

Tough balancing act, along with revenue taxes and a one-time super gains tax

SLPP Government’s 2022 budget aims an ambitious 46% revenue jump, with a 2.5% revenue tax on corporate top lines and notably a 25% one off tax on corporate net revenues above LKR 2bn on FY 2020/21 year. While taxes with retrospective effects are hardly equity positive, we do see the need for higher corporate taxes given the shrinking tax net and personal taxes. We would have been encouraged to see proposals spelling out a clearer approach to fight food inflation, interest rate fluctuations or earning foreign revenue. Banks continue to be a soft target for revenue collection.

Ambitious revenue targets

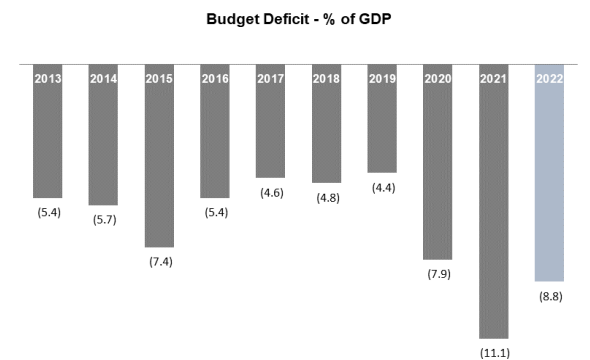
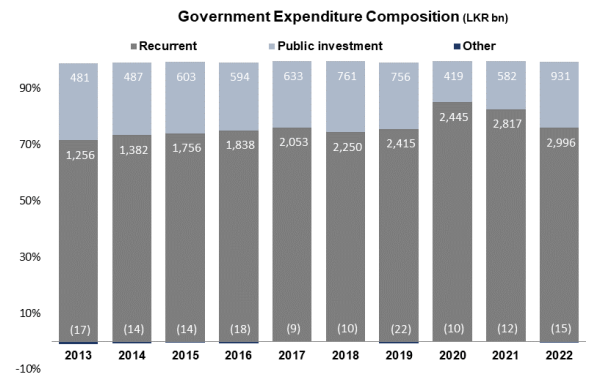
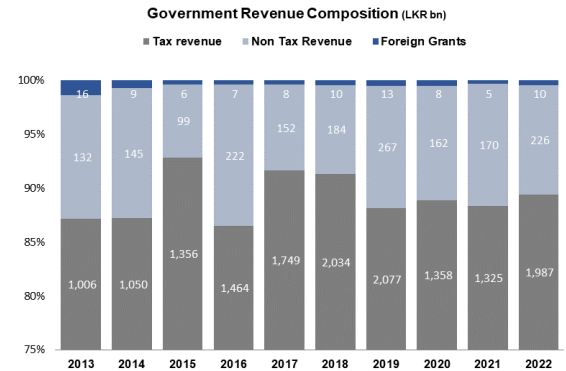
The Govt is looking at a 45% jump in revenue collection and the we see the two main approaches equity negative. Although the one off nature of the tax with retrospective effects has a limited impact on the valuations, we believe it could affect investor sentiment along with higher working capital financing and planning complications. With SL unable to reach capital markets, the financing happens entirely domestically. With the domestic credit demand just beginning to recover, we believe this could have spill-over effects on inflation.

Taxes consistent although expenditure needs a lid

While we see measures to curtail state expenditure which could be useful as MP’s pensions, telcom expenditure etc, we also see the salary bill rising and state graduate hiring increased and higher public investment. We look forward to a post pandemic injection led stimulus but we see a large allocation going towards highways and bridge construction which would be slower to kick start a growth spurt. We would have liked to see clarity on returning to chemical fertilizer which would have faught a domestic spike in food inflation.

Our call on the impact on coverage is mostly neutral

While we see proposals on construction, textile, manufacturing, healthcare and renewable energy as investment positive, we see larger corporates’ working capital and dividend ability for FY 2022 being impacted by the one off tax. We have assessed the proportionate impact to each counter on this and see limited explicit impact to valuations given its one off nature. The 2.5% on revenue social security contribution could be a larger impact to all corporates while the 3% increase in the VAT on FS will further delay a bank re-rating comparable with our peers. We see the large banks in the coverage worst affected getting a double whammy from the 3% FS VAT spike and the one off tax of 25%.



