REP-300

Budget FY24

Initial Impression

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Best Securities House: 2022
Best Investment Bank: 2022

Best Investment Bank: 2022

Best Equity House: 2022

Best Equity Advisor: 2021

Best Brokerage House: 2022
Corporate Finance House: 2022
Best Economic Research House: 2022
Best Equity Research Analyst: 2022

Top 25 Companies
(2019, 2018 & 2017)

Excellence Award
Leading Brokerage House for RDA 2021

Best Money Market Broker
(Islamic) 2021

Budget FY24

Budget Snapshot

The Federal Government earlier today announced the Budget for the next fiscal year FY24, with a total budgeted outlay of PKR 14.5trn (up 51% compared to the budgeted outlay of FY23).

- **Revenue:** Gross Revenue receipts are expected at PKR 12.2trn a jump of 38% YoY from FY23 revised estimates, contributed primarily by a 28% YoY jump in FBR taxes from FY23R which are budgeted at PKR 9.2trn. Non-tax Revenue is envisaged at PKR 2.9trn which is 83% higher YoY from FY23R.

- **Expenditure:** The government has allocated PKR 13.3trn for current expenditure (predominantly mark-up payments which are expected to be 85% YoY higher than the FY23 target), and is up 32% YoY compared to FY23 revised estimates. Defence Budget is targeted at PKR 1.8trn (+19% YoY from FY23R). Subsidies to different sectors would be PKR 1.1trn, -3% YoY higher than FY23's revised estimate of PKR 1.1trn. Total National PSDP is budgeted at PKR 2.5trn of which the Federal PSDP is budgeted at PKR 950bn (31% YoY higher than the FY23 budgeted allocation of PKR 727bn).

- **GDP:** The government has set a GDP growth target of 3.5% for FY24. Agriculture is expected to grow by 3.5% (target growth of livestock set at 3.6%). The industrial sector is expected to increase by 3.4% while the Services sector is forecast to grow at 3.6%. LSM is estimated to display a growth of 3.2% compared to a provisional decline of 8.0% during FY23R.

Exhibit: Budget Snapshot

PKRbn	FY23B	FY23R	FY24B	Change
Net Receipts	5,032	4,689	6,887	47%
FBR Taxes	7,470	7,200	9,200	28%
Direct Taxes	3,039	2,851	3,759	32%
Indirect Taxes	4,431	4,349	5,441	25%
Non-tax Revenue	1,935	1,618	2,963	83%
Provincial Share	4,373	4,129	5,276	28%
Total Expenditure	9,579	11,090	14,461	30%
Current Expenditure	8,709	10,528	13,320	27%
Mark-up Payment	3,950	5,520	7,303	32%
Domestic	3,439	4,795	6,430	34%
Foreign	511	725	872	20%
Defence	1,527	1,510	1,804	19%
PDSP	727	714	950	33%
Budget Balance	**(3,797)**	**(5,941)**	**(6,924)**	**17%**
Primary Balance	**153**	**(421)**	**379**	**nm**
% of GDP				
FBR Tax Revenue	9.6	8.5	8.7	
Non-tax Revenue	2.5	1.9	2.8	
Total Expenditure	12.2	13.1	13.7	
Current Expenditure	11.1	12.4	12.6	
Budget Balance	(4.9)	(7.0)	(6.5)	

Source (s): MoF, AHL Research

Budget FY24

Budget Snapshot

- **Fiscal Deficit:** The fiscal deficit is budgeted at PKR 6.9trn, which forms 6.5% of GDP as compared to 7.0% for FY23 revised estimates. The government aims to finance the budget majorly through domestic financing of PKR 5.0trn (+77% higher than FY23's budgeted number) while net external loans are budgeted to be PKR 2.5trn (+57% higher than FY23's budgeted number). The bulk of the domestic financing is expected from Bank financing which is budgeted at PKR 3.1trn (+271% higher YoY from FY23's budgeted PKR 843bn). Mark-up payments are budgeted to be 34% higher next year on domestic loans while external loan mark-up payments are expected to be 20% higher YoY.

