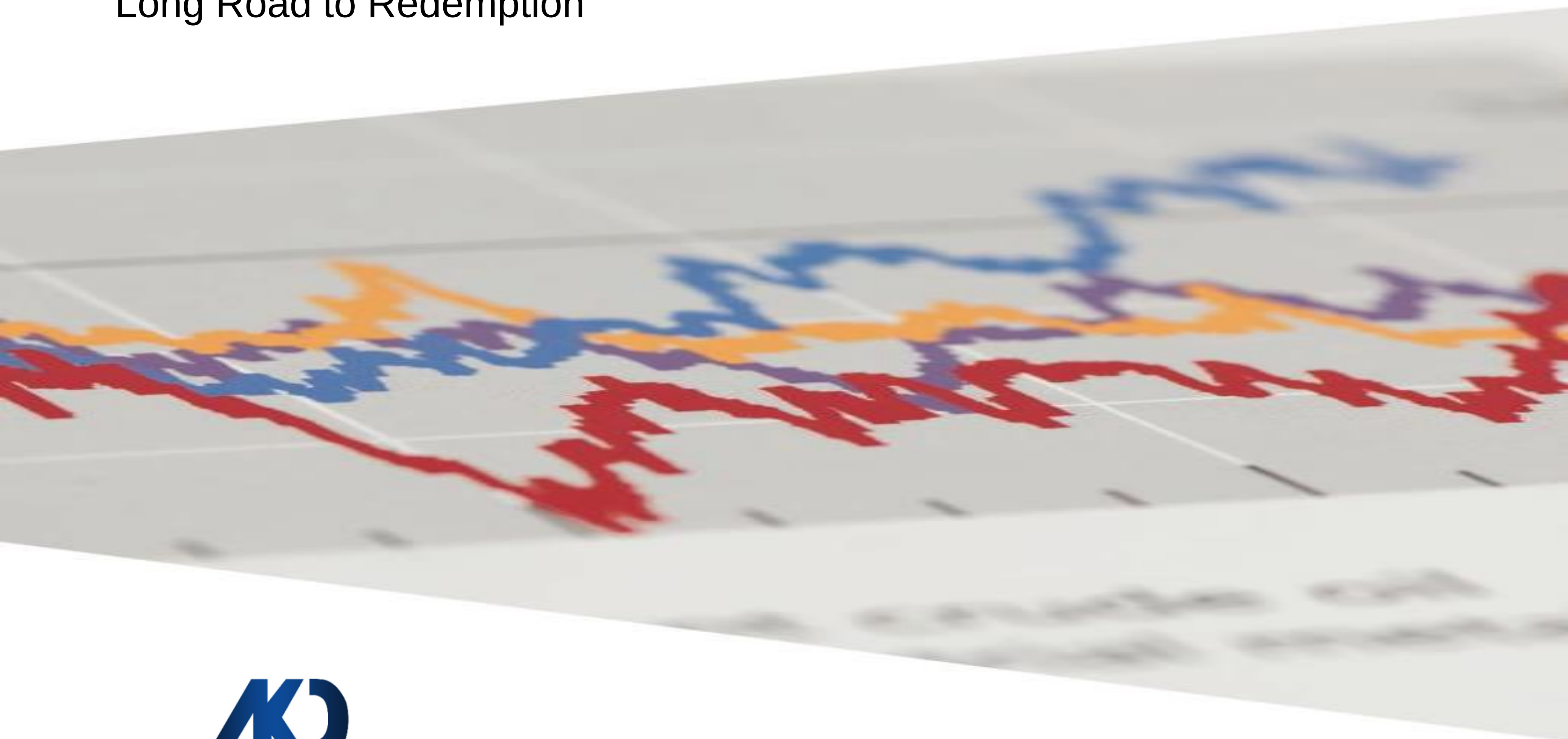
FEDERAL BUDGET 2019-20

Long Road to Redemption



REP-019

AKD Securities Limited

Painful, but necessary: The first real test of PTI's resolve, Budget'20 clearly focuses on documentation and increasing tax net at the expense of political mileage. Targeted tax collection at PkR5.55tn (FBR) certainly appears ambitious where we believe steps undertaken including rationalization of GST, FED and CDs on various sectors will likely be insufficient – AKD estimates tax collection at ~PkR5.0tn. Macro indicators continue to paint a dismal picture where FY20F GDP growth at 2.4% and CPI reading at 11%-13% raise eyebrows. Worryingly, the GoP forecasts account for subpar growth till FY22 (peak growth: 4.5%) while fiscal deficit estimate at 7.2% despite significantly higher revenues is concerning. Of interest are GoP's public debt targets where focus on shorter tenor bonds appears higher vis-à-vis longer tenors, contrasting IMF's historical mandate of skewing towards the longer paper (PIBs: -ve71%YoY growth in net proceeds; T-bills: +ve9.4x growth).

Equities – Lull to continue: Regulatory changes for capital markets per se have been far and few where i) continuation of CGT rate, ii) abolishment of tax credit for BMR investment and iii) freezing of corporate tax rates have disappointed. That said, increased tax rates on profit on debt and particularly bringing of capital gains on property sale under normal tax regime may bring some sense of positivity to equities. That said, increase in FBR rates to ~85% of market value may incentivize longer term holding periods. Coupled with stringent KYC requirements within capital markets (thank you FATF), flows from real estate to equities may actually fail to materialize.

Sectoral impacts have mostly ranged from Negative to Neutral with focus on the former. Implementation of Treasury Single Account (TSA) may weigh heavily on index heavyweight Banking sector. Other sectors with Negative impacts include i) Autos (FED levy), ii) Power (WHT on dividends increased to 15% from previous 7.5%), iii) Textiles (zero rating withdrawal; 17% GST), Consumer Goods (10% duty under 8th Schedule from previous exemption) and iv) Cable & Electrical (inclusion in Third schedule with 17% GST applicable). Pharmas, with positive budgetary developments, are a rarity in the current budget (RMs, APIs on more than 19 items now CD exempt from previous 3%).

