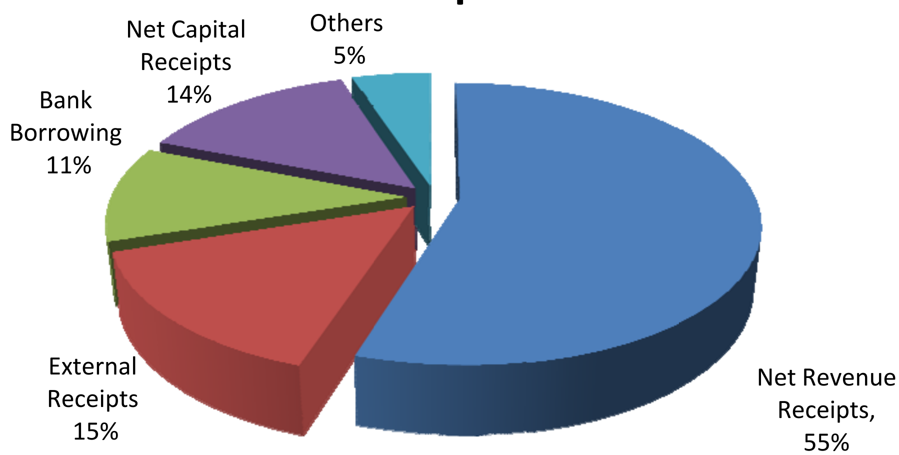
Dated June 5, 2011

Budget Review FY11-12

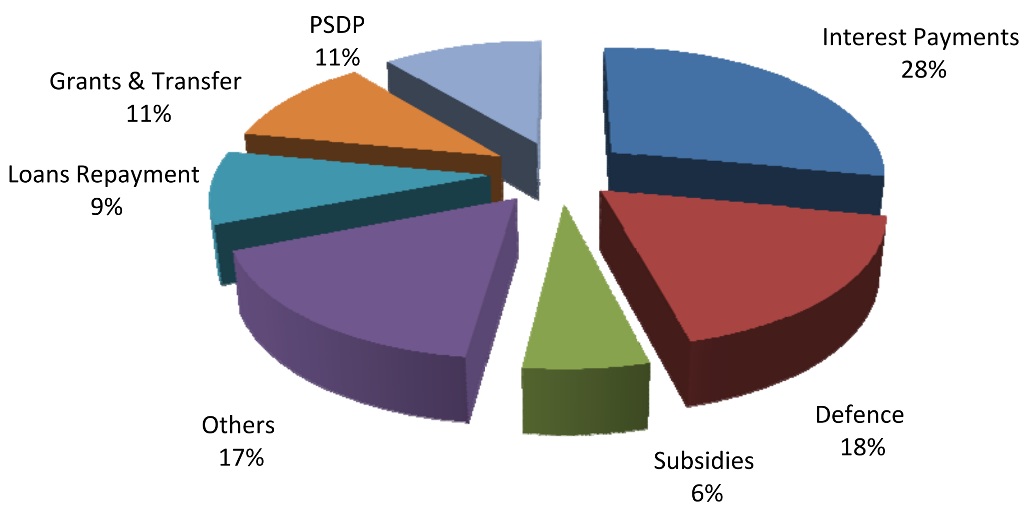
Budget at a Glance:

