



Telecom Economy

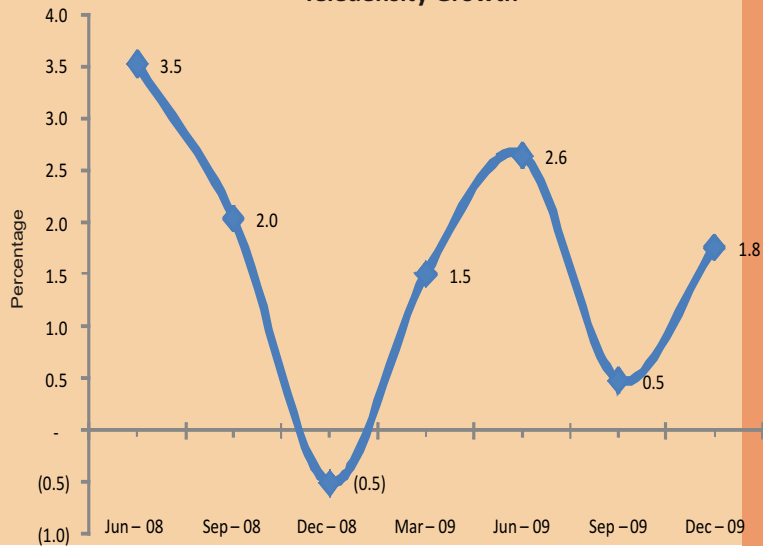
Telecom Economy

After passing through a difficult time in the year 2008-09, Pakistan economy is back on recovery path as indicated by the macroeconomic indicators for the first half of the fiscal year 2009-10. All macroeconomic indicators show positive sign except the budget deficit target, which was exceeded by a small margin. The exchange rate remained stable and international reserves position has strengthened during the first half of the fiscal year 2009-10. Economic growth in Pakistan has started recovering due to

improvement in large scale manufacturing sector's output resulted from improvement in global economy which has helped manufacturing export growth. However the growth recovery prospects also enclosed few risks and challenges including the security situation, power shortage, the drop in overall volume of trade and poor tax growth. A revenue shortfall and delays in disbursements of pledged donors support have complicated the fiscal management. Economic managers of the country

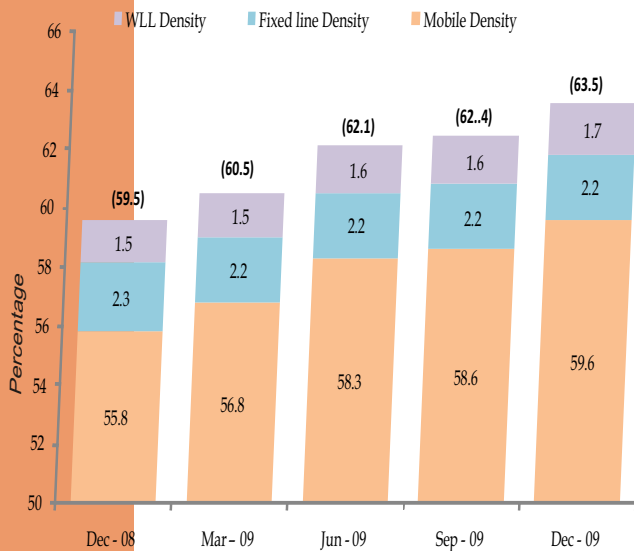
intend to introduce the VAT in the second half of the fiscal year 2010 which may recover the revenue shortfall¹. Country's engagement in war against terrorism has resulted in additional expenditures, putting pressure on federal budget. Consequently, the budget deficit for first quarter of the fiscal year 2009-10 has been reported 1.5% of GDP as compare to 1.1% in the first quarter of last year. Unprecedented surge in inflation (CPI) remained the concern of economic managers which has been contained in the year 2009-10 to some extent. CPI inflation dropped to 8.9% YoY in October 2009 (the lowest level in the preceding 26 months)

