



## Power to the People

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## POWER TO THE PEOPLE

### BUDGET FY10: STEADY AS SHE GOES

FY10 is the year of living cautiously. Pakistan faces considerable stress on its security complex which is crowding out spending in other sectors. The high cost of capital is vexing the economy, making resource mobilization and tax base expansion difficult. Dependence remains predominantly on foreign public sources for capital. Fiscal policy may be looking towards growth but the walk remains skewed towards protecting macro-economic stability; controlling inflation and sustaining currency. The thrust of fiscal policy is towards the industrial sector. Cements, cars and communication have been provided concessions, duties on pharmaceuticals, tractors and raw materials have been rationalized and industry is being given protection through higher import duty. Broad focus remains on energy and agriculture.

### ECONOMICS: INITIATING CPR!

An expansive PSDP program of PKR626bn will help to stimulate the economy while non materialization of foreign inflows remains a key risk to growth. Slippage with regards to revenue targets could put pressure on the projected fiscal deficit of 4.9%. The agriculture sector has been the focus in this budget with large allocations for water resource development, tractor schemes and productivity enhancement. Spending on construction in conjunction with an accommodative monetary stance should help revive manufacturing. However imposition of FED on services, increase in WHT on imports and carbon surcharge have the potential to re-initiate inflationary pressures. In this regard, increases in the price for crude oil will be critical in determining the macro pressures. Though recovery since Oct08 has been remarkable, persisting structural weaknesses threaten to derail future growth.

### MARKET STRATEGY: BE GREEDY

The KSE100 is trading at an unprecedented discount of 56.6% to the region. A re-rating is inevitable given improving risk perception with regard to the investment climate, consolidation of a democratic setup, concerted effort against internal security issues, comfortable balance of payments position, continuation of monetary easing, and access to liquidity with re-introduction of a leverage product on the cards. Also, fears of a gross asset tax, increase in the corporate tax rate and increase in equity transaction costs have been laid to rest. Valuations are cheap and fundamentals will remain key to KSE performance; our earnings growth estimates suggest room for re-rating towards a PER of 6.8x-7.0x and an implied target level of 8,400-8,700.

### TOP PICKS: STRONG FUNDAMENTAL PLAYS

Sector	Budget Impact	BMA Stance	Top Picks
Autos	Positive	Underweight	-
Cements	Positive	Overweight	LUCK, DGKC
Commercial Banks	Neutral	Underweight	UBL
E&P	Positive	Overweight	OGDC, POL, PPL
Fertilizer	Positive	Overweight	-
OMC	Positive	Overweight	PSO
Power	Positive	Overweight	HUBC
Refinery	Positive	Marketweight	-
Technology & Communication	Positive	Underweight	-
Textile	Positive	Marketweight	-

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## BUDGET FY10: STEADY AS SHE GOES

### In summary: A budget for difficult times

If FY09 was the year of living dangerously, FY10 must be the year of living cautiously. And as far as budgets go, this one is cautiously ambitious. This is understandable. The economy continues to face steep challenges and the country is facing considerable stress on its security complex. The need to counter this stress will crowd out spending in other sectors. Additionally the high cost of capital and deteriorating security situation are vexing the domestic economy making increased resource mobilization and expanded tax base a difficult task. Moreover the external environment remains weak with better days still in the distance. Inadvertently, the economy is increasingly dependent on foreign public sources for capital rather than private investors. Hence, in reality the scope of the budget has been limited by challenges. In that regard the fiscal stimulus, though conditional, augurs optimism - cautious optimism that is.

### Economic & budget targets: Ok not that V-shaped but not U-shaped either

Fiscal policy might be looking towards growth; but the walk remains skewed towards protecting the hard earned macro-economic stability – that is controlling inflation and sustaining currency stability. Growth for the year is projected at 3.3% YoY (led by agriculture and services) against 1.9% YoY in FY09 while inflation is projected to decline to 9.5% YoY (21.8% YoY in FY09). Achieving single-digit price stability would entail suffering slower growth for the time being.

The fiscal deficit projection is 4.9% for the year. However, stripped to the bare bones (that is taking out expenditure attached to external aid) the fiscal deficit is 3.4% against 4.3% during FY09. This represents significant pruning from last year and leads us to be more optimistic about price stability going forward. The increase in projected tax revenue is 20.7% YoY and much of that increase will come at the behest of additional taxes and some increase in the tax base. The aggregate revenue target is 17.8% higher YoY. Aggregate expenditure is 20.7% higher YoY with much of the increase coming in PSDP spending. In fact, current expenditure is expected to be curtailed by 15% YoY – a positive development. However, much of the increase in aggregate development expenditure is conditional; spending will reach its target only if external aid materializes.

Over the last 12 months Pakistan's external deficit has normalized rapidly. The final current account deficit for FY09 is 5.3%. To assist further normalization, the government has proposed a further increase in taxation on imports. For sectors that have not been individually addressed, WHT has been increased from 2% to 4%. For exporters, an investment support fund of PKR40bn is being put together. Additionally, importers of raw material will be able to deduct their WHT liability against the entire tax liability. This will provide some protection to local industry.

### **Budget measures: The slow march to revival**

The thrust of the fiscal policy is towards the industrial sector. This is understandable as LSM output contracted over FY09. A nod has been given to indigenous consumer good sectors with the 3 C's (cements, cars and communication) being provided significant concessions. There has also been a reduction/exemption in the custom and regulatory duties of pharmaceutical goods, tractors and other raw materials while local industry is being given protection through higher duties on imports.

Besides industry, the broad remains on energy and agriculture. The energy crises affecting Pakistan is well documented. To alleviate the crisis, there is action to reduce the circular debt overhang – the government has guaranteed the money owed by the energy chain to banks and has also decided to pay the USD1bn owed by the FATA regions. Moreover the carbon tax will contain the circular debt as 1.) government and energy chain will be on the same page as to the amount of liabilities and 2.) domestic prices will not be subsidized. For agriculture, there is comfort in the form of NO tax, more spending on water resources (dams, barrages and water course lining), incentives to livestock and continued subsidy on fertilizer.

There is an effort to increase the tax base by increased documentation. For instance manufacturers selling 90% of their wares to registered sales tax persons will get a 2.5% tax credit. Additionally persons having reasonable identifiable income/ resources are now required to file a return on income. NTN certificates are necessary for purchasing property, obtaining commercial/industrial gas/electricity connection and even opening a bank account. However even bolder measures have not made the final cut. The tax net has not been aggressively increased.

Instead, average tax rate is higher though taxation has become more progressive. Persons earning higher than PKR1.0mn a year will be charged 5% tax on their tax payable – the proceeds going to the IDPs of the war affected areas. Moreover there is relief for persons whose income is in between slabs. In the cases of indirect taxes, the carbon tax, that will replace the petroleum development levy (PDL), is of significance. This is a two edged sword as volatility in international prices would be passed through and this might lead to complications on immediate term inflation expectations but the prudence on the overall fiscal front will eventually outweigh the immediate impact – lower fiscal deficits almost always leads to better price stability in the country.

From a financial sector perspective, the budget is broadly neutral. The ambition is to tap increasing transaction value instead of corporate surpluses. While CVT on share transactions and the presumptive tax regime on stock brokers have been removed, stock brokers are now part of the FED regime and services rendered by them will be levied a 16% FED in VAT mode. Banking services would also become part of the FED regime entailing similar levies being imposed on services.

