

Grapevine

Budget FY10

Omar B. Chaghtai
Research Analyst

Budget FY10: Change in Tax Regime Could Affect Exporter Profitability

- A proposal highlighted in the Finance Bill 2009 suggests that the current 1% final tax liability on export proceeds be deemed minimum tax liability and implies that export revenue will be taxable at the normal corporate rate of 35%
- Export-oriented companies particularly textile and cement manufacturers will be adversely affected should this proposal be finalized
- Our initial assessment indicates a negative impact on LUCK's FY10E EPS of 11%. However, we await further clarity to emerge in this regard before incorporating the change in our estimates

A proposal highlighted in the Finance Bill 2009 suggests that exporter profitability may be adversely affected owing to a change in tax law.

Currently, taxes are collected from export proceeds at a rate of 1% which is deemed to be the final tax liability with regards to such revenue. However, the proposal suggests that moving forward this would now be deemed as minimum tax liability and implies that export revenue will be taxable at the normal corporate tax rate of 35%.

Cement and Textile companies could face the heat

Export-oriented companies, especially in the cement and textile sectors will experience pressure on the bottom line should this proposal receive a final nod.

The textile sector contributes 51% to total country exports and increased taxation would prove detrimental given that higher value-added products command greater margins and would witness a greater spike in their effective tax rate. This would prove to be counter productive, given the government's aim to increase overall exports by 10% in FY10E and particularly improve textile exports to USD25.0bn over the next 5 years.

Healthy demand in the GCC, India and Afghanistan has helped bolster cement exports with export dispatches rising at a 3 year CAGR of about 96% and up 50% in 11MFY09. LUCK in particular has been a key beneficiary in this regard with a 13.7% market share in volumetric exports.

Our initial assessment indicates that a rise in the effective tax rate could reduce LUCK's FY10E EPS by 11% to PKR12.04. However, we await further clarification and finalization of the proposal before incorporating the change in our estimates.

At current levels, LUCK offers 25.4% upside to our fair value of PKR73. Moreover, it is trading at a FY10E PER of 4.3x.