PAKOMAN ASSET MANAGEMENT

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Budget Review FY11

Budgetary Impact on Sectors

- Fertilizer – Neutral
- Insurance – Neutral
- Oil & Gas – Neutral to Negative
- Power Generation – Neutral
- Telecommunication – Neutral
- Cement – Neutral to Positive
- Textile – Negative
- Commercial Banks – Neutral
- Auto Assemblers – Positive

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Budgetary Measures and Impact on Sectors			
Sector	**Budgetary Measure Announced**	**Estimated Budgetary Impact**	**Sector 'Investment' Outlook**
Fertilizers	Increase in FED	Neutral	Over Weight
	Subsidy of PKR185mn for FFBL	Positive	
	Company listing concession of 5%	Positive	
Insurance	Imposition of 15% Vat from October	Neutral	Market Weight
Oil & Gas Exploration	Tax deductibility on decommissioning cost	Neutral	Over Weight
Oil & Gas Marketing Companies	Reduction of PSO dividend	Neutral	Over Weight
	Resolution of Circular Debt Issue (Indirect Steps)	Neutral	
Gas Utilities	Increase in turnover tax from 0.5% to 1.0%	Negative	Under Weight
Power Generation	Reduction of Subsidies	Neutral	Over Weight
	PSDP allocation to help sector grow	Positive	
Telecommunication	Increase in GST by 1% till VAT implementation	Neutral	Over Weight
	50% ad-hoc wages payable	Negative	
	10% Tax Credit for BMR	Positive	
Cement	FED to be maintained at PKR700/MT	Positive	Over Weight
	PSDP allocation of PKR663bn earmarked for projects	Positive	
	Increase in turnover tax from 0.5% to 1.0%	Negative	
Textiles	Subsidy on spinning sector removed	Negative	Under Weight
Commercial Banks	Withholding Tax of 0.3% extended to various banking instruments and payment mode	Neutral	Over Weight
Auto Assemblers	WHT on import of refurbished cars at 5%	Positive	Over Weight
	Continuation of duty structure on Auto Imports	Positive	

Budget Review - Highlights

Released on June 05, 2010, ***Budget FY11 is the third PPP budget, presented by its fourth finance minister***. The budget is predicated on an outlay of PKR3,259bn against previous year's initial outlay of PKR2,462bn – 32.4% higher; and actual outlay of PKR2,585bn – 26.1% higher. Total revenue collection for FY11 is projected at PKR2,574bn, which translates into a fiscal deficit of PKR685bn, i.e. 4% of GDP against FY10's projected deficit of 5.5% of GDP. Importantly, this target of 4.0% is 300bps shy of IMF's target of 4.3% for FY11. Over the past three years, the Federal Bureau of Revenue's (FBR) tax collection target has been one of the most anticipated and anxiously awaited figures due to its naively aggressive nature. Previous year, the government estimated tax collection at a gargantuan PKR1,494bn. Against this, the government has projected tax collections at PKR1,483bn over FY10. This year, the FBR has set a tax collection target of PKR1,779bn – 19.1% higher than FY10 initial and 19.9% higher than FY10 actual collections.

An important development that one should observe on the federal/provincial front comes in the form of greater decentralization. The government has announced an allocation of PKR1,033bn to provinces under the 7th NFC award compared to PKR655bn in FY10E. Although this would lead to greater expenditure on healthcare, education and other provincial portfolios, the tradeoff will adversely impact the government's treasury and its extended fiscal space. Resultantly, the nation is expected to witness greater government borrowings through commercial banks and a more vicious crowding-out effect. By extension, this crowding out will lead to higher real interest rates, lower investments, lower aggregate demand, lower production, higher unemployment, partial inflation and lower real wages/purchasing power.

Over FY11, the government has appropriated PKR126.68bn in subsidies for various entities and projects. This is 5.6% higher than FY10's initial appropriation of PKR119.92bn and 44.7% lower than what is actually estimated to be subsidized over FY10. Akin to previous years, we expect the government to overshoot the stated subsidy figure of PKR126.68bn this year as well.