- **Social Relief:** Gov't has announced some relief measures for lower income strata which include (but are not limited to): Increase in the allocation of BISP from PKR 415bn to PKR 460bn, subsidy allocation of PKR 35bn for utility stores corporation, addition PKR 5bn kept for Ramzan package.

- **Current Account:** The government projects a current account deficit for FY24 which would be 1.64% of the GDP (USD 6.0bn).

Exhibit: Fiscal Deficit and Financing

PKRbn	FY24B
Non Bank Borrowing	1,906
Net External Receipts	2,527
Multilateral & Bilateral Sources	926
Commercial & Euro Bond	1,601
Bank Borrowing	3,124
Privatization Proceeds	15
Federal Deficit	**7,572**

Source (s): MoF, AHL Research

Budget FY24

Relief Measures

- Salaries of government servants between grade 1-16 to be increased by 35%, and by 30% for grade 17 and above employees.
- Pensions augmented by 17.5% across the board.
- Exporters of Information Technology (IT) and IT enabled services have been incentivized through duty free import of IT related equipment equivalent to 1% value of their export proceeds.
- Sales tax to be exempted on import of IT equipment by exporters of IT and ITeS registered with Pakistan Software Export Board.
- Rate of tax on IT based system development consultants to be cut to 15% from 16%.
- One more API and 03 drugs added to the existing duty free regime for the Pharma sector.
- Continuation of concession on import of flavouring powders for food preparation for manufacturers of snacks till Jun'24.
- Extension in exemption of sales tax to NMDs (FATA/PATA) for another one year ending Jun'24.
- Grant of sales tax exemption on plant saplings, combine harvesters, dryer for agricultural products, no-till-direct seeder, planters, trans-planters, other planters and bovine semen.
- For tax year 2024, 2025 and 2026 there has been a continuation of concessionary fixed tax rate of 0.25% for IT and ITeS exports
- Removal of sales tax return filling requirement to avail concessionary fixed rate of 0.25% for IT and ITeS.
- There has been an increase in business turnover limit to qualify for concessionary tax regime for a manufacturer from Rs 250 Mn to Rs 800 Mn for SMEs and inclusion of IT and ITeS in SMEs definition.
- 20% of concessionary tax rate instead of 39% on banking company's income from additional advances to IT and ITeS exports.
- Source of income/assets to not be explained for foreign remittance remitted from outside Pakistan of up to rupee equivalent of USD 100,000 (previously PKR 5mn).

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Relief Measures

- On purchase of immovable property, a waiver of 2% final withholding for non-resident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad.
- For a builder, 10% reduction in tax liability or PKR 5mn (whichever is lower) and 10 % reduction or PKR 1mn (whichever is lower) for an individual for own construction of house for 3 years.
- 50% reduction in tax liability for a period of 3 years for youth entrepreneurship (maximum limit of PKR 2mn for Individual / AOP and PKR 5mn for a company). A person up to the age of 30 years is defined as youth.
- Two years extension for concessionary tax of 20% for banking company's income from additional advances to low-cost housing, agriculture, and SMEs including IT & ITeS.
- 1% concessionary final tax rate to indirect exporters to encourage export of commodities (Agriculture produce, gems, metals etc) through online platform.
- Reducing of minimum tax liability on turnover from 1.25% to 1% for companies listed on PSX.
- Extension of exemption for one-year granted to a person to profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme i.e., up to Jun'24.
- Agro based industries being set up as SMEs on or after 1st July, 2023 (from tax year 2024 to 2028) being granted a 5-year tax holiday.

