

Pakistan Federal Budget 2023-24

A case of "seen it all before"

Executive summary

The much-awaited federal budget has been unveiled by finance minister Ishaq Dar on 9th June which failed to stir any excitement among the masses. The budget has a total outlay of PKR14.4tr while tax collection is estimated at PKR9.2tr. The budget failed to impress on any reform measures as broadening of tax base took the back seat. Govt has continued the super tax for the current tax year where all persons earning above PKR500mn are subject to additional tax of 10%. In addition, a windfall tax of up to 50% has been imposed on profits/gains arising from abrupt commodity prices, exchange gain etc.

In our opinion, budget is neutral to negative for capital market as continuation of super tax will trim the bottom-line of the corporates, while tax on issuance of bonus shares will also negatively impact the sentiments. On the flip side, reduction in minimum turnover tax from 1.25% to 1.0% will provide some relief to listed space in current economic environment.

The market is currently trading at a steep discount to its historical average and clarity on economic/political front holds the key for market performance. We continue to advocate for companies having quality earnings, dollarized revenue stream and stable cashflows. There are multiple incentives for IT sector in the budget which will induce investment in the sector which can help in enhancing exports. Our top picks are MARI, FFC, EFERT, LUCK, MLCF, ACPL, ILP, SYS and APL.

Sectoral Impact of Budget FY23-24

Capital Market

Banks	Negative
Cements	Neutral
Fertilizers	Positive
Automobiles	Neutral
Textiles	Neutral
Information & Technology	Positive
Steel	Neutral
Power	Neutral
Oil & Gas	Neutral

Others:

Packaging	Neutral
Pharma	Positive
AutoParts & Acc.	Neutral
Food & Beverages	Neutral
Refinery	Neutral
Tobacco	Neutral

Source: Insight Research



Key macro indicators



GDP growth for FY24
3.5%



Inflation for FY24
21%



Tax Target for FY24
PKR9.2tr



Expenditure for FY24
PKR14.46tr



Fiscal Deficit as % of
GDP for FY24
6.5%



Primary Surplus as % of
GDP for FY24
0.4%

Key macro indicators



Export target for FY24
US\$30bn



Remittances for FY24
US\$33bn



Trade Deficit for FY24
US\$28.7bn



Defense Budget for FY24
PKR1.8tr



Civil Govt Budget for
FY24
PKR714bn



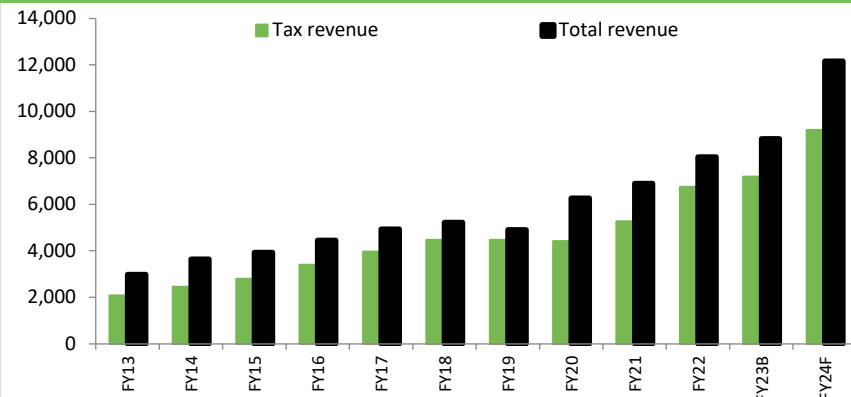
PSDP for FY24
PKR950bn

Aggressive revenue target lacks supporting measures

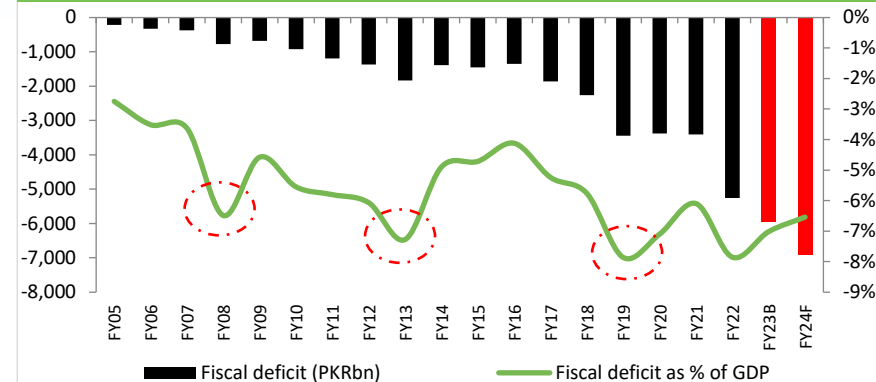
Tax collection target for FY24 has set an optimistic target of PRR9.2tr, up by ~28% from revised estimate of FY23. Direct taxes are expected to clock at PKR3.7tr vs. PKR2.8tr revised collection target in FY23. Similarly, targets for custom duties, sales tax and FED are expected to inch up by ~9%, 26% and 59%, respectively. We opine that the collection target is little optimistic given the overall slowdown in economic arena. Furthermore, revenue target is not backed with concrete revenue measures and there were no efforts to broaden the tax base.