While subsidies are almost always overshot, external funding is usually under-generated. Last year, the government estimated external receipts at PKR510.41bn. Against the initial expectation, the government has projected receipt of PKR577.99bn from donors, pledgers and creditors. Interestingly, only 45.6% of FoDP allocation is projected to be met over FY10. For FY11, FoDP receipts have been estimated at PKR55.3bn and it would be interesting to track exactly how many pledges are actually received.

On the administrative front, the government intends to present quarterly budget performance reports to the National Assembly to ensure that Parliament monitors the ongoing progress of government efforts. Although hypothetically this unveils the government's intention to be performance-motivated and monitored periodically; nonetheless, whether quarterly vigilance is actually being conducted or not will only be observed with time.

Economic Highlights

Over FY10, through some last minute fine-tweaking, the government was able to successfully maneuver the country's foremost presentational material, i.e. its GDP growth, to a much impressive level of 4.1%. One would truly find it miraculous that the final figure of 4.1% overwhelmed the year's initial target of 3.3% by a commendable 800bps, when only a couple of months ago even achieving the initial target seemed like a herculean goal. All that said, one must admit that the provisional figure of 4.1% has indeed put the country at par with counterparts who have managed to successfully record a relatively significant growth, while the rest of the world still tries to wriggle out of economic ashes.

Over FY10, the government was able to bring the country's forex reserves at par with the critical barrier of USD16bn with help from external financial assistance from WB, IMF, ADB and bilateral partners, in addition to reduced trade deficit, remittances and, by extension, the current account deficit. The exact crossover took place during May 2010. Remittances proved to be a major driving force behind the 66% lower current account deficit over 10MFY10. Over 10MFY10, remittances measured at USD7.31bn against the government's complete FY10 projected estimate of USD8.5bn.

With regard to fiscal deficit, the government still finds itself in hot water, as expected fiscal deficit is expected to reach 5.5% of GDP at year end. (9MFY10: 4.2%). This estimated figure, if realized, would exceed the IMF stipulated target by 4pps. Over FY11, the same target has been set at 4.3% by the multilateral agency, against the government's newly stated target of 4.0%.

PSDP and Development Expenditure

One must comment that the PSDP target for FY11 has been set at a realistic target after a long time. The PSDP allocation of PKR663bn is a mere 2.63% higher than previous year's initial target of PKR646bn. Nevertheless, the government is expected to miss FY10's target by a healthy PKR136bn (21.1% of total), which puts FY11's PSDP allocation of PKR663bn 30% higher than the actual projected expenditure of PKR510bn in FY10. Still, we maintain that the new target is more realistic in the sense that this time around, stakeholders can expect more than 80% of PSDP expenditure to be actually expensed by the government.

The federal component of PSDP has been stated at PKR280bn (42.2% of total) against previous year's PKR421bn (65.1% of total – Revised at 58.8%). Over FY10, the government the government completed 216 projects in transport, power and social sectors. Over FY11, the government intends to complete the following key projects:

1. Launching of Diamir-Basha Dam
2. 300 MW Chashma Nuclear Power Plant
3. 200 Km of Gwadar-Ratodero Road upto Hoshab
4. Gomal Zam Dam
5. Satpara Dam
6. Impoundment of water in Mangla Dam to add 3 MAF of storage

Apart from the above, the government has earmarked approximately PKR40bn out of PKR663bn for allocation to water, food and agriculture, livestock and dairy development sectors.

The PPP led government has always been known for its pro-poor face throughout Pakistan's history. Over FY11, the government intends to extend this recognition by extending the Benazir Income Support Program to PKR50bn for 4mn families, from PKR46bn for 3.5mn families over FY10. Apart from this, the government intends to initiate a health insurance scheme (Waseela-e-Sehet) that would provide a coverage of PKR25,000/person per family for hospitalization. Additionally, Pakistan Baitul Maal is stated to continue to run its pro-poor program with an allocation of PKR2bn.