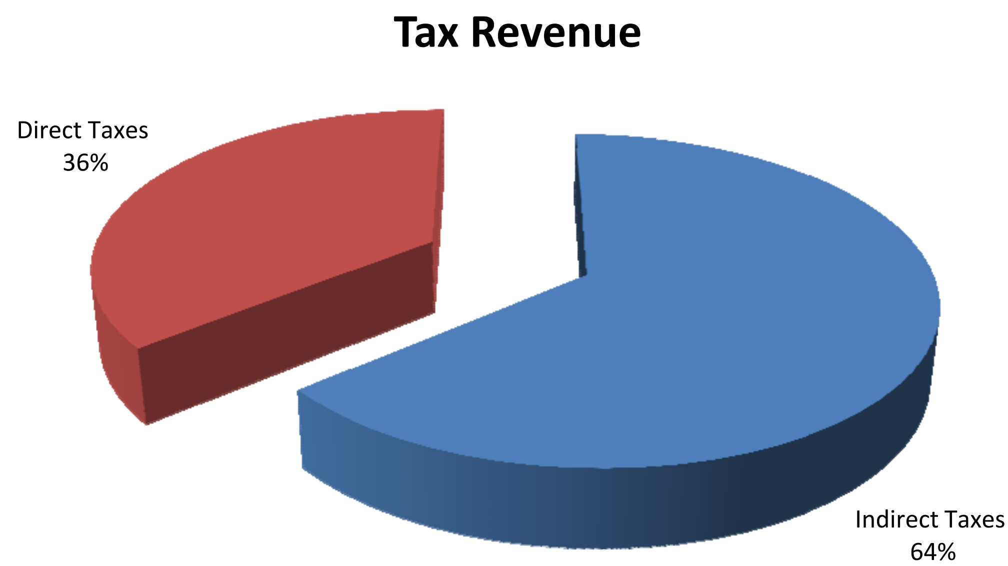
PKR mn			
Receipts	Budget FY12F	Expenditure	Budget FY12F
(a) Tax Revenue	2,074	**Current**	2,315
(b) Non-Tax Revenue	658		
Gross Revenue Receipts	2,732	Interest Payment	791
Less: Provincial Share	1,203	Pension	96
Net Revenue Receipts	1,529	Prepayment of Foreign Loans	243
Net Capital Receipts	396	Defence Affairs & Services	495
External Receipts	414	Grants & Transfers	295
Estimated Provincial Surplus	125	Subsidies	166
Bank Borrowing	304	Running of Civil Government	203
		Provision for Pay & Pension	25
		Development	452
		PSDP	355
		- Federal Government Development & Loans	300
		- Grants to Provinces	55
		Other Development Expenditure	97
TOTAL RESOURCES	**2,767**	**TOTAL EXPENDITURE**	**2,767**

Total Receipts 2011-12



Total Expenditure 2011-12





Subsidies (PKR bn)		
Classification	**Revised 2010-2011**	**Budget 2011-2012**
WAPDA	295.83	122.70
KESC	47.32	24.59
TCP	17.13	4.00
USC	4.20	2.00
Others	28.43	13.09
Total	395.80	166.45

Salient Features:

- The total outlay of budget 2011-12 is PKR2767bn which is 14.2% higher than the last year.
- The availability of resources has been estimated at PKR 2463bn during 2011-12 against PKR 2256bn in outgoing fiscal year.
- Net revenue receipts for 2011-12 have been estimated at PKR1529bn indicating an increase of 11% over the budget estimates of fiscal year 2011-12.
- The provincial share in federal revenue receipts is estimated at PKR1203bn during 2011-12 which is 16.4% higher than the budget estimates of 2010-11.
- The capital receipts (net) for 2011-12 have been estimated at PKR396bn against the budget estimates of PKR325bn in 2010-11 indicating an increase of 11%.
- The external receipts in 2011-12 are estimated at PKR414bn depicting an increase of 7.1% over the budget estimates of 2010-11.
- The overall expenditure during 2011-12 has been estimated at PKR2767bn of which the current expenditure is PKR2315bn and development expenditure at PKR452bn.
- Consolidated Budget deficit is estimated at PKR850bn which is 4.0% of GDP
- Current expenditure shows increase of less than 1% over the revised estimates of 2010-11, while development expenditure will increase by 64.4% in 2011-12 over the revised estimates of 2010-11
- The Expenditure on General Public Services (inclusive of debt servicing transfer payments and superannuation allowance) is estimated at PKR1660bn which is 71.1% of the current expenditure.
- Public Sector development Program (PSDP) allocation is estimated at PKR730bn. While for Other Development Expenditure, an amount of PKR97bn has been allocated. The PSDP shows an increase of 58% over the revised estimates of 2010-11.
- The provinces have been allocated an amount of PKR430bn for budget estimates 2011-12 in their PSDP as against PKR373bn in 2010-11.
- The Earthquake Reconstruction & Rehabilitation Authority (ERA) has been allocated PKR10bn in PSDP 2011-12.
- The much awaited relaxation on Capital Gain Tax (CGT) was not mentioned in the Finance Bill issued as part of the budget 2011-12.
- Defence Outlay up from PKR414bn to PKR495bn depicting an increase of 19.56%.
- General Sales Tax (GST) has been decreased by 1% to 16% from 17%.
- FED on cement declined by PKR200/ton to PKR500/ton from PKR700/ton.
- All types of SEDs have been removed.
- 15% increase in salaries of government employees and 15-20% increase in pensions have been announced in the budget 2011-12.
- Government has raised tax on dividend income from mutual funds from 10% to 20% for banks.
- Withholding tax on cash withdrawal of above PKR25k lowered from 0.3% to 0.2%.
- Minimum taxable salary level increased from PKR300k to PKR350k.
- CVT on redeemable capital & Modaraba have been withdrawn.