## 2

Mustafa Pasha  
Economist

## ECONOMICS: INITIATING CPR!

### FY09: GOOD RIDDANCE!

The last two fiscal years have been amongst the most challenging that Pakistan has faced since independence. Global commodity price shocks pushed inflation to a high of 25.3% and forced the SBP to raise the discount rate to 15%. The balance of payments deficit similarly went into overdrive before achieving some stability in the latter half of FY09. The PKR depreciated by 30% before finding traction around the 80 mark, while FX reserves dipped to precariously low levels (USD6.7bn), sparking fears of default and forcing subsequent entry into an IMF program.

The last six months have been devoted to macroeconomic stabilization and involved measures to curb imports (tariff increase on 397 luxury items), dollar outflows (regulation on money changers, SBP responsibility for oil payments), elimination of petroleum subsidies, rationalization of the fiscal deficit from 7.6% in FY08 to 4.6% in FY09E and appeals to the international community for much needed aid (FODP, WB, ADB, Kerry-Luger bill). While the economy seems to have bottomed from its lows in Oct08-Nov08 and headed towards a semblance of recovery, structural weaknesses remain threats to future growth.

### Agri carrying the load: Bumper wheat crop and all that

In contrast to the 1.1% growth seen in FY08, the agriculture sector is projected to grow at a very robust 4.7% in FY09. This spurt is largely a result of a bumper wheat crop which is estimated at 23.3mn tons this season. The government's decision to announce a PKR950/maund support price and commitment to procure 6.5mn tons incentivized domestic farmers to increase acreage under wheat cultivation.

However due to the bumper crop and drop in international prices (which suppressed private sector interest) an excess supply of wheat threatened to overwhelm small farmers. Moreover the government despite revising its wheat procurement targets upwards did not have the ability to purchase and store the requisite amounts. For this reason we have seen the government allocate PKR37bn to agricultural warehouse and storage facilities in the budget FY10, so as to hopefully avoid the situation that was witnessed this year.

In addition PKR18bn has been allocated for agriculture from PSDP against PKR14.4bn last year. The government has pledged to provide BT hybrid cotton seeds to farmers on an expedited basis, which is expected to increase cotton yields and lower the cost of production. Smaller farmers have been provided incentives in the form of the Benazir Tractor Scheme which will be launched with PKR4bn in funds, while PKR8bn have been allocated to a productivity enhancement program.

The allocation of PKR47bn for water resource development from PSDP has two aims; firstly, to increase the amount of water available to agriculture and ensure that crop yields do not suffer from droughts as in previous years and secondly, to

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minimize the leakages and loss of water through a deteriorating canal and irrigation system.

While the implementation of the above programs would go a long way towards revitalizing the agriculture sector and meeting the 3.8% growth target for FY10, perhaps the most effective way to ensure sufficient and even (exportable) surplus production is through the announcement of competitive support prices. We have already seen that attractive support prices for sugarcane and wheat led to spectacular increases in total output.

### **LSM woes: Blackouts galore**

The 3,000MW energy deficit that Pakistan currently faces has played a large part in exacerbating the deleterious effects of a deteriorating domestic and global environment on the manufacturing sector. A high interest rate environment (that was an integral part of the macroeconomic stabilization program) increased the debt servicing burden of local industry to unsustainable levels. As a result the corporate debt market became increasingly illiquid (with price discovery impossible) as a number of well known and established companies defaulted on their debt obligations. Price shocks in the form of higher commodity prices for coal and steel adversely affected the cement and auto sector, while a depreciating PKR increased the import bill for numerous manufacturing concerns. As a result LSM contracted by 7.7% during 9MFY09, while the overall sector is projected to post negative growth of 3.3% (BMA forecast: -4.0%).

The government has under the auspices of the IMF program committed to resolving the circular debt issue which has created a back log of financial charges and compromised the operational efficiency of the whole energy value chain. It has proposed the setting up of a holding company which will assume the PKR216bn outstanding loan liabilities of the banking sector and pay out financial charges through budgetary resources. PSDP allocation to the power sector has been increased by 100% to PKR22.8bn and 15 IPPs with a productive capacity of 2,921 MW have been proposed to be completed by 2011. The government is targeting an end to load shedding by the end of 2009 which seems optimistic at best.

Autos have received a boost with a 5% reduction on CKD units, while the FED on cement has been reduced by PKR200/ton. Massive fiscal spending which includes provisions for 32 small and medium dams, construction of 9,500 housing units and PKR50bn for IDPs is expected to stimulate domestic construction activity. While 1.8% growth may be possible (especially due to the low base effect of FY09) in FY10, monetary easing and a vastly improved security situation will be instrumental in meeting this target.

### **Revenue: Ambitious targets**

One of Pakistan's chronic ills has been a dismal tax to GDP ratio which has been on a continuous down trend from 14.4% in 1996. We are projecting that FBR tax collection will come in at PKR1142bn in FY09 which is a shortfall of PKR108bn from the initial target of PKR1250 bn. Tax to GDP ratio is projected at 8.5% (BMA forecast) for FY09 and the government is targeting an increase to 9.6% in FY10.

This 9.6% comes out to a tax collection target of PKR1378bn, which is almost a 21% increase over this year's expected collection.

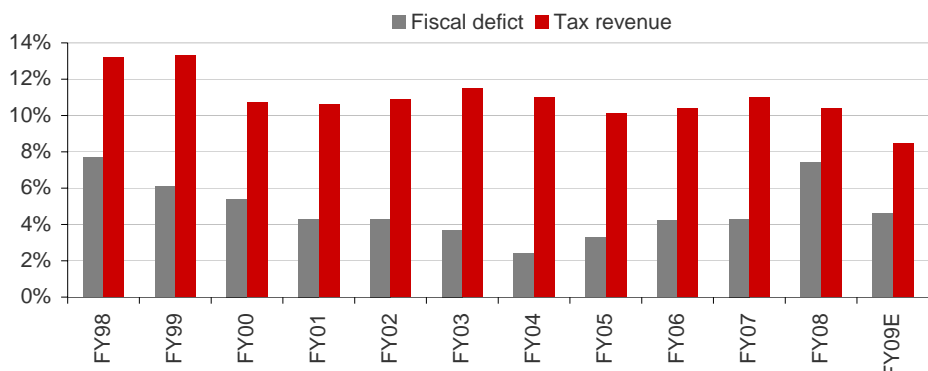
In order to achieve this target the government has decided to expand the tax net by reigning in the real estate and services sectors. The CVT on real estate transactions has been doubled from 2% to 4% and is expected to generate an additional PKR15bn in revenue. Meanwhile the banking, insurance, cargo handler and stock broker sectors will now have their services taxed at 16% FED in VAT mode and will produce PKR16bn for the government's coffers. In order to maintain stability on the balance of payments and in particular the trade deficit, the withholding tax of 2% on commercial imports has been increased to 4% and will generate PKR23bn.

Despite the additional PKR54bn to be generated from these new taxes, we believe that the tax target of PKR1378bn will present a stiff challenge to the government. The political will to implement new taxes in a slowing economy will be paramount in determining performance against the ambitious target. With the manufacturing sector contributing 60% of total tax collection and currently under enormous stress, an accommodative monetary policy will be necessary to generate the additional revenue. Thus the SBP is going to have to move aggressively with regards to the discount rate if the revitalization of industry is to be achieved.

### **Fiscal deficit: Threat to growth**

The government has targeted a fiscal deficit of PKR722.5bn or 4.9% of GDP, 1.5% of this deficit is expected to be financed from external sources. Whenever fiscal expenditures threaten to derail macroeconomic stability, PSDP spending is the first to go. Not only does this lead to a deceleration of direct tax growth as WHT receipts from cancelled development contracts decline but economic growth is directly compromised. To this end it is essential that the PKR226 bn expected by the government in external aid materializes. Without external sources to prop up PSDP and finance 30% of the deficit, the government may be forced to either borrow from the SBP which would sour relations with the IMF and lead to delays/cancellations in future tranches, or jack up NSS and government paper auction rates to procure the funds from domestic sources.