Non-tax revenue for next fiscal year, is estimated at PKR2.9tr vs. revised estimate of PKR1.6tr in FY23, up by ~83% YoY. Major chunk of non-tax revenue is coming from SBP profit, which is estimated to increase by ~200% to PKR1.1tr. On the other hand, PDL collection is estimated at PKR869bn against revised target of PKR542bn in FY23. We believe that govt is likely to achieve a significant portion of non-tax revenue on the back of healthy profits from OMO operation and full year impact of PKR50/ltr levy on petrol/diesel.

Tax and total revenue (PKRbn)



High fiscal deficit in election years



Fiscal snapshot

Resource and Expenditure for FY24 (PKRbn)

Resource		Expenditure	
Tax revenue	9,200	Interest payment	7,303
Non-tax revenue	2,963	Pension	761
Gross revenue	12,163	Defence affairs	1,804
Less provincial share	5,276	Grants and transfer	1,464
Net revenue	6,887	Subsidies	1,074
		Running civil govt.	714
Non bank borrowing	1,906	Provision for emergency	200
Net external receipts	2,527	Current	13,320
Bank borrowing	3,124	Federal PSDP	950
Privatization proceeds	15	Net lending	190
		Development	1,140
Total	14,460	Total	14,460

Source: MoF, Insight research

Continuation of super tax

Budget FY23-24 Super Tax Slabs

Particulars	FY22-23	FY23-24
Net Income does not exceed PKR150mn	0%	0%
Net Income above PKR150mn but below PKR200mn	1%	1%
Net Income above PKR200mn but below PKR250mn	2%	2%
Net Income above PKR250mn but below PKR300mn	3%	3%
Net Income above PKR300mn but below PKR350mn		4%
Net Income above PKR350mn but below PKR400mn		6%
Net Income above PKR400mn but below PKR500mn	4%	8%
Net Income above PKR500mn		10%

