Day Break

Thursday, June 20, 2024

Pakistan Construction Sector

Federal Budget FY25: Challenges and Opportunities for Pakistan's Construction Sector

- The FY25 federal budget was announced on Wednesday, 12th June 2024. The measures relating to the construction sector in the federal budget would have a neutral to negative impact on the sector as per our analysis.
- The measures relevant to the construction sector in the budget included revision in capital gain tax on immovable properties and advance tax on sale and purchase of the real estate assets, increase in Federal Excise Duty (FED) on cements, and rationalization of sales tax on steel.
- Federal PSDP allocation is set at a record high of PKR 1.4tn, representing a substantial increase of 112% compared to the revised figures for FY24. This significant boost highlights the government's commitment to infrastructure development.
- Going forward, we believe that the demand for Cement, Steel, and Glass would improve if the actual disbursement of the Federal PSDP is better than the historical trends.

Federal PSDP Allocation

The FY25 budget witnessed a 2.1x increase in the Federal PSDP allocation which can be viewed very positively for the construction sector in Pakistan but the history suggests that the actual disbursement has always been way below the allocation. Given the generous allocation to PSDP, we expect that the actual disbursement would be better than the historical numbers and this would have a positive impact on the entire listed construction space of Pakistan.

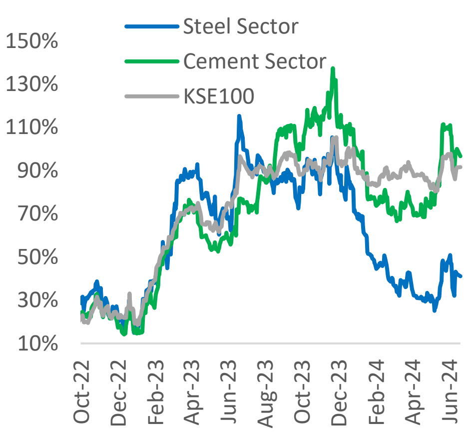
Increase in FED on Cement

Government in the Federal Budget announced an increase of PKR 1000/ton in the FED on cement, which would be passed on to the consumer by the Cement Manufacturers. In order to pass on the increase in FED to the consumers the cement prices would be raised by PKR 50-60/bag. This measure would make cement expensive and would be negative for the sector.

Revision in Real Estate Taxes

Government has revised the taxes on the real estate related transactions which, in our view, would reduce the speculative transactions in the real estate sector. The government has introduced three categories for this particular taxation measure which include: Filers, late filers, and non-filers. The non-filers and late-filers would have to pay significantly higher taxes as compared to the filers. The rates can be found in the below tables:

Performance Relative to KSE-100



Source: PSX, IGI Research

IGI Research
Laraib Nisar
laraib.nisar@igi.com.pk
Tel: (+92-21) 111-234-234 Ext: 974

Exhibit: Advance Tax on purchase of Immovable Property			
Category	**FMV < PKR 50mn**	**PKR 50mn < FMV < PKR 100mn**	**FMV > PKR 100mn**
Filers	3.0%	3.5%	4.0%
Late Filers	6.0%	7.0%	8.0%
Non-Filers	12.0%	16.0%	20.0%

Source: Income Tax Ordinance, Finance Bill 2024, IGI Research, FMV=Fair Market Value

Exhibit: Advance Tax on Sale/Transfer of Immovable Property			
Category	**Consideration < PKR 50mn**	**PKR 50mn < Consideration < PKR 100mn**	**Consideration > PKR 100mn**
Filers	3.0%	3.5%	4.0%
Late Filers	6.0%	7.0%	8.0%
Non-Filers	12.0%	16.0%	20.0%

Source: Income Tax Ordinance, Finance Bill 2024, IGI Research,

Exhibit: Revised CGT rates on disposal of immoveable properties					
S.No	Holding Period	Rate of tax on properties acquired before 30-Jun-24			Rate of tax on properties acquired after 30-Jun-24
		Open Plots	Constructed Flats	Flats	
1	Less than 1 year	15%	15%	15%	
2	More than 1 year and less than 2 years	12.50%	10%	7.50%	
3	More than 2 years and less than 3 years	10%	7.50%	-	
4	More than 3 years and less than 4 years	7.50%	5%	-	15%
5	More than 4 years and less than 5 years	5%	-	-	
6	More than 5 years and less than 6 years	2.50%	-	-	
7	More than 6 years	-	-	-	

Source: Income Tax Ordinance, Finance Bill 2024, IGI Research

Rationalization of Sales Tax Across FATA/PATA region on Steels

Currently the FATA/PATA regions benefit from a sales tax exemption which applies to the sale of steel within the region of operation of such steel manufacturing facilities, import of steel manufacturing equipment in that region. It is proposed in the FY25 budget that the sales tax would be imposed in a phased manner, set to expire towards the end of FY24, which would stay at 6% during FY25 and would be increased to 12% in FY26.

The current sales tax exemption, introduced six years ago to support the steel sector in tribal areas, aimed to encourage local production and sales within those regions. However, it resulted in unintended challenges where steel produced in tribal areas was sold outside at reduced prices, impacting companies in the listed space that paid sales tax. Removing this exemption is anticipated to create a more competitive landscape in the steel sector, favoring listed steel companies. This withdrawal of exemption would to much extent address the fake flying invoies issue as well.

Besides this the steel sector is likely to benefit from the proposed sales tax exemption on iron and steel scrap, this is more of a strealimining measure and would ultimately benefit the listed steel companies.

Final Tax Regime to end for exporters

The exporters currently fall under the final tax regime in which they pay a final tax of 1% on the export sales, as per the FY25 finance bill, it is proposed that this final tax regime be ended for the exporters and the taxation on exports would be normalized which would be negative for the cement and steel. The net margins for the cement sector in case of implementation of this measure would be squeezed, making the exports uncompetitive in the global markets. The same would be the case with the steel sector if the final tax regime ends for the exporters.

Duties to increase on import of glass products

The Finance Bill proposed that the duties on the import of glass products be increased which would be positive for the local glass manufacturers as this measure would make the imported glass product expensive in comparison to the local glass.

Outlook

In our view, higher PSDP allocation is likely to support demand within construction sector, however, growth is likely to pick up gradually. Withdrawal of sales tax exemption in FATA/PATA region is likely to benefit steel sector. Moreover, recent decline in commodity prices is likely to improve margins within the sector and decline in interest rates are further expected to suppot bottomline.

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IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Equity Sales

Zaeem Haider Khan	Head of Equities	Tel: (+92-42) 35301405	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Syeda Mahrukh Hameed	Branch Manager (Lahore)	Tel: (+92-42) 38303564	mahrukh.hameed@igi.com.pk
Shakeel Ahmad	Branch Manager (Faisalabad)	Tel: (+92-41) 2540843-45	shakeel.ahmad1@igi.com.pk
Asif Saleem	Equity Sales (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Equity Sales (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk

Research Team

Abdullah Farhan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Sakina Makati	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 810	sakina.makati@igi.com.pk
Laraib Nisar	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 974	laraib.nisar@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited
Website: www.igisecurities.com.pk

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780

Lahore Office
Shop # G-009, Ground Floor,
Packages Mall
Tel: (+92-42) 38303560-69
Fax: (+92-42) 38303559

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Office No. 2, 5 & 8, Ground Floor, The
Regency International 949, The Mall
Faisalabad
Tel: (+92-41) 2540843-45

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road
Tel: (+92-68) 5871652-3
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road
Tel: (92-61) 4512003, 4571183

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009