The first option would result in inflationary pressures and burgeoning external deficits, while the latter would exacerbate private sector crowding out and prolong the oppressively high interest rate environment. In short none of those two is really an option if Pakistan wants to return to a high rate of growth and avoid the social and security repercussions of a deep recession.



Source: MoF, BMA Research

### **Inflation:** Single digits may turn out to be a pipedream

The government is targeting an average inflation rate of 9.5% for FY10 against an expected average of 21.8% in FY09. While we expect the high base effect to push CPI down to single digits by the end of 1QFY10, resurgence in inflationary pressures may very well be witnessed in the following months.

The government has decided to abolish the PDL and replace it with a fixed carbon surcharge on petroleum products and gas. This surcharge is expected to generate PKR134bn in FY10. The low prices in FY09 allowed the government to earn estimated PDL of PKR120bn for the full year, however under the current formula, oil over USD70/barrel neutralized PDL to zero. With the introduction of the carbon surcharge, revenue needs and the stated intention of reducing consumption, an increase in retail prices seems to be on the cards. With petroleum and related products having an approximate 15% weight in the CPI basket a 5% increase in prices would push CPI up by 0.75%.

In addition the 10% increase in power tariffs, 16% FED imposition on all financial services, increase in WHT on imports to 4% is expected to increase the cost of production for the whole sector.

### **Macro outlook:** Appearances can be deceiving

While the recovery in macroeconomic indicators has been quite remarkable Pakistan's structural deficiencies threaten to derail growth in the event of any adverse movements in the local or global environment. A return to oil in excess of USD80/barrel would create problems for our external deficits as well as fuelling inflationary pressures. It may also jeopardize the SBP's intention to ease the interest rate environment over the course of the next fiscal year. A prolonged period of high interest rates would compromise the projected 1.8% in manufacturing growth. In addition the support of the international community is essential to continued stabilization. If the USD14bn in pledges do not come through then fiscal targets and the 3.3% GDP growth target would become untenable.

## 3

**MARKET STRATEGY: BE GREEDY WHEN OTHERS ARE FEARFUL**

FY09 was at best a challenging year for the KSE100. After witnessing a low of 4815 index level and a PER of 4.2x on Jan 09 the market has gradually recovered to the 7,000 index level and a PER of 5.8x. Despite the continued recovery, the KSE100 index is trading at a steep discount of 56.6% when compared to the historical average of 35% to the region.

The equity market is certainly poised for further re-rating – and why not? Improving risk perception with regards to the investment climate, consolidation of a democratic setup, concerted effort against internal security issues, comfortable balance of payments position, continuation of monetary easing, and access to liquidity with re-introduction of a leverage product on the cards. The time to be greedy is now.

**Market performance: Driven by economic fundamentals**

The IMF has provided the government with additional space in order to implement a counter cyclical fiscal policy and stimulate the economy. GDP growth is expected to recover from 1.9% in FY09E to 3.3% in FY10E. Concurrently, the monetary authorities, on the back of declining inflation, are expected to move aggressively with regards to the discount rate in FY10E. We project that by the end of next fiscal year the discount rate will be in single digits and provide the necessary relief to the manufacturing sector.

Market activity has been dull leading up to the budget mainly because of lack of leverage and liquidity in capital markets. It is expected that the SECP will move towards re-introducing a leveraged product that should increase the level of traded activity. In addition proposals for cash settled futures have also been floated and the presence of leverage should allow market volumes to pick up.

The announcement of Budget FY10 has laid to rest fears of a gross asset tax, increase in corporate rate of tax and increase in equity transaction costs. Brokerage services will now be subject to a 16% VAT replacing the 2bps CVT on purchase value; however 1bps WHT on sale value will remain in place. Additionally, CVT has been increased on real estate transactions which could potentially divert incremental liquidity towards capital markets. With the budget directly or indirectly positive for roughly 63% of total market capitalization, we expect positive sentiment to prevail going forward.

**Index target: Setting our sights on 8700 index level**

Fundamentals will remain key to capital market performance. Positive earnings growth over FY09-FY10E, cheap trailing and forward PERs, strong corporate profiles with unique competitive advantages and high dividend yields will continue to dominate our criteria for stock picking. It is no surprise that our top picks largely hail from sectors such as energy and infrastructure.

We expect earnings growth for FY10E and FY11E to clock in at 8% and 15% respectively; based on this, the index has room to re-rate upward to a PER of 6.8-7.0x which implies a target of 8400-8700 index level.

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**UNDERWEIGHT**
**Budget Impact**  
**Positive**

**Sana I. Bawani**  
 Auto Analyst

## **AUTOS: THE IGNITION IS ON**

Budget FY10 has brought good news for the auto sector which has been struggling for survival since the past year. Strong inflationary pressures, weak PKR, and high input costs had led the auto assemblers to increase their prices manifold during the year. This eventually resulted in sales declining by over 50% YoY. Some major changes have been made for the sector in budget FY10 which can be termed positive for autos.

### **Withdrawal of FED**

In FY09's budget 5% Federal Excise Duty was imposed on motor cars exceeding 850cc. This duty has now been withdrawn. This bodes well for the auto sector as it will result in a downward revision in prices and hence, increase demand. PSMC has the largest market share (52%) in passenger car segment followed by INDU (34%). However, an anticipated increase in demand will potentially have a larger impact on INDU's revenues as Toyota Corolla (small high segment) accounts for 78% of its total sales while Alto, Cultus, and Liana combined (economy segment) constitute 33% of PSMC's sales (11MFY09). Small low segment (less than 850cc engine capacity) will witness no change in prices as FED was not applicable on this segment.

### **Imposition of Advance Tax**

Advance tax on purchase of locally manufactured motor car/jeep is proposed to be extended to all types of motor vehicles and will be collected by the registering authority of Excise and Taxation Department at the time of registration. Therefore, buyers of other modes of transport including motorcycles and three wheelers will also be required to pay advance tax. While it may not be reflected in vehicle price, it will still factor into the final cost of vehicle acquisition to the customer.

### **Tractors exempted from duty**

Demand for farm tractors has remained flat at around 54,000 units annually since FY07 with Al Ghazi Tractors and Millat Tractors sharing 50% market share each. Continuation of exemption of duty on import of agricultural tractors in addition to allocation of PKR4bn to Benazir Tractor Scheme aim to enhance farmers' income and boost demand for tractors at the same time.

### **Relief for auto-rickshaws**

Duty on import of Kits for 4-stroke auto rickshaws has been reduced from 32.5% to 20%. This is likely to result in a reduction in the vehicle's prices and prove beneficial for the local rickshaw assemblers such as Sohrab and Sazgar.

### **Duty on smaller items**

Duty on spark plugs and wire condensers has been increased from 5% to 10%. Spark plugs are small in size but are responsible for the engine to operate and are, therefore, needed for all sorts of vehicles. Wire condensers are used mainly for A/Cs in cars. Higher duty on such small items will make local counterparts a relatively inexpensive choice for the assemblers. Furthermore, duty on silicon sealant used as an aid for sealing engines is also to be rationalized.

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### Unchanged duty structure for cars, jeeps, and LCVs

Duties on cars, jeeps, and LCVs remain the same as last year's which includes custom duty on localized CKD kits at 50% and un-localized at 32.5%. Since engine forms a major component of a vehicle and is imported by local assemblers, unchanged custom duty will keep the cost of production at its current level and assemblers are therefore, required to look for other cost-cutting measures.