Summary of Fiscal Performance as a % of GDP	Fiscal performance				
	2018	2019	2020	2021(RE)	2022 (Est)
Revenue & Grants	16.4%	15.8%	9.9%	9.5%	12.3%
Revenue	16.3%	15.7%	9.9%	9.4%	12.3%
Tax	14.3%	13.3%	8.5%	8.0%	10.7%
Expenditure	21.1%	20.2%	17.8%	20.6%	21.1%
Recurrent expenditure	14.5%	16.8%	15.3%	17.1%	16.2%
Public investment	4.4%	6.2%	2.6%	3.5%	5.0%
Key fiscal balances:					
Primary surplus (+)/deficit (-)	0.6%	-3.6%	-2.5%	-4.7%	-2.8%
Budget surplus (+)/deficit (-)	-5.3%	-9.6%	-7.9%	-11.1%	-8.8%

RE: Revised Estimates Est: Budget

2022 Estimates: 46% jump in revenues. 8.8% target deficit

With the projected increase in revenue, we see SL maintaining single digit expenditure growth.

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total revenue and grants	1,264	1,534	1,774	1,997	2,326	2,464	1,588	1,561	2,284
Total revenue	1,255	1,528	1,766	1,989	2,316	2,451	1,580	1,556	2,274
Tax revenue	1,050	1,356	1,464	1,749	2,034	2,077	1,358	1,325	1,987
Non Tax Revenue	145	99	222	152	184	267	162	170	226
Foreign Grants	9	6	7	8	10	13	8	5	10
Total Expenditure	1,855	2,363	2,414	2,667	3,001	3,149	2,854	3,387	3,912
Recurrent	1,382	1,756	1,838	2,053	2,250	2,415	2,445	2,817	2,996
Public investment	487	603	594	633	761	756	419	582	931
Other	(14)	(14)	(18)	(9)	(10)	(22)	(10)	(12)	(15)
Revenue Surplus/ (Deficit)	(128)	(247)	(194)	64	66	36	(865)	(1,261)	(722)
Budget Deficit	(591)	(830)	(640)	(680)	(675)	(685)	(1,266)	(1,826)	(1,628)
Total Financing	591	830	640	680	675	685	1,266	1,826	1,628
Total Foreign Financing	316	369	429	330	300	55	(225)	(48)	(179)
Total Domestic Financing	276	460	211	350	375	630	1,491	1,874	1,807
As a % of GDP									
Revenue and Grants / GDP	12.2	14.0	15.0	15.4	16.4	15.8	9.9	9.5	12.3
Revenue / GDP	12.1	14.0	14.9	15.3	16.3	15.7	9.9	9.4	12.3
Tax / GDP	10.1	12.4	12.4	13.5	14.3	13.3	8.5	8.0	10.7
Expenditure / GDP	17.9	21.6	20.4	20.6	21.1	20.2	17.8	20.6	21.1
Budget Deficit / GDP	(5.7)	(7.4)	(5.4)	(4.6)	(4.8)	(4.4)	(7.9)	(11.1)	(8.8)

In LKR bn

Deficit Financing

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Foreign Financing	316	369	429	330	300	55	(225)	(48)	(179)
Foreign borrowings	423	556	574	550	580	720	325	489	508
Foreign commercial	250	383	366	320	340	450	197	157	150
Debt repayments	(107)	(187)	(145)	(220)	(280)	(665)	(550)	(536)	(687)
Total Domestic Financing	276	460	211	350	375	630	1,491	1,874	1,807
Non bank borrowings	193	197	399	110	195	362	1,106	1,569	1,397
Foreign investment in T bills and I	21	223	(121)	70	60	180	(78)	(64)	(91)
Bank borrowings	62	41	(67)	170	120	88	464	368	501

In LKR bn

Banking sector worst hit by increased taxes. Coverage forecasts re-adjusted

Banking sector gets hit by the raising of Financial Sector VAT from 15% to 18% while the big three banks we look at COMB, HNB and SAMP are hit by the one- time, non- recurring of 25% of taxable income. Add to this the Social Security Contribution (SSC) of 2.5% on topline. We expect the banking sector low multiples compared to regional peers to remain in the forecast period. Banks, tobacco, alcohol and telco, the usual 'sin bin' suspects have taken the punch.