Teledensity Growth

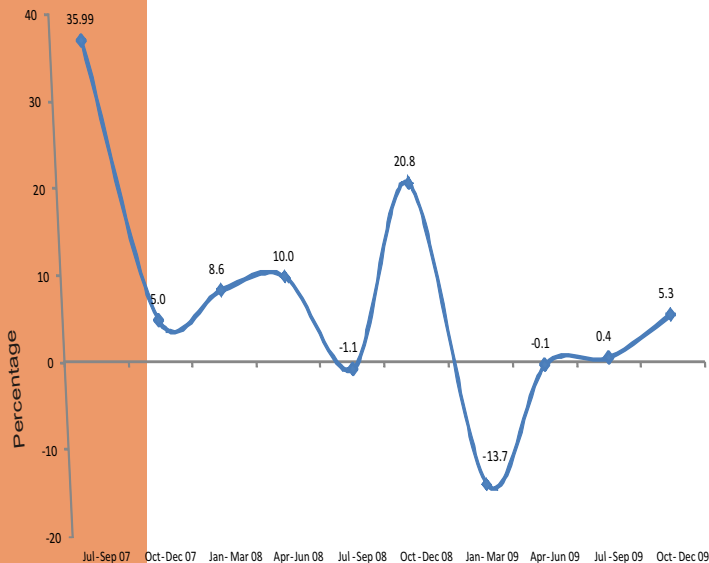


¹<http://www.imf.org/external/np/sec/pr/2010/pr1043.htm>

Teledensity



Telecom Revenue Growth



however, it went back to 10.5% in November 2009. As a leading economic indicator, this shows growth inflationary pressures in the economy. It is estimated that inflation may accelerate in the second half the fiscal year 2009-10 due to higher international commodity prices and lower than anticipated receipts. It is estimated by State Bank of Pakistan that GDP growth for the fiscal year 2009-10 would be around 3.3%, higher than the previous year's growth of 2.0%. Services sector would major contributor in this growth while improvement in industrial output is also expected in the year 2009-10. Average inflation is expected to be within the range of 10-12% as against the target of 9%².

Telecom sector too appears to be on the path of recovery after slow growth in the year 2008-09 due to slow down in the economy. The growth of teledensity remained topsy-turvy in the year 2008-09 where teledensity continued to decline from June 2008 to December 2008 (3.5% to -0.5%) and picked up again in June 2008 and reached at 2.6% in June 2009. Total teledensity declined again in the first quarter of the fiscal year 2009-10 however it started picking up in the second Quarter of the same year. The decline in teledensity the first quarter of 2009-10 is attributed to decline in cellular mobile numbers by major operators, Mobilink and Ufone, who dropped their numbers due to some definitional changes. PTCL also reported decline in fixed line subscribers during the period which caused decline in overall teledensity. PTA provided a uniform definition of active subscribers to all operators for reporting purpose where all have compliance to this definition.

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dropped their numbers due to some definitional changes³. PTCL also reported decline in fixed line subscribers during the period which caused decline in overall teledensity. PTA provided a uniform definition of active subscribers to all operators for reporting purpose where all have compliance to this definition.

Total teledensity of the country is up and reached to 63.5% in December 2009 which was 62.1% in June 2009. During the first two quarters of the fiscal year 2009-10, teledensity has increased by about 1.8% in overall. Mainly the rise has been witnessed in WLL density which grew by 6% while the cellular mobile teledensity grew by 2.2% in the first two quarters of the fiscal year 2009-10. However, the fixed line teledensity remained unchanged during the first two quarters of the fiscal year 2009-10. Main reason for slow down in the pace of teledensity could be attributed to the maturity of market where operators' efforts are now on retention policy instead of expansion of subscribers.

² State Bank of Pakistan, State of Pakistan Economy, First Quarterly Report 2009-10
³ For detail see chapter on Cellular Mobile

Industry Financials

Soaring inflation, cutthroat competition, expenditures on advertisements, rising utilities expenditures and power shortage have squeezed down the margins of the telecom companies in general. However, despite all these difficulties the revenues of the industry registered positive growth during the last few quarters. Main reason for this positive growth is attributed towards a tax relief provided to the industry in the budget of 2009-10 where the tax rate was reduced from 21% to 19.5%.

