

PAKISTAN



Federal Budget FY24

Balancing between elections and IMF

The Gov't has presented FY24 budget with a total outlay of Rs14.5tn that is 30% higher compared to FY23R estimates. The budget will mainly be funded by FBR revenue collection with an estimated ambitious target of Rs9.2tn (up by Rs2.0tn or 28% YoY). The reliance would be on both direct/indirect taxes with 32/25% YoY increase. Thus, the fiscal deficit target is set at 6.5% for FY24 against 7.0% in FY23R. Moreover, primary balance is set at 0.4% for FY24 versus -0.5% for FY23R. The FY24 budget financing need is set at a staggering ~Rs7.6tn compared to Rs5.9tn in FY23R.

The FY24 budget is compliant with IMF requirements as Gov't has projected a primary surplus, we believe extraordinary increase in pensions and salaries (including ad-hoc expenses) may prove to be a contentious point in negotiations with IMF.

From a stock market perspective, the budget is negative given continuation of super tax at 10%, imposition of tax on bonus share issuance and additional tax on companies earning higher profits in the last five years.

Salient features of Federal Budget FY24

Expenditure: The Gov't targets current expenditures at Rs14.5tn, up by 30% YoY. Defense budget would increase by 14% YoY while debt servicing is projected to jump by 32% YoY where domestic debt servicing would increase by 34% YoY to Rs6.4tn and external debt servicing would jump by 20% YoY to Rs872bn. Whereas, subsidies are expected to decline to Rs1.1tn (down by 3% YoY) due to 47% YoY lower subsidies to petroleum sector. On development front, the govt set Federal PSDP at Rs950bn vs Rs714bn last year, up by 33% YoY.

Revenue: The Gov't aims to increase gross receipts by 38% YoY with major contribution expected from 28% surge in FBR revenue collection. Bifurcation shows that the govt relies heavily on growth in direct(mostly income tax)/indirect(sales tax) collection by Rs908bn/1.1tn (up by 32/25% YoY) against total targeted incremental collection of Rs2.0tn. Thus, FBR tax-to-GDP ratio target would increase by 0.2ppt to 8.7%. Non-tax revenue increases to Rs3.0tn (up 83% YoY) mainly attributed to (1) increase in SBP profit of Rs742bn (up by 3.0x YoY) and (2) rise in petroleum levy collection by Rs327bn to Rs869bn.

Financing: The Gov't would finance the fiscal deficit from banks (~41% of total financing gap) and non-banks (~25%) while Rs2.5tn (~33%) would be financed through external sources which includes US\$5.5/3.2bn from commercial & eurobonds/multilateral & bilateral sources.

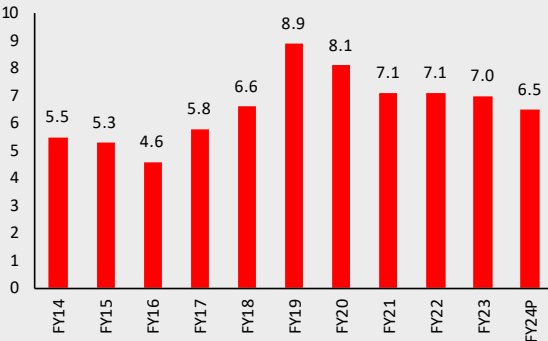
Negative from stock market perspective

FY24 budget is negative for the market due to continuation of super tax at 10%, imposition of tax on bonus share issuance and additional tax on companies earning higher profits in the last five years. Removal of 2% withholding tax on investment made by non-residents in immovable property may divert foreign remittances from abroad towards real estate. Moreover, introduction of digital micro National Savings Schemes at enhanced returns would shrink inflows to equities. However, allocation of Rs315bn subsidy targeted for power tariff reduction would lower the trajectory of inflation.

Winners and Losers

Sector wise, FY24 budget is Positive for Cements, Fertilizer, IT, OMCs and Refineries while Neutral for Power and Textile. Budget is Negative for E&P and Banks. For former due to imposition of additional tax and for latter due to imposition of additional tax, increase in tax on international payments through cards and WHT on cash withdrawals by non-filers. Higher PSDP allocation would be positive for Cement and Steel sectors but actual disbursement is likely to remain low given economic slowdown and external account constraints as IMF program is going to end in Jun'23.

