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PAKISTAN
BUDGET'19

REP-019
MARKET
VISTA

Populism trumps pragmatism, but only on face

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- **Amidst a divisive macro outlook and heady budgetary imbalances, the PTI-led GoP introduced its second finance bill to a rancorous opposition, while alluding to approaching the IMF for the 'final time', something FM Umer and PM Khan have vowed to uphold**
- **Market dynamics are expected to get a lift from i) abolishment of 0.02% WHT on share transactions, ii) capital loss carryover to be available for 3 years, iii) abolishment of tax on undistributed profits and iv) abolishment of super tax in FY20 on non-banking companies**
- **From a sectoral perspective, proposals in the budget can be seen to favor SMEs (concessionary tax on loans), Automobile OEMs (FED on 1800CC+ CBU, removal of non-filer sales ban on 1,300CC below models), parts vendors, small scale manufacturers, construction concerns (incentives for low-income housing), agri-reliant (fertilizers, tractors, lenders), renewable energy equipment manufacturers (5YR tax holiday), group holding companies (group-relief partially reinstated) and fertilizers (GIDC reduction)**
- **Market euphoria may, however, be tempered by Banking sector developments where despite specific tax concessions on finance income from advances to SMEs, agriculture and low income housing (20% tax rate vs. 35% currently), incidence of super tax at 4% on FY18 profits (previous: 0%) and increase to 4% in FY20 (previous: 3%) and FY21 (previous: 2%) may disrupt overall sentiment. The incidence of super tax will adversely impact our Banking coverage earnings by 6%-11% in CY19F**

Broad based positive market developments… Initial reaction to market related budgetary developments is likely to be euphoric where brokers will cheer the abolishment of the 0.02% WHT on share transactions. At the same time, the ability of capital market investors to carry forward capital losses for a three year period fulfills a long held demand and brings the treatment of losses for the investment community at a similar footing to other businesses. That said, the budget remained mum on rationalization of CGT in-line with the real estate industry, a step that had earlier been anticipated. Other broad positives include i) abolishment of tax on undistributed profits – implemented by the last government, ii) continuation of 1% reduction each year in corporate tax rate and iii) abolishment of Super tax in FY20 (rate: 1.0%) for non-banking companies.

..But Banking sector headwinds may temper sentiment: Headline banking developments were by and large positive, including i) reduction in tax to 20% (previous: 35%) to banks providing new loans to Micro & Small Enterprises (clarity needed on skipped Medium Enterprises), low cost housing and Agriculture finance, ii) elimination of super tax on the income generated from the above and iii) removal of WHT on banking transactions for filers (should ideally aid deposit growth). That said, drilling deep, the GoP has reinstated Super tax at 4% for FY18 from previous 0% while also kept the rate constant at 4% till FY21 in place of the previous cascading structure (FY19: 4%; FY20: 3%; FY21: 2%). The incidence of super tax will impact our Banking coverage space by 6%-11% in CY19F and may potentially lead to pressure on the sector. With Banks holding sway at the PSX (KSE-100 weight: 24%), any pressure on the sector may temper overall market sentiment.

Banks CY19 EPS estimates

	Current	Previous	Change
HBL	14.2	16.0	-10.9%
UBL	21.7	23.4	-7.6%
MCB	18.4	19.8	-7.0%
ABL	16.2	17.2	-6.0%
NBP	8.5	9.3	-9.1%
BAFL	7.4	7.9	-5.9%

Source: Company Accounts & AKD Research

Autos come out winners! Allowing non-filers to purchase vehicles below 1300cc is a big positive for Auto manufacturers with PSMC the clear winner given its concentration in the segment. INDU also looks well placed to gain given its popular GLI and XLI variants in the category as well as the potential introduction of the Vios in the 1300cc segment. HCAR's City also falls in the 1300cc segment and should also benefit. Other measures for Autos including i) Increase in excise duty on CBUs exceeding 1800cc to 25% (previous: 20%) and 30% on cars exceeding 3000cc and ii) incidence of 10% duty on locally assembled cars exceeding 1800cc should have positive connotations for HCAR and INDU where upper variants of both (Corolla Altis/Grande for INDU and Civic for HCAR) fall in the <1800cc category. At the same time, removal in import duties on RMs specifically for Auto part assemblers (THALL, LOADS, TREET, AGIL) is another positive.

