AKD Securities Limited
TREC Holder & Registered Broker
Pakistan Stock Exchange

Equity Research / Pakistan

REK-216
www.jamapunji.pk

AKD Daily

Friday, Dec 23, 2016

Today's Daily

Pakistan Market: Good intentions do not make good policy

Shifting of policy stances (gas price curtailment, privatizations), incidence of higher taxation (supertax continuation, real-estate) and sector specific packages (auto policy, incentives for textile exports) add up to a 'hit-or-miss' policy environment for domestic industry. Sectors bearing the brunt of policy actions include: 1) Textiles through zero-status scheme granted to all export-oriented sectors and accompanying DLTL and ERF incentives, 2) Autos from the introduction of AIDP-II and accompanying incentives shifting long term competitive dynamics in the sector, 3) Fertilizer on support from GST reduction, cash subsidies and reduced feedstock prices in April'16, and 4) Cements, as they faced higher FED, difficulty in approval for coal expansions and blowback from real estate taxes. For CY17, we expect regulation pertaining to export competitiveness to continue, while expansion projects with FDI elements (foreign ownership) to continue remaining in favor. Moreover, as election year approaches, targeted subsidies for agri-linked sectors, consumer cyclicals (Autos, Consumer Goods) from widely accepted populist tilt, are expected to gain steam.

KSE100 - Index

Current	46,699.78
Previous	46,993.31
Chg.	-0.62%

Mkt Cap. (PkRbn/US$bn)

Current	9,312 / 88.82
Previous	9,354 / 89.22
Chg.	-0.44%

Daily Turnover (mn)

Current	270.43
Previous	388.57
Chg.	-30.4%

Value Traded (PkRmn/US$mn)

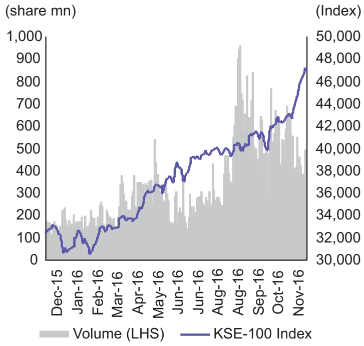
Current	13,069 / 124.66
Previous	21,417 / 204.28
Chg.	-39.0%

News and Views

- The Federal and provincial government evolved consensus for prioritising two development projects and establishment of two industrial parks in each federating unit for inclusion under the CPEC including Orange Line project, Karachi Circular Railways, Keti Bandar, mass transit system for Quetta and Peshawar.

- Chinese-led consortium offered approximately US$85mn for acquiring 40% stake of the Pakistan Stock Exchange (PSX). The consortium consisting of China Futures Exchange, Shanghai Stock Exchange, Shenzhen Stock Exchange, Pak-China Investment Company (PCIC), and Habib Bank Ltd. (HBL) submitted the highest bid of PkR28/share for the 40% strategic stake (~321mn shares) of PSX.

- The Islamabad High Court approved the amalgamation of Mobilink and Warid Telecom leading way for the two companies to create the country's biggest telecom operation. The merged company will serve more than 51 million customers in Pakistan. Earlier this year, Mobilink and Warid had received approvals from PTA, Competition Commission of Pakistan, SECP and SBP.



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Textile: Promoting competitive exports, the GoP announced tax exemptions in Budget FY17 for the textile sector with main incentives including: 1) zero-status scheme granted to all export-oriented sectors extending the facility to major input costs, 2) extension of Drawback of local taxes (DLTL) scheme

CY16 Sectorwise Regulatory Snapshot

Sector	Regulatory Action	Impact
Banks	Continuation of Super Tax	Negative
Textile	Inclusion in Zero rated tax regime 50bps reduction in ERF rates 10% additional (on top of 10% existing) duty on yarn imports Extension of drrawback of local taxes scheme	Positve
Fertilizer	PkR300/390/130/bag reduction in DAP/Urea/NP via lower sales tax and subisidies Anulment and subsequent judicial revie of GIDC Gas tariff reversal for feed stock to PkR123/mmbtu from PkR200/mmbtu	Positve
Power	Focus on shifting ownership to foreign entities and local coal Following approvals, deadline for projects on upfront tariff on coal declared Initiation of proceedings for KEL's MYT extension Approval of transmission tariffs for crucial grid capacity at competitive rates Tarriffs and licenses approved for RLNG projects Move to competitive bidding and whole sale market reforms initiated	Positve
Auto	Introduction of AIDP-II, favouring new entrants with reduced import rates for CKD FTAs progressing with Thailand, China, Turkey and Malaysia favor lower import costs	Neutral
Steel	Anti dumping action againt imported billets with proposal to increase to 30% Regulatory duty on rebar raise to 30%	Positve
Pharma	Drug Pricing Policy active with some clauses under litigation	Positve
Cement	Increase in FED/bag with the quantum raised to PkR1/kg Imposition of taxes on real-estate sector Expansion in Coal power gaining steam, but faces hurdles	Negative
E&Ps	Extension and upgradation of applicable policy for SUI Field Lack of clarity circular debt holds receivables scenario on edge	Neutral
OMCs	Raised margins for MOGAS/HSD and CPI linkage Upgradtion of RON standard for MOGAS De-regulation of premium fuels segment	Positve

