AKD Daily

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Today's Daily

Budget FY18: Proposals and Implications

The incumbent government is due to present its last federal budget on May 26'17 where we expect the government to move ahead with its growth agenda. Setting an ambitious GDP growth target of 6% in FY18F, the GoP is likely to enhance its development expenditure primarily making its case on uptick in CPEC led activity, with news flows suggesting federal PSDP allocation at PkR1,001bn vs. PkR800bn in FY17B. However, fiscal constraints will remain in play where higher tax collection is likely to be supported by increase in duties and continued penalization for non-filers. For capital market, incoming PSX proposals including: 1) reduction in CGT, 2) bonus tax applicability on face value instead of the value of the bonus issued, 3) extension in tax credit for new listings to five years and 4) reduction in corporate tax rate to 30%, entail positive implications, attempting to increase the depth in the market. Specifically, we feel continued support will be extended to exporting industries via relief packages (positive for Textiles) while infrastructure focus is to keep Construction and Allied sectors (positive for Cements, Autos) in limelight. Banks might bear the brunt of additional taxation measures (continuation of super tax likely) alongwith Dairy manufacturers in case of any increase in sales tax on tea whiteners.

KSE100 - Index

Current	51,373.51
Previous	50,742.03
Chg.	1.24%

Mkt Cap. (PkRbn/US$bn)

Current	10,196 / 97.24
Previous	10,095 / 96.28
Chg.	1.00%

Daily Turnover (mn)

Current	240.19
Previous	345.05
Chg.	-30.4%

Value Traded (PkRmn/US$mn)

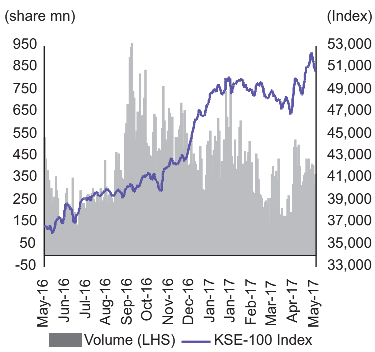
Current	12,571 / 119.89
Previous	12,489 / 119.11
Chg.	0.7%

News and Views

- Sindh Engro Coal Mining Company (SECMC) has signed two separate coal supply agreements with the Thar Energy Limited (TEL)(a subsidiary of HUBC) and ThalNova (JV between subsidiaries of THALL & Novatex Ltd) to supply 1.9mtpa coal to each.

- KPK government has signed four agreements for mega projects worth of US$10.86bn (PkR1,173bn) with the Frontier Works Organization (FWO). The mega projects will include Peshawar Model/Smart City Township (US$4.6bn), KP China Investment Plan (KPCIP)-M1 City Nowshera (US$4.4bn), three hydro power plants in Chitral (US$1.11bn), one cement plant at Haripur (US$160mn) and one state-of-the-art oil refinery at Karak (US$600mn).

- The GoP has allocated PkR250bn in the FY18 budget for various special social programs to improve socioeconomic developments. Of the total allocation, major chunk will be utilized under different PM's initiatives, which include: 1) PkR30bn for PM's global sustainable development goals (SDGs) program, 2) PKR20bn for PM's youth scheme and 3) PkR10 bn for PM's national health program.



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Economic targets set too ambitiously: The GoP has revealed that FY17 GDP growth is provisionally recorded at 5.28%, crossing the 5% mark to reach its 9yr high, primarily reflecting 3.46% recovery in the Agriculture sector from a low base (0.27% in FY16R) and encouraging trend in the LSM sector (4.93% in FY17 vs. 2.94% earlier. Maintaining the momentum, GDP growth for FY18 is ambitiously targeted at 6%, however we expect it to remain lower at 5.48% on the back of LSM growth stagnating around current levels as energy bottlenecks linger amid higher inflationary outlook. Keeping in line with the growth agenda and likely populist nature of the budget before elections in 2018, Budget FY18 is expected to lean towards greater development expenditure where news flows suggest that federal PSDP allocation would be raised to PkR1tn vs. PkR800bn in FY17B (total PSDP at PkR2.141tn vs. PkR1.675bn in FY17B) to cater for CPEC related activity. However, fiscal constraints will remain in play with the GoP setting tax collection target at an ambitious PkR4tn (vs. PkR3.6tn in FY17B), likely to be supported by increase in duties and continued penalization for non-filers. That said, in lieu of maintaining its populist tilt, we expect continued support to export and other industries through relief packages. Fiscal deficit target for FY18B has been set at 4% of GDP, slightly lower than the upwards revised target of 4.1% of GDP for FY17, though we expect the deficit for FY18 to cross 5% of GDP on the back of low tax collection.