Conclusion – still skeptic in the short run but long term positive: Pakistan is likely to witness some tough economic times where tax collection and deficit control are likely to be formidable challenges. While we believe the incumbent government has taken steps in the right direction, confidence building measures will need to be undertaken particularly with respect to GoP's narrative. P/E at 7.3x in isolation appears positive, however, is insipid when compared with sovereign yields. We believe any euphoria whether on the Market Support Fund or else may be short-lived where from budget's context, negatives certainly outweigh the positives, at least in the now.

Sector	Budget Impact	Key Measures	Analyst Comments
Market	Neutral	CGT rate to continue at 15%	Rate continued at 15% for filers and increased to 30% for non-filers. Market neutral given stringent KYC has already reduced the number of non-filer investors.
	Neutral	Corporate tax rate frozen at current level of 29%	Market neutral as was widely expected while negligible impact on valuations
	Positive	Taxation of profit on debt increased by 5%	Rates of taxes increased by 5% till PkR36mn and taxed at normal rates thereafter. Theoretically positive for equities, however, differential is not large enough to initiate a tectonic shift
	Positive	Income from capital gains on immovable properties	Normal tax rate to be applied on different slabs depending on sale timing. Increase in FBR rates on property, however, may incentivize holding and slowdown shift to equities
	Negative	Abolishing tax credit for investment in BMR	Reduction in tax credit to 5% in FY19 and nil thereafter is market negative, particularly for expanding companies.
	Neutral to Negative	Broker regime changed from FTR to MTR	Bigger houses may potentially be adversely impacted
Fertilizer	Neutral	Uniform GST of 2% on all fertilizers maintained Final Tax regime to be treated as minimum tax except for exporters and sellers of petroleum products No update on GIDC	No tax credit for machineries in FY20 may spell negatively for ENGRO and its subsidiary which are contemplating expansion projects. No update on GIDC is also a sentiment dampener.
Chemicals	Neutral	Zero rating on exports of PVC and PMC to Afghanistan and Central Asia Exemption of duty on import of plant and machinery for hydrocracker plants (oil refinery) proposed Additional custom duty may be enhanced from existing rate of 2% to 4% and 7% on tariff slabs of 16% and 20%, respectively Tax credit for machinery installed till 30th June'19; tax credit proposed to be reduced from 10% to 5% (Negative for EPCL, ENGRO)	While Budget FY20 seems to bode negative for expanding companies, government's supporting stance towards establishment of hydrocracker plants and zero rating on exports of PVC to select destination are potential positives for the sector.
Power	Neutral	Tax rate on dividend from power companies raised to 15%	Reduces the relative returns for investors in IPPs
Cement	Negative	FED increased by PkR25/bag to PkR100/bag	Local manufacturers to fully pass-on the impact however long-term sustainability remains a question
		Federal PSDP increased to PkR701bn from PkR675bn	Actual PSDP release to remain low as GoP presses on with fiscal consolidation
		Reduction in tax credit to 5% in FY19 and nil thereafter	LUCK, KOHC and PIOC most affected.

Banks	Negative	Treasury Single Account (TSA) Implemented Additional income earned from additional investment in Federal Government Securities shall be taxed at 37.5% Depreciation and Business losses should not be included in Super Tax calculation Provisions on doubtful debt is disallowed for tax purpose Tax credit on health insurance for both filers and non-filer Government plans to restrict borrowings from Central Bank	Effective tax rate is likely to increase for the sector, dampening valuation for banks. However, a more negative development is the Government deciding on the implementation of TSA, however clarity is needed on its timing (gradual or immediate). Amidst the gloomy picture, likely shift in borrowings from Central Banks can allow banks to reap higher yield spreads and extension of tax credit on health insurance to non-filers as well could pull bancassurance fee income.
Autos	**Negative**	FED levy on vehicles formalized and expanded to all vehicles progressively, based on displacements with 2.5/5.0/7.5% levy on >1000CC/1000-2000CC/2000CC+ Withdrawal of 2% additional tax levy on auto parts Withdrawal of 2% additional tax levy on tyres sold to OEMs Removal of 3% CD on imported tariff lines for minor components	10% FED Levy on Vehicles above 1,700CC imposed in Mar'19 has significantly depressed demand for the vehicle segment, where an expansion of the same to all vehicles has the risk of softening demand further. This levy comes on the heels of 15-17%YoY rise in variant prices (pose drastic devaluation), in addition to WHT (~2.5% for filers) and a slew of additional levies (token tax, registration charges) already applicable on CKD offerings.
Pharmaceutical	**Neutral to Positive**	Raw materials and concentrated nurtrients, salts and APIS spanning more than 19 items for medicinal are now CD exempt vs. 3% previously These include Insulin, hormone medications, Vitamins, various Neurological medications	Removal of CD's are seen to favor margins for unregulated, OTC supplements and nutritional offerings where margin expansion is possible, but competition is fierce.
Misc.	Positive	Customs duty reduced on paper from 20 to 16%	

Cable & Electrical	**Neutral to Negative**	Household electrical goods to be included in sales tax regime (Third Schedule) with applicable sales tax of 17% Removal of 3% CD on various core components for Deep Freezers and Fridges including Coolants, Vacuum Pumps and Compressors Removal of 3% CD on Alumimiumn Sheets for Electrical equipment	While reducing minor levies at import stage of components, the inclusion of electrical appliances in Sales Tax regime is a broad negative as the final retail price for offerings are markedly higher. In a macro backdrop inhibiting consumer durable spend, Sales Tax may dampen demand further.
Consumer Goods	**Neutral**	Streamlining of sales tax regime applicable on dairy products bringing tea whitening powder, concentrated milk in-line with UHT milk at 10% Retail taxation measures to widen the tax net aimed at regulating grey/loose milk retail sales	Sales tax burden on regulated industry segments, particularly packaged foods is broadly negative for domestic produces. Some relief may be provided from retailers being dragged into the wider tax net, whereby unregulated/grey supply (of dairy in particular) would be a welcomed trend.
Steel	**Neutral to Negative**	Restoration of normal tax regime for steel manufacturers) vs. previously taxed under Sales Tax Special Procedure withholding rules 2007. Decrease in customs duty on import of scrap to 0%.	Abolishment of special procedure will be marginally negative as the net tax liability is expect to increase though reduction of duty on import on coal will provide comfort to local manufacturers.
Textile	**Negative**	Import duties on textile-related chemicals reduced Zero-rated status for textiles abolished and will now be subject to 17% input tax. However, so Subsidies on Gas and electricity removed. Refund clearance system introduced. Local sales will now be subject to 17% sales tax however, export sales will remain exempted.	While the withdrawal of zero-rating status could create liquidity problems for domestic apparel manufacturers, the impact of same will be partially offset by the introduction of automated fund clearance if properly implemented. Reduction in import duties is a positive and would result in lower input cost. Higher sale tax rate on domestic supplies is a pass on for domestic manufacturers however this could lead to demand compression. Higher turnover tax will increase tax liability for the manufacturers, with more profound impact on players with the higher exports share.