- Limit for tax credit on investment in mutual funds and IPOs raised to PKR500k or 15% of income (whichever is less) but a condition for 3-year holding introduced.
- Government has announced 100% tax rebate for capex (new plant or BMR) made purely from equity.
- The sales tax on sugar on import and local supply has been replaced by FED at 8%.
- Value Addition Tax has revised upward to 3% o commercial imports compared to2% last year.
- Exemption of sales tax on cement/concrete blocks and bricks has been withdrawn to estend similar treatment in line with other inputs used in the construction industry.
- Reduction of duty to 5% on pharmaceutical raw materials to provide relief to common man.
- Concession in machinery and equipment will be given to incentivize oil exploration companies.
- Government has announced to remove Federal Excise Duty (FED) on 15 items with the gradual removal on all the items in next three years.
- For encouraging investments made by non-residents in Government Securities, the withholding tax on profit on debt instruments (TFCs, T-Bills and PIBs) at 10% has been set as the final tax.
- Advance tax on capital gains on sale of shares shall be payable within a period of 21 days after closing of each quarter instead of 7 days previously.

Budgetary Measures & Impact on Sectors			
Sector	**Budgetary Measure Announced**	**Estimated Budgetary Impact**	**Sector 'Investment' Outlook**
Capital Market	CGT not exempted	Neutral to Negative	
Telecom	Telecom GST to remain at 19.5%	Neutral	**Under weight**
	Target of PKR 75bn from issuance of 3G license by the Government	Negative	
	Tax rebat of 100% on BMR and on New projects	Positive	
Insurance	Insurance companies will continue to pay CGT as per its specific rules	Neutral	**Market weight**
	Tax credit on income tax for life insurance investors	Positive	
Automobile Assemblers	Sales tax lowered from 17% to 16%.	Positive	**Over weight**
	No change on WHT on car purchase and duty structure of CKDs	Neutral	
	The regulatory and custom duty remains unchanged	Neutral	
Fertilizers/Chemical	Reduction in GST by 1%	Positive	**Over weight**
	No change in PTA duties	Neutral	
	Feed gas prices remained intact	Neutral	
Oil & Gas	Reduction in GST by 1%	Positive	**Over weight**
	Deemed duty remained same at 7.5%	Positive	
	Increased in petroleum levy by 71%	Negative	
Cement	PSDP allocation PKR 730bn	Positive	**Over weight**
	Reduction in FED by PKR 200/ton	Positive	
	Removal of 2.5% SED	Positive	
	decline in GST by 1%	Neutral	
	Rise in development expenditure by 64%	Positive	
Power	Lower Subsidy	Neutral	**Over weight**
	No devlopment on circular debt	Negative	
	decline in GST by 1%	Neutral	
	Allocation of PKR 115bn for project development	Neutral	
Textile	Sales tax set at 5%	Neutral	**Market weight**
	100% tax rebat on BMR	Positive	
	No Change in ERR	Neutral	
Commercial Banks	Tax on dividend income to 20%	Negative	**Over weight**
	Reduction in withholding tax to 0.2%	Neutral	
	Corporate tax rate remained unchanged	Neutral	

Fertilizer/ Chemicals:

Key Budgetary Measures announced:

- Subsidy for FFBL has been cut short by 12% YoY to PKR 162mn.
- In line with other sectors, GST has also been reduced on fertilizer products by 1% to 16%.
- No changes have been brought around in customs duty on imported PTA.
- No advancement has been made regarding removal of subsidy in feed gas prices, which is a positive sign for the fertilizer industry.
- The tax rebate has been enhanced from 5% to 15% in the year a new company is listed.
- Tax rebate has been allowed up to 100% on BMR and other industrial undertakings, if completely financed by equity.