Investment Perspective: By and large, Budget FY18 is likely to hold positive implications for the market. The incoming budgetary proposals remain largely in favor of Cements (continued infrastructure push), Fertilizers (agri-related incentives), and Autos (rationalization of GST on tractors, announcement of car schemes). While super tax is an earnings dampener for banks, we feel it has been already priced in by the market. Reiterating our index target of 55,808, we look favorably towards OGDC, UBL, DGKC, FCCL, MLCF, FATIMA and PSO.

Market level Proposals and implications

Proposals	Impact
Reduction in corporate tax rate by 1ppt to 30% for non-banking companies.	Positive
Continuation of Super tax at 3%/4% for banking/non-banking companies having profits above PkR500mn.	Neutral
PSX proposes reduction in CGT rates	Positive
Bonus tax of 5% to be imposed on face value	Positive
Extension in tax credit period to 5 yrs (vs. 3 yrs) for new listings.	Positive
Further segregation between filers and non-filers in case of taxation on dividends.	Neutral

Source: Newsflows & AKD Research

PSX's CGT Proposal for Filers

Holding Period	Existing	Proposed
upto 6months	15.00%	10.00%
>6months - 12months	15.00%	8.00%
>12months - 24months	12.50%	0.00%
>24months - 48months	7.50%	0.00%
> 48months	0.00%	0.00%

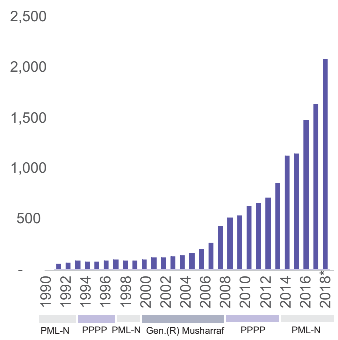
Source: AKD Research

FY18 Preliminary Budget Estimates

	FY16R	FY17B	FY18T*
Current Expenditure (PkRbn)	3,599	3,844	4,350
Defence Expenditure	776	860	950
PSDP (PkRbn)	1,393	1,675	2,141
Federal	661	800	1,001
Provincial	732	875	1,140
FBR Tax Collection (PkRbn)	3,104	3,621	3,887
Fiscal Deficit (% of GDP)	4.6	4.1	4.0

T= target; *estimates from news flows
Source: MoF, Newsflows, AKD Research

Total PSDP-Govt wise (PkR bn)