### Rationalization of duty

Certain inputs for manufacturing parts/components for engineering sector including the auto assemblers have been exempted from duty. Also, duty on carbon black has been rationalized. Carbon black is a minor input used by auto manufactures to increase the durability and strength of the rubber compound especially in tyres.

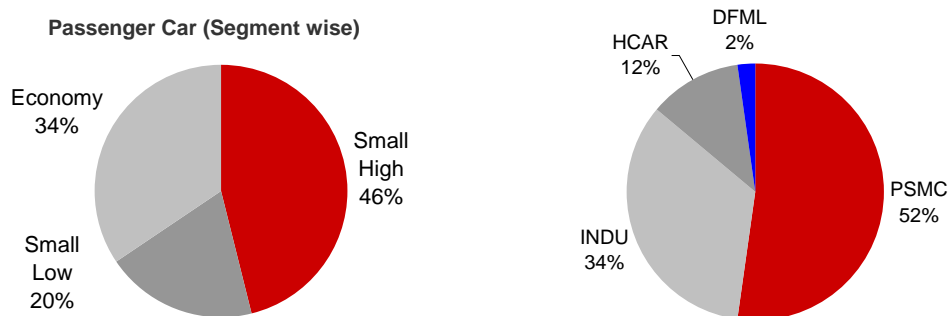
### Positive for motorcycles

Custom Duty on CBU motorcycles is proposed to be reduced from 70% to 65% while custom duty on non-localized components and sub-assemblies of motorcycles is proposed to be reduced from 20% to 15%. These measures aim to enhance competition between imported CBUs and local assemblers and give consumers a wider range to choose from. An additional duty of 32.5% is proposed to be increased on four localized parts of motorcycles to protect the local industry. Honda has the largest market share (77% in 11MFY09) in the motorcycle segment and is set to benefit from these measures.

### Withholding tax on imports:

WHT at the rate of 4% has been imposed on all imports. Therefore, the same is also applicable on all auto-related imports. WHT, however, is refundable against corporate tax and is therefore, a non-event for the auto companies.

### Market shares-11MFY09



Source: PAMA, BMA Research

### Outlook FY10E

With the exception of FED, the rest of the measures largely remain the same as last year's. Passenger cars (exceeding 850cc) are likely to witness a slight drop in their prices with an unchanged duty structure in place. Improvement in economic conditions, availability of finance, and stability of the exchange rate will be the key drivers for auto sales in FY10. Consequently, we maintain our UNDERWEIGHT stance on the sector.

#### Sales Forecast

Sales (units)	FY08A	FY09E	FY10E	FY11E	FY12E
INDU	47,845	33,257	35,585	39,143	45,015
PSMC	114,270	49,618	51,912	55,545	61,100
HCAR	14,201	11,082	11,594	12,290	13,028
DFML	9,075	2,339	2,447	2,594	2,750
<b>Total</b>	<b>185,391</b>	<b>96,296</b>	<b>101,538</b>	<b>109,573</b>	<b>121,892</b>

Source: PAMA, BMA Research

**OVERWEIGHT****Budget Impact  
POSITIVE****Omar B. Chaghtai**  
Cement Analyst**CEMENT: CONCRETE STEPS**

Budget FY10 unveiled several positive measures which were in line with our expectations and should help bolster domestic cement demand both directly and indirectly.

**Federal Excise Duty (FED) reduced to PKR 700/MT**

FED has been slashed by 22.2% from the previous PKR900/MT to PKR700/MT, which translates to an impact of PKR10/bag at the retail level. While this has no effect on manufacturer retention price, lower retail prices should help set the stage for a rebound in domestic cement volumes in FY10E. As it is, we expect a 15% decline in cement prices in the coming fiscal, given that (a.) additional expansion has come online with LUCK's line 'G' raising its capacity to 7.75mn tpa in 3QFY09, and (b.) a steep decline in input costs with international coal prices down 65.7% to USD60.6/MT in FY09YTD. This also suggests the possibility that prices may actually decline more than our expectation; however, on the other hand, cement companies could also opt to pass on only a partial benefit of the duty cut to consumers, thereby keeping margins buoyant. At any rate, FED reduction should bode well for cement growth, moving forward.

**Multiple Development Projects and a Substantial PSDP Outlay**

The GoP has termed FY10E as the "Year of Industrial Revival". Given Pakistan's substantial power and water deficits, infrastructure development will remain key to this commitment. To this end, a PSDP target of PKR626bn has been announced; this is a whopping 74.4% higher than the PKR359bn which the government expects to spend by end FY09E. Of particular interest in this budget is the focus on water resource development which entails;

- Water sector allocation of PKR60bn (14% of federal component)
- Financing of 32 small and medium dams (8 per province)
- PKR12bn for raising of Mangla Dam, including resettlement
- PKR10bn for the improvement of water courses
- PKR15bn for canal improvement and rehabilitation of irrigation system
- PKR4bn for 4,500 MW Diامر Basha Dam Project

PKR50bn has been allocated for facilitating internally displaced persons (IDPs), including reconstruction. Additionally, as part of the worker's welfare development scheme, construction of 9,469 housing units and flats for industrial workers has also been proposed. Moreover, tax credit limit on interest paid on housing loans should also be enhanced from PKR500K to PKR750K.

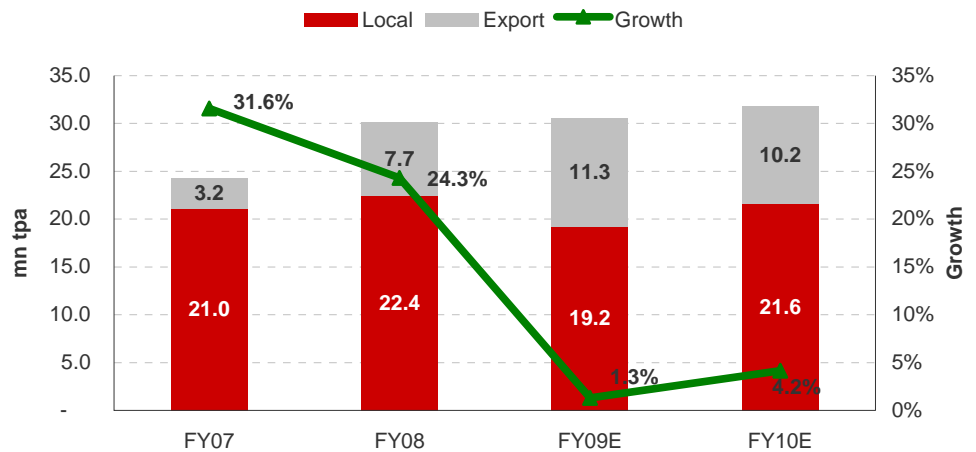
While the PSDP target is indeed ambitious, we do believe spending in FY10E will be markedly improved compared to the previous fiscal, even if the entire target is not achieved. Also, while there is a lag of 2-3 quarters between project initiation and its consequent cement needs, it is pertinent to note that preparatory work has already initiated on at least 4 dams, including Basha. Hence, we do expect

the relevant cement demand to materialize during the current fiscal. Overall, we expect robust domestic offtake in light of budget FY10E commitments.

**Outlook FY10E**

While cement exports will likely start to dwindle as regional capacities come online, domestic demand should register a surge, especially in 2HFY10E. We expect total sector offtake to improve by 4.2% YoY in FY10E, and with financial charges coming off in a declining interest rate scenario, select companies should post earnings growth in the coming year. A key downside risk however, is lower-than-expected foreign aid, which the government has currently budgeted at PKR230bn – this is essential to help maintain the deficit at 4.9% and, in the event of a downward revision in this estimate, PSDP spending will likely be hurt.

