

An interview with Adnan Afridi, Managing Director, National Investment Trust

'SBP must connect expat investors with local mutual funds'

Adnan Afridi has more than two decades of international experience in change management, business transformation, innovation and profitability enhancement in blue chip companies, public sector and start-up situations. His career in financial services and capital markets includes serving as Managing Director of the Karachi Stock Exchange (now Pakistan Stock Exchange); CEO of the Overseas Chamber of Commerce and Industry; Chairman National Clearing Corporation of Pakistan, and member Board of Directors of Central Depository Company (CDC). Currently, Afridi, who has a degree in Economics from Harvard University and a degree in Corporate Law from Harvard Law School, is also a Member of the SECP Policy Board.

In this interview, BR Research picks his brains on the current stock market situation and its outlook and his view on key economic indicators. We also discuss some of the factors that are limiting Pakistan's mutual fund industry from realizing its potential and his strategic plans for NIT.



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BR Research: Let's start talking about the equities market. Do you think it has bottomed out?

Adnan Afridi: It is difficult to predict the exact bottom. But I will say that the market is offering very attractive returns, even though the sentiments aren't yet capturing that. As a result, equity prices that you are seeing today, in many cases, don't reflect fundamental value.

Equity markets in Pakistan have enjoyed a very long bull-run starting from 2001 to 2002. Even after the 2005 and 2008 crises the market bounced back pretty quickly and reached new heights, concluding around mid-2017. Now it's in its third year of bear run. So, we have had a very long bull cycle and people are now complaining about the long bear cycle because they are not used to it, especially in a thinly traded market like today. Back in 2007 the traded value would often exceed \$1 billion, and the average traded for the year would be \$500 million, which would put us at par with Singapore and Hong Kong. Today, the daily value traded is as little as \$10 million. And sentiments have a big role in a shallow market, which Pakistan is whether you look at it in free-float terms or in terms of daily value traded. Negative sentiments in a shallow market mean that the market under reacts to positive news and overreacts to negative news.

BRR: How attractive are those attractive returns?

Adnan Afridi: It would not be prudent for me to be pitching specific stocks, but there are at least 20 stocks that are trading at less than half of their book value, some even at one-third of their book value. Forget about replacement value, because dollar is much higher. If you were to go and buy an entire company of steel or cement sector, I don't think you will get it cheaper than you have it in our market.

There are also 20 to 25 listed companies currently trading at a forward P/E of less than 3x, when, in fact, those stocks have historically not traded at less than 5x to 6x. There are more than 10 stocks whose dividend yield today exceeds fixed income returns. And yet in the mutual fund industry we are seeing redemptions now at 30,000-level instead of at 35,000, or 40,000 level.

BRR: Do you think equities won't fall further from current levels?

Adnan Afridi: I am not saying that the market will not go down further; like all other asset types, equity market investments are also subject to various risks. But based on current market fundamentals, I think there's a high probability that over a one-year horizon and longer, equities will outperform fixed income.

For fixed income, you need to take at least a one-year view and let's say you get 12-13 percent on that, which is unlikely to compensate for the loss an equity investor is taking

at these levels. If anyone was to actually invest more in the equity market today or even retain their original in the market today, they are going to get 10 to 11 percent in dividends, and a good chance of double digit capital gain, which is simply two upper circuits away.

BRR: The market's forward multiple is hovering around 4x to 5x, which is perhaps the lowest ever, and is surely attractive. But some quarters fear that India's hostilities in Kashmir warrant a war risk premium for our equities market. As a result, should we be expecting a multiple of 2x to 3x? Do you subscribe to that view?

Adnan Afridi: I don't. We have seen these geopolitical blips come and go. Financial market participants cannot predict what will happen in that geopolitical space. But I think investors need to break it down to individual sectors and companies. Will Pakistan's oil and gas companies shut down operation in the case of increased hostility; will fertilizer plants stop working; will we stop making clothes; will we stop making food; I think these are the kind of questions people need to ask.

BRR: At the PSX, this seems to be a buyback season. Would you shed some light on that?

Adnan Afridi: From what I hear anecdotally, there are several buybacks in the pipeline, in addition to the ones already announced, which again vindicates the value proposition thesis. If the company itself is buying back the shares, it should reflect to the investors that this is a good time to be buying and not selling. All over the world when you have buybacks, it indicates that they have confidence, the sponsors have confidence in their own company and they understand these values don't represent the intrinsic value,

BRR: Which type of investors are the biggest drivers of redemptions at NIT and elsewhere in the mutual fund industry? Are they mostly high net worth individuals (HNI), corporates, institutions, provident funds, or mom-and-pop savers?