*estimates from news flows
Source: MoF & AKD Research

Sector	Proposals	Impact	Comments
Bank	Continuation of super tax	**Negative**	Extension in super tax is expected to impact AKD Banking Universe by 4-6%
	Deletion of seventh schedule from income tax ordinance	**Neutral**	While taking away certain allowances on provisions, abolition of the seventh schedule should also bring banks under the corporate tax regime lowering their tax rate to 30% (vs. flat 35% on all income sources) in the process.
Oil & Gas	CPI linkage of OMC margins (slated for June'17), payments to relieve circular debt constraints on liquidity for PSO and continued implementation of monthly pricing regime	**Neutral**	Delivering what has been promised to the sector and accomodated in investor expectations is a prerequisite for long term dynamics of the sector (alleviating energy shortages, privatization plan). Any shortening of the pricing period could normalize inventory variations.
	FBR proposes riasing the GST rate on POL products by ~3%	**Negative**	Low oil prices continue to encourage higher demand, where the marginal propensity of transport customers may wane in an environment of higher global oil prices (shift to CNG).
	Inclusion of E&P in normal corporate tax structure from current higher tax rate of 40%.	**Positive**	Currently E&P sector is taxed at higher rate of 40% as compared to corporate tax of 30% (FY18) on other sectors. Inclusion of E&Ps (OGDC, PPL, POL & MARI) in normal tax regime will be positive for sector, improving their bottomline.
Cements	The GoP is expected to continue maintaining its focus on infrastructure development in FY18 as well, where Federal/Provincial PSDP allocation is expected to rise by 25/27% to PkR1/1.1tr against allocation of PkR800/875bn in FY17 budget respectively.	**Positive**	Relatively higher infrastructure spending is expected to sustain domestic growth momentum where we anticipate the same to register double digit growth in FY18 (+10.7%YoY in 10MFY17).
	APCMA has proposed to increase customs duty on the import of clinker from 10% to 20%, along with registration of foreign clinker exporters with the Pakistan Standards and Quality Control Authority.	**Positive**	The move will extend support to local manufacturers from low-grade quality cement being dumped in the Pakistani market.
	Reduction of 1% in corporate tax	**Positive**	Expected reduction in corporate tax rate by further 1% to 30% should improve profitably across the sector.
Autos	Regulairize deviations in import stage (SRO 499) and retail stage taxation measures for OEMs, effectively acting as a double taxation.	**Positive**	Undue cost escalations arise from dual taxation as OEMs pass on duties and cesses at import stage, and retail level taxation is also borne by consumers, where any reduction may support demand.
	Continued implementation of AIDP-II incentives, framework and reforms.	**Neutral**	BoI is the focal agency for approving incentives under the policy, where new entrants are currently being encouraged, with implementation of health, saftey and recall standards yet to be seen
	Rationalization of input and output sales tax for tractor manufacturers(Current input/output sales tax stands at 17%/5%)	**Positive**	This is likely to improve liquidity situation of tractor manufacturers
	Expected announcement of Punjab passenger vehicle subsidized scheme (~100000 vehicles)	**Positive**	Replacing Punjab Rozgar Scheme, any such announcement will be positive for PSMC's sales growth
Fertilizer	Removal of GST on all fertilizer products as replacement of current cash subsidy.	**Positive**	Currently 17% GST is charged on fertilizer product, except urea on which 5% GST is applied. Removal of GST will save the sector from excessive delay in subsidy refunds, hence easing pressure on woking capital and liquidity.
	Continuation of current fertilizer subsidy	**Positive**	Further allocation to the ferlizer subsidy announced last year to stimulate demand going forward and restrict further inventory pile-up.
Power	Increased GST on RFO (FY17 average of 22%)	**Negative**	Raises EPP costs that are passed through to consumers and end up raising circular debt accretion
	Headway on circular debt clearance, reforms and privatizations	**Positive**	Highly unlikely as poilitcal motives favour short term, stop gap responses, where as long term solutions may be initiated post May'18 elections
	Supertax continuation	**Negative**	KAPCOs NPAT falls by the amount of the levy, negating any favourable movement of indexation barometers
Textile	Payment of all pending sales tax refunds, duty drawbacks, and other export package claims	**Positive**	Textile industry is in deep liquidity crisis due to pending claims, disbursement of pending claims will alleviate liquidity concerns and reduce financing cost.
	Zero-rating tax regime for all textile manufacturing inputs	**Positive**	The said proposal demanding zero-rated tax regime for all inputs (packaging material, spares, coal, HFO etc) will extend support to margins and industry competitiveness resulting in higher exports. While on the flip side, GoP recently reimposed duty and sales tax on import of cotton/manmade fibre.
	Abolition of GIDC & other surcharge on gas and electricity, respectively	**Positive**	Reduction and rationalization of electricty and gas tariffs will definitely improve industry competitiveness, however implementation of proposal is unlikely considering heavily subsidized textile sector.

Source: Newsflows & AKD Research

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