Estimated Impact: Neutral

- The subsidy cut on FFBL will result in a cost increase, which is believed to be passed on to the consumer.
- Despite much hype about the removal of subsidy on feed gas by rationalization of gas tariffs, there was no change in feed gas prices.
- The 1% reduction in sales tax will lower the fertilizer products' prices.
- Moreover the reduced tax rebate on new listing will bode well for Engro's upcoming listings.
- With regards to 100% tax rebate allowed on BMR and other industrial undertakings, Lotte PTA will reap the benefit out of it keeping their expansion plan in view.

Sector Outlook: Overweight

Currently, DAP prices stand at a little higher than PKR 4,000 per bag while urea prices stand at about PKR 1,250 per bag, after having recently been revised upwards post latest gas supply concerns. While enhanced farmer incomes seem to be maintaining fertilizer demand in the current season, higher notified gas curtailment could have an upward impact on the prices leading to demand erosion.

Government's Dividend Expectations from its Entity (PKR mn)			
Company	Budget 2010-11	Revised 2010-11	Budget 2011-12
Fauji Fertilizer Company	46	36	36

Oil and Gas:

Key Budgetary Measures announced:

- The target for subsidy on electricity has been reduced to PKR 148bn for FY12 as against that of PKR 229bn in FY11. This means that the government is planning to gradually increase power rates which will improve the cash flows of energy chain.
- Like all other sectors, the GST on oil and has also been reduced by 1% to 16%.
- Deemed duty on HSD, the major profit driver of refineries remains at 7.5%.
- Petroleum Levy (PL) target of PKR 120bn has been set for FY12, while the amount collected in FY11 is only PKR 70bn.

Estimated Impact: Neutral

- The new budget has no major implications for the heavy weight E&P, OMCs and Refinery sector.
- The reduction in GST is likely to be passed on.
- Meanwhile, to achieve the target for petroleum levy, the government would have to not pass on the impact of lower international oil prices, or it would end up collecting lower amount in the said account.

Sector Outlook: Overweight

The Budget FY12 stands a null event for the sector. There had been news flows regarding removal of deemed duty from HSD, which has not been the case post budget. The market, in lieu of this, is expected to perform positively for the sector. Thus, we review the sector outlook as overweight.

Government's Dividend Expectations from its Entities (PKR mn)			
Company	Budget 2010-11	Revised 2010-11	Budget 2011-12
Oil & Gas Development Company	29,000	15,000	25,000
Pakistan Petroleum Limited	6,506	7,696	8,442
Pakistan State Oil	770	385	385
Sui Northern Gas	670	348	660
Sui Southern Gas	194	535	600

Cement:

Key Budgetary Measures Announced:

- For FY12, the PSDP allocation has been announced to PKR 730bn as compared to PKR 462bn in FY11 depicting an increase of 58%YoY.
- Federal Excise Duty (FED) has been reduced by PKR200/ton to PKR500/ton that will result in decrease in cost by PKR 10/bag.
- Special Excise Duty (SED) which was previously at 2.5% on imports has been completely removed that will result in decrease in cost by PKR 7-8/bag.
- General Sales Tax (GST) has been reduced to 16% which was previously set at 17% so it will result in cost reduction by PKR 3-4/bag..
- Development Expenditure has been increased by 64.4% in this budget 2011-12.
- Tax rebate of 100% will be given on Balancing, Modernization & Renovation (BMR) activity to the companies which finance these activities by 100% equity.

Estimated Impact on the Sector: Positive

- PSDP increment is positive for the sector but the point is that how much amount is utilized. Previous trend shows 25-35% utilization of PSDP. This year's maximum utilization is expected at 35% due to flood reconstruction across the country.
- FED has been reduced as it gives an impact that govt. is more focusing on infra structure development which is positive for the sector.
- Removal of SED is positive for the sector as cement manufacturers import coal as raw material.
- Increase in development expenditure is positive for the sector.
- Tax rebate of 100% will have positive impact on the sector.

Sector Outlook: Overweight

As in this budget 2011-12, most of the budgetary measures that were announced are in the favor of cement sector as decline in taxes which will result in lower cost of production by approximately PKR 20/bag. Meanwhile, massive increase in PSDP allocation will result in higher sales; hence the sector outlook is overweight.