During July-September 2009, total industry revenue were reported Rs. 81.3 billion while in the second quarter of 2009-10 (Oct-Dec,09) the industry revenue reached Rs. 85.88 billion. During the first half of Fiscal Year 29-10 (July-Dec,09), telecom industry earned 167.2 billion revenues compare to Rs. 161.8 billion in previous half yearly revenue. Cellular mobile sector share in total revenue comes out about

68% which has shown a positive growth in revenue generation in the first 6 months of the fiscal year 2009-10 where it registered growth of about 5% during the period. Fixed line sector grew about 0.5% during the first half of fiscal year 2009-10.

Despite the squeezing margins of the telecom industry owing to economic difficulties, heavy taxes and falling exchange rates, sector continued to contribute in national revenues through taxes and duties imposed by the authorities. During the first 6 months of the fiscal year 2009-10, telecom sector contributed about Rs. 48.6 billion in national kitty through these taxes of which major share comes from GST revenues where sector deposited over Rs. 21.44 billion during the period. Major decline in tax revenues has been observed in Activation tax which is imposed @250 per new connection, in this head companies deposited over Rs. 3.8 billion compare to Rs. 14.2 billion in last full year. This decline is understandable because of the market maturity. PTA collections are quite comfortable where it collected over Rs. 4.91 billion in the first half of the fiscal year.

Telecom Contribution to Exchequer

(Rs. in Billions)

| Period | GST | Activation Tax | PTA Deposits | Others | Total |
|----------------|-------|----------------|--------------|--------|--------|
| 2006-07 | 36.28 | 17.60 | 9.72 | 36.95 | 100.55 |
| 2007-08 | 44.61 | 19.20 | 10.86 | 36.96 | 111.63 |
| 2008-09 | 49.35 | 14.20 | 9.15 | 39.30 | 112.00 |
| Jul - Dec - 09 | 21.44 | 3.80 | 4.91 | 18.45 | 48.60 |

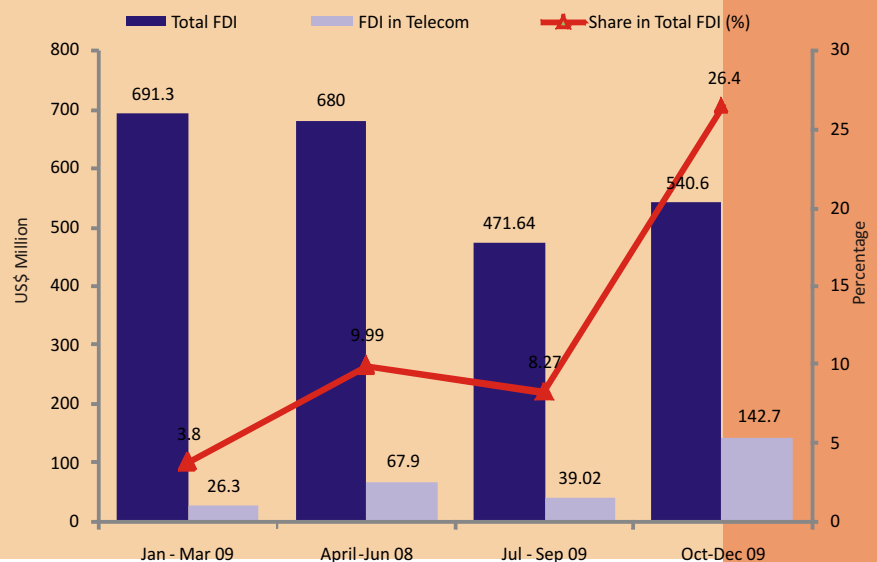
Source: Central Board of Revenue and Pakistan Telecommunication Authority.
 Note: PTA's contributions comprise of all its receipts including Initial and Annual License Fee, Annual Spectrum Administrative Fee, USF and R&D Fund Contributions, Numbering Charges, License Application Fee, etc.
 Others include custom duties, WH Tax and other taxes.
 Others are estimated

Foreign Direct Investment

Telecom industry continued to attract Foreign Direct Investment (FDI) to expand the infrastructure and maintainance of their networks. However, the volume of FDI also continued to decline with the maturity of market over the time. Foreign Direct Investment consists of the amount remitted from abroad and the reinvestment of profits earned by the companies which were supposed to be repatriated by the foreign firms.