Perhaps most important of the government's pro-poor efforts for FY11 stems from the raising of minimum wage from PKR6,000 to PKR7,000. Although barely sufficient compared to yearly inflation (+16.7% wage increment against +11.8% CPI in FY10), the raise marks progressive way forward. Moreover, to ensure proper commitment, implementation and execution by employers, the government has made it mandatory for employers to make salary payments through commercial banks.

Lastly, the government national internship program has been extended from PKR3.24bn to PKR3.6bn for FY11.

Development on VAT/GST platform and Tax Net Expansion

After a much anticipated and controversial imposition of 15% Value Added Tax, the government ended up delaying the tax till October 01, 2010. The delay has reportedly been caused due to settlement issues between the federal principal and its provincial subjects. Till these differences are resolved, the government has temporarily increased the prevalent General Sales Tax from 16% to 17%. In essence, the budget has ended costing the lower-income strata rather than benefiting the same through VAT. Although the GST increment is a temporary solution, we would like to point out that the probability of this stretching beyond October is high due to the inflationary impact that would be achieved right before October through the 6% power tariff hike in August and the month of Ramadan over August/September. Since VAT is itself expected to increase inflation in the range of 100-150bps, we expect that the government might end up delaying VAT imposition to 2HFY11 to avoid excess inflation over October-December 2010.

The proposed VAT reform holds the following essential points:

1. Uniform 15% VAT imposition will eliminate multiple GST rates ranging between 16 – 25%
2. VAT will not apply on health, education and food items consumed by the poor
3. Will not apply to turnover of less than PKR7.5mn per year (currently GST at PKR5mn)
4. Will be automated to reduce corruption and refund delays
5. Will help to broaden tax net and reduce pressure on existing tax payers

With regard to Customs Duty, Federal Excise Duty, Sales Tax and Income Tax, the following important measures have been announced:

Exemptions:

1. No increment in customs duty for any product.
2. Decrease or simplification of customs duty for 29 products.
3. Reduction in Import Duty on Palm Oil from PKR9,000/MT to PKR8,000/MT to ease food costs.
4. Concessionary import of 6 additional medical raw materials and medicines. Import of X-ray films exempted from customs duty as well
5. Import of four dedicated renewable energy machines to be given 5% concessionary import duty.
6. Duty free import of Energy Saving Light to resolve power crisis within country.
7. Reduction of customs duty from 15% to 10% on import of Soap and Detergent raw materials.
8. 5% concessionary duty on copper & Aluminum tubes and electro-galvanized steel sheets if imported by manufacturers of evaporators and washing machines.
9. Salaried tax payer's 'exemption threshold' increased from PKR0.2mn to PKR0.3mn.
10. Non-salaried tax payer's 'exemption threshold' increased from PKR0.1mn to PKR0.3mn.
11. 50% income tax relief for senior citizens above 60 (conditional upon income not exceeding PKR0.1mn).
12. Income Tax collected with electricity bills from Industrial and Commercial Consumers reduced from 10% to 5%. Relief of PKR4.5bn expected for 66,000 tax payers.
13. Cumulative Tax exemption of PKR2bn provided to 300,000 tax payers from Khyber Pakhtunkhwa province (including FATA and PATA).
14. Tax free profit payments on debt securities to non-residents.
15. Final withholding tax on non-specified profit payments to non-residents reduced from 30% to 20%.
16. 10% withholding tax as final charge on profit on debt (debt instruments, government securities) for non-residents.
17. 10% tax credit form BMR for all companies (especially beneficial for Chemicals, Fertilizers and other Industrial Units).
18. Withdrawal of restriction on adjustment of FED on beverage concentrate (will allow for downward revision of FED, benefiting beverage industries).

Impositions:

1. Increase in Sales Tax from 16% to 17%.
2. Increment in taxes for different tax slabs.
3. FED Incidence on all categories of cigarettes to be enhanced. FED at PKR1/filter rod to be imposed to discourage low quality cigarettes.
4. FED on Natural Gas to be increased from PKR5.09/mmbtu to PKR10.00/mmbtu. Impact to be borne by farmers (Fertilizer) and Cement Manufacturers.
5. 10% FED imposition on Air-Conditioners and Deep Freezers to reduce electricity consumption.
6. 7.5% - 10% Capital Gains Tax (CGT) imposition on equity investments (Commercial Banks: 35% previously in place).
7. Withholding tax payable commercial importers increased from 4% to 5%.