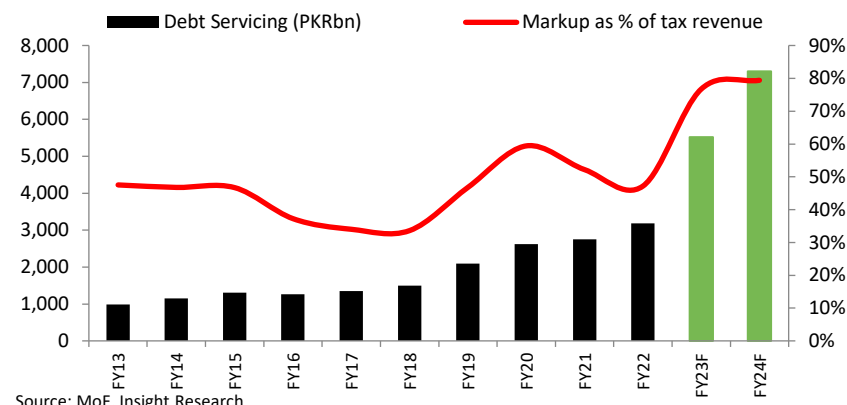
Source: Finance Act, Insight Research

Swelling current expenditures to catch IMF's eye

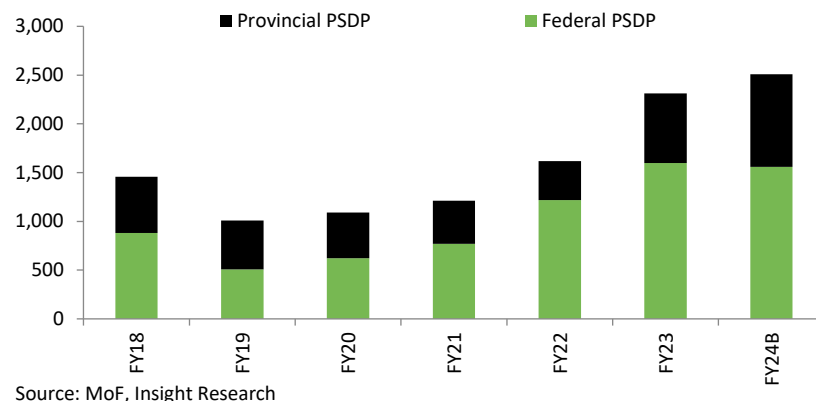
Budget's total outlay is estimated at PKR14.4tr where current expenditure is estimated at PKR13.3tr, up by ~27% YoY. A significant chunk of expenditure is allocated to markup payments of PKR7.3tr, up by ~32% from revised estimate of FY23, which makes up ~54% of total expenditures. Excluding markup payments, current expenditure for the year stands at PKR6tr, up by ~20%.

Government is targeting fiscal deficit of PKR7.5tr for FY24 vs. PKR6.4tr revised estimate of FY23. This will take fiscal deficit as % of GDP to ~6.5%. This deficit is primarily financed by bank borrowing which stands at PKR5.0tr for next fiscal year. Government has also budgeted PKR0.9tr and PKR1.6tr from multilateral & bilateral sources and commercial & euro bonds, respectively. We opine that, given the tough domestic macro environment and sub-par credit rating it is very unlikely for the country to avail financing of this tune from international markets.

Debt servicing burden to increase



Federal PSDP & Provincial PSDP (PKRbn)



Financing of fiscal deficit

Fiscal deficit and financing for FY24 (PKRbn)

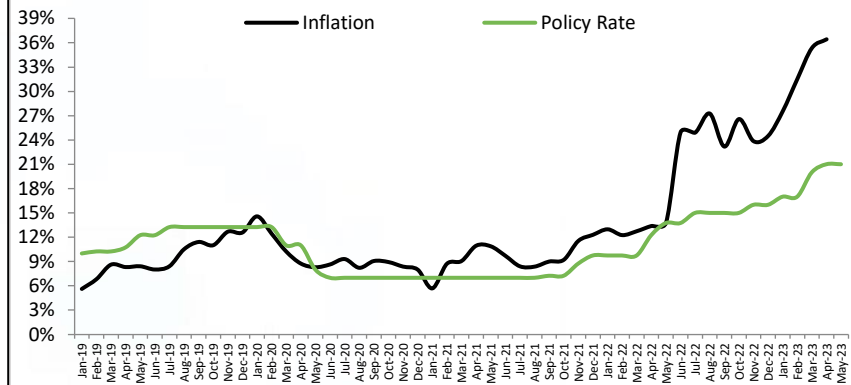
Fiscal deficit		Financing	
Federal Revenue	6,887	Net external financing	2,527
		Multilateral & bilateral	926
Total expenditure	14,460	Commercial & euro bond	1,601
Current	13,320	Net domestic financing	5,031
		National saving scheme	7
Development and lending	1,140	Bank (Govt. securities)	5,023
Federal PSDP	950		
Net lending	190	Privatization proceed	15
Federal Deficit	(7,573)	Total financing	7,573

Source: MoF, Insight research

Inflationary pressure to ease; upside risk looms

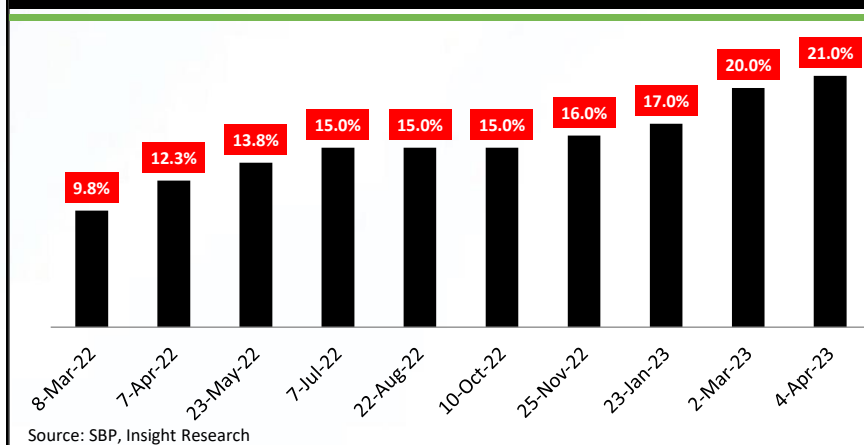
Headline inflation in 11MFY23 has clocked in at ~29% vs. ~11% in SPLY, increase in inflation is primarily attributable to higher food prices, supply chain constraints, PKR devaluation and rationalization of energy tariffs. As per our estimates, CPI has peaked in May'23 where it was recorded at ~38%. We expect headline inflation to start receding from Jun'23 primarily due to high base effect. Govt. is targeting inflation to average at ~21% in FY24. However, PKR devaluation and supply side challenges can result in higher inflation. As per our estimates, CPI is likely to average at ~22.9% in FY24 vs. 29.3% in FY23.