The SSC of 2.5% will have a more recurring impact and harder one on businesses driven on high volume/ low margins like supermarkets and, yes the banks. With already spiking inflation, pass through ability may be limited.

The 25% non-recurring surcharge is at subsidiary level and not at conglomerate/ holding company level to avoid double counting.

Companies like TJL and EXPO in our coverage are saved from this tax as the earnings made inside domicile fall below threshold. Although loosely worded, this is the understanding we have arrived at after discussions with accounting bodies and company managements.

Revised EPS for Companies in Coverage

	<i>FY 20/21 PBT Actual (LKR mn)</i>	<i>FY 21/22 PBT- Initial Estimate (LKR mn)</i>	<i>FY 21/22 - Tax Estimate (LKR Mn)</i>	<i>FY 21/22 EPS - Revised Estimate (LKR)</i>
CTC	25,433	26,143	6,658	104.02
COMB	21,740	28,401	5,575	22.23
HAYL	19,234	24,665	5,649	13.79
RCL	9,860	10,348	3,828	5.88
LWL	4,582	4,715	1,494	11.80
NEST	4,264	4,825	940	72.30
SUN	3,307	4,008	887	3.55
LLUB	3,099	2,897	796	8.75
TILE	2,855	2,925	740	8.24
AEL	2,345	6,349	346	6.02

We expect at least the following 20 to be impacted on FY 2021 taxable income

	FY 20/21 PBT Actual (LKR mn)	25% tax charge	Market Capitalization	P/E
1 Hatton National Bank	22,049	5,512	84,306	4.9
2 Valibell One	19,036	4,759	70,727	8.6
3 Sampath Bank	18,070	4,517	63,398	4.9
4 Dialog Axiata	17,821	4,455	91,027	5.7
5 Melstacorp PLC	12,642	3,161	67,476	10.9
6 Disteleries Lanka	11,934	2,984	81,420	11.3
7 John Keells Holdings	11,383	2,846	197,106	19.5
8 LB Finance	10,299	2,575	35,460	1.8
9 National Development Bank	9,235	2,309	26,820	2.8
10 LOLC Finance	8,158	2,040	130,200	19.2
11 Dipped Products	7,676	1,919	29,153	5.4
12 Nations Trust Bank	7,325	1,831	16,769	2.8
13 People Leasing	7,226	1,807	19,832	4.2
14 Seylan Bank	5,581	1,395	27,401	6.1
15 DFCC Bank	5,389	1,347	20,033	4.9
16 Cargills	4,855	1,214	57,977	15.2
17 Commercial Leasing and Finance	4,820	1,205	466,211	115.7
18 Ceylon Theatres	4,721	1,180	35,448	13.3
19 Watawala Platations	2,707	677	16,590	6.4
20 Lanka Indian Oil	2,565	641	13,365	6.7