**Local and Export Dispatches FY07-10E**



Source: APCMA, BMA Research

LUCK remains our top pick in the sector offering 27.5% upside to our fair value of PKR73 from current levels and trading at an FY10E PER of 4.4x. We also like DGKC which should benefit particularly from lower interest rates in FY10E; its current price implies 23.4% upside to our fair value of PKR35 and an FY10E PER of 9.5x.

**UNDER WEIGHT****Budget Impact**

Neutral

Mustafa Pasha

Banking Analyst

**COMMERCIAL BANKS: CHALLENGES REMAIN**

We have already seen the effects of inflation and high interest rates on the banking sector. Non performing loans as a percentage of gross advances increased significantly to over 12%. Moreover a slowing economy reduced the demand for working capital and made bank's highly conservative in lending to the private sector. Advances growth for CY09 to date has thus been contained to under 0.5%, while deposit growth has similarly been sedate at around 4.0%.

The government's stated intention of raising PKR200 bn from national savings schemes does not bode well for the banking sector, as it may make rates downward sticky in an easing monetary environment. In this scenario long term time liabilities may be diverted to the government and leave banks scrambling for short term demand liabilities. Not only would this worsen the liquidity profile of the banks but also lead to a narrowing of their advance to deposit spreads. We have already seen that interest expenditure for banks has grown due to the 5% minimum on PLS accounts. This puts a definite limit to the amount that deposit costs could be decreased once monetary easing well and truly commences. With KIBOR coming down the spike in interest income (witnessed in 1QCY09) may also turn out to be a one time phenomenon. And with provisioning against NPLs expected to continue, banking profitability will see further declines in CY09.

**16% FED in VAT mode on banking services (slightly negative to neutral)**

In order to increase the tax base of the economy, the government has decided to introduce 16% FED on all banking services. While we believe that banks will be able to pass on most if not all of this increase to the end consumer, it does not bode well for growth in non interest income. We have already seen declines in fee income and FX income during 1QCY09. The tax add on will only serve to depress the demand for these services and dilute growth prospects going forward.

**Tax deduction against provisioning (slightly positive to neutral)**

As part of its relief measures the government has re-allowed banks to deduct provisioning expenses from their tax liability. However the deduction will only be allowed against NPLs classified as doubtful and loss, while the total deduction will be limited to 1% of total advances. Given that bank's are currently deducting total provisioning expense on their profit and loss statements and creating deferred tax assets, no impact on earnings is expected from this measure. The only foreseeable effect will be on slightly increased cash flows as current tax liability decreases. Overall impact is expected to be negligible

**Outlook CY09E**

We maintain our underweight stance on the banking sector for CY09 as higher provisioning on account of ageing NPLs, lower liquidity and narrowing spreads are expected to compromise earnings growth throughout the year. Our top pick in the sector is UBL having a fair value of PKR67 and trading at CY09E P/E and P/B of 5.0x and 0.9x respectively.

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**OVERWEIGHT****Budget Impact****Neutral****Hamad Aslam**

Energy Analyst

**E&P: PLAYING THE PEAK-OIL THEORY**

No specific measures were announced in the budget regarding the Oil and Gas Exploration sector. It should be noted that the sector is largely regulated through Petroleum Policies issued by Ministry of Petroleum and Natural Resources; for which the latest one was announced in March, 2009.

Nonetheless, materialization of measures announced to address circular debt issue in the system (discussed in Power sector) is likely to bode well for cash flows and dividend payment capacity for the exploration sector as well.

**Outlook FY10E**

We maintain OVERWEIGHT stance on Oil & Gas Exploration sector as it continues to offer cash rich balance sheets, low leverage, good quality of earnings, stable cash flows and high conviction on earnings. Moreover, with the revenue stream denominated in USD, the sector offers a hedge against PKR depreciation which is expected at 5-7% in FY10E.

We continue to be proponents of Peak Oil Theory that suggests that the growth in global demand for crude oil is far outpacing the increase in supply – projecting a severe supply deficit in the years to come. Our current oil price forecasts are USD 60/bbl, USD 50/bbl and USD 55/bbl for FY09, FY10 and FY11, respectively; while we reiterate that there is more upside risk to our forecasts than downside risk (current crude oil price of USD 70/bbl is just one indication of the upside potential).

Pakistan's rich untapped natural resources offers additional advantage to equity holders of E&P stocks – particularly for companies like OGDC which has been pursuing an aggressive exploration program to capitalize on these resources; and has demonstrated a success ratio of 3:5 wells over the last 10 years. Nonetheless, security situation in Northern region may pose a possible risk to volumetric offtake and future discovery potential in the region surrounding the troubled areas.

Our top pick from the sector is OGDC with a NAV based fair value of PKR 130/share, reflecting a potential upside of 78% from current prices. The stock is currently trading at FY10E PER of 5.8x and offers prospective FY10E dividend yield of 14.6%.

For POL, our NAV based fair value is PKR 263/share, reflecting an upside potential of 79% from current prices. The stock is trading at FY10E PER of 5.1x; though we believe future direction of market prices for POL are likely to be driven on clarity emerging on timeline for Production Enhancement Facility for Tal Block (we currently estimate additional capacity to come online in Jan10).

Our NAV based fair value for PPL is PKR 270/share, reflecting potential upside of 46% from current prices. With the stock trading at FY10E PER of 7.4x, we would like to point out the expected drop in next year's earnings (on the back of lower projected gas wellhead prices for 1HFY10) to pose a hurdle for any significant price gains in the stock.

**OVERWEIGHT****Budget Impact  
POSITIVE****Omar B. Chaghtai**  
Fertilizer Analyst**FERTILIZER: AGRILICIOUS!**

While no new incentives arose for fertilizer manufacturers specifically, the government's agrarian focus ensures that fertilizer demand should remain robust over FY10E. Agriculture registered 4.7% growth in FY09 and the government has set a target of 3.8% for FY10E. Multiple measures have been undertaken to ensure that the target is achieved.

**DAP subsidy no more, urea's to continue**

As expected, the PKR2,200/bag subsidy on DAP declared in the previous budget was withdrawn in Budget FY10E. The precedent for this is obvious. International DAP prices have declined about 75% from 2008 highs and resultantly, local DAP prices have come off to about PKR1,900/bag. Subsequently, DAP offtake has also surged in CY09YTD.

Subsidy on urea imports will continue though FY10E will be the last year for the government to bear this burden; ENGRO's 1.3mn tpa capacity expansion will come online in mid-CY10 and the domestic industry will henceforth have a surplus.

**Agricultural self-reliance remains prominent theme**

Self-reliance and food security through improved productivity of crops remain key concerns. In this regard, the government will provide support in the form of enhanced R&D facilities, productive use of water through precision land levelling and high efficiency irrigation systems and ensuring availability of agricultural credit. Specific steps include;

- 25% increase in PSDP allocation for agriculture to PKR18.0bn
- PKR2.5bn proposed to ensure food security and productivity enhancement for farmers
- Development of water resource to boost production of crops (discussed in detail previously under the "Concrete Steps" section)
- Development of agriculture infrastructure including warehousing facilities at a cost of PKR37.0bn of which PKR500.0mn will be allocated for FY10E
- Benazir Tractor Scheme to assist farmers at a cost of PKR4.0bn over two years

The aforementioned initiatives should resultantly help keep fertilizer offtake healthy over FY10E and beyond.

**Outlook FY10E**

Our top pick amongst the fertilizer manufacturers remains FFC; it offers limited upside of 8.0% from current levels to our fair value of PKR110 however, it has an attractive CY09E dividend yield of 12.0%.