Power:

Key Budgetary Measures Announced:

- Government has reduced the total WAPDA subsidy at PKR 123bn which is 58.44% lower than the revised figure of PKR 296bn in FY11.
- Tariff differential subsidy has also been set excessively low at PKR 50bn which was PKR 239bn in FY11.
- No clear measures have been announced by government to solve the circular debt issue.
- Government is planning to gradually increase the power rates to settle the inter-corporate debt issue.
- Tax rebate of 100% will be given on Balancing, Modernization & Renovation (BMR) activity to the companies which finance these activities by 100% equity.
- General Sales Tax (GST) has decreased by 1% to 16%.
- Government has allocated PKR 115bn for ongoing and new schemes in power sector from PSDP.

Estimated Impact on the Sector: Neutral to Positive

- Lower power sector subsidy allocation reiterates the government's focus on reducing the inter-corporate debt.
- Cash flows of IPPS would be better in the starting of year as government has recently cleared due amount of PKR 120bn of inter-corporate debt, however due to prevailing circular debt issue; cash flows are expected to decline at the end of year.
- Reduction of 1% GST is expected to be passed on to the consumer that will be adjusted later on by increase in power rates.
- Earnings of IPPs are based on the fixed return formula as their earnings are not so much dependent on the cost variation.
- Power crisis could be managed to some extent as government has allocated fund for new schemes and ongoing projects in power sector.
- Tax rebate of 100% will have positive impact on the sector.

Sector Outlook: Overweight

Government is more focusing on reducing subsidies by increase in power rates as government wants to clear the issue of inter-corporate debt. So in this scenario we expect the better cash flow of IPPs in the near future. The country is facing the power crisis issues and there is a huge gap between supply and demand so there is a much room for power sector. As a result, the sector outlook is overweight.

Textile:

Key Budgetary Measures Announced:

- Sales Tax on local supplies has been standardized to 5% on yarn and processed cloths both, which was previously 4% on yarn and 6% on processed cloths.
- Tax rebate of 100% will be given on Balancing, Modernization & Renovation (BMR) activity to the companies which finance these activities by 100% equity.
- Special Excise Duty (SED) of 1% that was imposed recently has been removed in this budget 2011-12.
- No change has been announced in Export Refinance Rates (ERR).

Estimated Impact on the Sector: Neutral

- Standardizing sales tax would not have any impact on the margins of textile companies because on one item it has been increased while on the other item it has been decreased, thus net impact will be zero.
- Completely removal of SED would have positive impact on the margins of textile companies.
- No change in ERR would continue giving benefits to the textile companies means it has neutral impact on the textile sector.
- Tax rebate of 100% will not have much positive impact on the sector as the sector is highly leveraged but they can get benefit by small expansions as they finance small expansions through equity.

Sector Outlook: Market weight

The measures that have been taken in this budget 2011-12 will not have much positive impact on the textile sector. There is more need for development in this sector so in this scenario; our sector outlook is neutral for the sector.

Government has allocated fund in PSDP for textile sector development, removal of SED and 100% tax rebate on BMR activity through equity would give positive impact on the sector hence our sector outlook is overweight.

Telecom:

Key budgetary measures announced:

- General sales tax rate decreased by 1% to 16% while telecom services will continue having a higher rate of 19.5%.
- The government had set an unrealistic revenue target of PKR 75bn from issuance of 3G license
- 100% tax credit on corporate industrial undertakings which are 100% equity financed up to 5-years after commissioning. The same will be applicable for new BMR activities.
- Dividend target from PTCL set at PKR 6.5bn that is PKR 2.05/share.

Estimated impact on the sector: Neutral

- This years target like last year's seems to be unrealistic and such an ambitious target would highly affect the financial positions of the telecom companies knowing the fact that the industry has reached the point of being stagnant.
- Knowing the belief that the cellular companies would feel hesitant to purchase the 3G license from the government, the budget proves to be uneventful for this sector.

Sector outlook: Underweight

The Government has not provided any leniency for GST of this sector while it did decrease 1% for all others. Instead, it has expected higher revenue from this sector in this year. These two dimensions could prove to have negative impact on this sector as a whole.