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Revenue Measures

- Withdrawal of exemption of sales tax on edible products sold in bulk under brand names or trademarks.
- Augmented sales tax from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products.
- Electric power transmission services to be taxed @ 15% (ICT only).
- 0.6% advance adjustable withholding tax re-imposed on non-ATL persons on cash withdrawal.
- Super tax slabs for tax year 2023 i) 0% for income below PKR 150mn, ii) 1% for income between PKR 150-200mn, iii) 2% for income between PKR 201-250mn, iv) 3% for income between PKR 251-300mn, v) 4% for income between PKR 301-350mn, vi) 6% for income between PKR 351-400mn, vii) 8% for income between PKR 401-500mn, and viii) 10% for income exceeding PKR 500mn.
- 10% final withholding tax on issuance of bonus shares by a company (20% for non-ATL).
- Imposition of additional tax not exceeding 50% on profit and gains of a person or class of persons on account of extraordinary gains due to exogenous factors.
- Increase in WHT from 1% to 5% on payment to non-resident through debit /credit or prepaid cards (2% to 10% for Non-ATL person).

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Key Measures

Custom Duty:

- CD exempted on import of machinery, equipment and inputs used for manufacturing of solar panels, inverters and batteries.
- Reduction of CD from 10% to 5% on non-localized (CKD) of Heavy Commercial Vehicles (HCVs).
- CD on import of pet scrap for manufactures of polyester filament yarn has been reduced.
- CD exemption on raw materials / inputs for rice mill machinery.

Regulatory Duty:

- Reduction of RD on 151 PCT codes relating to second hand clothing, fish, tiles, sports goods.
- RD removal on IT related equipment to encourage information technology sector.
- RD removal on Synthetic Filament yarn of Polyester not manufactured locally.
- Removal of RD on Silicon Steel sheets.
- Removal of RD proposed on flat panels, monitors, and projectors.
- Exemption of RD on special steel round bars and rods of non-alloy steel exceeding diameter 50 mm
- To protect local industry there has been an increment/ levy of RD on imports of articles of glass.
- 20% of RD imposed to discourage the use of inefficient Tungsten Filament Incandescent Bulbs.
- An increase from 10% to 15% of RD on export of Molasses.

Budget FY24

Overall Take – Negative to Neutral

Tough tax measures have been undertaken to meet the mammoth revenue collection target of PKR 9.2trn. Pertinently, the imposition of super tax (higher quantum and wider slabs), would hit earnings of most corporates listed at the PSX. Moreover, re-imposition of 10% tax on income arising to the shareholder of a company, from the issuance of bonus shares. This could be a sentiment dampener, particularly due to the high influx of bonus announcements witnessed recently. While a levy of up to 50% to be imposed on companies on income and gains booked between 2019 to 2023 on account of extraordinary gains due to exogenous factors such as exchange or inventory gains; although we believe this will attract significant litigation. Albeit, minimum turnover tax on listed companies has been reduced to 1% from 1.25% previously, providing some relief to corporates.

Moreover, real estate and REITs measures are expected to encourage a shift in investments to those assets. These include i) extension of exemption for one-year granted to profits and gains on sale of immovable property or share of special purpose vehicle to any type of REIT scheme up to Jun'24, ii) on purchase of immovable property, a waiver of 2% final withholding for non-resident individual POC/NICOP holder where immovable property is acquired through foreign remittances remitted from abroad, and iii) for a builder 10% reduction in tax liability or PKR 5mn (whichever is lower) and 10% reduction or PKR 1mn (whichever is lower) for an individual for own construction of house for 3 years. Whereas indirect benefits consist of a two years extension in concessionary tax of 20% for banking company's income from additional advances to low-cost housing, encouraging mortgages.