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Other Sectors – A mixed bag: While details on GIDC solution for the fertilizer sector are to be announced later, the Finance Minister already announced a likely reduction of PkR200/bag in the price of urea as a consequence. The event is likely to be negative for EFERT (Enven) and FATIMA given fixed pricing structure while neutral for FFC and positive for FFBL (DAP). Positives for Textiles included the announcement of sales tax refund payments through promissory notes. For conglomerates, tax on inter-corporate dividend has been reduced to the extent of percentage of shareholding the recipient of dividend has in the distributing company (Neutral for ENGRO and INIL as both have a pending case against this). A detailed table on sector/company impact is given at the end.

GoP targeting growth over containment: A hallmark of supply side, pro-growth policies, features of the budget fail to include major taxation measures, or impose additional burdens on salaried individuals or raise indirect taxes significantly (earlier, plugging of PkR150-160bn revenue shortfall had been anticipated). Adhering to a pro-industry, pro-export and pro-poor mode of tariff rationalization and incentives, the latest measures are likely to strain the budget in the near term, while catalyzing growth over the medium to long term. The PTI government has a hard task to master given FY19 fiscal deficit already expected at 6.3% (AKD estimates). The medium term economic framework and any alterations in Regulatory Duty structures, likely to be announced next week, may somewhat address this imbalance over an extended period. In short, the PTI's move to shift the needle in favor of organic industrial growth and enhance manufacturing is a major departure from previous Governments' policies, and may lead to a revival in business confidence, if successful.

Major Features of Second Supplementary Finance Bill 2019

Proposal	Sector/Company Impact
Abolishment of advance tax on share transactions (0.02% previously)	Positive for the market
Capital losses can be carried forward for three years	Positive for the market
Group-relief condition for inter-corporate dividends taxation is re-imposed only if losses are shared between the group companies for the tax year, as per share of ownership amongst group companies	Neutral for Conglomerates
Manufacturing of renewable energy equipment (solar panels, wind turbines) will have tax holiday of 5yrs, similar to SEZ incentives	Positive for DLL
Tariff line reduction for raw materials, where the focus is on SMEs, auto vendors, manufacturing	Positive for LOADS, SPEL, TREET, THALL, AGIL
Abolishing Supertax for FY20 from non-banking companies (1% in FY20 for non-banking)	Positive
Super Tax on banks restated for tax year 2018 to 4% and increased for tax year 2020 and 2021 to 4% each vs. previously 3% and 2% respectively	Negative for Banks
Continued 1% reduction in corporate tax regime	Positive
Removal of tax on retained earnings (previously 5% tax was levied if profit distribution is less than 20%)	Positive
Reduced tax on banks on finance income from low income housing loans, Small and Micro sector advances and Agriculture loans to 20% from 39% currently	Positive for Banks particularly BAFL
Formation of PkR5bn revolving fund for subsidized loans targeted to low income housing construction	Neutral - mode yet to be determined
Removal of WHT on banking transactions for filers of income tax	Positive for deposit growth for entire banking space
Non-filers allowed to purchase vehicles below 1,300CC segment, but with a higher applicable rate for non-filers	Positive for PSMC, INDU and HCAR for mid to low segment vehicles, LCVs
CKD vehicles above 1,800CC will have an additional 5% (previously 20%) Federal Excise Duty, while imported (CBU) vehicles of displacement above 3,000CC will carry additional 30% FED levy	Positive for HCAR and INDU given lower FED
News print input tax exempted	Positive for MDTL
Reduction in custom duties on raw material for footwear, tanners, Leather and Glove manufacturers	Positive for specific textiles
Reduction in custom duties on raw materials for ceramics industry from 11% to 3%	Positive for STCL
Reduction in custom duties on raw materials for home appliance sector	Positive for WAVES and PAEL
Reduction in custom duties on raw materials for infant milk producers	Positive for SEARL and ICI

Source MoF & AKD Research

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Buy	**> 19% expected total return (Rf: 13% + Rp: 6%)**
Neutral	**> 13% to < 19% expected total return**
Sell	**< 13% expected total return (Rf: 13%)**

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Buy	**> 20% upside potential**
Accumulate	**> 5% to < 20% upside potential**
Neutral	**< 5% to > -5% potential**
Reduce	**< -5% to > -20% downside potential**
Sell	**< -20% downside potential**
Not Rated	**No investment opinion or recommendation**

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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