Government's Dividend Expectations from its Entity (PKR mn)			
Company	Budget 2010-11	Revised 2010-11	Budget 2011-12
Pakistan Telecom	5,457	5,457	6,500

Insurance:

Key budgetary measures announced:

- Insurance companies will continue to pay CGT as per its specific rules/ordinance and there is no change in this Budget.
- Tax credit on income tax can be availed by individuals investing in life insurance policies. However, this can only be done on either the amount of premium up to 15% of taxable income or Rs. 500,000, taking the one that is lower.

Estimated impact on the sector: Neutral

- The expected decision to increase corporate tax rate would have led to major drawbacks for the sector. However, this remains unchanged this year.
- No change in CGT has resulted in neutral impact.
- The tax credit allowed on life insurance will give a boost to the sector leading to normal outcomes because the industry itself is slow moving as only one company (EFU) offers like insurance.

Sector outlook: Market weight

The adversity that was expected for the sector by the budget did not take place. For this reason the sector's hype dampened. However, the tax credit opportunity for people investing in life insurances will move the sector into a safe arena.

Automobile Assemblers:

Key budgetary measures announced:

- SED which was increased to 2.5% in March'11 is completely removed.
- Sales tax lowered from 17% to 16%.
- No change on WHT on car purchase and duty structure of CKDs.
- The regulatory duty (50% on 1801c and above) as well as custom duty on imported, used and new CBUs is unchanged.

Estimated impact on the sector: Positive

- Removal of SED and GST being lowered suggests that the car prices would decrease by almost 2-3%. This will have a slightly positive impact on car assemblers as their sales volume would increase a little.
- The impact on imports would have an increasing trend due to removal of SED and stagnancy of custom duty as per last year.

Sector outlook: Overweight

If we analyze the above alterations in the sector post budget 2011-2012, we can reach to the conclusion that the performance of its shares would be better and the sector's profitability would eventually push up due to higher sales in response to lower prices.

Banks:

Key Budgetary Measures announced:

- The rate of tax on dividends received by banks from Asset Management Companies has been increased from 10% to 20%.
- Meanwhile, the withholding tax rate on cash withdrawals exceeding amount of PKR 25,000 and instruments like pay order, demand draft, etc. has been reduced from 0.3% to 0.2%.
- No steps have been taken in regards to increasing corporate tax rate for Banks.

Estimated Impact: Neutral

- The increase in tax rate on dividend income will affect banks' profitability minimally as the exposure of investment in mutual funds account for 0.3-1.1% of asset base of big-five banks. Thus, the decision aims to check an arbitrage opportunity and balance sheet inflation practice of banks.

Sector Outlook: Overweight

The banking and financial sector have showed continuous growth during the previous year. Going forward, the sector is to reap further benefits from the government with regards to government's 84% reliance of PKR 850bn deficit that comes from local bank borrowings. As the economy recovers further, they are expected to perform considerably better and hence the sector outlook is overweight.

Government's Dividend Expectations from its Entities (PKR mn)			
Company	Budget 2010-11	Revised 2010-11	Budget 2011-12
National Bank	22	24	27
United Bank Limited	11	17	18
Habib Bank Limited	52	61	65

Budgetary Impact on Capital Market:

On the capital market front, the FY2011-12 budget has disappointed the capital market investors as the government has not provided any respite to the investors on capital gain tax. Individual investors will continue to pay CGT at 10% if shares sold within 6 months and 8% if sold between 6-12 months. Banks, insurance firms, investors of mutual funds and corporate will also continue to pay CGT as per their specific rules and there has been no change in this budget. The initial reaction at the Karachi Stock Exchange would be negative as it is not in line with the expectations, not only affecting the market depth and volumes but also having adverse implications to the government plan to privatize its units through the stock market.

In addition to this, the government has not also taken any measure to resolve the prolonged delayed circular debt issue of energy chain, which is hampering the operations of oil & gas and power sectors.

On a positive note, the government has given some relief by not increasing corporate tax, decline in sales tax, eliminating special excise duty, and discontinuation of 15% flood tax.

Furthermore, tax rate on dividend income earned by banks from mutual funds has been increased from 10% to 20%. Also, limit for tax credit on investment in mutual funds and IPOs raised to PKR 0.5mn or 15% of income, whichever is lower, but a condition for 3 year holding introduced. Tax relief is proposed to be provided to withdrawals exceeding PKR 0.5mn from a Voluntary Pension Fund. Based on the above measures we foresee ‘**Neutral to Negative’** impact on the stock market.

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