8. Turnover tax for loss making units increased from 0.5% to 1.0% (adverse for gas utilities and cement manufacturers in loss)
9. 5% withholding tax on domestic air travel.
10. 0.3% withholding tax for cash withdrawal through Demand Draft, Pay Order, Online Transfer, Telegraphic Transfer, TDR, CDR, STDR and RTC (contingent upon cash withdrawal above PKR25,000).
11. Tax exemption on dividends received by Investment Corporation of Pakistan withdrawn.

Incentive based/Non-Incentive based Tax Net Expansion:

1. 5% tax credit proposed to be allowed for company in its first year of tax enlistment.

Capital Markets & Capital Gains Tax (CGT)

Having been postponed for a long time, the Capital Gain Tax has finally been imposed as initial impressions and expectations insinuated. The government has announced a phased imposition of the tax over a total of 7 years.

- ✓ During its first year, CGT will be imposed at 10% for holdings that will be liquidated within 6 months.
- ✓ For holdings that will be held between 6 to 12 months, CGT to the tune of 7.5% shall be imposed on the investor.
- ✓ For holdings that would be liquidated after 12 months, CGT exemption shall be provided to the investor.

After imposition of CGT from July 01, 2010 onwards, a frozen period of two years (till FY12 end) will be provided to investors over which the tax structure will remain the same.

- ✓ From FY13 onwards, the <6-months tax will be raised by 2.5% till such a time when the cumulative taxation reaches the ceiling of 17.5%.
- ✓ For those investors who liquidate their equity investments within 6-12 months, the applicable tax rate shall grow by 0.5% till the total rate reaches a ceiling of 10%.
- ✓ Interestingly, investors with an investment horizon greater than 12 months shall remain exempted through all these years.

The following table portrays the incremental Capital Gain Tax over 2010-2017.

Table 1: Capital Gain Tax Imposition and Incremental Structure

Investment Period	FY11	FY12	FY13	FY14	FY15	FY16	FY17
< 6 months	10.0	10.0	12.5	15.0	17.5	17.5	17.5
> 6 months < 12 months	7.5	7.5	8.0	8.5	9.0	9.5	10.0
> 12 months	0	0	0	0	0	0	0

Source: Karachi Stock Exchange

At present, the commercial banking sector is already subject to a 35% CGT and will not be impacted by the imposition.

Power & Circular Debt

Although no substantial or concrete declarations were made for relieving the existing circular debt in the budget, some secondary measures by the government have been announced which are expected to prevent future cashflow traps and certainly assist in keeping future circular debts at bay.

1. Establishment of an Energy Development Fund to the tune of PKR20bn with the help of Asian Development Bank (ADB).

2. Signing of IP gas pipeline and initiation of transparent measures to import LPG (most likely from Iran).

3. Allocation of PKR131bn has been made for hydel, thermal and nuclear energy projects to augment power generation and improve transmission.

Table 2: Total Revenue Sources and Total Expenditure

Revenue Receipts	FY08	FY09	FY10	FY11
(A) Tax Revenue	1,031	1,251	1,513	1,779
(B) Non-Tax Revenue	338	428	514	632
Gross Revenue Receipts (A+B)	**1,369**	**1,679**	**2,027**	**2,411**
Less: Provincial Share (W)	466	568	655	1,034
(a) Net Revenue Receipts (A+B-W)	902	1,111	1,372	1,377
(b) Net Capital Receipts	59	221	191	325
(c) External Receipts	259	300	510	387
(d) Self Financing of PSDP by Provinces	123	124	173	342
(e) Change in Provisional Cash Balance	52	79	73	167
(f) Privatization Proceeds	75	25	19	0
(g) Bank Borrowing	80	150	146	167
Total Resources (a+b+c+d+e+f)	**1,550**	**2,010**	**2,484**	**2,765**