Market

CGT rates – Continuation for filers; changes for non-filers: Capital Gains Tax (CGT) rate for filers is slated to continue at 15% for a period of 4 years while the same has been enhanced to 30% for non-filers (previous: 20%)

Analysis: The market is likely to be disappointed with the status-quo in CGT rate, though a change was highly unlikely in the first place. Increase in CGT for non-filers is a non-event given higher KYC requirements particularly for bigger investors.

Corporate tax rate frozen: Corporate tax rate has already reduced from 35% in FY13 to current 29%. In order to ensure increased tax base, the GoP has decided to freeze corporate tax rate at the current level of 29%.

Analysis: The decrease in tax rate should be market neutral given already broad expectations of the same. From a valuation standpoint, the impact has a negligible impact.

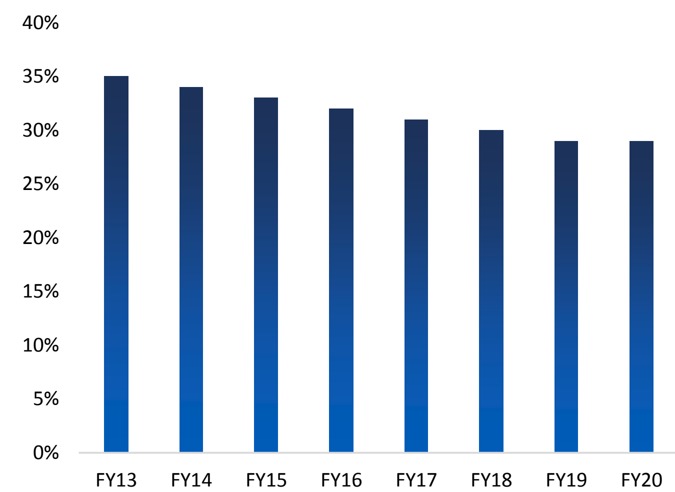
Taxation of profit on debt: : Tax rates on different slabs for profit on debt till PkR36mn have been increased by 5% each while any profit exceeding PkR36mn will be made part of total income and taxed at normal rates.

Analysis: Theoretically, a positive step for equities, however, given prevalent economic conditions, sub-par equity valuations and not-so-substantial tax gap, switch to equities may remain limited. Mutual funds, however, may witness some switching between equity and fixed income funds.

Capital Gain Tax

Holding Period	FY20	
	Filer	Non-filers
0months to 12months	15%	30%
>12months - 24months	15%	30%
>24months - 48months	15%	30%
> 48months	15%	30%
Holding Period	**FY19**	
	Filer	**Non-filers**
0months to 12months	15%	20%
>12months - 24months	15%	20%
>24months - 48months	15%	20%
> 48months	15%	20%

Corporate Tax Rates



Source: MoF & AKD Research

Income from capital gains on immovable properties: Prevalent slabs are being abolished and income from capital gains are being brought under the normal tax regime and taxed at normal rates.

Analysis: Normal tax rate will be applied on full gain on property sold within one year (constructed property: full gain to be taxed), 75% gain on property sold between 1-10 years (1-5 years for constructed property) and tax free for 10 years or more (constructed: 5 years or more). Since FBR rates on immovable property are simultaneously being taken to ~85% of actual market value, the incentive to hold will be considerable higher. At the same time, taking into account stringent KYC requirements within capital markets, flow from real estate to equities is unlikely to materialize, in our view.

Transition from Final Tax Regime to Minimum Tax Regime for Brokers: Brokerage income collected on transactions will now be treated as minimum tax liability instead of the previous final tax liability.

Analysis: The measure is likely to have Neutral to Negative connotations for the brokerage industry where the bigger names may likely face a relatively bigger pinch.

Abolishing tax credit for investment in BMR: Tax credit of 10% allowed to expanding / BMRE activity companies is being scaled to 5% for FY19 and abolished thereafter.

Analysis: Negative for expanding companies particularly Cements (LUCK, KOHC, PIOC), MUGHAL and EPCL.

Tax on Immovable Property (Land)

Holding Period	Amount of Gain Taxed
<1 year	100%
1-10 years	75%
>10 years	0%

Source: Finance Bill FY20

Tax on Immovable Property (Constructed)

Holding Period	Amount of Gain Taxed
<1 year	100%
1-5 years	75%
>5 years	0%

Source: Finance Bill FY20

Pakistan Economy

Fiscal side – more needs to be done

- The PTI's government 1st full year budget has rightly put its emphasis on fiscal consolidation, with a keen focus on broadening tax base, rationalization of sales tax regime, and austerity drive. The budget targets primary/fiscal deficit at 0.6%/7.1% of GDP for FY20, lower than deficits of 2.2%/7.2% of GDP in FY19.
- The authorities have set a bold revenue target of PkR5,550bn, translating into an increase of 34%YoY, one of the highest in recent years. The revenue target appears ambitious particularly in context of economic slowdown amidst high interest rate environment. The gov't itself expects the economic growth to slow down to alarming level of 2.4%YoY – a decade low.
- Even more of a concern is the govt's inflation forecast of 11-13%YoY, potentially signifying a further monetary tightening.
- While the gov't resolve of practicing fiscal discipline including 5% cut in civil gov't expenditure and freeze on defense spending is encouraging and holds sentimental value, a more meaningful cut in spending is needed to reduce the overall current spending.
- The quota for development spending has been increased to PkR843bn, up 27%YoY compared to disbursement of PkR662bn in the outgoing year - we remain skeptical regarding disbursement in the next year as well, considering the higher allocation for PSDP from revenue account.
- Despite limited fiscal space, the budget also has a socialist tilt in line with the party's manifesto, allocating a hefty PkR190bn for social spending aimed at protecting low income population in the current tough macro cycle