We also like ENGRO, albeit from a longer term buy and hold perspective. At current levels, it offers potential upside of 20.6% to our fair value of PKR160 and is currently trading at a CY09E PER of 15.9x.

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## OVERWEIGHT

### Budget Impact Positive

Hamad Aslam  
Energy Analyst

## OMC: GETTING CARBON CREDIT

Fiscal Budget FY09-10 has re-emphasized the government's intent to focus on energy deficit in the country while maintaining its commitment with the IMF to eliminate all oil subsidies. In this regard the government has taken the following measures:

### Replacing Petroleum Development Levy (PDL) with Carbon Surcharge

The government has announced replacement of PDL on petroleum products with Carbon Surcharge. The surcharge will be a pass-through item (as was the case in PDL) and is not likely to affect OMC/dealer margins.

However interestingly, the said surcharge is to be fixed per litre/kg of petroleum product rather than being a variable component as was the case in PDL. The notified charge on each product are as follows:

Petroleum Products	Unit	Carbon Surcharge Rate	Current Applicable PDL
High Speed Diesel Oil (HSDO)	PKR/Litre	8	10.00
Motor Spirit (MS)	PKR/Litre	10	10.54
Kerosene (SKSO)	PKR/Litre	6	6.88
Light Diesel Oil (LDO)	PKR/Litre	3	3.95
HOBC	PKR/Litre	14	14.32
Compressed Natural Gas (CNG)	PKR/Kg	6	-

Source: OGRA, GoP, BMA Research

The replacement of policy for determining prices for petroleum product prices inherently implies that the government no longer intends to cushion any increase in global crude oil prices through application of Petroleum Differential Claim (PDC). As a result, any further surge in global prices is likely to result in proportional increase in retail petroleum prices each month.

While the new pricing mechanism inherently implies upside risk to inflation projections, it should be noted that (official) withdrawal of oil subsidies signals lower likelihood of further increase in piling circular debt in the system.

Another interesting takeaway of this surcharge pertains to CNG. While carbon surcharge has replaced PDL in all petroleum oil products, it should be noted that currently there is no PDL on CNG. The government is currently collecting Gas Development Surcharge on gas and there has been no indication by the authorities on its abolition. Hence carbon surcharge is likely to increase the retail price for CNG by PKR 6/kg (12.5%) to PKR 54/kg.

### Budgetary Measures to Promote Overall Petroleum Offtake

The government re-iterated its intent to address the growing power deficit in the country. With thermal-based power plants being the quickest solution to the problem, 15 Independent Power Projects (IPPs) projects with a total capacity of 2,921 MW are in different stages of development. As a result, we project Furnace Oil offtake to grow at 11% for FY10 and at a CAGR of 7% for FY09-FY12.

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Moreover, increased prices for CNG (compared to Motor Gasoline and Diesel) appears to be in-line with government's earlier stated intention of discouraging CNG consumption due to depleting gas reserves in the country. Hence we foresee some switching from CNG consumption to Motor Gasoline and Diesel consumption.

#### **Resolution to Address Circular Debt Crisis to be a much Needed Breather**

The budget outlined the measures to be taken to address the ongoing circular debt in the system (discussed in Power Sector section). Newspaper reports suggest that outstanding dues against PSO have swelled to PKR 94bn against power sector and PIA while the company is in dire need of PKR 39bn to retire its outstanding L/Cs by July 09, 2009.

While we do not foresee any possibility of PSO defaulting on its commitments, the gravity of this crisis can no longer be overlooked. Hence the measures announced in the budget, if materialized in time, are likely to result in better cashflows, lower financial charges and higher furnace oil offtake for Oil Marketing Companies.

#### **Outlook FY10E**

We maintain an OVERWEIGHT stance on Oil Marketing Companies as they stand to benefit from higher Furnace Oil, MoGas and Diesel offtake. Moreover huge inventory and exchange losses incurred in FY09 are not likely to recur in FY10 while recent increase in global crude oil prices only hint towards potential inventory gains for the sector.

Our top pick from the sector is PSO with a DCF based fair value of PKR 297/share, implying an upside potential 39% at current prices. The stock is currently trading at FY10E PER of 5.9x and a prospective FY10E dividend yield of 10.2%.

**OVERWEIGHT****Budget Impact  
Positive****Hamad Aslam  
Energy Analyst****POWER: ADDRESSING THE DEFICIT WITH THE  
RIGHT MIX**

Chronic power deficit in the country has long been regarded as a major bottleneck for industrial and commercial activities. Pakistan's current installed capacity is estimated to be 19,898 MW with the largest contributor being Thermal sources at 65%, followed by Hydel at 33% and Nuclear at 2%. However after accounting for forced outages, lower available capacities and inefficiencies arising from circular debt issue, the total generation capability is estimated to be 15,225 MW per year.

With electricity demand having grown at a CAGR of 6% during FY03-08 and no major addition to the energy supply grid in the past decade, current supply shortfall is estimated at around 3,000 MW per year. Realizing the gravity of the situation, the government had already started to take proactive actions to address the issue and re-iterated its intentions in the budget.

**Timeline for Completion of Thermal based Projects**

It was disclosed that 15 Independent Power Projects (IPPs) projects with a total capacity of 2,921 MW are in different stages of development. Out of these, nine projects for 1,861 MW are projected to be commissioned in 2009, four projects for 776 MW will be completed in 2010 and two projects for 284 MW are due for completion in 2011.

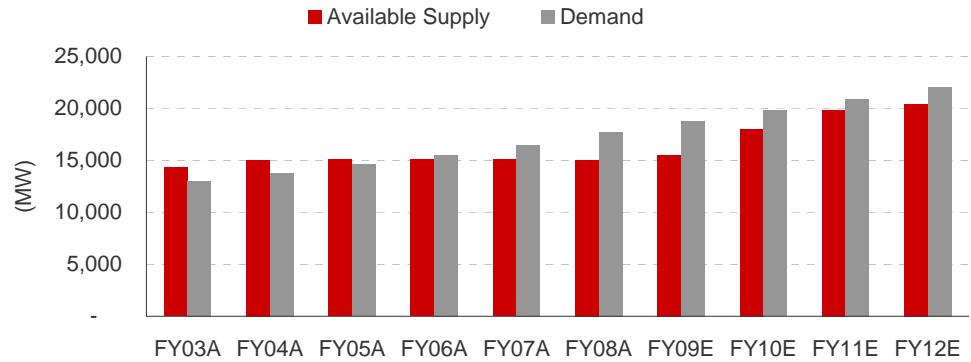
This will be further augmented by five rental power projects with a total capacity of 800 MW (agreements for which have been finalized) and two new combined cycle power projects of 500 MW by the public sector.

**Hydel Power Projects Crucial for Balance of Payments**

While thermal based electricity generation may be the quickest solution to prevailing power crisis, it should be noted that they mostly rely on imported furnace oil – resulting in increasing pressure on the country's external deficit. Encouragingly, current budgetary measures propose increased attention towards cheaper and more sustainable Hydel based generation.