(A) Current Expenditure	**1,056**	**1,493**	**1,701**	**1,998**
General Public Service	642	930	1,189	1,388
Defence Affairs and Services	275	296	343	442
Public Order Safety Affairs	25	27	35	51
Economic Affairs	79	201	85	67
Environment Protection	0	0	0	0
Housing and Community	1	1	2	2
Health Affairs and Services	5	5	7	7
Recreational, Culture services	3	3	4	4
Education Affairs Services	24	25	32	35
Social rpotection	2	5	4	2
(B) Development Expenditure (k + l)	**520**	**550**	**646**	**663**
Federal Government	370	400	446	290
Provincial Government	150	150	200	373
(C) Est. Operational Shortfall	**(49)**	**(77)**	**(20)**	**(20)**
(D) Other Dev. Expenditure	**23**	**44**	**157**	**124**
Total expenditure (A+B+C+D)	**1,550**	**2,010**	**2,484**	**2,765**

Source: Federal Board of Revenue

Fertilizer   Budgetary Stance: Neutral   Sector Outlook: Over Weight

Key Budgetary Measures Announced

- As anticipated, the proposal of FBR for an increase in Federal Excise Duty (FED) on natural gas from the prevailing level of PKR 5.09/mmbtu to PKR 10.00/mmbtu has been incorporated into the budget FY11.
- Government has announced PKR185mn subsidy for FFBL.
- The tax credit for BMR is being provided at 10%, however, no BMR's of fertilizer manufacturers are expected this year.
- 5% tax credit facility for listing at bourse.

Estimated Impact - Neural

- It all comes down to the fact that the increase in FED on gas would lead to increase in costs of production as natural gas remains a crucial input to the industry. The sector's strong grip on the pricing power due to inelastic demand will eventually mean that any incremental costs would be passed down to end consumers (Farmers).
- An unstable factor for the sector comes from the new GST and VAT regime. An imposition of final retail tax is expected to materialize from implementation of VAT, which would generate PKR8bn for the government in revenue. The sector was exempted from final retail GST since FY09 which was beneficial for the farmers in terms of lower prices. Nevertheless, the inclusion of the sector into the VAT regime would make fertilizers pricier. Apart from this, increment of 1% GST on input costs would also contribute in increasing prices till October 2010.
- The provision for subsidy on wheat import is now 48% less than previous year's allocation. This might lead to a possible wheat crisis in the country.

Sector Outlook - 'Over Weight'

With a brewing surplus of urea production in the pipeline, the withdrawal of subsidy from this sector will not have an impact on the sector, nor will an increase in costs due to proposed revised FED charges. These FED charges will be passed down to the end consumers – a testament to the sectors pricing power in light of inelastic demand. The budgetary measures for the fertilizer sector, therefore, hold no major implications for the sector.

Insurance   Budgetary Stance: Neutral   Sector Outlook: Market Weight

Key Budgetary Measures Announced

- The proposed 15% VAT imposition has been postponed till October 2011. 17% GST applicable till then.

Estimated Impact – Neutral

- Previously in FY10, the FED levied on the insurance sector was raised to 16% from 10% in FY09, which drew certain negative impacts on the consumers in the form of high premium collections. The imposition of 15% VAT is awaited by the sector as there seems to be a muted impact on the industry from the current 1% GST increment.

Sector Outlook - 'Market Weight'

The insurance sector foresees space for potential growth as the penetration ratio is still low. Overall impact of the budgetary measures remains neutral owing to the null impact deriving from the federal budget 2011. Implementation of 15% VAT from October 1, 2010 is not being seen as a highly positive action as the decline of 2% will not provide enough of an incentive for consumers. Based on the impacts drawn from the long on-going judicial-political friction prevailing in the country, insurance companies are recommended to improve their underwriting results rather than using non-operating income as the sole backing element. Also, it is suggested that the claims ratio should be worked upon as the uncertainty in the region persists. Hence, a 'Market Weight' stance is maintained on the sector.