Fiscal Deficit roadmap



Source: MoF, SBP, Foundation Research, June 2023

Sectorwise Impact	Impact	Outlook
Market	-ve	+ve
Banks	-ve	+ve
E&P	-ve	+ve
Cements	+ve	+ve
Fertilizer	+ve	+ve
Power	NU	+ve
Textile	NU	+ve
Auto	+ve	NU
OMC/Refinery	+ve	+ve
Steel	+ve	+ve
Chemical	-ve	-ve
FMCG	-ve	-ve
IT	+ve	-ve

Source: MoF, Foundation Research, June 2023

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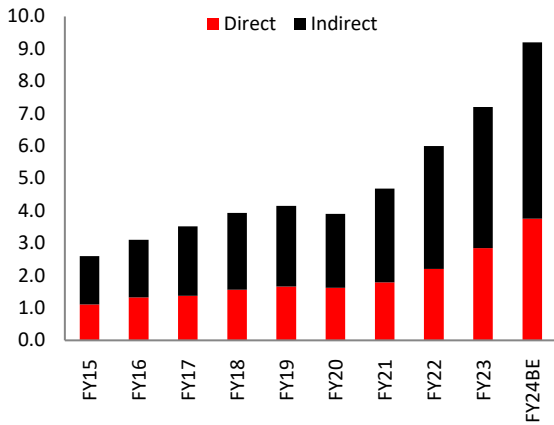
Foundation Securities (Pvt) Ltd
 Saturday, June 10, 2023

Table 1: Federal Budget Snapshot and Consolidated Fiscal Deficit

(PkR bn)	FY23BE	FY23R	FY24BE
REVENUE RECEPITS			
Tax Revenues	7,004	7,200	9,200
Direct	2,573	2,851	3,759
Indirect	4,431	4,349	5,441
Non-Tax Revenue	2,000	1,618	2,963
Gross Revenue Receipts	9,004	8,818	12,163
Less: Provincial Transfers	4,100	4,129	5,276
Net Revenue Receipts	4,904	4,689	6,887
EXPENDITURES			
Current Expenditure	8,694	10,376	13,320
Debt Servicing	3,950	5,520	7,303
Defense	1,523	1,587	1,804
Subsidies (current)	699	1,103	1,074
<i>Subsidy to WAPDA/PEPCO</i>	490	677	579
<i>Subsidy to KESC</i>	80	193	315
<i>Subsidy to Petroleum</i>	71	102	54
<i>Subsidy to USC</i>	17	30	35
<i>Subsidy to PASSCO</i>	7	4	10
<i>Subsidy to Naya Pakistan Housing Authority</i>	-	0	1
<i>Subsidy to others</i>	34	97	81
Others	2,522	2,165	3,139
Development Expenditure	727	714	950
PSDP - Federal	727	714	950
Total Expenditure (Federal)	9,421	11,090	14,270
Federal Fiscal Deficit	(4,517)	(6,401)	(7,383)
Est. Provincial Cash Balance	750	459	650
Net Lending	31		190
Consolidated Fiscal Deficit	(3,798)	(5,942)	(6,923)
As % of GDP	-4.9%	-7.0%	-6.5%
Primary Deficit	152	(421)	380
As % of GDP	0.2%	-0.5%	0.4%
GDP	78,197	84,658	105,817

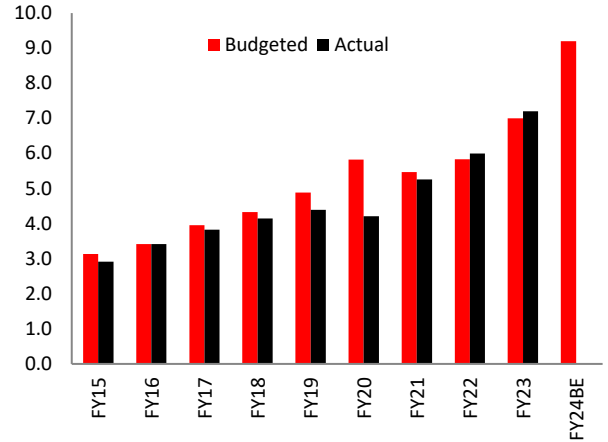
Source: MoF, Foundation Securities, June 2023