During the quarter ending December 2009, telecom sector attracted US\$ 142.7 million FDI

Foreign Direct Investment



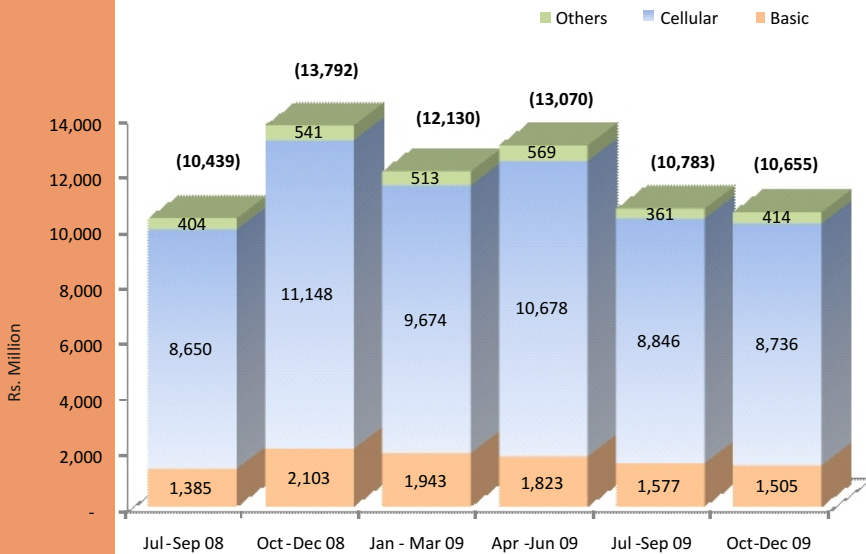
Source: State Bank of Pakistan

which was 26.4% of the total FDI in the country during this period while in previous quarter FDI in telecom sector was reported US\$ 39 million that was about 8% of the total FDI in the country. During the last one year, sector has attracted about 37% of total FDI in Pakistan which is a commendable.

Taxes on the Sector

Pakistan telecom sector has been burdened with various taxes by different organs of the Government of Pakistan. These taxes include GST/CED, With Holding Tax, Income Tax, Activation Tax, regulatory fee, spectrum charges, stamp duties and various fees by civic authorities etc. Operators are required to deposit a handsome amount of their revenues to national kitty in the form of these taxes which are squeezing their profit margins. A comprehensive study is required to analyze these taxes and rationalize the tax structure for this growing sector that could be a win-win situation for all parties.

Quarterly GST/FED Collected



Source: Central Board of Revenue

Among all these taxes, GST/CED is a major tax which is imposed on telecom operators @19.5% of their revenues. In the year 2008-09, Government of Pakistan suddenly increased the rate for GST/CED for telecom sector from 15% to 21% which has a negative impact on revenue generation as well on the growth of the sector. Regulatory Authority raised this issue with authorities along with facts and figures, consequently Government of Pakistan agreed to reduce this burden in the budget of 2009-10 where this tax was reduced by about 7% and set @19.5%. It certainly gave relief to operators which enabled them to divert sources for network expansion. However, total revenue in this head could not be increased in the first half of Fiscal year

