

Pakistan Strategy

PAK MSCI EM Stocks at Risk of Exclusion

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MSCI to Announce Semi-Annual Review on Nov 13

- Based on our working on Morgan Stanley Capital International's (MSCI) existing market cap requirement, none of the existing five companies of Pakistan (HBL, OGDC, MCB, UBL & LUCK) that are part of standard MSCI EM index (Large & Mid cap) meet the Free Float requirement as per yesterday's closing. Among five companies, HBL & OGDC barely meet the criteria while MCB, UBL & LUCK fall far behind in meeting the requirement. To note, Pakistan's current weight in MSCI EM index is estimated at 0.06%.
- MSCI is going to announce its Semi-Annual Index Review on Nov 13, 2018 (effective from Dec 3, 2018), which will be based on its framework for a country under three set rules 1) Economic Development, 2) Size and Liquidity Requirements and 3) Market Accessibility Criteria, as per our understanding. The price cut-off for the upcoming index review will be any one of the last 10 business days of October 2018.
- For a country to be in MSCI Emerging Market (EM) index, at least three of its companies have to meet aforesaid benchmarks. While two criteria (Economic Development & Market Accessibility) are subjective, Size & Liquidity requirement for a company can be gauged through 1) Free Float, 2) Full Mkt Cap and 3) 15% Annualized Traded Value Ratio (ATVR) and the company has to meet all three quantitative criteria (Free Float, Full Mkt Cap and ATVR) to be part of standard MSCI EM index.
- MSCI's current threshold for Free Float and Full Mkt Cap. requirement is US\$797MN and US\$1594mn, respectively. However, the market cap requirement is reviewed semi-annually and we believe that the upcoming review will be based on revised market capitalization.

Emerging Markets Down 15% in 2018YTD

- However, it is unlikely that Pakistan will be removed from MSCI EM in the upcoming Semi-Annual review as a country's status is usually reviewed on annual basis. Our correspondence with MSCI representatives suggest that if at least 3 companies of a country (belonging to MSCI EM) do not meet the set MSCI rules, the country's status will be reviewed in the next annual MSCI review (May-Jun 2019) after which, investors will be allowed a year or so to adjust to the new rule.
- To note, in 2018YTD, the KSE-100 index lost market capitalization of ~US\$19bn (down 1,674pts or 4.1%) on the back of pressure on external account front while Dollar against PKR appreciated 21% in 2018YTD.
- We highlight here that there had been across the board selling in emerging markets lately due to shift in geopolitical balance (US-China trade war and Turkey spat with USA to name a few) where emerging market currencies also lost ground against dollar.
- In last year (in its semi-annual review in Nov 2017) when MSCI demoted ENGRO from its standard MSCI EM to small caps, the said exclusion was based on upward revision of its market cap requirement. To note, emerging markets in Jan-Oct 2017 were up 29% while market capitalization criteria was revised up by 16%.

Pak Weight in MSCI EM Might Fall; Current 0.06%

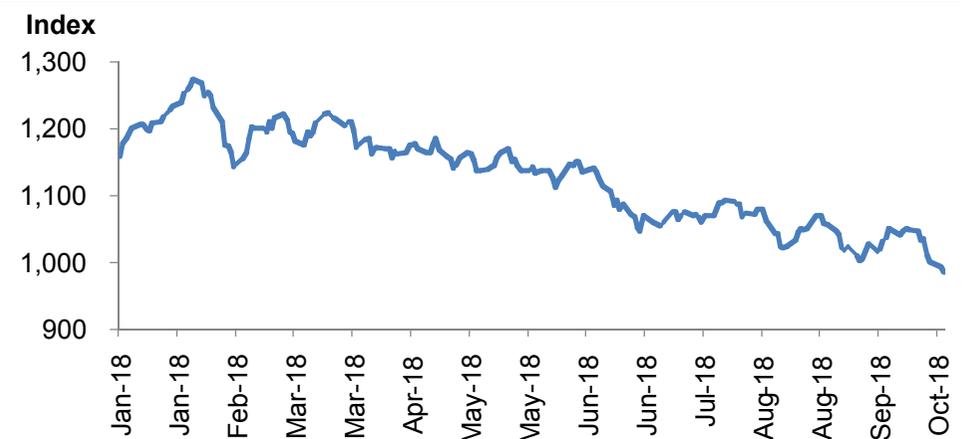
- Since emerging markets are under pressure (down 15% in 2018YTD), there is a likelihood that MSCI may revise down its market cap requirement. If Free Float requirement is revised down by around 15% there is a chance that HBL, OGDC and MCB may hold the ground in MSCI EM index. In case LUCK and UBL are removed from the MSCI EM Index, potential outflow is estimated at US\$54-71mn.

Pakistan Constituents in MSCI EM Index

Symbol	FF Mkt. Cap (US\$mn)	Est. Weight in MSCI EM	Est. Outflow (US\$mn)
HBL	755	0.02%	41-55
OGDC	734	0.01%	40-54
MCB	604	0.01%	33-44
UBL	519	0.01%	29-38
LUCK	451	0.01%	25-33
Pak's Est. Weight in MSCI EM		0.06%	

Source: PSX, MSCI, Topline Research

MSCI EM Index Return 2018YTD



Source: Company Accounts, PSX, Topline Research

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