Key Economic Indicators*

	FY19B	FY19R	FY20B	FY21F	FY22F
Real GDP Growth (YoY%)	6.20	3.30	2.40	3.00	4.50
GDP at market prices (PkRbn)	38,388	38,559	44,003	49,568	55,380
Inflation (YoY%)	6.00	7.20	11-13	8.30	6.00
Fiscal Deficit	(4.9)	(7.2)	(7.1)	(5.1)	(3.6)
Current Account Deficit	(4.0)	-	-2.2%	-	-
Revenue					
Total Revenue	16.3	14.5	16.7	18.3	19.2
Tax Revenue	13.9	12.6	14.4	16.0	17.0
FBR Tax Revenue	11.6	10.8	12.6	14.2	15.1
Non Tax Revenue	2.4	1.9	2.3	2.3	2.2
Expenditure					
Total Expenditure	21.2	21.7	23.8	23.4	22.8
Current Expenditure	16.5	18.3	20.2	19.7	19.0
Development Expenditure	4.7	3.4	3.6	3.7	3.8

* as % of GDP unless stated in other unit

Fiscal Snapshot

(PkRbn)	FY19B	FY19R	FY20B	YoY%	AKD Estimate	YoY%
Revenue						
Tax Revenue	4,889	4,394	5,822	33%	5,253	20%
- FBR Taxes	4,435	4,150	5,555	34%	4,986	20%
- Other Taxes	454	244	267	10%	267	10%
Non-Tax Revenue	772	638	894	40%	778	22%
Gross Revenue	5,661	5,032	6,717	33%	6,031	20%
Less: Provincial Share	2,590	2,463	3,255	32%	2,895	18%
Net Revenue	3,070	2,569	3,462	35%	3,136	22%
Expenditure						
Current Expenditure	4,179	4,661	6,193	33%	6,379	37%
- Debt servicing	1,620	1,987	2,891	45%	3,036	53%
- Pension	342	342	421	23%	442	29%
Development Expenditure	1,068	662	843	27%	717	8%
- Federal PSDP	800	501	701	40%	596	19%
Total Outlay	5,246	5,323	7,036	32%	7,096	33%
Federal Deficit	2,176	2,754	3,574	30%	3,959	44%
Provincial surplus/(deficit)	286	(22)	423	-	423	-
Fiscal Deficit	-1,890	-2,776	-3,151	14%	-3,536	27%
Fiscal Deficit (as % of GDP)	(4.92)	(7.20)	(7.16)	-	(8.04)	-
Primary deficit (as % of GDP)	-0.7	-2.0	-0.6	-	-1.1	-

Source: FY20 budget & AKD Research

Revenue mobilization is at the core of fiscal adjustment

- **An ambitious revenue target:** Considering the tough macro environment, the gov't has set an ambitious revenue target, budgeting 34%YoY increase in total revenue. The bulk of it is coming from withdrawal of tax exemptions and rationalization of sales tax on inputs. The gov't is budgeting a sharp 41%YoY increase in sales taxes, 37%YoY growth in FED and 36%YoY in taxes from custom duty.

- Banking primarily on broadening tax base, the gov't seems overly optimistic, targeting 25%YoY growth in direct taxes when economic growth is sharply losing momentum. The gov't expects economic growth to further slow down to 2.4% in the next year.

- **Expenditure - Austerity alone won't help:** The current expenditure for FY20 is expected to jump 33%YoY primarily driven by large increase in domestic debt servicing which is likely to rise by 45%YoY as a result of aggressive monetary tightening (SBP has raised policy rate by c650bps).

- While the austerity drive is step in the right direction but it has limited impact in terms of fiscal consolidation, as the current spending ex of interest related cost is set to grow by 23%YoY, signifying potential need for more meaningful cuts in current spending.

Tax Revenue (PkR bn)

Description	FY19B	FY19R	FY20B	YoY%	AKD Estimate	YoY%
Total Tax Revenue	**4,889**	**4,394**	**5,822**	**33%**	**5,253**	**20%**
- FBR Taxes	**4,435**	**4,150**	**5,555**	**34%**	**4,986**	**20%**
Direct Taxes	**1,735**	**1,659**	**2,082**	**25%**	**1,874**	**13%**
Indirect Taxes	**2,700**	**2,491**	**3,473**	**39%**	**3,112**	**25%**
Customs Duties	735	735	1,001	36%	850	16%
Sales Tax	1,700	1,490	2,108	41%	1,897	27%
Federal Excise	265	266	365	37%	365	37%
- Other Taxes	**454**	**244**	**267**	**10%**	**267**	**10%**
Petroleum Levy	300	203	216	6%	216	6%

Current Expenditure (PkR bn)

Description	FY19B	FY19R	FY20B	YoY%	AKD Estimate	YoY%
Current Expenditure	**4,179**	**4,661**	**6,193**	**33%**	**6379**	**37%**
- Debt Servicing	**1,620**	**1,987**	**2,891**	**45%**	**3036**	**53%**
Domestic Debt	1,391	1,682	2,532	51%	2,658	58%
Foreign Debt	229	306	360	18%	378	24%
- Pension	342	342	421	23%	442	29%
- Defense Affairs & Services	1,100	1,138	1,153	1%	1,153	1%
- Grants and Transfers	478	478	831	74%	831	74%
- Subsidies	175	255	272	6%	272	6%
- Others	-	-	194	-	194	-
- Civil government	463	460	431	-6%	431	-6%