Fig 1: Indirect taxes forms majority of FBR revenue



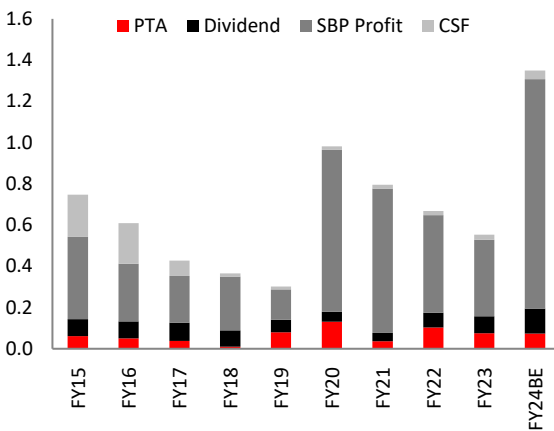
Source: MoF, Foundation Research, June 2023

Fig 2: Ambitious revenue target set once again



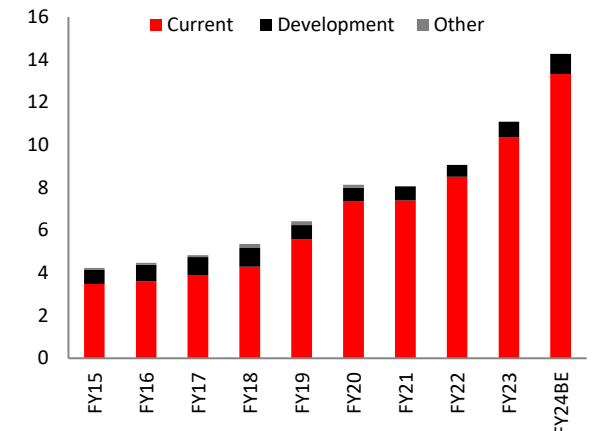
Source: MoF, Foundation Research, June 2023

Fig 3: SBP profits to dominate non-tax rev. in FY24



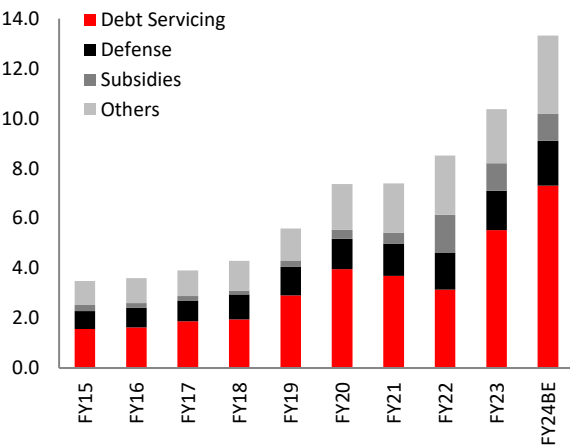
Source: MoF, Foundation Research, June 2023

Fig 4: Development exp. will remain small



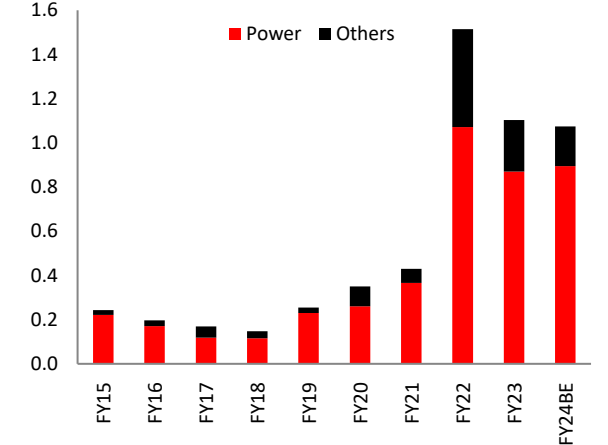
Source: MoF, Foundation Research, June 2023

Fig 5: Debt servicing the biggest expenditure



Source: MoF, Foundation Research, June 2023

Fig 6: Subsidies mostly go to power sector...