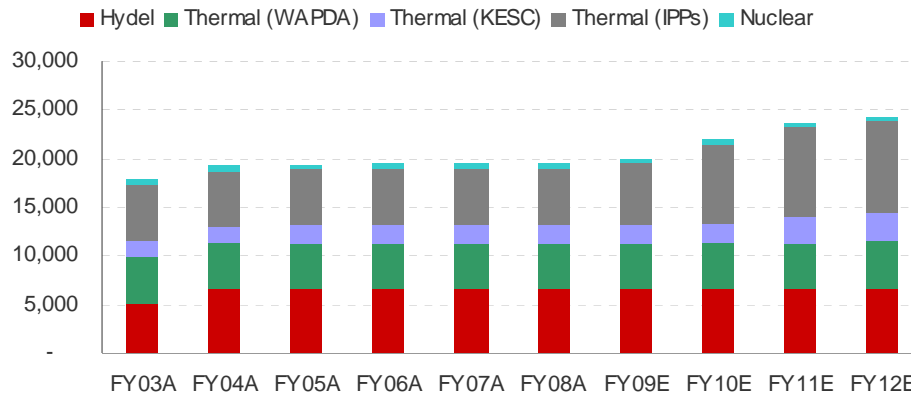
It was revealed that work on 16 Hydropower projects in the private sector with a total capacity of 4160 MW has been initiated while induction of two additional projects with a total capacity of 168 MW was announced. Furthermore, an allocation of PKR 4bn has been made for Diamer Basha Dam Project with planned production capacity of 4,500 MW.

**Electricity Supply Demand Situation**



Source: PPIB, GoP, BMA Research

**Electricity Supply Demand Situation**



Source: PPIB, GoP, BMA Research

**Resolution of Inter-Corporate Debt on Cards**

Currently net outstanding circular debt in the system is estimated to be over PKR 100bn. While the problem may not be as grave as it was in January 2009, it nonetheless requires serious attention from the fiscal authorities. Encouragingly the government has not shied away from the problem and announced the following measures to address the issue:

- Government will assume the entire bank loan liabilities of PKR 216bn and pay the markup on these loans from budgetary resources;
- Government will assist to settle the remaining payables of PEPCO at PKR 61bn;

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- It has been decided to pick up the entire past arrears of PEPCO against FATA consumers to the tune of PKR 80bn and pay the current electricity bill of FATA; and
- Government will help PEPCO to clear its outstanding receivables from federal and provincial government departments and entities, mainly KESC and KW&SB.

Furthermore, the government has announced an amount of PKR 62.9bn for WAPDA and PKR 3.8bn for KESC in the budget as General Sales Tax (GST), GoP's share for agriculture tubewells and inter-Discos tariff differential. The government has also allocated PKR 3bn to pay interest on TFCs and PKR 1bn for FATA (no such amount was earmarked for this purpose last year).

Given the government's commitment with IMF to resolve the inter-corporate debt issue by the end of FY09, a timely materialization of these measures can be expected. According to our estimates, WAPDA currently owes around PKR 35bn (including overdue amount of PKR 28bn) and PKR 25bn (including overdue amount of PKR 16bn) to Hub Power Company and Kot Addu Power Company, respectively. Hence budgetary announcements with regards to the issue bode well for the IPP sector and are likely to result in 1) lower financial charge, 2) better availability of furnace oil supplies, 3) higher Load Factor and 4) higher conviction on their capacity to meet dividend payouts.

#### **Cut in Power Subsidies – 10% Hike in Power Tariffs**

In-line with its commitments with IMF, the government has announced a cut in subsidies in power tariff by over 40% to PKR 68bn (against PKR 112bn spent during FY09). Tariff differentials of PKR 30bn and PKR 15bn have been withdrawn from WAPDA and KESC while PKR 10bn subsidy has been allocated for FATA.

Resultantly, the government re-iterated its intention to hike power tariffs by 10% while further hikes can be expected in-line with any increase in costs.

#### **Outlook FY10E**

While most of the budgetary announcements pertain to addressing the broader energy supply-demand situation in the country, the government's resolve to address the inter-corporate debt bode well for listed IPPs.

We maintain OVERWEIGHT stance on the sector foreshadowing possible triggers in the form of materialization of announcements to eliminate the circular debt in the system. Moreover, IPP friendly Power Policy as well as incentives for higher Load Factor and capacity expansions (in case of HUBC) are likely to result in higher core earnings while recent (and potential) PKR depreciation is projected to keep bottomline growth at robust levels.

Our top pick from the sector is HUBC with a DDM based fair value of PKR 35/share, reflecting potential upside of 35% from current levels. The stock is currently trading at FY10E PER of 7.2x and offers prospective FY10E dividend yield of 12.6%.

## MARKETWEIGHT

### **Budget Impact** Positive

**Hamad Aslam**  
Energy Analyst

## **REFINERIES: LESS THAN REFINED**

While no direct measures have been taken in the budget that would directly impact the refinery sector, following points need to be considered:

### **No Announcement on Deemed Duty**

Reduction in global crude oil prices in 1HFY09 led to severe pressure in refining margins. As a result, Petroleum Ministry in principal agreed to increase Deemed Duty on High Speed Diesel Oil (HSD) from existing slab of 7.5% to 10%. The incremental deemed duty was to be applicable as long as international crude oil (Arab Light) prices stay below USD80/bbl. However the issue still awaits a formal approval from Economic Coordination Committee (ECC). Against market expectations, no announcement in this regard has been made in the budget which may result in negative sentiments for the sector.

Nonetheless, recent reversal in global crude oil prices, as well as refining margins, implies decreased importance of imposition of Deemed Duty.

### **Carbon Surcharge to be a Pass-through Item**

While the proposed Carbon Surcharge is to be paid by refineries, it is implicit that the final incidence of the tax will be the end consumers. Hence the surcharge will be built in the computation for final petroleum product prices, making it a non-event for refinery sector.

### **Resolution of Circular Debt to Ease Cash flows**

Needless to repeat that any materialization of government's stated intentions to address the circular debt crisis will undoubtedly result in better cash flow for the sector.

### **Outlook FY10E**

With recent phenomenal price performance in refinery stocks and lower 4QFY09 Gross Refining Margins, we have downgraded our stance on the sector from OVERWEIGHT to MARKET WEIGHT.

Nonetheless our top pick from the sector, NRL still implies 8% upside to our DCF based fair value of PKR 220/share. The stock is currently trading at FY09E and FY10E PERs of 8.0x and 4.7x, respectively.

UNDERWEIGHT

**Budget Impact**  
POSITIVE**Omar B. Chaghtai**  
Telecom Analyst

## **TECHNOLOGY & COMMUNICATION: BOTH** THE CARROT AND THE STICK

Telecom remains the government's favorite cash cow; while some of the announced measures such as reduction in FED on telecommunication services and SIM activation tax should provide some relief to operators, other measures such as FED on short messaging service (SMS) aim at boosting revenue collection from the consumer.

### **FED on Telecommunication Services Reduced to 19%**

After a massive jump of 6% in the previous budget, FED on telecom services has been cut by 2% to 19%. Two possible outcomes exist, depending on how operators react to this change.

As discussed in our budget preview for the sector (In Focus dated June 11, 2009), FBR figures showed that post FED hike in the previous budget, collection from the sector actually declined in subsequent quarters as higher rates led to a decline in call volumes. Hence, if operators opt to pass on this decline to the consumer, it could help boost call volumes, consequently, improving profitability for them and leading to higher tax collection.

On the other hand, given already low call rates, if the benefit is not passed on, operator margins should still improve. This will provide relief to PTC for example, which has recently experienced a squeeze on margins amidst a declining top line and higher costs related to inflation and PKR depreciation (which adversely affects foreign operator charges). However, in this case, there will be no impetus for increased tax collection; in fact, collection would actually decline.

