

Relief for banks in the revised Finance Bill 2022

- While majority of the amendments in the revised Finance Bill were already known by the market, thanks to news media, a surprise relief from the original bill for banks should be taken positively by the market.
- Currently banks are charged 1) a flat rate of 35% on income from all sources, 2) 4% super tax on pre-tax profit, and 3) up to 40% tax on income derived from investing in Federal government securities if the ADR is 50% or less.
- In the budget on June 10th, 2022, 1) income tax on banks was proposed to be increased from 35% to 45% from tax year 2023 (CY22), 2) poverty alleviation tax of 2% was proposed to be imposed on everyone who earn profits in excess of PKR300mn from tax year 2022 (CY21), 3) super tax of 4% was proposed to be abolished from tax year 2023 (CY22), and 4) tax rates on income derived from investing in Federal government securities in case ADR is 50% or less were proposed to be increased to up to 55%.
- After the announcement of the budget till June 23rd, the banking sector lost 3.6% due to the proposed increased taxation.
- On June 24th, the government announced imposition of a one-time super tax of 10% on 13 sectors (including banks) and increase in poverty alleviation tax to up to 4% (for profits of over PKR300mn) from 2% initially announced. From there banks shed another 5.6% till yesterday making a cumulative plunge of 9% since the announcement of the budget for FY23.
- Banks have been provided a relief from the initial budgetary measures in the final Finance Bill 2022, which include:
- Income tax rate applicable from tax year 2023 (CY22) has been reduced to 39% from the earlier proposal of 42%. The amended Finance Bill states to replace "42%" with "39%", whereas the original bill available on FBR's website had set banking companies tax rate at "45%" and so has been incorporated by the market.
- Poverty alleviation tax has been replaced with super tax with a one-time charge of 10% for tax year 2023 (CY22) and 4% afterwards (in case income exceeds PKR300mn).
- It needs to be highlighted here that banks were already paying 4% super tax on their pre-tax profits and it was incorporated in earnings estimates for CY22 and onwards before the announcement of budget.
- Moreover, there is no tax charge on CY21 earnings and the one-time charge of 10% is applicable for tax year 2023 (CY22), therefore, banks would book this tax on a quarterly basis while charging it for two quarters in Jun'22 results.
- As far as the ADR based tax is concerned all of our coverage banks are expected to maintain ADR above 50% and therefore, no incremental tax is expected to be charged going forward.
- All in all, the final proposed tax measures are likely to bring down CY22 earnings by around 16.5% - 17%. Whereas recurring earnings for CY23 onwards are now estimated to decline by 7% - 7.5% from our pre-budget earnings estimates compared to around 13% drop estimated on the basis of initial budget announcement.

Taxes and their impacts for banks

	Pre-Budget	Initial FB22	Final FB22
Income Tax	35.0%	45.0%	39.0%
Recurring Super Tax	4.0%	0.0%	4.0%
Poverty Alleviation Tax	0.0%	2.0%	0.0%
Total recurring Tax	39.0%	47.0%	43.0%
One-time Super Tax	0.0%	0.0%	10.0%

Source: Revised Finance Bill 2022, Next Research

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- Considering the recent performance by banks in general and undemanding valuations where our coverage universe is trading at CY22 and CY23 Tier-1 P/B of 0.7x and 0.6x, respectively and PER of 4.1x and 2.7x, respectively. Furthermore, double-digit dividend yields offered by BAFL, UBL and MCB makes them our preferred picks from the sector.

Impact on EPS and TPs of banks for CY22 and CY23

	CY22 EPS estimates			CY23 EPS estimates			Dec'22 TP		
	Pre-budget	Revised	Change	Pre-budget	Revised	Change	Pre-budget	Revised	Change
AKBL	8.12	6.73	-17.1%	12.81	11.86	-7.4%	40	35	-12.5%
BAFL	12.18	10.16	-16.6%	15.69	14.56	-7.2%	45	40	-11.1%
BAHL	19.31	16.04	-16.9%	30.51	28.26	-7.4%	108	93	-13.9%
BOP	2.39	1.98	-16.8%	4.75	4.39	-7.5%	12.5	11	-12.0%
HBL	27.22	22.62	-16.9%	40.46	37.5	-7.3%	145	128	-11.7%
MCB	31.11	25.88	-16.8%	41.01	38.16	-7.0%	187	170	-9.1%
MEBL	27.68	23.05	-16.7%	32.3	29.88	-7.5%	130	120	-7.7%
UBL	29.04	24.12	-16.9%	40.84	37.88	-7.3%	175	157	-10.3%

Source: Revised Finance Bill 2022, Next Research

Annexure

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