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PAKISTAN STRATEGY

REP-019

MARKET VISTA

One sunrise does not make a summer

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- **The PTI-led GoP passed the second amendment of the Finance Supplementary Bill 2019, where minor 'tweaks' have been made to provisions introduced in its previous edition with positives in place for Autos (scrapping of non-filer sales ban) and negatives for Banks (continuation of Super tax beyond 2020).**
- **From a macro lens, the second supplementary budget remains mute on concrete measures to address fiscal woes, where recent data points necessitate immediate action to instill budgetary discipline. The GoP's reliance on collecting GIDC arrears remains in place, a measure we believe will prove to be inadequate in balancing the prevailing fiscal equation**
- **For Banks, imposition of super tax on FY18 income (CY17 profits of the sector) could dampen 1QCY19 earnings by ~PkR0.3-1.5/sh across our universe (already incorporated), with HBL and UBL on the higher end of our estimates and BAFL and MEBL at the lower end, while the extension of super tax levy beyond 2020 cuts our valuation for the sector by ~4-6%**
- **For Autos, non-filer ban removal irrespective of engine capacity is a clear positive for the space, where previously indicated partial removal (upto 1,300CC) in the first draft of the Supplementary Bill had kick-started price performance in PSMC (up 89.1%CYTD), and is likely to spur price performance in HCAR (100% of sales from 1,300CC+ segment).**
- **For equity investors, we believe the initial euphoria of 'positive measures' in the Bill have largely worn-off due to its long gestation period (first introduced in parliament on Jan 22nd), showcased by lackluster performance on its eventual passing. Standing by our cautious stance on market performance, we retain a liking for Banks (MEBL, MCB) and PkR-hedge oriented plays (NML, HUBC, OGDC).**

Key highlights:

Proposed	Actual
Non-filers can purchase vehicles having engine capacity up to 1300cc	Non-filers can purchase vehicles of any engine capacity
10% FED levied on car of cylinder capacity above 1800cc	10% FED levied on car of cylinder capacity above 1700cc
4% super tax till FY20 for banking sector	4% super tax extended beyond FY20 for banking sector

Source: Finance Supplementary Bill & AKD Research

Super tax is here to stay for Banks: The GoP stood with its proposal of imposing super tax on the banking sector on FY18 income at 4% while also extending it for period post 2020. Imposition of super tax on FY18 income (CY17 profits of the sector) could dampen 1QCY19 earnings by ~PkR0.3-1.5/sh across our universe, with HBL and UBL on the higher end of our estimates and BAFL and MEBL at the lower end. Additionally, extension of super tax levy beyond 2020 cuts our valuation for the sector by ~4-6%. However, the GoP has incentivized the banking sector to lend to Agricultural, SME and low-cost housing sectors by reducing the tax rate to 20% on income derived from such financing (Current tax: 35% + 4% super tax). ABL, HBL, MEBL having 10-16% share of agri-related financing in total advances mix and BAFL due to higher exposure to SME segment could benefit through lower effective tax rate.

AKD Banking Universe: Earnings impact

	TP (PkR)	Chg %	CY19E EPS	EPS impact of CY17 Super tax	Agri/total advances
ABL	105.7	-5.3%	14.4	(0.75)	15.8%
HBL	130.5	-3.7%	11	(1.40)	9.9%
MCB	196.3	-4.7%	21.3	(1.00)	2.7%
NBP	40.7	-5.0%	8.48	(0.70)	5.5%
UBL	133.3	-4.3%	16.1	(1.40)	1.3%
BAFL	45.7	-4.8%	7.4	(0.36)	1.7%
MEBL	108.9	-5.7%	10.4	(0.30)	11.6%

Source: Finance Supplementary Bill & AKD Research

Auto sales given the greenlight: Reversing its previously stated continuation and modifications (keeping ban on 1300CC+ segments) to the sale of vehicles to non-filers, the GoP has erred on the side of auto industry participants, scrapping the restriction entirely. This is clearly a positive development for the space, where partial removal (sale of upto 1,300CC vehicles) in the first draft of the Supplementary Bill had kick-started price performance in PSMC (up 89.1%CYTD). Based on revenue split by segment we expect HCAR (1300CC+ segment sales are 100% of sales with Civic's share at 49.2%) to benefit most from the ban removal. INDU (Corolla 1.3/Corolla 1.6-1.8//4X4 segments contribute 47%/34%/19% to revenues) cements its place in the fight for industry market share, where their premium 4x4 segment and strong rural demand base (55-60% of sales) are supported by this measure crystalizing our bullish outlook. For PSMC (Swift only variant above 1,300CC mark contributing ~4% to their topline) the removal of non-filer ban could temper the stock's performance as competitors are now at a level playing field. Additionally 10% FED has been levied (against lobbying efforts of new entrants) on all vehicles of displacement above 1,700CC, which will dissuade demand from price sensitive customers.

Fiscal woes remain unaddressed: As contended in our earlier note (dated 24th Jan 2019), the second supplementary budget is a market positive and a macro negative, as it lacks any concrete

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measures to address the fiscal woes. Latest 1HFY19 fiscal data points to mild scale fiscal blowout if no further remedial action is undertaken. Despite notable 36%YoY cut in development spending, the 1HFY19 fiscal deficit hit five year high of 2.7% of GDP (PkR1.03trn) vs. 2.2% of GDP (PkR0.79trn) in 1HFY18, where significant current expenditure overrun (up 17%YoY) and poor revenue collection (down 2%YoY) were key culprits. Additionally, more recent data on revenue collection reportedly shows a revenue shortfall of PkR235bn during 8MFY19, clearly implying the need for fiscal consolidation. The authorities seem to be banking on a collection of GIDC arrears amounting PkR208bn to plug the revenue shortfall. Taking a cue from the last GIDC settlement in CNG sector (PkR12bn realized against total outstanding bal. of PkR39bn), we contend the authorities' sole reliance on GIDC arrears remains inadequate to balance the prevailing fiscal equation. Lack of tangible policy action on the fiscal side leaves monetary policy as the only tool to rein in macro-challenges. We expect a further 25-50bps policy rate hike in the upcoming monetary policy by the end of Mar'19.

Outlook: Even in its amended form, the supplementary amended Finance Bill (technically the PTI-led Governments third set of policy proposals) fails to address the root of the problem i.e. tackle twin deficits with a focus on fiscal prudence. Business friendly measures remain at the core, where kick-starting organic growth through inclusion of undocumented segments of the economy (SMEs, rural or unorganized sectors), clearance of dues to export oriented sectors (formation of Refund Settlement Company under FBR) and pro-reinvestment measures (five year tax holiday on Greenfield ventures, group relief on inter-corporate dividends) are supportive policies being applied.

Investment Perspective: Fertile grounds for business activity alone fails to address the situation at present, i.e. budgetary deficits or external imbalance vulnerabilities, where IMF negotiations (a question of when not if) are expected to be divisive on the question of politically unpopular but vital measures for instilling fiscal discipline. For equity investors, we believe the initial euphoria of 'positive measures' in the Bill have largely worn-off due to its long gestation period (first introduced in parliament on Jan 22nd), showcased by lackluster performance from broad based sectors on its eventual passing. Standing by our cautious stance on market performance, we retain our liking for Banks (MEBL, MCB) and PkR hedge/oriented plays (NML, HUBC, OGDC).

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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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- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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