Economy: Policy rate vs. Inflation



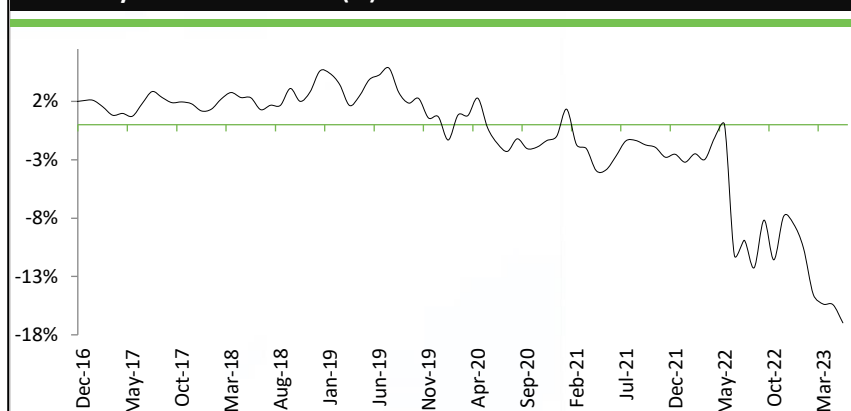
Source: SBP, PBS, Insight Research

Recent MPC decisions



Source: SBP, Insight Research

Economy: Real Interest rate (%)



Source: PBS, SBP, Insight Research



Key changes in income tax act

- Rationalization of Super Tax under section 4C to apply on all persons across the board on income above PKR150mn: insertion of additional three new income slabs of PKR350mn to PKR400mn, PKR400mn to PKR500mn and PKR500mn above to be taxed at 6%, 8% and 10% respectively
- Reintroduction of 0.6% advance adjustable WHT on cash withdrawal for non-ATL individuals
- 10% final withholding tax has been reimposed on the issuance of bonus shares by companies (20% for non-ATL)
- Withholding tax rate has been increased from 1% to 5% on payments to non-residents through debit/credit or prepaid cards (2% to 10% for non-ATL individuals)
- Introduction of an additional tax, not exceeding 50% on income, profit, and gains of individuals or specific groups resulting from extraordinary gains attributable to factors such as exchange gain, commodity price etc
- Increase in the monetary limit of foreign remittances, from PKR5mn to the rupee equivalent of US\$100,000, for the purposes of section 111(4), which bars inquiries into the nature and source of unexplained income/assets
- Final withholding tax of 2% exempted on the purchase of immovable property for nonresident individual POC/NICOP holders, provided the property is acquired using foreign remittances
- Minimum tax liability on turnover replaced from 1.25% to 1.0% for companies listed on PSX
- Correction of a technical error in the banking sector super tax regime by replacing tax year 2022 with tax year 2023
- Introduction of an enabling provision for the computation, collection, and payment of super tax under section 4C



Key changes in custom act

- Customs duties exempted on imported machinery, equipment, and inputs for manufacturing of solar panels, inverters, and batteries
- Duty-free import allowed for IT-related equipment equivalent to 1% of export proceeds for IT and IT-enabled services
- Customs duties on non-localized (CKD) of Heavy Commercial Vehicles (HCVs) reduced from 10% to 5%
- Exemption of customs duties on raw materials/inputs of mining machinery
- To promote agriculture, customs duties are exempted on import of seeds
- RD on second-hand clothing withdrawn to relief impoverished segment of society
- To incentivize IT sector, RD on imports of IT-related equipment has been abolished
- Removed RD on imported synthetic filament yarn of polyester not manufactured locally
- Exempted RD on special steel round bars and rods of non-alloy steel exceeding 50 mm diameter
- The removal of capping on fixed duties and taxes has been announced for the import of Asian-made used vehicles above 1300 CC