Source: News, Regulaory Filings, Budgetary Documents & AKD Research to current fiscal year, and 3) duty free import of machinery. Alongside, ERF borrowing rates were reduced by 50bps to 3.0% while ensuring energy availability for the sector via RLNG supply. Moreover, GoP also imposed 10% additional regulatory duty (RD) on cotton yarn imports as a protectionist measure. Despite these incentives, textile exports have remained dismal (5MFY17: down 1.9%YoY). That said, the anticipated textile exports incentive package, expected to be worth PkR75-100bn could spur profitability.

Autos: The introduction of AIDP-II and accompanying incentives for new entrants and sick units, are having the intended effect (reduce barriers to entry), opening the flood gates of increased competition. While new entrants may take time to assemble locally, they stand to benefit from 10-20% reduced import duties, making a compelling case for entrants. Having a knock-on effect for incumbents, increased threat from entrants has spurred a push for expansions, product launches and diversification, threatening a breakdown of pricing and market segmentation prevailing in the industry.

Fertilizer: Positively impacted by reduction in feedstock gas prices for fertilizer manufacturers by PkR77/mmbtu to PkR123/mmbtu (Aprl'16) in exchange in lieu of PkR60-70/bag reduction product prices in order to provide relief to the the farmer. The GoP in the budget FY17 announced an encouraging package in order to enhance agriculture productivity and support depressed farm economics through price reduction of fertilizer products (Urea: PkR390/bag, DAP: PkR300/bag, NP: PkR130/bag) via reduction of GST (from 17% to 5%) and cash subsidy. Consequently, post subsidy declining fertilizer offtake trend marked a reversal in the later part of the year, after falling significantly during 5MCY16 (down 31%YoY).

Cements: Cements Sector has experienced a boom in domestic demand (+12.13%YoY higher dispatches in 5MFY17) in spite of slowdown in private housing development in the wake of highetened tax environment for real estate imposed in FY17 budget. Additional levied taxes included one-time 3% supertax and ~2x increase in FED to PkR1/kg from 5% of Maximum Retail Price. Out of this, the cement manufacturers completely passed on the increase in FED. On the energy front, LUCK encountered issues in getting its generation license approval for its 660MW coal IPP as the government asked it to modify the plant specification to produce power on local coal. LUCK has complied with the government's directive and progress continues to remain on track.

Steel: Steel re-bars industry was marred by Chinese re-bars dumping resulting in lower domestic re-bars prices and dispatches. To support the domestic industry, MoF increased the Regulatory duty by 15ppt to 30%. Though it helped in providing support to local re-bars prices, cheaper Chinese re-bars (inclusive of duties) continue to pressure indigenous sales. While we do not foresee any further increase in RD, proposed 30% anti-dumping duty in place of 15% Regulatory Duty will provide further support to GM of integrated steel re-bars manufacturers.

Power: Despite setting out on an ambitious plan of enacting power generation reforms and adding significant capacity (largely from coal), the GoP wavered on approving imported coal projects with local sponsors. Reforms adopted by NEPRA gained pace as amended licenses and transmission project approval set out detailed analysis of costs and imposed strict guidelines for maintaining standards. Lastly, lack of developments on the privatization front, and more importantly circular debt clearance continued to relegate the sector's liquidity.

OMC: Increase in margins on retail fuels were a positive, long awaited development. Accompanied by upgraded RON standards, and deregulation of premium fuels segment (previously HOBC), OMC sector profitability is increasingly reliant on retail fuels growth, as opposed to debt prone power segment consumption. Linkage of margins to CPI provides impetus to this hypothesis, setting up a roadmap for aggressive retail and storage expansion in the downstream space.

E&P: Other than a one-time supertax imposition, the government has remained supportive of the industry. In this regard, the government continued to roll over extension of Sui field lease to PPL to meet energy requirement. The recent developments suggest that the government will sign new production lease agreement for Sui field for a period of 10 years where the new wellhead gas price will be indexed to 55% of 2012 policy price.

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