

Pakistan Equity | Banks | Sector Research

Jun 13, 2022

REP-057

Budget proposes increased taxation for Banks Profitability impact of 15-20%



Best Local Brokerage
House 2015-16, FY2020

ASIAMONEY

Best Local Brokerage House
Brokers Poll 2011-14, 2016-21



Best Brokerage
House 2018,19-20



Best Research
House 2019-20



Best Brokerage
House 2019-21

Umair Naseer

umair.naseer@topline.com.pk

Tel: +9221-35303330 Ext:133

Topline Securities, Pakistan

Earnings growth in 2022 to slowdown from 30% to 10% in 2022

- Government has introduced major changes in Federal Budget FY23 for banking sector which is likely to significantly impact bottom-line of the sector. These changes include 1) increase in corporate tax rate for banks, 2) an additional 2% tax on account of poverty alleviation is imposed, and 3) increase in tax rate on interest income on government securities.
- As per the Finance Bill, corporate tax rate has been increased from 35% to 45% from tax year 2023 and onwards (CY2022 and onwards) and super tax of 4% has been abolished. Hence, effectively the tax rate has been increased by 6% from 39% to 45% which will impact earnings from 2022 and onwards.
- An additional 2% poverty alleviation tax has been imposed on banking sector (banks with earnings of Rs300mn and above) from Tax year 2022 onwards (CY2021 onwards) as per 7CA of Seventh Schedule of Income Tax ordinance.
- Furthermore, tax rate on interest income from government securities with banks having an ADR of 50% or more is increased from 35% to 45%. For banks with ADR of 40-50%, the rate has been increased to 49% from 37.5% and for banks with ADR of less than 40%, it is increased to 55%. In the Finance Bill, it is also clarified that this tax will apply on total income attributable to total investment in government securities and not on additional income.
- The implementation of the said increase in tax rates on certain ADR threshold will apply on a retrospective basis from CY2021 and onwards (Tax Year 2022 and onwards). It will likely lead to higher effective tax rate of around 53% in 2022 and will settle down to ~48% in 2023.
- Since the SBP amendment Act 2021, government has to rely mostly on commercial bank borrowing for financing its fiscal needs which resulted in rise in secondary market yields on government securities. In order to limit banks to take undue advantage of the given situation, government has imposed higher taxation on banks, specially on interest income from government securities, we believe.
- The above announced measures will impact profitability of the sector by around 20% for 2022 and 15% for 2023. Banks will now gradually try to shed high cost deposits and will also look to increase exposure in advances to minimize the impact of these measures. Banks may also contest this huge increase in taxes from relevant authorities.
- After these measures, Topline Banking Universe earnings is expected to grow by 10% in 2022 and remain flat in 2023. We maintain our 'Overweight' stance on banking sector as is still trades at attractive PE of 4.3x and PBV of 0.6x.

Proposed Tax Rates			Proposed Tax Rates with different ADR		
Description	Tax year 2022	Tax year 2023	Gross Advances to Deposit Ratio on the last day of the tax year	Existing Tax Rate	Proposed Tax Rate
Normal rate	35%	45%	Upto 40%	40%	55%
Super tax	4%	0%	Exceeding 40% but not Exceeding 50%	37.5%	49%
Poverty alleviation tax	2%	2%	Exceeding 50%	35%	45%
Effective tax rate	41%	47%			
Source: Finance Bill, Topline Research			Source: Finance Bill, Topline Research		

Earnings Impact on Banking Sector

Impact of new taxation on Banking Sector

	Gross ADR	Effective tax rate CY2022	Effective tax rate CY2023	CY2022 Earnings Impact (%)	CY2023 Earnings Impact (%)
BAFL	60%	52%	47%	21%	13%
BAHL	56%	52%	47%	21%	13%
BOP	54%	52%	47%	21%	13%
HBL	52%	52%	47%	21%	13%
MCB	45%	56%	50%	28%	18%
MEBL	52%	52%	47%	21%	13%
NBP	52%	53%	47%	23%	18%
UBL	45%	57%	50%	29%	18%
Sector				23%	15%

	Current Rate on income of Govt. Securities	Proposed Rate on Govt. Securities
Tax on Government Securities		
ADR below 40%	40.0%	55%
ADR 40-50%	37.5%	49%
ADR above 50%	35.0%	45%

Assumptions:

1. Corporate tax rate increased from 39% to 45% from Tax Year 2023 (CY2022) and super tax abolished from Tax Year 2023
2. Poverty Alleviation Tax of 2% imposed from Tax Year 2022 onwards
3. Taxes on Interest income on government securities to be implemented from Tax Year 2022 and onwards (2021 and onwards)
4. Retrospective one time impact of increased tax on government securities taken on 2021 income for banks with different ADR
5. ADR assumed as of 1Q2022

Source: Finance Bill, Topline Research

Analyst Certification and Disclosures

The research analyst(s), denoted by an “AC” on the cover of this report, primarily involved in the preparation of this report, certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject companies/securities/sectors and (2) no part of his/her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Furthermore, it is stated that the research analyst or its close relative have neither served as a director/officer in the past 3 years nor received any compensation from the subject company in the past 12 months.

Additionally, as per regulation 8(2)(i) of the Research Analyst Regulations, 2015, we currently do not have a financial interest in the securities of the subject company aggregating more than 1% of the value of the company.

Rating System

Topline Securities employs three tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Stock will outperform the average total return of stocks in universe
Neutral	Stock will perform in line with the average total return of stocks in universe
Sell	Stock will underperform the average total return of stocks in universe

For sector rating, Topline Securities employs three tier ratings system, depending upon the sector’s proposed weight in the portfolio as compared to sector’s weight in KSE-100 Index:

Rating	Sector’s Proposed Weight in Portfolio
Over Weight	> Weight in KSE-100 Index
Market Weight	= Weight in KSE-100 Index
Under Weight	< Weight in KSE-100 Index

Ratings are updated daily to account for the latest developments in the economy/sector/company, changes in stock prices and changes in analyst’s assumptions or a combination of any of these factors.

Valuation Methodology

To arrive at our 12-months Target Price, Topline Securities uses different valuation methods which include: 1). Present value methodology, 2). Multiplier methodology, and 3). Asset-based methodology.

Research Dissemination Policy

Topline Securities endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as email, fax mail etc. Nevertheless, all clients may not receive the material at the same time.

Disclaimer

This report has been prepared by Topline Securities and is provided for information purposes only. Under no circumstances this is to be used or considered as an offer to sell or solicitation of any offer to buy. While reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. From time to time, Topline Securities and/or any of its officers or directors may, as permitted by applicable laws, have a position, or otherwise be interested in any transaction, in any securities directly or indirectly subject of this report. This report is provided only for the information of professional advisers who are expected to make their own investment decisions without undue reliance on this report. Investments in capital markets are subject to market risk and Topline Securities accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors, who should seek further professional advice or rely upon their own judgment and acumen before making any investment. The views expressed in this report are those of Topline Research Department and do not necessarily reflect those of Topline or its directors. Topline as a firm may have business relationships, including investment-banking relationships, with the companies referred to in this report.

All rights reserved by Topline Securities. This report or any portion hereof may not be reproduced, distributed or published by any person for any purpose whatsoever. Nor can it be sent to a third party without prior consent of Topline Securities. Action could be taken for unauthorized reproduction, distribution or publication.