Oil & Gas

Budgetary Stance: Neutral to Negative **Sector Outlook: Over Weight**

Key Budgetary Measures Announced

- Dividend targets for OGDC and PPL have been declared at PKR7.90/sh. and PKR10.0/sh., respectively for FY11. FY10 dividend for OGDC has been scaled down from PKR9.8/sh. to PKR7.90/sh. due to the company cash constraints.
- Dividend target for PSO has been set at PKR17.6/sh. for FY11. FY10 dividend target has been revised from PKR17.5/sh. to PKR8.81/sh. due to company cash constrained situation.
- Dividend targets for SSGC and SNGP have been declared at PKR0.50/sh. and PKR3.4/sh., respectively for FY11. Government has targeted PKR30bn under Gas Development Surcharge (GDS).
- Circular debt is one of the key factors to impede the profitability growth of gas supply sector; however, the budget did not contain any concrete resolution plans on the issue.
- Gas tariff will experience a hike as the government intends to raise FED to PKR10/mmbtu in FY11 from the previous PKR5.09/mmbtu in FY10.
- Turnover tax for loss making units increased from 0.5% to 1.0%.
- Tax deductibility of decommissioning cost for E&Ps.

Estimated Impact – Neutral to Negative

- Since circular debt crisis has not been addressed, there will be no positive impact on the OMC sector as it would continue to experience high short-term leverage, low working capital, low dividend payouts and high operating and cash conversion cycle.
- For E&Ps and gas utilities, increase in FED shall be passed on to the end consumer resulting in higher prices of gas. Tax deductibility on decommissioning cost for E&Ps shall be only marginally positive for the E&P sector.
- Since higher of turnover tax and PBT tax is applicable for gas utilities, increase in turnover tax from 0.5% to 1.0% bodes extremely ill for the sector. Gas utilities is the only sector from the entire Oil & Gas chain to be impacted adversely from budget FY11.
- Reduction of FY10 dividend targets for PSO and OGDC would relive the companies of additional payouts. OGDC has already paid PKR4.0/sh. out of the revised target of PKR7.9/sh., while PSO has defrayed PKR3/sh. out of targeted PKR8.8/sh.

Sector Outlook – 'Over Weight'

The Oil & Gas sector has not been adversely impacted by the budget in general. Out of the four sectors covered, only gas utilities will be impacted adversely due to increment in turnover tax. Lack of concrete commitment to resolve the circular debt issue deprives the OMC sector of any expected positives. A reduction in dividend estimates for OGDC and PSO had been expected and doesn't come as a surprise. Despite reduced dividends, the sectors remain Over Weight due to their underlying fundamentals and industry dynamics.

Power Generation

Budgetary Stance: Neutral **Sector Outlook: Over Weight**

Key Budgetary Measures Announced

- The government has catered to the sector by setting a power subsidy target of PKR87.3bn (WAPDA: PKR84bn, KESC: PKR3.3bn)
- The previous year's revised subsidy target was a colossal PKR180bn
- During FY11, completion of certain on-going construction projects is foreseen, which includes Mangla Dam, Diamer Bhasha Dam Project, Satpara Dam and Gomal Zam Dam. Commissioning of these projects would help bridge the demand supply gap in the medium-term to long-term.
- We expect major power tariff hike of 6%, majorly owing to IMF's conditions for the Stand By Arrangement (SBA)
- The budget did not reveal any developments on the inter-corporate debt resolution while PKR20bn from Asian Development Bank (ADB) fund have been allocated to tackle the huge circular debt problem, along with allocation of PKR131bn for setting up of hydel, thermal and nuclear plants.

Estimated Impact - Neutral

The sector has seen a fall in allocation of subsidies owing to IMF's condition to eliminate them altogether. Completion of newer dams would help ease load shedding and its peril on Pakistan. A tariff hike could soon be expected which would be passed down to consumers with limited subsidies available to the consumers. In light of passage of costs and inelastic demand, the budget bodes a neutral impact on the power generation sector.

Sector Outlook – 'Over Weight'

The power sector continues to face growing demand and the sector has shown fair performance. Emergence of new projects, announcement of completion of other power projects under PSDP and high payouts have assured a strong future for the sector, which currently places it under our recommendation of 'Over Weight'.