Source: MoF, Foundation Research, June 2023

Table 2: Key budget proposals by sector

Policy measures	Details	Impact	Severity	Comment
Market		Negative		
-Continuation & Rationalization of Super Tax	-Introduction of progressive slabs to be taxed at 0% to 10%	Negative	High	-Corporate profits to take hit
-Bonus tax	-Re-imposition of WHT on bonus issuance @10%	Negative	Low	-Discourage companies to issue bonus shares
-Imposition of additional tax	-Extraordinary gains to be taxed up to 50% of income on retrospective basis	Negative	High	-Would trim profitability of companies earning above average profits on retrospective basis
-Encashment of remittance without declaration of source	-Increased from Rs5.0mn to US\$0.1mn (Rs28.9mn)	Positive	High	-Improve investment in PSX
-Waiver on WHT for non-resident on purchase of immovable property	-2% tax abolished	Negative	Mod	-Divert cash flows towards real estate
-Exemption on CGT for Non-residents investing in sovereign bonds	-0%	Positive	Mod	-Improve external account position of the country
-Reduction in turnover tax	-From 1.25% to 1.0%	Positive	Mod	-Improve profitability of distressed sectors
Banks		Negative		
-Imposition of additional tax	-Extraordinary gains to be taxed up to 50% of income on retrospective basis	Negative	High	-Profitability to take hit due to higher taxes on higher gov't securities and foreign incomes
-Increase in imposition of advance tax on international transactions by credit cards	-From 1/2% to 5/10% on filers/non-filers	Negative	Mod	-Credit card business is expected to decline
-Reduced tax rate on lending to IT, SMEs, low cost housing & agriculture	- Reduced to 20% from 39%	Positive	Mod	-Risk of higher NPLs limit advantages of this relaxation
-Reduced ST on payment through card, mobile wallet & QR scanning	-Increase deposits and enhance digitalization	Positive	Mod	-Benefit banks through higher card and transfer fees
-Abolished ADR based tax	-Taxed as normal income	Neutral	Mod	-Already announced measure
-Re-imposition of WHT on non-ATL	- 0.6%	Negative	Mod	-Deposit growth to slow down
Construction		Positive		
-Rs1,150bn allocated for PSDP	-PSDP allocation is 58% higher from Rs900bn in FY22	Positive	High	-Would increase public sector spending and increase construction activity
-Increased infrastructure spending	-Rs267bn	Positive	Mod	-Increased infrastructure spending by Gov't would encourage local investors to take part in development
-Funds for development of Dam	-Rs100bn allocated	Positive	Mod	-Would increase cement and steel sales
- Abolishment of WHT for non-residents	- from 2% to 0%	Positive	Mod	- Increase spending in housing projects by overseas Pakistani's
-Exemption of CGT tax on REITS	-0% for 2024	Positive	Mod	-Spur construction activity
- Reduction in builder and individual owned construction tax liability for three years	- Lower of 10% or Rs5mn for Builder - Lower of 10% or Rs1mn for own construction	Positive	Mod	-Encourage Construction activity in the country
-Imposition of RD on import of Glass	-Ranging from 15% to 30%	Positive	High	-Positive for TGL
-Creation of SEZ and CPEC projects		Positive	Mod	-Positive for cement and steel
Oil & Gas		Negative		
-Imposition of additional tax	-Extraordinary gains to be taxed up to 50% of income on retrospective basis	Negative	High	-May hit OMCs, Refineries and E&P tax rates
-Bonded Bulk Storage Policy for POL products	-limit inventory and exchange rate losses	Positive	High	-Reduce losses of Refineries and OMCs in declining oil prices and volatile exchange rate
Fertilizer		Positive		
-Lower GIDC collection target	-Set at Rs40bn	Positive	High	-Improve liquidity of fertilizer players
-Encourage export of commodities	-1% final tax to exporters	Positive	Mod	-Increase profitability of farmers
-Tax holiday for Agri based SMEs	- from Jul'23 to Jun'28	Positive	Mod	-Increase profitability of farmers through value addition of Agri products and reduce input cost
-Increase in agriculture advances	- from Rs1,800bn to Rs2,250bn	Positive	Mod	-Will result in enhanced liquidity for farmers and commodity traders
- Removal of duty on import of seeds	- 0%	Positive	Mod	-Enhance per acre yield
-Allocation of funds for conversion of tube wells to solar	- Rs30bn for 50k tube wells	Positive	Mod	-Would result in higher disposable income of farmers