Banks – Negative to Neutral

Proposal	Impact
Reintroduction of 0.6% advance adjustable WHT on cash withdrawal for non-ATL individuals	Negative
Introduction of an additional tax, not exceeding 50% on income, profit, and gains of individuals or specific groups resulting from extraordinary gains attributable to factors such as exchange gain, commodity price etc	Negative
Introduction of an enabling provision for the computation, collection, and payment of super tax under section 4C	Negative

Our Take:

We opine that the budget is neutral to negative for banking sector as re-imposition of advance tax on cash withdrawal will negatively impact banking sector's deposit and will increase the size of informal economy. Furthermore, continuation of super tax will trim earnings of ISL banking companies by ~12%. Commenting on debt restructuring, finance minister has categorically denied any restructuring exercise for domestic debt. We opine that profitability of the sector will firm given the heightened borrowing by the government from local banks along with healthy NIMs.

Agriculture and Fertilizers – Neutral to Positive

Proposal	Impact
Agricultural loan limit enhanced from PKR1,800bn to PKR2,250bn	Positive
PKR30bn are allocated to convert 50,000 agriculture tube-wells to solar energy	Positive
Customs duties are exempted on import of seeds and combine harvesters	Positive
PKR10bn are allocated to provide subsidized loans to small farmers and PKR5bn are allocated for concessionary loans provided to Agro industries	Positive
5-year tax exemption will be awarded to Agro-based industrial units with annual revenue exceeding PKR10mn	Positive
PKR6bn has been allocated for subsidizing imported urea	Neutral

Our Take:

We opine that government aims to prioritize agriculture sector to ensure food security and achieving autarky by increasing production and yields of various crops which will bode well for fertilizer sector. However, imposition of super tax is negative for profitability of fertilizer companies in our universe. As per our estimates, super tax will reduce profitability by 9% on annualized basis.

Information Technology – Positive

Proposal	Impact
Concessional fixed tax rate of 0.25% for IT & ITeS exports extended for tax years 2024, 2025, and 2026	Positive
Duty-free import allowed for IT-related equipment equivalent to 1% of export proceeds for IT and IT-enabled services	Positive
Application of a concessional tax rate of 20% to banking company's income derived from additional advances to the IT & ITeS sector, replacing the standard rate of 39%	Positive
RD on imports of IT-related equipment has been abolished	Positive
PKR5bn are allocated for establishing venture capital funds for IT industry	Positive
Professional training will be provided to 50,000 IT graduates	Positive

Our Take:

We believe IT sector is biggest winner in this budget, wherein, all of these proposals are expected to boost growth of domestic IT industry. Government has recognized potential of domestic industry's IT and ITES exports with a goal to increase IT related exports to US\$4.5bn in FY24. To note, in 10MFY23, IT exports stood around US\$2.1bn.

Textile – Negative to Neutral

Proposal	Impact
Regulatory duty removed on imported synthetic filament yarn of polyester not manufactured locally.	Positive
Custom duty of Pet Scrap has been decreased from 20% to 11% for manufacturers of polyester filament yarn.	Positive
Sales tax increased from 12% to 15% on sales by tier-1 retailers dealing in leather and textile products.	Negative
Allocation of funds for subsidized LNG reduced from PKR40bn to nil.	Negative
Minimum wage set at Rs32,000/month.	Negative

Our Take:

The textile sector which accounts for 60% of Pakistan's exports, was neglected in the FY24 budget. The withdrawal of LNG subsidies and an increase in sales tax for tier-1 retailers will negatively impact the sector. Moreover, the increase in the minimum wage will further dent the sector's margins, considering its labor-intensive nature. However, there is some relief with the removal of RD on synthetic filament yarn and a reduction in customs duty on pet scrap for polyester filament yarn manufacturers. Furthermore, reimposition of supertax would reduce profitability of textile ISL universe from 1% to 3%.

Cement – Neutral to Positive

Proposal	Impact
Government has allocated PKR950bn under Federal Public Sector Development Programme vs. PKR714bn, up by ~33%. Whereas, provincial PSDP has been allocated PKR1.6tr, taking nation total PSDP to PKR2.5tr vs. PKR2.3tr in SPLY.	Positive
An additional PKR200bn (previous PKR73bn) to be allocated under Public Private Partnership.	Positive
Reduction in tax liability by 10% or PKR5mn whichever is lower for a builder and 10% or PKR1mn whichever is lower for an individual for three years, respectively.	Positive
The exemption for profits/gains on the sale of immovable property or share of SPV to REIT scheme has been extended for an additional year, until Tax Year 2024.	Positive

Our Take

Imposition of super tax from 4% to 10% will slash sector earnings by 6%-9%. Moreover, increase in development spending likely provide some respite to construction industry. However, we believe actual disbursement of PSDP would remain on lower side than target of FY24.

