated 28.5% in the midst of assassinations and emergencies. I think this is illustrative of the opportunity that Pakistan offers and the international investor is willing to look behind the headlines. Even in an unstable political terrain, Pakistan has posed a great investment opportunity."

Speaking on the current economic environment he further added, "Government spend has increased substantially on infrastructure and other development areas

over the last few years and that trend is expected to continue, given the large projects already in implementation and in the pipeline. In 2008, now that elections are behind us, and a new government is to be formed, we are optimistic of the country's growing economic prospects."

Local Entrepreneurs Bullish

Given that the elections were conducted harmoniously and no apparent political upheavals appear in sight, the major players in the local market are hoping for a further boost in the economy.

Naseeb Networks is a leading provider of a portfolio of websites including ROZEE.PK and Naseeb.com. ROZEE.PK is Pakistan's largest and fastest growing job website delivering over 1.4 million applications to jobs posted by 8,800 employers that include Mobilink, Nestle, Oracle, McDonalds, United Bank Limited, Microsoft, GlaxoSmithKline, Engro Foods, Proctor & Gamble and others.



Its CEO and Founder Mr. Monis Rehman, is looking forward to aggressively expanding its Pakistani presence given the recent cash infusion from its Silicon Valley investors. Speaking to DinarStandard he said, "Investments continue to happen because the fundamentals are strong. Pakistan has a population of 160 million consumers. 70 million of them now have mobile phones. Over \$1 Billion has been invested in broadband and WiMAX infrastructure. While there is a lot to be concerned about, there is also a lot to look forward to."

Commenting on the viability of its new media venture in Pakistan, he said, "Pakistan has a rapidly growing 7.5% internet penetration rate compared to India's 4.5%. None of the top 10 sites viewed from within Pakistan are local, which suggests a huge opportunity for creating local content. Online advertising is also at its infancy and with the current market dynamics, is poised for strong growth."

Similarly, major players in the telecommunications league think no different. Zuhair Khaliq, CEO of Mobilink, the subsidiary of Egypt-based Orascom, when asked to comment on the company's future plans in Pakistan said "We are envisaging sustainable growth in Pakistan. With mobile penetration still at around 43%, the room for growth is immense. The growth is not only limited to mobile telephony, as there are huge opportunities in other fields like broadband (optic fiber, DSL, WiMax), LDI etc. This coupled with the enabling environment being provided by the Pakistan Telecommunications Authority ensures an excellent future for this sector."

Meanwhile, the outlook for banking which serves as the back bone to an economy also seem bright for 2008, as the Central Bank Governor Dr. Shamsad Akhtar announced the country's "extraordinary growth" of financial sector assets which grew to \$180 billion or 125% of the Gross Domestic Product (GDP) in 2007. Fitch Ratings also recently reported that the Pakistani banking system, over the last decade, has gradually evolved into an active private sector driven system with

the private sector controlling nearly 80 percent of the system assets, as opposed to the early 1990s when 90 percent of the system assets were controlled by the government.

Another growth driver is the growth in Islamic Finance. In Pakistan there are currently six dedicated Islamic Banks with a total of 186 branches along with 102 standalone Islamic Banking branches of conventional banks. According to Meezan Bank, the first IF bank in Pakistan, their total deposit base is over US \$1.98 billion while the overall Islamic banking assets are worth \$2.83 billion.

'Easier to do Business' than in China and India?

The World Bank annually releases an Ease of Doing Business ranking which provides objective measures of business regulations and their enforcement across 178 countries. Its 2008 report showed Pakistan's ranking (#76) as better than the emerging markets of China (#83) and India (#120). It was also identified as one of the leading reformers during 2005-08 and within OIC member countries was only behind Egypt in terms of the number of new business friendly reforms.

An example of such a business reform noted by the project is that customs clearance at the Karachi international container terminal has dropped from 10 days in 2004 to 4 hours in 2007.

Indeed, a variety of business friendly measures during the past few years and relative political stability have played a positive role in investor confidence. It's certainly hoped that the new political structure can only improve upon these measures and resolve the many issues remaining to be addressed.

Opportunities to Invest

The recently created JS Private Equity Fund sees opportunities in both export-related industries such as textiles, leather and medical supplies, as well as domestic-demand related industries such as consumer goods, media and advertising. Speaking to MarketWatch recently, Steve Smith, JS Funds Managing Director, further identified opportunities in inefficiencies within infrastructure, transportation and logistics, as well as agriculture and horticulture.

The JS Private Equity Fund has already made two investments. The first is for a controlling stake in Optimus, the Hertz franchise in Pakistan, which specializes in long-term vehicle contract-leasing to businesses. The second is a minority investment in Engro Asahi Polymer & Chemicals, the only Pakistani producer of PVC resin.

Meanwhile, BMA Capital sees the biggest investment opportunities in energy & power, refinery, gas distribution, fertilizer, autos, banks, cement, fmcg (fast moving consumer good), telecom, and textile sectors.

Overall, the horizon for prosperity and growth seems lustrous for Pakistan. The general sentiment is undimmed and is driving the masses to believe that change for a better economy and a better future is within their sight. Despite being considered a politically unstable terrain, Pakistan as an economy still has a lot to offer and is rightfully called by Mark Matthews of Merrill Lynch as "the greatest information-arbitrage opportunity in the world."