Policy measures	Details	Impact	Severity	Comment
Power		Neutral		
- Subsidy	- ~Rs579bn allocated for power sector subsidies	Neutral	High	- Actual disbursement on government's ability to rationalize tariff, increase recoveries and international oil prices
FMCGs		Negative		
-Increase in minimum turnover tax	-From 0.25% to 1%	Negative	High	-Effect profitability of FMCGs
-Withdrawal of ST exemption on edible oil		Negative	High	-Negative for UNITY
Automobiles		Positive		
-Reduction in CD on CKD of Heavy Commercial Vehicles	-From 10% to 5%	Positive	Mod	-Positive for GHNL & GHNI
Textiles		Neutral		
-Reduction in RD on imports	-From 5% to 0% on Synthetic Filament Yarn -From 20% to 11% on Pet Scrap	Positive	Mod	-Improve profitability of sector
-Removal of duty on import of used cloths	- from 10% to 0%	Positive	Mod	-Enhance sector margins
-Increased ST on branded clothes	-From 12% to 15%	Negative	Mod	-Local sales to take a toll
-Allocation of funds for subsidized LNG	-Reduced from Rs40bn to Nil	Negative	High	-Effect profitability of Textiles
Pharma		Negative		
- Exemption of CD on APIs & Drugs	- 1 APIs & 3 Drugs included	Positive	High	-Exemption of CD APIs is expected to lift profitability of pharma companies
-Increase in minimum turnover tax	-From 0.25% to 1%	Negative	High	-Effect profitability of Pharma
IT Sector		Positive		
-Professional training	-50k candidates	Positive	Mod	-Improve HR quality
-Continuation of concessionary tax	-0.25% for till tax year 2026	Positive	Mod	-Positive for SYS, AVN, OCTOPUS, NETSOL
-Concessionary tax rate on banks for lending to IT companies	-Reduced to 20% from 39%	Positive	Mod	-Easier to take loans

Source: FBR, Foundation Research, June 2023

Table 3: Super tax on income of companies/individual

S. No	Rs in mn	Rate of Tax	
		FY23-Onwards	FY22
1	income<150	0%	0%
2	150<income<200	1%	1%
3	200<income<250	2%	2%
4	250<income<300	3%	3%
5	300<income<350	4%	4%
6	350<income<400	6%	4%
7	400<income<500	8%	4%
8	500<income	10%	4%

Source: MoF, Foundation Research, June 2023

Table 4: Minimum turnover tax

S. No	Sectors	Tax
1	SSGC & SNGPL (for the cases where annual turnover exceeds Rs1bn), PIA and poultry industry	0.75%
2	Oil refineries, Motorcycle dealers and OMC	0.50%
3	Companies listed on Pakistan Stock Exchange	1.00%
4	In all other cases	1.25%

