

DIRECTORS' REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2021

The Board of Directors of MCB-Arif Habib Savings and Investments Limited (MCBAH) are pleased to present Report on the affairs of MCBAH for the quarter ended September 30, 2021.

PRINCIPAL BUSINESS

The Company is a Non-Banking Finance Company, licensed as an Asset Management Company, Investment Advisor and Pension Fund Manager under the Securities and Exchange Commission of Pakistan's regulatory regime.

THE BUSINESS ENVIRONMENT

Economy and Money Market Review

The fiscal year started on a robust note as Covid-19 vaccination drive gathered paced which helped to lift lockdowns across the country. The economic recovery was higher than expected as lagged impact of monetary easing, higher remittances and government incentives such as TERF facilities provided impetus to economic growth. The GDP growth clocked at 3.94% in FY21 with government expecting the economic growth to clock at 4.8% for FY22.

However, the robust recovery in domestic demand, coupled with higher international commodity prices, led to a strong pick-up in imports and a rise in the current account deficit. This put pressure on the local currency as rupee depreciated by 13.1% against USD during this quarter.

Current account deficit posted a deficit of USD 2,290 million in the first two months of fiscal year compared to a surplus of USD 838 million in the corresponding period of the last year. The deterioration came in primarily on the back of higher imports which grew by 67.8% in the first two months compared to export growth of 35.4%. Trade Deficit increased by 100.2% to USD 6.8bn compared to USD 3.4bn last year. Foreign exchange reserves of central bank saw an increase of USD 1.6bn as Pakistan received USD 2.75 billion from the IMF under its new SDR allocation to back economically vulnerable countries combating the coronavirus pandemic.

Inflation remained a concern for the government as rising commodities continued to create challenges for policy makers. Headline inflation represented by CPI averaged 8.58% during the quarter, with food inflation averaging 9.5% during the period. Inflation was also effected by increase in fuel prices on account of increase in international oil and LNG prices. Nevertheless, core inflation as measured by Non Food Non Energy was still controlled and averaged 6.5% for the period. The MPC committee conducted two monetary policies during the quarter and increased policy rate by 25bps in the Sep-21 meeting. SBP increased the interest rate to control the current account deficit and prevent the overheating of the economy as it noted the need to gradually increase the interest rates to protect the nascent economic growth.

On the fiscal side FBR Tax collection increased by 38% over last year in this quarter to clock at PKR 1,395bn compared to target of PKR 1,211 exceeding it by PKR 186bn. This was on the back of higher custom duty and sales tax due to higher import.

Secondary markets yields have increased significantly in the quarter as SBP has started the monetary tightening cycle. The recent depreciation in rupee along with persistently high commodity prices will add

pressure to inflation and we expect average FY22 inflation to clock above the range of 7-9% forecasted by SBP. 3Y, 5Y and 10Y bonds saw a rise of 73 bps, 46 bps and 51 bps respectively during the period.

Equity Market Review

The KSE-100 index closed the first quarter down by 5.2% compared to a positive return of 17.9% same period last year. Weakness in macroeconomic indicators, uncertainty over Pak-Afghan relations post US exit from Afghanistan, and MSCI's decision to downgrade Pakistan from Emerging Market to Frontier Market all weighted heavily on the index. Foreigners continued to offload as they sold stocks worth of near USD 83 million, while on the local front Individuals and Banks added about USD 33/21 million respectively to their positions. During the quarter, average trading volumes saw a decline to 412 million shares compared to about 669 million shares during the preceding quarter. Similarly, average trading value during the quarter saw a drop of 35% over last quarter to near USD 85 million.

Cements, Oil & Gas Exploration companies, Refinery, Oil & Gas Marketing companies, & Fertilizer sectors were the major contributors to index decline posting negative returns of 20.2%/6.2%/35.4%/10.8/2.2%, respectively. In the cement sector, unprecedented surge in international coal prices amid price control measures by GoP created a weak near-term earnings outlook for the sector leading to selling pressure. Moreover, decline in E&Ps and OMCs were largely on the account of continuous accumulation of circular debt. In the case of Refineries, delay in approval of refinery policy dragged the entire sector performance.

Economy & Market – Future Outlook

The government has set a GDP growth target of 4.8% for fiscal year 2022 (FY22). Covid-19 vaccination drive is continuing with success as over 50 million people have received the first dose of coronavirus vaccine. This has helped to lift lockdown across the country and we expect the Covid-19 situation to remain under control. Broader economy also appears to be operating close to pre-covid levels gauged by LSM growth, cement sales, auto sales, etc. However, the recent surge in commodity prices poses challenges to both to Fiscal and External Accounts. Due to the recent government steps to curtail demand we see some downside risks to government growth target. We expect GDP growth to clock higher as compared to previous year but it is likely to remain lower than the government target of 4.8%.