Source: FY20 budget & AKD Research

Key Revenue Measures

- Sales tax at the rate of 17% to be levied on household electrical goods, including air conditioners, refrigerators, deep freezers, television, recorders and players etc.
- Sales tax at the rate of 17% to be levied on storage batteries excluding those sold to automotive manufacturers or assemblers.
- Sales tax at the rate of 17% to be levied on motorcycles and auto rickshaws.
- Sales tax at the rate of 10% to be levied on various forms of milk.
- Zero-rating of five export oriented sectors to be withdrawn through removal of SRP 1125.
- Increase rate of FED to 17% on edible oils/ghee/cooking oil.
- It is proposed to enhance the rates and redefine the thresholds by abolishing the third tier introduced earlier on cigarettes.
- 5% sales tax to be imposed on import of LNG for CNG sector and other local supplies.
- FED on cars to be rationalized with 2.5/5/7.5% to be levied to locally manufactured cars of 0 to 1000CC/1001 to 2000CC/2001CC and above.
- FED on cement sector to be increased by PkR25/bag.
- Gift to be treated as income from other sources, however genuine gift transactions are excluded
- Minimum tax rate is enhanced to 0.25-1.5% from 0.2-1.25%.
- Tax credit reduced to 5% from 10% for FY19 whereas no tax credit would be available after 2019 for BMR activities
- 100% increased tax rate for persons not appearing under Active Taxpayer List.
- Additional brackets for Income from Property
- Sales tax at the rate of 17% to be levied on household gas appliances, including cooking range, ovens, geysers and gas heaters.
- Tax rate on services is increased to 4% of the gross amount of turnover from 2% currently.
- Sales tax on ginned cotton imposed at 10%.
- Royalty to a resident person is now subject to 15% of the gross amount of royalty
- Threshold of taxable income as well as tax rates are revised for salaried and non-salaried class
- Corporate tax is kept unchanged for FY20-21 at 29% vs. gradual reduction to 27% previously.
- Sales tax at the rate of 17% to be levied on tyres and tubes excluding those sold to automotive manufacturers or assemblers.
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Key Revenue Measures

- Taxation on Capital Gains/Income on immovable property is being rationalized.
- Focus on transitioning to Minimum Tax Regime from Final Tax Regime
- Depreciation and Business losses are disallowed for calculation of Super Tax.
- Sales tax at the rate of 17% to be levied on lubricating oils, brake fluids, transmission fluid, and other vehicular fluids sold in retail packaging.
- Tax on dividend from power generation companies is enhanced to 15% from 7.5%. Further, tax rate on dividend income from companies that are tax-exempt or no tax is payable due to availability of tax credits/bought forward losses, is chargeable at 25%.
- Flat tax of 15% on dividends from mutual funds/REIT.
- Sales tax at the rate of 17% to be levied on paints, distempers, enamels, pigments, colors, varnishes, gums, resins, dyes, glazes, thinners, blacks, cellulose lacquers and polishes sold in retail packaging.
- FED on cigarettes has been increased by PkR700-1000 per 1000 sticks
- Initial allowance of 15% in case of buildings is abolished.
- Tax on Profit on Debt is increased to 15-20% vs. 10-15% previously.
- Measures have been undertaken to avoid profit shifting to dealers.
- Sales tax at the rate of 17% to be levied on foam or spring mattresses and other foam products for household use.
- Threshold of non-probed foreign remittances reduced to PkR5mn.
- Provision against doubtful debts for the Banking Companies has been disallowed whereas banks are charged a higher tax rate of 37.5% of additional income earned on additional investments in Government Securities.
- Improvement in Mechanism on amortization of expenditures on intangible assets.
- Withholding tax enhanced on dealers, commission agents and arhatis.
- Procedural measures have been undertaken to improve tax base.

Key Relief Measures

- Sales tax exempt on cottonseed oil and wheat bran
- Customs Duty on import of various inputs of Pharmaceutical industry decreased from 3% to 0%.
- Customs Duty on import of raw material for Nitrogenous fertilizers and other fertilizers decreased to 0% from 3%.
- Customs duty on import of resins decreased to 0% from 3%.
- Customs duty on import of various synthetic materials decreased to 11% from 16%.
- Customs duty on import of scrap reduced to 0% from 3%.
- Customs duty on import of granules and powders decreased to 0% from 3%.
- Customs duty on import of copper wire decreased to 0% from 3%.
- Customs duty on import of tin and tin alloys decreased to 0% from 3%.
- Customs duty on import of vacuum pumps, thermostats and air compressors for use in manufacturing of fridges decreased to 0% from 3%.
- Customs duty on import of conveyor belt for cement plants decreased to 0% from 3%.
- Customs duty on import of spinning and weaving machines decreased to 0% from 3%.
- Refund clearance through promissory funds.

Banking Sector - Negative

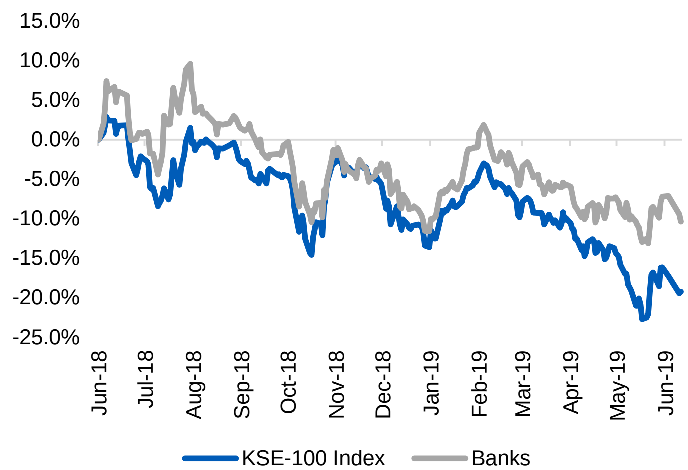
Key Measures

- ❑ Taxable income arising from additional income earned from additional investment in Federal Government Securities for the tax year 2020 and onwards shall be taxed at 37.5%.
- ❑ Government plans to restrict borrowings from Central Bank.
- ❑ Depreciation and Business losses should not be included in Super Tax calculation.
- ❑ Provisions on doubtful debt is disallowed for tax purposes. Hence, only provisions on loans in loss category would be included as a deductible expense.
- ❑ Tax credit on health insurance for both filers and non-filers.
- ❑ Treasury Single Account (TSA) Implemented

Comments

Taxation measures are likely to increase tax burden on the sector (Clarity on the meaning of additional investments is required) however, we believe timing of implementation of TSA (immediate or gradual) would define investor sentiments going forward. Clarity on the meaning of additional investments is also required to access the tax impact. Amidst the negatives, likely shift in borrowings from Central Bank can allow banks to reap higher yield spreads and extension of tax credit on health insurance to non-filers as well could pull bancassurance fee income.