Source: MoF, Foundation Research, June 2023

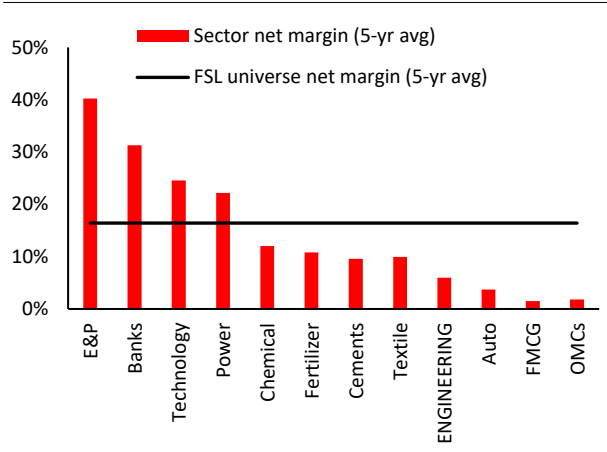
Bonus Shares to be taxed

Every company, issuing bonus shares to the shareholders of the company, shall withhold 10% of the bonus shares to be issued. Bonus shares withheld shall only be issued to a shareholder, if the company collects from the shareholder, tax equal to 10% of the value of the bonus shares issued to the shareholder including bonus share withheld, determined on the basis of day-end price on the first day of closure of books in the case of listed company and the value as prescribed in case of other companies. Bonus tax shall be deposited by the company, within fifteen days of closure of books, whether or not tax has been collected by the company. A company liable to deposit tax shall be entitled to collect and recover the tax deposited from the shareholder, on whose behalf the tax has been deposited, before the issuance of bonus shares. If a shareholder neither makes payment of tax to the company nor collects its bonus shares, within fifteen days of the date of issuance of bonus shares, the company may proceed to dispose of its bonus shares to the extent it has paid tax on its behalf. Issuance of bonus shares shall be deemed to be the income of the shareholder and the tax collected by a company under this section or proceeds of the bonus shares disposed of and paid under this section shall be treated to have been paid on behalf of the shareholder. Tax paid under this section shall be final tax on the income of the shareholder of the company arising from issuing of bonus shares

Additional tax on income, profits and gains

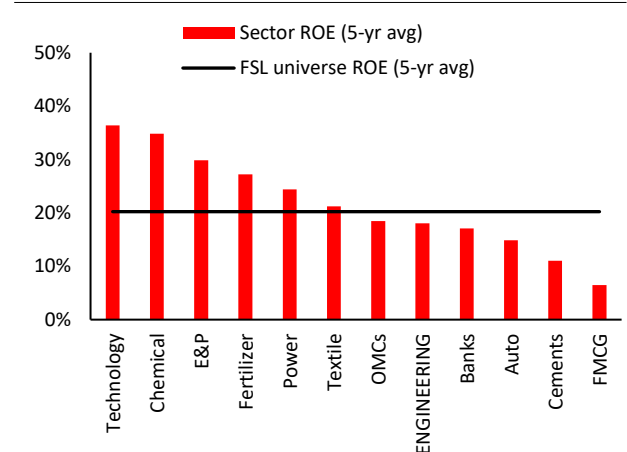
An additional tax shall be imposed on every person who has any income, profit or gains that have arisen to any person or class of persons due to any economic factor or factors that resulted in unexpected income, profits or gains whether or not disclosed in the financial statements for any of the preceding five tax years from tax year 2023 and onwards.

Fig 7: E&P, Banks profits remain higher



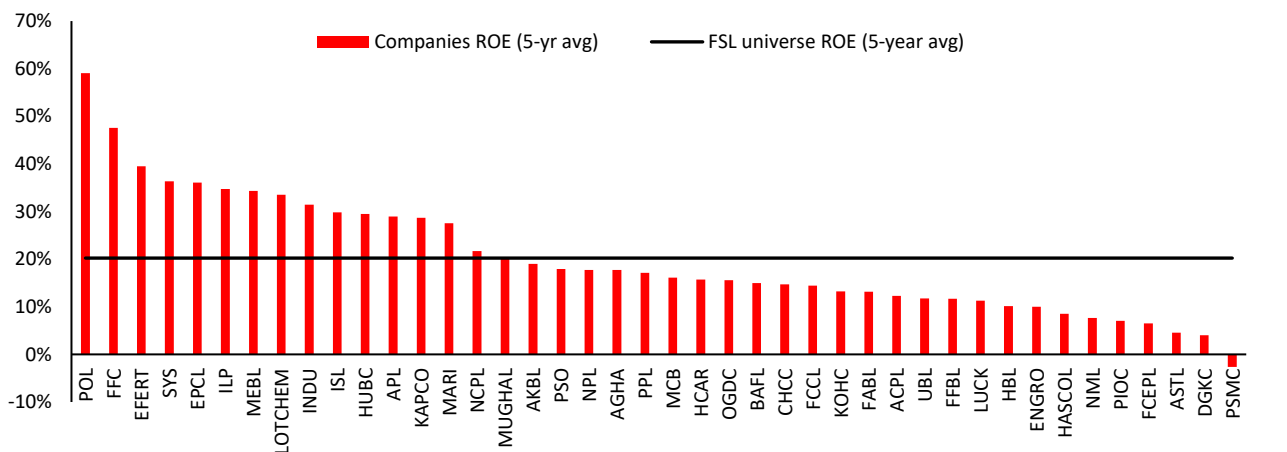
Source: PSX, Foundation Research, June 2023