Adnan Afridi: It would be difficult to speak for the industry, but anecdotally, I think over the last few years there was a mushroom growth of what is called Separately Managed Accounts. These SMA accounts, which could be held by a family office, an HNI, an SME or a large corporate, allow investors to have control over what stocks or sectors they want to invest in. When the market hit 30,000 levels, many of these SMA accounts saw redemptions across the industry; some even closed their accounts entirely and invested directly into PIBs or T-Bills. In NIT, the bulk of the redemption has taken place by provident funds of large corporates, many of which are state owned. I must

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emphasize they have every right to do so because they are provident funds and they are governed by trustees and I respect their independence. But my comment to them has always been that based on fundamental analysis that I just explained to you, they may be missing an upside opportunity to their investments by divesting at these levels

BRR: Does NIT have SMAs?

Adnan Afridi: We don't actually have SMAs. But we have received our Investment Advisory License recently and plan to offer SMAs to all our clients now.

BRR: What is your outlook on interest rates? Do you see it peaking by March, as many market participants do?

Adnan Afridi: I think the rates may peak even before that, perhaps within this calendar year. There is one caveat: if our fiscal performance doesn't improve then there is strong likelihood of a mini budget, and if that happens that could potentially change the landscape. But as things stand today, it would be a fair statement that we are closer to the top than the bottom as far as interest rates are concerned.

BRR: And what is your FX outlook for FY20 and after?

Adnan Afridi: I think barring any shocks, we are back to our historical average of 6 percent depreciation per annum or so.

BRR: In our interaction with HNI, family offices or even institutions, investors complain that sales force of Pakistan's asset management industry doesn't have sufficient product knowledge, partly because of poor incentive structure. What's your view on that?

Adnan Afridi: I would tend to agree. The simple answer is much like the rest of Pakistan, HR remains a major problem and our industry is no stranger to that. I think with mutual funds there is more complexity because average financial literacy in Pakistan is quite low, in addition to the issue of lack of training and lack of know-how, which I think the industry needs to address.

For NIT, there was this issue of lack of incentive. Unlike most other asset management companies, NIT has actually zero load. We only charge a management fee, which is not shared with the sales team. The sales team at NIT is purely on salary. We have 27 branches all over Pakistan and they are all on a fixed compensation. But that is in the process of changing because we also understand that beyond a certain point the branch manager does not have any incentive to go out and get business.

Just to give you some perspective, our entire nationwide sales force is less than 100 people. Considering that we have the largest assets under management in the industry,

it is a fairly small team, compared to our peers who have a team of at least 500, on average. We've been blessed with legacy AUMs because we were in the game before anybody else was. We were also fortunate that we got a lot of state-related enterprise funds, but I think the environment is now different. For us to remain competitive we need to increase our sales team and also compensate them as per market norms.

BRR: We imagine, then, you are planning to increase your sales team.

Adnan Afridi: First of all, there has to be culture change. Traditionally at NIT, there was no sales function. The sales function was within the marketing department. With the approval of our board, we now have bifurcated sales and marketing.

The sales function has two components: retail and corporate. Retail is our branch network and we have just hired someone to head our retail sales. We are now trying to find the same for corporate. Both these heads will report to a national sales manager, and to show our seriousness, I have taken the additional role as national sales head until this process gets codified.

BRR: What other changes are you bringing about to your business model?

Adnan Afridi: In addition to changing the incentive structure, and increasing our sales team, we are going digital. NIT was one of the few funds left, which has an online presence but not an interactive one, which means we couldn't do sales, or offer redemption to clients through our website. They couldn't check their balance as well. But in the next 90 days, we will have all of that online presence for which we are signing up with 1-Link to allow IBTF bank transfers. We are also launching an app within 90 days, to allow our customers to interact with us through NIT's application in their handheld device.

BRR: While NIT is the largest in equity, it doesn't fare too well in fixed income. What are you doing about that?

Adnan Afridi: For equity, we still remain by far the largest; NIT's equity fund - NIUT - is more than 50 percent of the total equity fund size of the market. We used to be lagging behind in fixed income. But in the last six months that I have joined, our money market fund has grown from a few hundred million rupees to 5 billion rupees. In the last five years, our money market fund was consistently ranked 27th or 28th in terms of returns, out of 30 AMCs. But over the last three months, we are now consistently in the top three; in many weeks, we are in fact number one. Similarly, in the government bond fund, we are in the top three. This goes to show that active management and relentless focus on performance does translate into a material change in performance whether an organization is State managed or privately managed.

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BRR: How many dormant unit holders and bearer unit holders do have NIT and what are you doing about it?