Banking Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price	TP	Total	EPS(PkR)		PE(x)		PB(x)		DY(%)	
		(PkR)	(PkR)	Upside (%)	CY19	CY20	CY19	CY20	CY19	CY20	CY19	CY20
Allied Bank Limited	ABL	103.49	118.50	14.50	13.09	16.07	7.91	6.44	1.03	0.97	7.73	9.66
Bank Al Habib	BAHL	79.96	97.64	22.11	8.20	10.60	9.75	7.54	1.61	1.39	5.00	6.88
Bank AlFalah	BAFL	44.99	50.89	13.12	7.57	8.20	5.94	5.49	0.90	0.81	4.45	6.67
Habib Bank Limited	HBL	122.68	143.25	16.77	11.72	18.06	10.47	6.79	0.81	0.74	4.89	6.52
Habib Metropolitn Bank	HMB	37.81	43.81	15.88	6.92	8.34	5.47	4.53	0.93	0.79	6.40	7.72
MCB Bank Limited	MCB	175.30	224.73	28.20	21.95	26.29	7.99	6.67	1.26	1.18	9.13	11.98
Meezan Bank Limited	MEBL	89.41	115.80	29.52	11.63	14.04	7.69	6.37	2.03	1.75	4.47	6.71
National Bank of Pakistan	NBP	37.78	66.51	76.04	10.44	14.79	3.62	2.55	0.36	0.34	13.23	21.18
United Bank Ltd	UBL	154.50	154.60	0.07	17.40	24.10	8.88	6.41	0.96	0.86	5.83	8.41

Key Measures

- Additional FED levy on retail sales price of vehicles formalized beyond the currently applicable 10% on displacements above 1,700CC expanded to all vehicles progressively, based on displacements with 2.5/5.0/7.5% levy on >1000CC/1000-2000CC/2000CC+
- Withdrawal of 2% additional tax levy on auto parts and tyres sold to OEMs (not applicable on sales in the aftermarket)

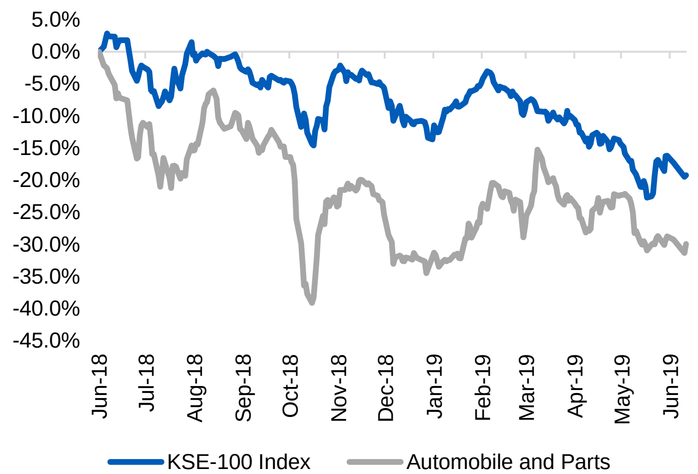
Comments

With the 10% FED Levy on Vehicles above 1,700CC imposed in Mar'19 (surprise move, with negative sentiment expressed by OEMs) has significantly depressed demand for the vehicle segment, where an expansion of the same to all vehicles has the risk of softening demand further.

Additional FED on top of WHT, registration fee and additional levies only raises the cost of purchasing a new vehicle. While restrictions on imported vehicles and major devaluation of the PkR has made imports uncompetitive, additional levies on CKD variants could keep demand restricted over the medium term.

Repercussions for new entrants can be seen, where doubts have already been raised over Greenfield investment by Renault. Even so, CD levies envisioned under AIDP-2 have been retained in the Finance Bill.

Automobiles Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price (PkR)	TP (PkR)	Total Upside (%)	EPS(PkR)		PE(x)		PB(x)		DY(%)	
					CY19	CY20	CY19	CY20	CY19	CY20	CY19	CY20
Indus Motors	INDU	1,156.4	1,465.2	35.5	177.7	179.2	6.5	6.5	2.3	2.0	9.1%	9.1%
Pak Suzuki Motors	PSMC	274.9	244.9	-19	1.7	21.6	162.7	12.7	0.8	0.7	-	2.2%

Cable & Electrical Goods – Neutral to Negative

Key Measures

- ❑ Household electrical appliances to be included in sales tax regime (Third Schedule) with applicable sales tax of 17%, while downstream dealer network sales tax registration and collection to be made mandatory for concessionary import duties
- ❑ Removal of 3-8% CD on various core components for Deep Freezers and Fridges including Coolants, Vacuum Pumps and Compressors (pursuant to various regulatory approvals and quotas)
- ❑ Removal of 3% CD on Aluminum Sheets for Electrical equipment primarily used in Power Transformers
- ❑ 10% CD imposed on Glass board imported for manufacturing LED TVs

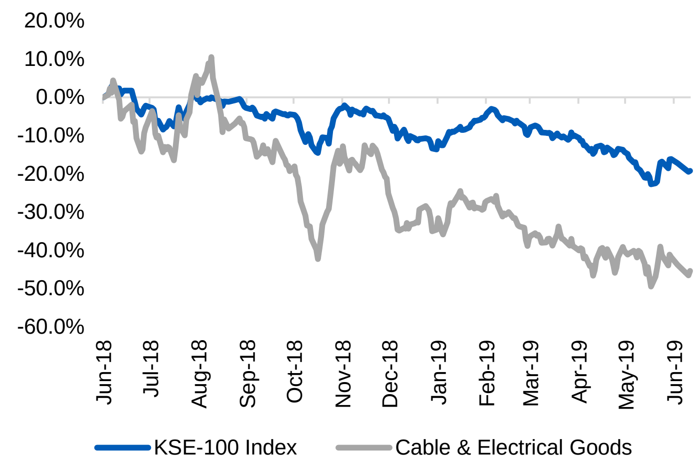
Comments

While minor improvements in imported component customs levies could ease the burden of rapid rise in material COGS for PAEL, we believe the inclusion of household appliances in the sales tax regime is broadly negative.