Exhibit: Budget Impact on Different Sectors

Sector	Impact
Market	Negative to Neutral
Banks	Negative to Neutral
Cement	Neutral to Positive
Fertilizer	Negative to Neutral
Power	Neutral
Autos	Negative to Neutral
Textile	Neutral to Positive
Steel	Negative to Neutral
Chemicals	Negative
E&P and OMCs	Negative to Neutral
IT	Positive

Source (s): AHL Research

Budget FY24

Overall Take - Negative to Neutral

From the sectoral perspective, the budget will garner a mixed reaction. First off, all corporates whose income exceeds PKR 150mn will be subjected to a 1-10% super tax, which will hit all major sectors. In particular, the budget will be negative for the heavy-weight **banking** sector which will face the brunt of augmented taxes (43% to 49%) amid augmented super tax. This is expected to erode the bottom-line of banks by 11% on average in CY23. Moreover, withholding tax has been re-imposed on withdrawals above PKR 50,000 in a single day from the bank account of the non-filers. This will discourage non-filers from depositing their money in banks. On the other hand, a two years extension in concessionary tax of 20% for banking company's income from additional advances to low-cost housing, agriculture, and SMEs including IT & ITeS, encouraging mortgage and agro sector.

In addition, the government has proposed an amendment to the Petroleum Products (Petroleum Levy) Ordinance whereby the government may change the quantum of PDL through a notification in the official gazette, as opposed to via a Bill passed by the Parliament, which suggests a change in petrol prices at any given time. Impact on **OMCs** will be neutral. Furthermore, the exemption of customs duties on raw materials / inputs for mining machinery is proposed by the Govt. Keeping in view companies such as OGDC, and PPL have diversified into mining project (Reko Diq Mining), it will save additional CAPEX of **E&P** companies.

Moreover, the Govt. has proposed to exclude companies engaged in production, transmission and distribution of electricity from the scope of sales tax as recommended by National tax council. The said tax would be treated as provincial tax starting from 1st Jul'23 and revenue of which will be received by respective provinces. We view this to be neutral for the power sector.

Budget FY24

Overall Take - Negative to Neutral

In order to support **Information Technology** (IT) Sector, the government has proposed a series of relief measures: removal of regulatory duty on IT related equipment to encourage IT sector, reduction of tax from 16% to 15% on IT based system development consultants, scope of IT and IT enabled services is proposed to be harmonized with scope envisaged under the Income Tax Ordinance, 2001, continuation of concessionary fixed tax rate of 0.25% for IT & ITeS exports for Tax years 2024, 2025 and 2026, withdrawal of sales tax return filing requirement for availing concessionary fixed tax rate of 0.25% for IT & ITeS exports, increase in business turnover limit of a manufacturer from PKR 250mn to PKR 800mn to qualify for concessionary tax regime for SMEs and inclusion of IT & ITeS in SMEs definition, and concessionary tax rate of 20% on banking company's income from additional advances to IT & ITeS sector instead of standard rate of 39%.

Some other optimistic developments have also been made. Federal PSDP has been increased from PKR 727bn to PKR 950bn, with provision for infrastructure under Federal PSDP increased by 37% YoY to PKR 491bn. Whereas allocation for provinces has jumped up to PKR 1.6trn, taking the overall PSDP to PKR 2.5trn vis-à-vis PKR 2.3trn last year. Albeit, we believe the expenditure may supports the public sector led demand for **cement** and **steel** sectors. While extension in sales tax exemption by another year for players operating in the FATA / PATA region will remain negative for the formal steel sector.

For the **tiles** sector, a reduction of regulatory duty on import of tiles will be negative for local manufacturers given it will encourage the influx for imported tiles.

Budget FY24

Overall Take - Negative to Neutral

Whereas, the removal of the cap on fixed duties and taxes for the import of old and used vehicles of Asian make above 1300cc will give a positive boost to local **auto assemblers**. In addition, the reduced 1% import duty on hybrid vehicles is now exclusively applicable to locally assembled variants, only benefiting the assemblers who import them. This, coupled with reduction of CD from 10% to 5% on non-localized heavy commercial vehicles (CKDs), will aid the sector.

Textile sector is set to benefit from the reduction in customs duty on import of pet scrap for manufactures of polyester filament yarn, which will improve the gross margins of the manufacturing companies. In addition to this, it has been proposed to remove regulatory duty on synthetic filament yarn of polyester not manufactured locally. However, sales tax is proposed to be increased from 12% to 15% on supplies made by the POS retailers dealing in leather and textile products.