Adnan Afridi: There is a sizeable number, but the number has come down substantially. In 2004, there were almost 280 million bearer units. Also keep in mind that the 1965 bearer rules actually prohibit us from switching from bearer to registered against someone's will. Today, after NIT's consistent efforts to track these folks down and to convince them to register, we are down to less than 14 million bearer units.

With new AML & CFT regulations that have come into force, compliance is something that NIT is taking very seriously. The first hiring that took place when I took over was actually in the Compliance department, rather than in any other department.

A few thousand are without CNIC and for those we are also in the process of registering. We have got a call center with a dedicated resource that does just this all day long, contact these people and try to get their CNIC. To remain compliant with the FATF requirements, we have frozen those accounts. This means that no transaction can go through, until documentation requirement is fulfilled. So this is not a growing problem, it's a dwindling issue and we are putting all our resources to make sure that this happens.

BRR: As far as the core team is concerned, one of the key problems that this industry faces is that the fund managers change jobs, and unit holders generally have no idea whether the next fund manager at the AMC they have invested with will have the same investment acumen or not. Two people with the same academic or professional background may not have the same investment acumen! So how should the industry track that?

Adnan Afridi: I think fund managers' compensation should be tied to the long-term performance of their funds, not to the short-term performance. That could be one of the solutions. Another thing that could go a long way is probably to publish the profile and performance of fund managers, their qualification, along with the fund managers' report, so investors can make an informed decision.

BRR: How long are we talking about?

Adnan Afridi: That depends on the type of fund. I think if it's an equity fund then there probably needs to be two levels of compensation; one is on an annual basis, and the other could be on a 3-year or a 5-year basis. So if a fund manager has been sticking around enough, then his or her payout should be a lot more at the end of those 3 years or 5 years.

BRR: Why hasn't the mutual fund industry been able to channel diasporas money into Pakistani AMCs? Are there certain policies or procedural problems that are preventing this or is it about the AMCs' failure to market in places like the US and the UK?

Adnan Afridi: The diaspora is indeed an excellent opportunity for the mutual fund industry to address. Even your foreign investor, particularly in fixed income segment, is a good opportunity for Pakistan's AMCs. But there is a lacuna which I have raised with the central bank. The lacuna is that while the State Bank's SCRA is connected with the Pakistan Stock Exchange for direct investment in equities, the AMCs are not connected on the SCRA platform.

This means that right now there is no mechanism, for anyone living in London or Dubai, to buy an NIT or anyone else's unit, unless you physically open an account here and have local rupees to pay. There is no SCRA connection between them and the AMCs. That has to change; SCRA should be extended to AMCs, just like there are custodian banks for the equity business; those custodian banks should also be available to the AMCs to act as the counter party. Once that is done, only then it becomes a marketing challenge for us as an industry.

BRR: Is it just NIT which is lobbying with the State Bank to fix this lacuna or is it being done at the level of Mufap?

Adnan Afridi: At the moment, it has been a personal initiative of mine, hoping that it would benefit NIT. But I would hazard a guess that the industry would agree with me and this would benefit the entire industry.

BRR: There are two ways to look at AMCs' size; one being the size of their AUM and the other being the number of their unit holders. Where does NIT stand in number of unit holders in comparison to the industry?

Adnan Afridi: We have about 57,000 units for all our funds, of which there may be a few overlaps, which means we should have about 50-55,000 unit holders. I cannot say about the industry because of absence of data. I think, as an industry, we need to change such that a person can have 10 accounts with 3 AMCs or 10 accounts with one AMC, but he or she should be counted as a unique investor.

BRR: What's the growth number you are targeting for NIT in terms of unit holders?

Adnan Afridi: I would like growth to be in double digits.

BRR: What new products do you think NIT could be offering, or what new products could we see in the industry over the next two years?

Adnan Afridi: We are launching an asset allocation fund which is in the final stages of approval with the SECP. We believe that this is an opportune time to launch that simply because it allows fund managers the discretion to move between fixed income and equities. We are also hoping to be the first or among the first to launch an ETF. We have applied for it to the SECP and are waiting for SECP's ETF regulations to be approved. Everything is ready from our end. It is going to be called NIT Gateway ETF. We will start with five stocks, which will be of different sectors to give an overall representation of the market.

From an industry perspective, and I certainly hope NIT can also take a lead in this, I think there is tremendous opportunity to have a startup fund. Obviously, investors need to have expertise for investing in Pakistan's tech or startup space, which means that these should only be pitched to accredited investors. It will also need to have some regulations around that, but I think there is certainly a space for that as well, as infrastructure funds.