Sector Analysis of the Impact on Budget Proposal

Industry	Proposal	Impact
Tourism	<p>To Promote and link the country to the wellness tourism industry which is valued at USD700bn.</p> <p>Promote different forms of tourism events like exhibitions conferences and designation tourism to benefit the industry.</p> <p>A trade surplus is expected amounting to USD1.0bn from tourism, ports, and IT export services which will be increased to USD8.0bn by FY27.</p>	<p>These initiatives coupled with the ease in travel restrictions are likely to induce foreign inflows into the country and aid the revival of the hospitality and leisure sectors as well.</p>
Manufacturing	<p>To focus on building an export oriented economy by manufacturing products aimed at local and foreign markets including the re-export of products after value additions have been made.</p> <p>To allocate LKR5.0bn to establish a new investment zone.</p>	<p>Likely to enhance production as the infrastructure will be provided. Further, we may see more dollarized revenue coming in to ease forex.</p>
Automobile	<p>Impose fees on vehicle modification, alteration and refurbishment.</p> <p>Fees on vehicles meeting with accidents with the opportunity to reimburse this fee from Insurance companies.</p>	<p>May reduce the claims made through insurance providers. However, does not address the losses faced by the vehicle imports.</p>
Consumer Durables and Apparel	<p>Easing the obstacles faced in purchasing raw materials for the production of electrical and electronic appliances targeting international markets.</p> <p>To promote local manufacturing of electric and electronic appliances using renewable energy and Investment Zones.</p>	<p>Improving the quality of the final export oriented products which in turn would increase future foreign inflows.</p>
Telecommunication	<p>Cut down the telephone expenses of government institutions by 25%.</p> <p>Propose to install a country wide Telecommunication network expeditiously covering all 10,155 schools in the country using Fibre Optic technology.</p>	<p>This would impact on SLTL top line as they have most exposure to Govt institutions</p> <p>Favorable initiation for telecommunication companies like SLTL, DIAL.</p>
Construction & Engineering	<p>Establishment of techno-parks.</p> <p>Obtain investments through public-private partnerships and local and international sources to implement mixed development projects comprising of shopping malls, financial services, hotels, office facilities, cinema halls, entertainment centres, apartments etc.</p> <p>Provide required lands and tax concessions to encourage investors to establish an international school and a hospital in every district.</p> <p>Establishing new investment zones and for which LKR 5 Bn will be allocated.</p> <p>Action will be taken targeting to provide 3,314,500 new water supply connections around the country.</p> <p>It is expected to complete the National Road Development programme within the next three (03) years.</p> <p>Colombo Port Access Elevated Expressway, New Kelani Bridge - Athurugiriya Elevated Expressway, Central Expressway, Kurunegala – Dambulla Expressway, Ruwanpura Expressway, Colombo – Moratuwa Marine Drive and the Fly Overs in the city of Colombo will be completed in the medium term of 2022-2024.</p> <p>An extra LKR 2 Bn is allocated for urban housing and an additional LKR 5 Bn is allocated for the development of rural housing. It has also been planned to complete the construction of condominiums that are already under construction in Colombo and its suburbs by 2024.</p> <p>Focusing on urban development programmes including integrated road and transport network, comfortable housing and eco-friendly urban forests.</p>	<p>The infrastructure development programs will help developers like AEL.</p>

Real Estate	Obtain investments through public-private partnerships and local and international sources to implement mixed development projects comprising of shopping malls, financial services, hotels, office facilities, cinema halls, entertainment centres, apartments, etc.	AEL directly. TKYO, cable and tile companies indirectly
Power	Government Institutions are encouraged the shift to electricity generated through solar power. Investment opportunities in energy sector have been opened for private sector. In order to fulfil 70% of the aggregate electricity demand through renewable energy by 2030. Add approximately 2,000 Mw to the National Grid within the next three (03) years with the support of the private sector by generating electricity from Renewable Power Plants of Uma Oya, Pooneryn, Siyambalanduwa, Mannar, Boardland, Moragolla and Seethawaka.	SPEN will get the first mover advantage. Also, other power companies too will get opportunities to expand their existing renewable energy plants.
Healthcare	Encourage private sector for pharmaceutical production while maintaining stable prices. Expansion of business focus of SL insurance corporation to move into untouched segments.	In-house manufacturing of molecules could save the currency volatility and price ceiling concerns of importing Higher insurance penetration will help the healthcare sector
Food, Beverage & Tobacco	Tax on cigarettes.	CTC has historically sneaked a price rise to its taxation bringing its resultant TR higher. We could expect it to continue.
Plantation Agri/ Livestock/Diary	Restriction on importing rubber based products & promote investments in production of rubber related products. Actions taken to review issues, requirements & deficiencies in production. LKR 1bn is allocated for further investment in the livestock segment.	Rubber manufacturers will have more pricing power locally. The availability of such agri based commodities would lower the pressure on prices due to temporary shortages. Considered positive to the industry. Could result in better breeding stock and capital constraints for livestock players

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