Telecom

Budgetary Stance: Neutral **Sector Outlook: Over Weight**

Key Budgetary Measures Announced

- Expected imposition of 15% VAT from October 2010.
- 50% increase in the ad hoc salaries of government employees has been pledged.
- For the wellbeing of listed company, a tax credit for BMR costs incurred by such a company is proposed to be provided at 10% for the tax year of its incurrence.
- In Budget FY11, the custom duty on import of mobile phones has been maintained at PKR250/handset.
- The government has revised its dividend expectation from PTCL for FY10 to PKR1.70/sh. from PKR1.95/sh. For FY11, expectations stand at PKR1.70/sh. as well. The cumulative amount that the government expects to generate from the company stands at PKR5,457bn per year for FY10 and FY11.

Estimated Impact – Neutral

- In budget FY10, FED was reduced from previous 21% to 19.5%. The further decline of FED from 19.5% to 15% VAT in October 2010 is likely to have a positive impact on the sector as the telecom industry is highly taxed among all other local sectors.
- Increment in ad hoc salaries will cast an impact on the cost of the sector, PTCL in particular since PTCL remains the biggest contributor to the telecom sector.
- Expansion of the sector can be included in BMR despite contrary trends, creating a marginally positive impact on the sector.
- Restatement of dividend to PKR1.70/sh. relieves the sector from any pressure of additional dividend declaration. The firm has already declared PKR1.75/sh. in dividend for FY10. The revised estimate for FY10 bears a neutral impact.

Sector Stance - 'Over Weight'

The ad hoc salary measure remains our biggest concern for the Telecom sector as this would lead to considerable SG&A expenses. On the taxational front, we should expect a positive impact after the implementation of 15% VAT in October 2010. Moreover, BMR tax credit can prove to be a boon for PTCL's expansion over FY11. An 'Over Weight' stance has been maintained for the sector for now.

Cement Budgetary Stance: Neutral to Positive Sector Outlook: Over Weight

Key Budgetary Measures Announced

- PSDP allocation of PKR663bn has been announced, depicting a rise of 2.63% as opposed to PKR646bn in FY10. Completion of certain on-going projects such as Mangla Dam, Satpara Dam and Gomal Zam Dam has been announced whereas construction of Diamer Bhasha Dam is to begin in FY11.

- FED is to be maintained at PKR700/MT in FY11 (equivalent to PKR35/bag) against initial expectations of a rise to PKR900/MT.

- 16% of GST would be replaced by 15% VAT effective from October 1, 2010. However, till then a GST of 17% shall be applicable on the sector.

- Increment of FED on natural gas from PKR5.09/mmbtu to PKR10.00/mmbtu.

- Increment of Turnover tax from 0.5% to 1.0% for loss making units.

Estimated Impact – Neutral to Positive

- The forthcoming allocation of PSDP shows signs of some encouragement as the figures have improved for FY11 as opposed to FY10. PSDP has been earmarked at PKR663bn (up by 44.13%). The government displays strong determination in terms of completion of already established projects, however, such announcements shall start to impact the sector after FY11 – resulting in a neutral impact for FY11.

- Even though the margins of the sector are following a downward trend, implementation of 15% VAT from October 1, 2010 and the concurrent removal of 17% GST will provide some respite for final cement prices.

- The FBR has maintained FED at PKR700/ton in an attempt to generate supplementary revenue of PKR4-5bn in FY11, which is likely to extend negative effects to the end-consumers. Demand needs to be improved at the domestic levels, and a decline in FED would have served that purpose. However, since we initially anticipated an increase in FED, the maintenance of status quo remains more on the positive side.

- Increment in natural gas prices would increase production cost and the final consumer price if passed on. This is expected to bode ill for future sales volume.

- Due to the relatively high leverage that the Cement industry is exposed to, many existing cement units are experiencing losses. In such a scenario, increment in turnover tax (applied on sales) would prove to be extremely adverse.