The robust recovery in domestic demand on the back of pro-growth measures by the government, coupled with higher international commodity prices, has led to a strong pick-up in imports and a rise in the current account deficit. The current account deficit is expected to increase to USD 13.1 billion (4.0% of GDP) in FY22, amid rising international crude oil prices along with general increase in international commodity prices. The Current Account deficit is likely to further weaken the local currency and we expect the exchange rate to close the year around 176 PKR/USD. Swift resumption of IMF program will be a key prerequisite to keep the financial account in positive zone. SBP has indicated that the flexible market determined exchange rate and gradual tightening of interest rates would be used in tandem to ensure sustainable current account position. The remittances along with bilateral and multilateral flows would also be crucial in managing our external position.

CPI averaged 8.9% in FY21. The expected utility adjustments, currency depreciation and higher international commodities prices will lead to increase in inflation in this year. We expect Average FY22 inflation to clock at 9.7% with inflation going in double digits in second half of the fiscal year. Based on our expected inflation, the real interest rates now fall into negative range thus requiring adjustments in the monetary policy during the current fiscal year. However, SBP has shown its focus to avoid any shocks to economic growth and will gradually increase interest rate to achieve mildly positive interest rate over the medium term. We expect the Policy Rate to reach 9.0% by the end of the year.

From capital market perspective, particularly equities, the recent correction in stock prices have opened up valuation. The market has priced in expected interest rate increase and currency depreciation. Market cap to GDP ratio has declined to 15.9%, a discount of 43% from its historical average. Similarly, risk premiums are close to 5.9%, compared to historical average of 1.5% signifying abnormal returns for long term investors. We believe a micro view of sectors and stock will remain important and investment selection should focus on companies which trade at a deep discount to their intrinsic value. Similarly, focus should also revert back to companies that are expected to exhibit stellar earnings growth over the medium term.

For debt holders, we expect Money Market Funds to continue to seamlessly mirror policy rates throughout the year. On the other hand, government bonds yields may continue to rise given expected increase in interest rates. We remain cautious at the current levels of bond yields and would continue to monitor the data points to capitalize on opportunities.

Mutual Fund Industry Review

The Net Assets of the open end mutual fund industry increased by about 1.4% during the quarter to PKR 1,032bn at the end of 1QFY22. Total money market funds grew by about 1.1% since June 2021. Within the money market sphere, the conventional funds dominated as they grew by about 8.1% to PKR 308bn while Islamic funds declined by 9.9% to PKR 164bn. In addition, the total fixed Income funds increased by about 8.5% since June 2021, as the conventional income funds grew by 13.6% to PKR 143bn. Equity and related funds declined by 4.4% over last quarter as market witnessed a decline in the quarter eroding AUMS and concern over macroeconomic and geopolitical factors kept investors at bay.

In terms of the segment share, Money Market funds were the leader with a share of around 46%, followed by Equity and Equity related funds with a share of 28% and Income funds having a share of 26% as at the end of 1QFY22.

Mutual Fund Industry Outlook

The recent increase in interest rates along with prospect of further monetary tightening would increase flows in the money market funds. The money markets funds by virtue of its short duration would be the ideal for investors with a short term horizon and low risk profile. However recent correction in stock prices have opened up valuations and long term investors would look to add equity exposure at these attractive levels. Our operations remained seamless and given our competitive edge due to aggressive investment in digital access and online customer experience, the environment provides an opportunity with growing number of investors available online.

COMPANY'S PERFORMANCE REVIEW

Like FY 2020-2021 the first quarter of 2021-2022 also started with success. In comparison with the corresponding period, the Company witnessed significant growth and AUMs under its management increased by Rs. 43 billion to Rs. 163 billion compared to AUMs of Rs. 120 billion at September 30, 2020. The increased AUMs resulted positively and the Company earned Rs. 237.5 million as compared to Rs. 174.2 million in the corresponding period.

During the first quarter KSE 100 showed negative return of over 5% compared to over 17% gains in the corresponding period. The negative returns of PSX resulted in Company earning loss of Rs. 18.9 million compared to gain of Rs. 74 million for the same period. However, due to higher management fee, the Company earned profit after taxation of Rs. 65.02 million (EPS: Re. 0.90) compared to Rs. 114.1 (EPS: Rs. 1.58) million in the corresponding period.

ACKNOWLEDGEMENT

The Directors would like to express their deep appreciation to our shareholders who have consistently demonstrated their confidence in the Company. We would also like to place on record our sincere appreciation for the commitment, dedication and innovative thinking put in by each individual of the Company and are confident that they will continue to do so in the future.

For and on behalf of Board

Muhammad Saqib Saleem
Chief Executive Officer
Karachi: October 22, 2021.

Nasim Beg
Director and Vice Chairman