Whereas the exemption of custom duties on raw material / input for **rice** mill machinery has been proposed which will support companies such as MFL to undergo repairs and expansion if required. Additionally, in order to protect the local industry, the Govt. proposes to increase regulatory duty on import of **glass** articles to the tune of 15-30%. The Govt. also recommends removing regulatory duty on parts for flat panels, monitors, projectors, as well as eliminating regulatory duty on silicon steel sheets, which will bode well for **appliances** manufacturers such as PAEL and SIEM. Abolishment of customs duty on raw materials of diapers, sanitary napkins and adhesive tape has been proposed, which will be positive for the **personal care** sector.

Budget FY24

Overall Take - Negative to Neutral

It has also been proposed to increase export regulatory duty on the export of Molasses from 10% to 15%. This will hurt gross margins of exporting **sugar** producing companies. The government has proposed to withdraw exemption of sales tax on edible products sold in bulk under brand names or trademarks, which is expected to hurt the gross margins of the companies producing edible products (**food** sector).

It has also been suggested to increase custom duty on calcium carbides to 11% from 3%. Moreover, it is proposed to abolish customs duty on organic composite solvent and thinners for companies manufacturing Butyl Acetate and Dibutyl Orthophthalates. These measures are positive for the **chemical** sector given their gross margins will improve. The government proposes to include one more active pharmaceutical ingredient (API) and three drugs in the present duty free regime, which will be positive for the **pharmaceutical** sector (improving the gross margins of the importing companies).

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Historical Market Performance

- Observing market performance since FY14, we noted a positive momentum on average being displayed by the KSE-100 index in anticipation of the budget. 30, 60 and 90 days prior to the announcement of the Federal budget, the domestic equity bourse generated an average return of 3.2%, 5.7% and 5.1%, respectively.
- Meanwhile post budget data displayed a mixed trend (during FY18 & FY19 foreign outflows and uncertainty on the political front suppressed market performance while investors remained hesitant post FY20 budget due to uncertainty over the IMF program conditions). On average, the local bourse garnered less enthusiasm, with returns of -1.1%, -0.3% and -1.3% over 30, 60 and 90 days respectively, subsequent to the budget announcement.

Exhibit: KSE100 Performance

Budget Year	30-Days	60-Days	90-Days
Before Budget			
FY24	2.0%	5.2%	0.3%
FY23	-2.0%	-9.0%	-3.8%
FY22	6.9%	7.4%	10.3%
FY21	2.7%	11.5%	-4.0%
FY20	-0.2%	-7.2%	-11.0%
FY19	0.8%	6.1%	2.2%
FY18	5.6%	8.1%	7.4%
FY17	5.4%	10.1%	14.7%
FY16	0.5%	7.1%	2.3%
FY15	2.0%	3.9%	11.2%
FY14	10.3%	19.3%	25.8%
Average	**3.1%**	**5.7%**	**5.0%**
After Budget			
FY23	-1.6%	0.2%	-0.5%
FY22	-1.5%	-2.4%	-3.5%
FY21	4.6%	17.2%	23.2%
FY20	-2.3%	-15.1%	-12.1%
FY19	-7.6%	-9.4%	-7.6%
FY18	-12.0%	-12.8%	-19.7%
FY17	1.5%	6.9%	6.8%
FY16	4.2%	5.6%	1.1%
FY15	0.7%	2.7%	-3.4%
FY14	3.2%	4.1%	3.0%
Average	**-1.1%**	**-0.3%**	**-1.3%**

Source: PSX, AHL Research

Analyst Certification and Disclaimer

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Equity Research Ratings

Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2023 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -15% from last closing of market price(s)

Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

Risks: The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

Disclosure required under Research Analyst Regulations, 2015:

In order to avoid any conflict of interest, we hereby disclosed that;

Arif Habib Limited (AHL) has shareholding in OGDC, NBP, BAFL, BOP and PTL.

ARIF HABIB LIMITED