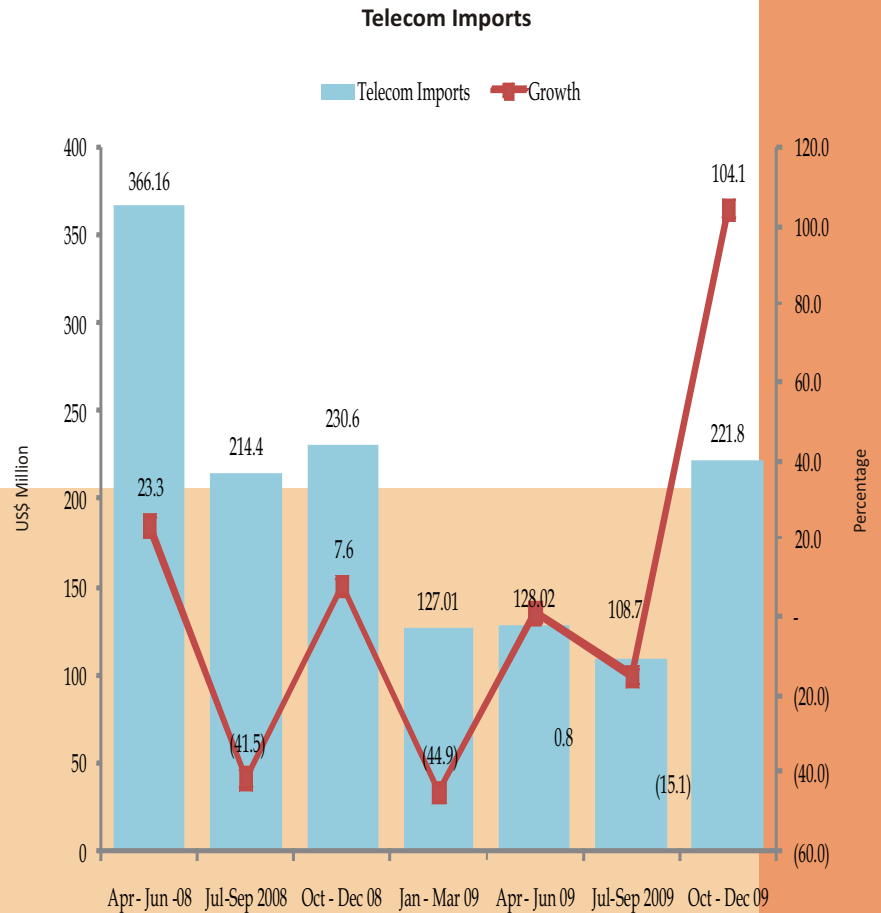
2009-10 as expected owing to drop in call rates, slowdown in economy, falling exchange rates and rising inflation etc. During the first half of fiscal year 2009-10, FBR collected Rs. 21.4 billion against Rs. 25.2 billion in previous quarter and Rs. 24.2 billion in quarters before. During the this first half of the fiscal year 2009-10, GST/CED revenues of the cellular mobile companies dropped by about 13% compared to previous 6 months while the revenues of Basic service declined by 18% in the same period. FBR needs to revisit the situation and provide further relief to operators in terms of rate of GST/CED, so that more revenue be generated.

Activation tax is another tax which is charged @ Rs. 250 per new connection from all operators. This tax also has increased the mobile acquisition cost where companies are compelled to pay this tax from their own pocket due to competition in the market. This tax is also burden on the cellular mobile companies. Since, the market is moving towards maturity where new addition in cellular mobile subscribers has also reduced, this tax also needs to be reviewed and may abolished to provide further cushion to operators for further expansion in the sector. Revenue generation in tax has also reduced considerably. During the first of the fiscal year, FBR collected Rs. 3.8 billion while the previous year, companies deposited over Rs. 14.3 billion against activation tax. FBR has also imposed WH tax @10% on cellular mobile companies which is an advance income tax, this tax is unjustified because most of the cellular mobile subscribers belong to poor strata of the society who are not liable to pay income tax.

Telecom imports

In the year 2008-09, Government of Pakistan imposed custom duty and regulatory duty @Rs. 750 per mobile handset to discourage the mobile imports and save foreign exchange. Consequently, the import of mobile handsets declined sharply and very next quarter of the fiscal year 2008-09 (July-September 2008), the cellular mobile handsets imports declined to US\$70.7 million compared to US\$ 127.6 million in previous quarter. This trend continued for next quarter as well where the imports of mobile handsets reached just US\$ 12 million in Jan-Mar 2008. However, the imposition of custom duty increased the smuggling of mobile handsets in the country and eventually the country was flooded with smuggled Chinese and handsets of other origins which gave loss to national exchequer. In the budget of 2009-10, Government of Pakistan took back the regulatory duty on mobile handsets imports which gave impetus to the imports of handsets in subsequent quarters.

Total imports of telecom sector registered about 104% growth in the second quarter of Fiscal year 2009-10 compared to previous quarter mainly the import of equipments. Soon after reducing the regulatory duty on mobile handsets, growth of mobile handsets increased by about 27% in the next quarter ending September 2009.



Source: State Bank of Pakistan
 Note: April June 09 Telecom Imports Revised