Amidst a tepid macro backdrop, consumer durable spending is expected to face a terse outlook, where the only respite is parallel rise in levies and prices of imported alternatives, making for limited substitutes.

Consumers are expected to trade down, limit purchases and favor price competitive offerings. Minor respite for PAEL may arise from consistent power sector reforms, where a preference for T&D CAPEX is yet to materialize.

Cable & Electrical Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price (PkR)	TP (PkR)	Total Upside (%)	EPS(PkR) CY19	EPS(PkR) CY20	PE(x) CY19	PE(x) CY20	PB(x) CY19	PB(x) CY20	DY(%) CY19	DY(%) CY20
Pak Elektron Ltd	PAEL	20.78	23.61	16	2.02	2.93	10.3	7.1	0.3	0.3	2.4%	4.8%

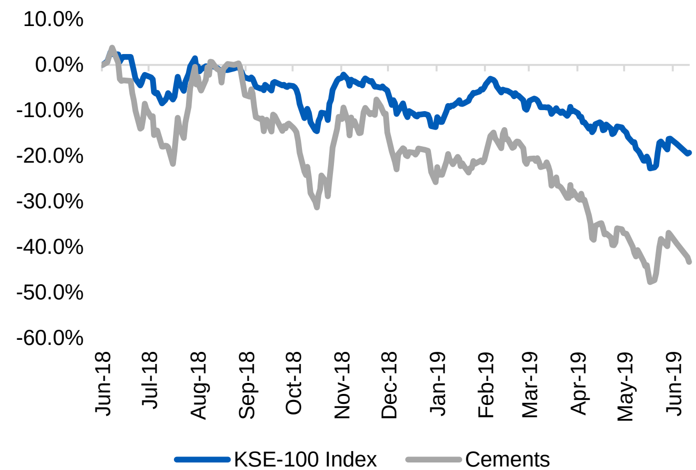
Key Measures

- Increase in FED to PkR2/kg from PkR1.5/kg
- Federal PSDP target stands at PkR701bn for FY20 vs. PkR675bn for FY19, up by 3.8%YoY
- Tax credit on BMR and expansion has been decreased to 5% with applicable limit reduced to Jun'19 from Jun'21

Comments

Although budgeted PSDP has increased, the actual releases are expected to remain low due to the ongoing fiscal consolidation which will result in muted demand growth. On the other hand, taking cue from recent price increase and our correspondence with industry players, we expect the full impact of increase in FED to be passed on though the long term sustainability remains a question. Reduction in tax credit will be negative for local players, namely LUCK, KOHC and PIOC, whose expansions are under construction while players like MLCF and CHCC who availed the credit during FY19 might have to reverse almost half the amount booked under tax credit.

Cement Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price (PkR)	Mkt Cap (US$mn)	EPS(PkR)		PE(x)		PB(x)		DY(%)	
				FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
DG Khan Cement	DGKC	53.4	154.4	6.8	7.8	7.9	6.9	0.3	0.3	2.5%	2.9%
Lucky Cement	LUCK	386.1	824.3	30.4	27.2	12.7	14.2	1.4	1.3	2.5%	2.2%
Maple Leaf Cement Factory	MLCF	22.1	86.47	5.2	3.5	4.2	6.4	0.4	0.4	4.7%	3.1%
Fauji Cement Company Ltd.	FCCL	14.6	133.00	2.1	1.7	7.0	8.8	0.96	0.9	12.0%	10.1%
Pioneer Cement Limited	PIOC	21.9	32.95	3.9	2.9	5.6	7.5	0.36	0.4	4.6%	3.4%
Cherat Cement Co Limited	CHCC	30.8	35.93	10.1	2.6	3.0	11.8	0.45	0.44	6.8%	1.9%
Gharibwal Cement Ltd	GWLC	10.5	27.75	2.70	3.69	3.89	2.84	0.34	0.32	16.70	21.40

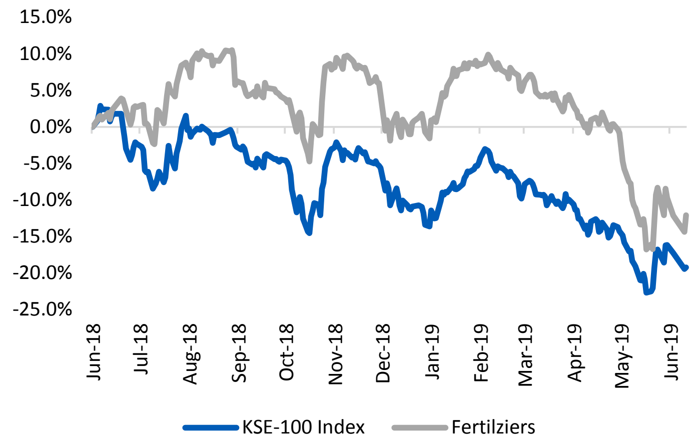
Key Measures

- ❑ Uniform GST of 2% on all fertilizers maintained
- ❑ Final Tax regime to be treated as minimum tax except for exporters and sellers of petroleum products
- ❑ Corporate tax rates freeze at 29% for 2 years
- ❑ Rate on sales tax on LNG reduced to 5% from 7%
- ❑ Tax credit for machinery installed till 30th June'19; tax credit proposed to be reduced from 10% to 5% (Negative for EPCL, ENGRO)
- ❑ No update on GIDC

Comments

While Budget FY20 does not have explicit implications for Fertilizer sector, status quo w.r.t. sales tax on fertilizer should be taken in positive light, despite our belief that Fertilizer players would have passed on the impact of higher GST. However, no tax credit for machineries in FY20 may spell negatively for ENGRO and its subsidiary which are contemplating expansion projects. No update on GIDC is also a sentiment dampener.