Fig 8: Banks remain low on RoE in last five years



Source: PSX, Foundation Research, June 2023

Fig 9: Company wise last 5-Yr average ROE



Source: PSX, Foundation Research, June 2023

Revenue measures

- Rationalization of Super Tax under section 4C to apply on all persons across the board on income above Rs150mn insertion of additional three new income slabs of Rs350mn to Rs400mn, Rs400mn to Rs500mn and Rs500mn above to be taxed at 6%, 8% and 10% respectively.
- Re-imposition of 0.6% advance adjustable withholding tax on non-ATL persons on cash withdrawal.
- 1% increase in withholding tax rates on supply of goods other than sale of rice, cotton seed or edible oils, on rendering of services including service subject to concessionary tax rate of 3% but excluding electronic and print media advertising services and on execution of contracts excluding sportsperson.
- 0.5% increase in withholding tax rate for commercial importer on import of goods falling in Part III of Twelfth Schedule to the Income Tax Ordinance, 2001.
- Re-imposition of 10% final withholding tax on issuance of bonus shares by a company (20% for non-ATL).
- Increase in withholding tax rate from 1% to 5% on payment to non-resident through debit/credit or prepaid cards. (2% to 10% for Non-ATL person).
- Imposition of an adjustable advance tax at Rs200,000 at the time of issuance of work permit/visa on employment of a foreign domestic helper.
- Imposition of additional tax at the rate not exceeding 50% on income profit and gains of a person or class of persons on account of extraordinary gains due to exogenous factors.
- Imposition of FED on energy inefficient fans at Rs2,000/fan and incandescent bulbs at 20% ad valorem is proposed as approved by the Federal Cabinet in Case No. 01/01/23, dated 03.01.2023.
- The scope of FED on services is proposed to be enhanced by adding royalty and fee for technical services.
- Withdrawal of capping of the fixed duties and taxes on the import of old and used vehicles of Asian Makes above 1300CC under SRO 577(I)/2005 by omitting serial number 4,5 and 6 of the said SRO.
- Withdrawal of exemption of sales tax on edible products sold in bulk under brand names or trademarks.
- Enhancement in reduced rate of sales tax from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products.
- Electric power transmission services are proposed to be taxed at 15%

Relief measures

- Continuation of concessionary fixed tax rate of 0.25% for IT & ITeS exports for Tax years FY24, FY25 and FY26.
- Withdrawal of Sales Tax return filing requirement for availing concessionary fixed tax rate of 0.25% for IT & ITeS exports.
- Automated issuance of an exemption certificate for payment to a non-resident person within 30 days of application.
- Increase in business turnover limit of a manufacturer from Rs250mn to Rs800mn to qualify for concessionary tax regime for SMEs and inclusion of IT & ITeS in SMEs definition.
- Concessionary tax rate of 20% on banking company's income from additional advances to IT & ITeS sector instead of standard rate of 39%.
- Enhancement of monetary limit of foreign remittance remitted from outside Pakistan from Rs5mn to rupee equivalent of US\$0.1mn, which places bar on asking nature and source of unexplained income/assets.
- 10% reduction in tax liability or Rs5mn whichever is lower for a builder and 10% reduction or Rs1mn whichever is lower for an individual for own construction of house for three years.
- 9.50% reduction in tax liability for 3 years for youth entrepreneurship (max limit Rs2mn for Individual/AOP and Rs5mn for a company).
- Extension for two years for the purpose of concessionary tax rate of 20% for banking company's income from additional advances to low cost housing, agriculture, and SMEs including IT & ITeS.
- Minimum wage set at Rs32,000/month.
- Waiver of 2% final withholding tax on purchase of immovable property for nonresident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad.
- Encouraging export of commodities (Agriculture produce, gems, metals etc) through online platform by providing 1% concessionary final tax rate to indirect exporters.
- Reduction of minimum tax liability on turnover from 1.25% to 1.0% for companies listed on Pakistan Stock Exchange.
- Extension of exemption for one-year granted to a person to profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme i.e. upto June 30'2024.
- Extension of Income Tax exemption for one year i.e. upto June 30'2024 for resident persons of FATA/PATA.
- Five years tax holiday for agro based industries being SMEs set up on or after 1st July, 2023 from tax year 2024 to tax year 2028.

