

morning shout

Pakistan Daily Notes

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Higher DAP subsidy & wheat prices needed

- With lack of clarity on the future of subsidy on phosphate fertilizer (DAP), its application continued to suffer in June, down 95% YoY.
- This should prompt the government to respond and announce a balanced rise in DAP subsidy and wheat support prices for FY09, needed to optimize crop yields and discourage smuggling.
- Despite announcement of higher DAP prices in June, the actual change in subsidy is yet to be notified. Pakistan is paying huge financial, social cost and risk premia due to the delayed announcement of wheat support prices and DAP subsidy in FY08. Food inflation topped at 32.05% in June and was 17.53% in FY08.
- We remain Overweight on the fertilizer sector, which provides an exposure to rising commodity prices and farm income. FFC and Engro are our top picks.

DAP application continues to suffer

With lack of clarity on the future of subsidy on phosphate fertilizer (DAP), its application continued to suffer in June, down 95% YoY. 2Q08 DAP sales data indicates the lowest level of DAP application in Kharif season for the past 10 years. This should prompt the government to respond promptly and announce a balanced rise in DAP subsidy and wheat support prices for FY09 before the next crop season in Sept to avoid lower crop yields and food shortages in the future.

Increase in DAP subsidy – Clarity still awaited

Despite the announcement of higher DAP prices by PRs530/bag to PRs1,000 per bag in June, the actual change in subsidy is yet to be notified to DAP importers/producers. So far the companies have not received clarity on 1) whether the subsidy will apply on new stock or the entire stock available for sale in FY09; and 2) the potential increase in subsidy or no pass-through, given a hike of more than PRs530/bag in landed cost of imported DAP (-PRs5,000/bag).

Need of the hour: Maximization of wheat output

There is strong need to rationalize both wheat support price and DAP subsidy to optimize crop yields and discourage smuggling. Our sensitivity analysis for wheat crop economics suggests that to replicate the record level of wheat crop (23mn tons), the government should ideally increase DAP subsidy to PRs1,500/bag and wheat support price to PRs1,000/40kg, so that farmers can achieve a net income margin similar to that last year. Since FY07 was the best year in terms of highest wheat crop production and optimal level of urea: DAP application (2.05: 1.00), we have taken FY07 production and fertilizer application levels as the benchmark for our calculations. The higher the wheat support price, the lower the subsidy required on DAP. To counter the threat of smuggling, in our view the government should find a balance between increasing the wheat support price versus increasing the DAP subsidy.

Agflation and macro implications

Pakistan is paying huge costs - financial (food imports), social (inflation), and risk premia - due to the delayed announcement of wheat support prices and DAP subsidy in FY08. Food inflation topped at 32.05% in June and was 17.53% in FY08. With wheat support prices of Rs1,000/kg and DAP subsidy of Rs1,500, we believe Pakistan can produce 23mn tons of wheat, saving US\$800-1,000mn in import bill. This will also reduce 1) gap in local/foreign prices, 2) hoarding, and 3) inflation. Wheat and related products make up 8.25% of the CPI basket and play an important role in forming inflation expectations. We see limited impact of enhanced wheat support prices on inflation and subsidy, as the market price of wheat is already at Rs950/kg.

We remain Overweight on Pakistan fertilizer plays

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Jan-May 2008 Fertilizer Sales

Urea - 000 t	Jan-Jun 08	YoY Change
Industry	2,693.8	33%
FFBL	351.0	126%
FFC	1,191.8	18%
Engro	552.5	42%

DAP - 000 t	Jan-Jun 08	YoY Change
Industry	140.7	-70%
FFBL	36.9	-74%
FFC	22.9	2008%
Engro	27.4	-82%

Source: NFDC

Morning News

► **FBR reported 29.7% increase in tax collection during July (BR)**
 In the first month of FY09, FBR reported provisional tax collection of PRs66bn (up 29.7% YoY). We believe higher collection is driven by higher domestic oil prices, 1% increase in sales tax announced in the last budget, and Rupee depreciation against the US dollar. We believe PRs1.25tr tax collection target for FY09 is achievable on the back of expected surge in nominal GDP by 23% in FY09.

Technical View

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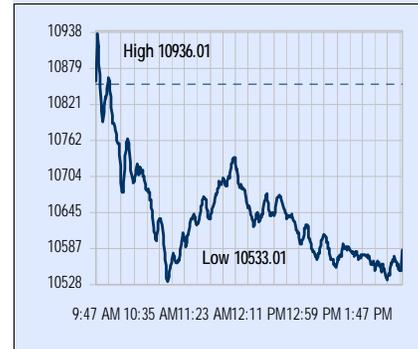
Buy Between 10,325 Points And 10,435 Points; First Resistance 10,690 Points, Second Resistance 10,740 Points

The index opened on a positive note and after touching its day's high it took to a downtrend to close well into the red. Volume showed a marginal decline of 1.17% and stood at 115.20 mln. The index's resistance trendline (black line) proved to be a big hurdle for the index as it succumbed to widespread profit-taking as it failed to breach it. There is likelihood that the index witnesses a rebound after filling its gap between 10,448 and 10,562 points. Failure to hold above said level to trigger further pressure towards 9,800 points being the first support and 8,700 points being the next critical support level.

The Stochastic Oscillator has leveled off and is on the verge of generating a buy signal. The 14-D RSI however is witnessing quite a bit of erratic movement however has managed to maintain itself above the oversold region. the good thing is that the MACD continues to maintain a gradual uptrend, generating a buy signal in the process.

It is suggested to buy between 10,325 points – 10,435 points. The first resistance is at 10,690 points and the second resistance is at 10,740 points.

KSE-100 Intra-day Movement



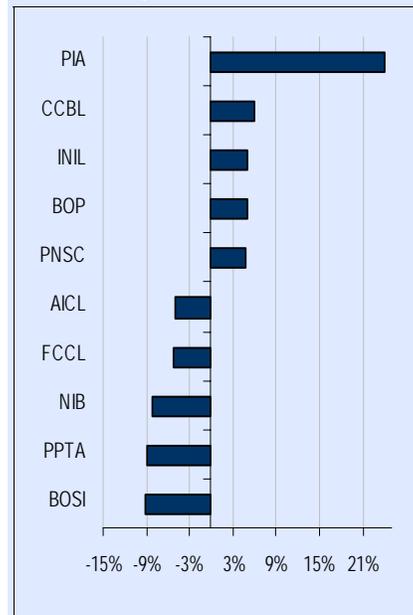
Source: KSE

Index Data & Volume Leaders

	Close	% Chg	Vol. US\$m
KSE30	12,001.67	-3.25%	131.35
KSE100	10,593.58	-2.39%	136.26
KSE All Share	7,636.25	-2.47%	144.83
AHSL	133.67	-5.00%	22.80
NBP	119.74	-5.00%	12.67
MCB	271.00	-2.61%	11.83
JSCL	352.26	-5.00%	10.73
PSO	373.35	-5.00%	10.56

Source: KSE

KSE-100: Top Gainers & Losers



Source: KSE