At any rate, we expect the reduction to be positive for telecom operators, albeit marginally

### **Reduction in SIM Activation Tax**

SIM activation tax which is borne by cellular operators as a subscriber acquisition cost, has yet again been slashed from PKR500 to PKR250. This will bode well for operators such as Zong which are still enjoying significant growth owing to a low base. However, for larger operators the benefit, while present, is not as significant. Subscriber growth in 10MFY09 has clocked in at a dismal 4.5% versus 34.6% in 10MFY08, indicating that the industry is well close to maturity and hence, subscriber acquisition cost for operators has already been reduced drastically. Given that we expect growth to remain subdued moving forward, the longer term impact of this relief remains marginal; our growth estimate for Ufone suggests a terminating impact of only about 2-3% on PTC's earnings for FY10E.

### **Reduction of Duty on Mobile Phones**

Customs duty which was levied in the FY09E budget at PKR500/set primarily aimed at reducing mobile phone imports. This has now been reduced to PKR250/set. As mentioned earlier, subdued cellular growth now implies a lower demand for cellular phones as well and it is unlikely that the reduction will bolster mobile phone imports. Furthermore, the existence of a large secondary market

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which caters to the lower socio-economic strata through cheaper used and stolen mobile phones has also ensured ample supply. As such, mobile cellular segment dynamics will remain unaffected.

#### **Enhancement of FED on SMS**

A levy of PKR0.20 per SMS in addition to the charge per SMS has been proposed. We expect this to be a pass through for cellular operators and should have no impact on their top and bottom line. Despite the increase in cost, SMS will still largely remain a cheaper alternative to cellular calls and hence, demand for this service should remain inelastic. Growth in the SMS segment may come under pressure; however, this was already due given that the segment has grown at a 3yr CAGR of about 250% to register 25.5bn SMS sent by mobile operators in FY08 and will no longer benefit from a low base effect. It is also pertinent to note that data services comprise no more than 8-10% of any cellular operator's revenue.

In the most conservative scenario, if SMS usage posts no growth over FY09-10E, the government would still be able to collect over PKR5.0bn through this new levy.

#### **Outlook FY10E**

Overall, we believe that as the economy continues to revive, demand for telecom services should pick up as well in the form of improved call volumes.

PTC offers significant upside of 126.2% to our fair value of PKR35, from current levels. However, given consistent subscriber decay and resultantly, revenue attrition, we advise caution and look for some top line stability to emerge before advising accumulation.

**MARKETWEIGHT****Budget Impact**  
**Positive****TEXTILE: STITCHING IT TOGETHER**

With textile sector accounting for over 50% of the country's exports, Fiscal Budget FY09-10 has taken a number of steps that directly or indirectly affect the sector.

**PKR40bn Export Reinvestment Fund to Replace R&D Facility**

The facility of Research and Development (R&D) for the textile sector has been completely withdrawn. The government had allocated a revised amount of PKR 4bn under this head for FY09. Moreover, 3% mark-up subsidy to spinning sector has also been reduced to PKR 500mn from PKR 810mn earmarked in the revised estimates for 2008-09.

In return, the government has allocated PKR 40bn for establishment of Export Investment Fund; out of which around PKR 27bn has been set aside for Pakistan's main export earner - cotton and textiles. The budgetary support allocated this year is not only higher in magnitude but the is also likely to be more efficiently utilized than the previous R&D facility.

**Withdrawal of FED on Import of Viscose Staple Fiber (VSF)**

VSF is man-made biodegradable fiber with characteristics akin to cotton and is widely used in apparels, home textiles, knitted wear, non-woven applications and dress material. Hence the withdrawal of FED bodes well for Composite sector particularly Nishat Mills and Azgard Nine.

**Other Measures**

While removal of oil subsidy may result in higher overall energy costs; other measures such as formal announcement of 12% reduction in gas tariffs, no increase in minimum wage rate and proactive measures to address energy shortfall are likely to bode well for the long term sustainability of the textile sector.

Additionally, the government has announced expedited work on genetically modified BT cotton seeds (for small farmers) which is expected to increase crop yield quality and lower cost of production.

**Outlook FY10E**

The only significant listed company out of the textile sector is Nishat Mills. We maintain BUY stance on the company; but more so on the basis of its portfolio holdings rather than the core textile operations.

**OTHERS**

**THE BEST OF THE REST**

SECTOR	MEASURES ANNOUNCED	OUTLOOK AND KEY PLAYERS
<b>Tobacco</b>	<ol style="list-style-type: none"> <li>1. Withholding tax rate is to be reduced from 3.5% to 1% for Cigarette Distributors</li> <li>2. Federal Excise Duty slabs raised on Cigarettes</li> </ol>	<b>OUTLOOK:</b> NEGATIVE <b>KEY PLAYERS:</b> PAKISTAN TOBACCO COMPANY LAKSON TOBACCO COMPANY
<b>Cable and Electrical Goods</b>	<ol style="list-style-type: none"> <li>1. Increase of duty on multi system airconditioners of capacity 5 tones and above from 10% to 35% plus regulatory duty @ 15%</li> <li>2. Reduction of duty on raw materials of transformers and control panels</li> <li>3. GoP has also made an elaborate plan for electrification of all villages where electricity can be extended from grid supply. This was achieved in 6,419 new villages last year.</li> </ol>	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYERS:</b> PAK ELEKTRON
<b>Automobile Parts and Accessories</b>	<ol style="list-style-type: none"> <li>1. Duty on spark plugs and wire condensers has been increased from 5% to 10%</li> <li>2. Duty on carbon black (used in tyres) has been rationalized</li> <li>3. Certain inputs for manufacturing parts/components for engineering sector including the auto assemblers have been exempted from duty</li> <li>4. Rationalization of duty on silicon sealant</li> <li>5. Additional Duty of 32.5% is proposed to be increased on four localized parts of motorcycles to protect local vendor industry</li> <li>6. Exemption on inputs for manufacturing parts/ components for engineering sector</li> <li>7. Tyres have been included in TBS on statutory rate of duty</li> </ol>	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYERS:</b> AGRIAUTO INDUSTRIES THAL LIMITED GENERAL TYRE & RUBBER CO.
<b>Pharmaceuticals</b>	<ol style="list-style-type: none"> <li>1. Concession/exemption on pharmaceutical raw materials, lifesaving drugs and cancer diagnostic</li> <li>2. Reduction in concessionary rate by 5% on import of pharmaceutical packing materials (PVC rigid film and aluminum foil)</li> <li>3. On pharmaceutical product distributors, withholding tax rate is being reduced from 3.5% to 1%</li> </ol>	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYERS:</b> ABBOT LAB (Pakistan) GLAXOSMITHKLINE HIGNOON (LAB) SEARLE PAKISTAN
<b>FMCGs</b>	Exemption from duty on import of Linear Alkyl Benzene from 5%	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYER:</b> UNILEVER PAKISTAN
<b>Chemicals</b>	Increase in duty on hydrogen peroxide from 5% to 10% to protect local manufacturer	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYER:</b> SITARA PEROXIDE
<b>Companies Selling to Entities Registered under Sales Tax Act</b>	Every manufacturer, registered under the Sales Tax Act, 1990, shall be entitled to a tax credit of two and a half per cent of tax payable for a tax year, if ninety per cent of his sales are to the person who is registered under the aforesaid Act during the said tax year.	<b>OUTLOOK:</b> POSITIVE <b>KEY PLAYERS:</b> PACKAGES LIMITED TRI-PACK FILMS
<b>Loss Making Entities</b>	Last year the provision regarding payment of minimum tax on declared turnover by the companies showing losses for one or other reasons was deleted mainly for the reason that the revenue collection was insignificant. Subsequently, it was found that actual collection from this source was much higher, however due to misclassification, the same could not be reported properly. In view of huge revenue loss the provision is being revived.	<b>OUTLOOK:</b> NEGATIVE <b>KEY PLAYERS:</b> PAKISTAN PTA