- Exemption from customs duties on the import of machinery, equipment and input materials for the production of solar panels, inverters and batteries.
- Customs duty exemption for raw materials of diapers, sanitary napkins and adhesive tapes.
- Reduction of Customs duty from 10% to 5% on non-localized (CKD) of Heavy Commercial Vehicles (HCVs).
- Concession of Customs duty on raw materials/inputs for manufacturers of Capacitors.
- By including one more (API) and 03 drugs in the existing duty free regime have been exempted from Customs duties.
- Exemption of Customs duties on specific papers and Art card and board for Printing of Holy Quran.
- Waiver of 2% final withholding tax on purchase of immovable property for nonresident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad.
- Extension in exemption of sales tax to NMDs (FATA/PATA) for another one year FY24.
- Grant of exemption of sales tax on contraceptives and accessories.
- Grant of exemption of sales tax on plant saplings, combine harvesters, dryer for agricultural products, no-till-direct seeder, planters, trans-planters, other planters and bovine semen.
- Grant of exemption of sales tax on import of IT equipment by exporters of IT and ITeS registered with Pakistan Software Export Board.
- Exemption of ACD on import of raw materials of Hemodialyzers fluid/powder.
- Extension in exemption on machinery and equipment imported by erstwhile FATA areas till Jun'24.
- Continuation of concession on import of Flavouring powders for food preparation for manufacturers of snacks till Jun'24.
- Exemption of Customs duty on Organic Composite Solvent and Thinners for manufacturers of Butyl Acetate and Dibutyl Orthophthalates.
- Reduction of Customs duty on import of pet scrap for manufactures of polyester filament yarn.
- Exemption of Customs duties on Raw Materials for manufacturing of Moulds and Dies.
- Exemption of Customs duties on raw materials/ inputs for Mining machinery.
- Exemption of Customs duties on raw materials/ inputs for Rice mill machinery.
- Exemption of Customs duties on raw materials/ inputs for Machine tools.
- Alignment of Part(V) of Fifth Schedule to the Customs Act with Auto Industry Development and Export Policy (AIDEP) 2021-26.
- Exemption of Customs duties on import of seeds for sowing to promote growth in agricultural sector.
- Exemption of Customs duties on import of shrimps/prawns/juvenile for breeding in commercial fish farms and hatcheries.
- Exemption of Customs duties on roasted peanuts for manufacturing of ready to use supplementary foods (RUSF) by World Food Program certified manufacturers.
- Increase of Customs duty on Carbides of Calcium from 3% to 11% to protect the local industry.
- Services provided by restaurants including ready-to-eat food service outlets are proposed to be taxed 5% if payment is made through debit or credit cards, mobile wallets or QR scanning.

Acronyms

BMR	Balancing, Modernization and Replacement	Tn	Trillion
CD	Customs Duty	Bn	Billion
CGT	Capital Gain Tax	Mn	Million
CSF	Coalition Support Fund	FY	Fiscal Year
ERF	Export Refinance Facility	R	Revised
FBR	Federal Board of Revenue	Bps	Basis Points
FED	Federal Excise Duty	SBP	State Bank of Pakistan
FinMin	Finance Minister	TY	Tax Year
GDP	Gross Domestic Product		
GDPg	Gross Domestic Product Growth		
GST	General Sales Tax		
MoF	Ministry of Finance		
ppt	percentage points		
PSDP	Public Sector Development Program		
RD	Regulatory Duty		
REIT	Real Estate Investment Trust		
LNG	Re-gasified Liquefied Natural Gas		
TDC	Tariff Differential Claims		
VAT	Value Added Tax		
WHT	Withholding Tax		
+ve	Positive		
-ve	Negative		

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Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.

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