Fertilizer Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price	Mkt Cap	TP	EPS(PkR)		PE(x)		PB(x)		DY(%)	
		(PkR)	(US$mn)	(PkR)	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
Engro Corporation	ENGRO	268.53	1,021.4	348.8	43.6	56.4	6.2	4.8	0.8	0.6	11.5%	11.5%
Engro Fertilizers Limited	EFERT	64.33	567.1	71.5	11.5	11.6	5.6	5.6	1.8	1.7	15.5%	15.5%
Fauji Fert. Bin Qasim Ltd.	FFBL	18.29	112.8	35.7	2.5	5.9	7.4	3.1	1.3	1.1	10.9%	13.7%
Fauji Fertilizer Company	FFC	95.60	803.0	115.8	12.7	13.6	7.6	7.0	3.3	3.0	10.5%	11.5%
Fatima Fertilizer	FATIMA	27.58	382.4	32.5	8.2	7.3	3.4	3.8	0.9	0.8	10.9%	11.8%

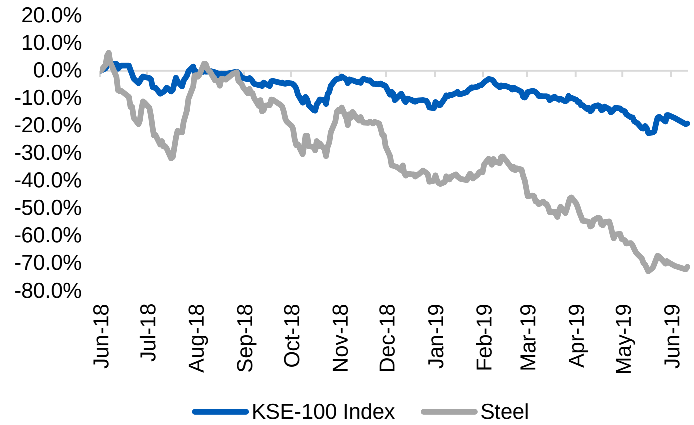
Key Measures

- Restoration of normal tax regime for steel manufacturers (i.e. 17% FED applicable in sales tax mode) vs. previously taxed under Sales Tax Special Procedure withholding rules 2007 (i.e. PkR13KwH/unit on electricity and PkR5600/ton on import of steel scrap).
- Decrease in customs duty on import of scrap to 0% from 3%.

Comments

The abolishment of special procedure is marginally negative for local manufacturers, considering slightly higher tax liability and limited pricing power of the producers to pass on. Removal of customs duty on import of scrap is positive, providing a relief to local manufacturers in times of muted demand and pressure on prices.

Steel Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price (PkR)	TP (PkR)	Total Upside (%)	EPS(PkR) FY19	EPS(PkR) FY20	PE(x) FY19	PE(x) FY20	PB(x) FY19	PB(x) FY20	DY(%) FY19	DY(%) FY20
Amreli Steels Ltd.	ASTL	22.91	58.00	176	2.38	5.00	9.06	4.31	0.50	0.44	-	11.6

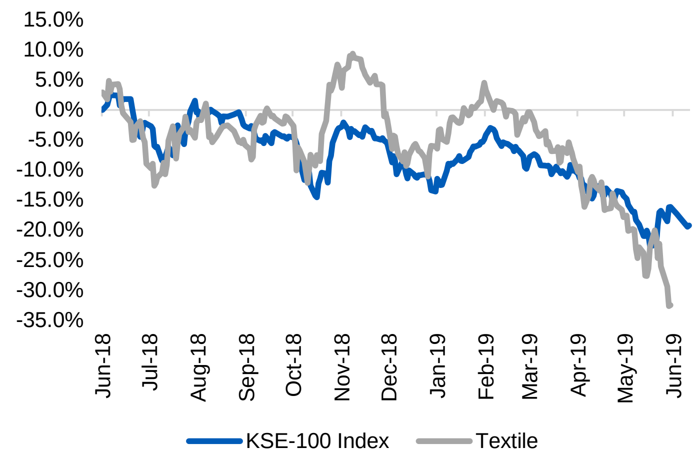
Key Measures

- Withdrawal of zero rating regime
- Higher sales tax on local supplies of finished textiles articles (i.e. 6% to 15% for integrated units and 9% to 17% for others)
- Introduction of automated fund clearance system
- Reduction in import duties on raw materials
- Sales tax levy of 10% on ginned cotton (previously exempt)
- Minimum turnover tax raised to 1.5% (previously 1.25%)

Comments

While the withdrawal of zero-rating status could create liquidity problems for domestic apparel manufacturers, the impact of same will be partially offset by the introduction of automated fund clearance if properly implemented. Reduction in import duties is a positive and would result in lower input cost. Higher sale tax rate on domestic supplies is a pass on for domestic manufacturers however this could lead to demand compression. Higher turnover tax will increase tax liability for the manufacturers, with more profound impact on players with the higher exports share.

Textile Sector vs. KSE100 Index



Source: PSX & AKD Research

Stock	Symbol	Price (PkR)	TP (PkR)	Total Upside (%)	EPS(PkR) FY19	EPS(PkR) FY20	PE(x) FY19	PE(x) FY20	PB(x) FY19	PB(x) FY20	DY(%) FY19	DY(%) FY20
Nishat Mills Ltd	NML	97.25	158	62	13.70	14.92	5.50	6.00	0.4	0.4	6	7
Nishat Chunian Ltd	NCL	35.30	55.0	55	9.30	9.30	3.8	5.0	0.6	0.5	6.6	5.31

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To arrive at our period end target prices, AKDS uses different valuation techniques including:

Discounted Cash Flow (DCF, DDM)

Relative Valuation (P/E, P/B, P/S etc.)

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

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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%)

Old Rating Definitions (Discontinued)	
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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