Engineering – Negative to Neutral

Proposal	Impact
Continuation of exemption of sales tax to NMDs (FATA/PATA) for another one year up to June 2024.	Negative
Removal of RD on silicon steel sheets, special steel round bars and rods of non-alloy steel exceeding diameter 50 mm.	Positive
minimum turnover tax on listed companies has been reduced to 1% from 1.25% which will provide some respite to corporates.	Positive
Imposition of super tax at 10% for TY23 and onwards	Negative

Our Take:

Imposition of super tax will slash sectors earnings by 8%. Whereas, extension of sales tax to NMDs will harm formal rebar and flat steel industry. However, reduction in minimum tax and removal of RDs on steel sheets, special steel round bars and rods of non-alloy steel would be positive for the sector.

Autos – Neutral to Positive

Proposal	Impact
Reduction of Custom duty (CD) from 10% to 5% on non-localized (CKD) on Heavy Commercial Vehicles.	Positive
Removal of capping on fixed duties and taxes on import of Asian-made used vehicles above 1300 CC.	Positive
Reduction of Custom duty (CD) from 16% to 15% on Agriculture tractors - with engine capacity exceeding 26kW but not exceeding 75kW while for others, CD has been reduced to 10% from 11%.	Negative
Reduced custom duty (CD) of 1% on import of CBU of hybrid electric vehicles (HEV) will only be applicable to those manufactures who will provide locally assembled units.	Positive
Turnover tax has been reduced from 1.25% to 1%	Positive

Our Take

Aforementioned measures will likely to benefit INDU which is going to bring in local assembled HEVs. Other than this, removal of capping on import of vehicles will discourage the used car imports (Above 1300cc). Continuation of 10% super tax is likely to trim the annualized earnings by 9%. We believe that automobile industry will remain under pressure due to supply constraints, escalating car prices, expensive auto financing and lower purchasing power of consumers.

OMCs – Neutral

Proposal	Impact
Removal of capping on Petroleum Development Levy (PDL) previously set at PKR50/litre. This will allow the Government to increase the PDL without prior approval.	Neutral
PKR11bn has been allocated to pay off remaining Price Differential Claim (PDC) on Petrol payable to OMCs.	Positive
Policy of bonded bulk storage for POL products has been proposed which will allow refineries and OMCs to buy Crude oil and POL products from foreign supplier directly.	Positive
Imposition of an additional tax, not exceeding 50% on income, profit, and gains resulting from extraordinary gains due to exogenous factors such as forex gain, Inventory gains etc.	Negative

Our Take

OMCs will likely to get the benefit from this policy of bounded bulk storage for POL products which will ease out pressures of losses arising from FX volatility, declining oil prices, LCs clearance issues and delays in the overall supply chain due to congestion at ports. Continuation of super tax of 10% will likely to trim the sectors annualized earnings by 9%. In addition, imposition of an additional tax on exchange/inventory gain will hurt the company's profitability.

E&Ps – Neutral

Proposal	Impact
Introduction of an additional tax, not exceeding 50% on income, profit, and gains resulting from extraordinary gains due to exogenous factors such as forex gain, Inventory gains etc.	Negative
Exemption of customs duties on raw materials/inputs of mining machinery.	Positive

Our Take

Since, E&P companies have dollarized revenue stream and in current circumstances they will continue to enjoy higher profitability. However, imposition of additional tax resulting from extraordinary gains will decrease this profitability. Furthermore, continuation of super tax of 10% will likely to trim the sector annualized earnings by 9%.

Others – Neutral

Proposal	Impact
Removal of Sales tax on edible products sold in bulk under brand names or trademarks	Positive
Continuation of concession on import of flavoring powders for food preparation for manufacturers of snacks till June, 2024.	Positive
Removal of Customs duties on raw materials for Rice mill machinery.	Negative
Increase in RD on import of glass articles to protect local industry.	Positive
Withdrawal of RD on parts of electrical goods.	Negative
Reduction in RD on import of tiles	Negative
Removal of Custom duty on Raw material of manufacturing solar panels, inverters and batteries.	Positive



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- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate



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