Sector Outlook - 'Over Weight'

Given the positive impact expected from certain developmental projects in FY11 and maintenance of FED at PKR700/ton, cement sector is one of the few sectors expected to stage some recovery in the upcoming fiscal year. On the contrary, cement exports are expected to decline over FY11 owing to high fuel prices, ascending leverages and decline in international demand. That said, the overall stance on the sector remains 'Over Weight', with the budget having an offsetting neutral to positive impact.

Textile — Budgetary Stance: Negative — Sector Outlook: Under Weight

Key Budgetary Measures Announced

- The labor intensive textile sector would see a considerable increase in its production costs owing to increase in the minimum wage from the previous level of PKR6,000 to PKR7,000.

- Enhancement in the rate of FED on natural gas will drive down competitiveness of the sector in the international market.

- The sector will enjoy zero-rated status till the implementation of VAT, which would bring the whole supply chain under its umbrella. It is bound to increase the costs of the sector and hence competitiveness and profitability.

- The government has removed 3% mark-up subsidy for spinning sector

Estimated Impact - Negative

Major players in the textile sector have already incorporated minimum wage levels which would not have a muted impact on the sector. The textile sector would lose its charm and competitiveness in the international market owing to the increase in FED on natural gas. The increase in FED and removal of mark-up subsidy on spinning sector bode ill for the entire textile division.

Sector Outlook – 'Under Weight'

The Budget FY11 has some developments that would impact the textile sector adversely. This would be witnessed throughout the forthcoming year, before exacerbating further with imposition of VAT (more textile products will be excluded from zero-rated regime). Our sector outlook is 'Under Weight'.

Commercial Banks **Budgetary Stance: Neutral** **Sector Outlook: Over Weight**

Key Budgetary Measures Announced

- Contradictory to our anticipations, no declaration was brought forward on conversion to Single Treasury Account
- An important development came as banking instruments and other payment modes such as demand drafts, pay orders, RTCs, CDRs, online transfer and standing orders were brought under the same withdrawal charge of 0.3% on transactions amounting to PKR25,000 and above. This WHT of 0.3% was previously restricted to cheques only.
- Changes were brought about in the provisions relating to SME lending where tax deductibility was raised by 100bps to 5%.

Estimated Impact - Neutral

In a bid to generate revenue, Withholding Tax has been expanded to various banking instruments which would not have any effect on the volume of transactions. Therefore, the aforementioned tax impositions carry a neutral impact.

Sector Outlook – 'Over Weight'

The banking and financial sector have showed continuous growth during the previous year and as the economy recovers, they are expected to perform considerably better. The sector outlook remains 'Over Weight'.

Auto Assemblers — Budgetary Stance: Positive — Sector Outlook: Over Weight

Key Budgetary Measures Announced

- It was highly desired by auto importers to expect a decline in the import duty of CBU or a relaxation on age of used cars. The budget bode ill for the importers as no such provisions have been declared and current levels of duties would continue for FY11
- The new sales tax increment would certainly impact this sector, which would raise prices of locally assembled cars as GST rises to 17%, until 15% VAT regime sets in
- Auto Industry Development Plan (AIDP) has yet again been delayed which, if implemented, would have raised costs by 6% to 7%
- WHT on import of vehicles has been raised by 100bps to 5%
- Auto parts will be charged at the prevailing rate of WHT of 3%
- Road Sweeping Lorries have been provided a concession on customs duty on import, while LNG buses are exempted from the duty altogether.

Estimated Impact - Positive

A marginal rise in prices of cars due to increase in taxes would be witnessed as pricing mechanism shifts to adapt to the new tax structure. In absence of any import policy change, the budget was not successful at dampening the pricing power of local assemblers. On the contrary, importers have been slapped with an increment of 1% in import WHT. Resultantly, the budget remains surprisingly positive for the sector.

Sector Outlook – 'Over Weight'

Since the inception of a tight import policy on used cars, the sector has shown amplified results which will continue through FY11. Importers of used cars will not find any boon within the budget, especially with increase in WHT to 5%. The trend of growth is likely to continue for local auto assemblers in FY11.

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