

# Budget 2023:

## Additional Company Tax on Commercial Banks

The Papua New Guinea 2023 National Budget was presented by the Treasurer, Hon. Ian Ling Stuckey, MP on 29 November 2022.

One of the budget measures that has engendered most discussion is the introduction of Additional Company Tax applicable to Commercial Banks in Papua New Guinea.

It is our understanding that the new 45% tax rate, rather than the standard 30% company tax rate, will be applied to earnings from commercial banking operations in PNG from 1 January 2023.

We provide some high level analysis to assist investors in understanding the impact of these changes on the banking sector generally and KSL and BSP in particular as these companies are listed on PNGX.

- Currently there are four fully licensed commercial banks in PNG:

1. BSP Financial Group
2. Kina Bank
3. Westpac Banking Corporation PNG
4. ANZ Bank PNG.



- 45% Company Tax Rate will apply to profits from PNG commercial banking operations (assuming other activities are carried out in separate corporate entities).
- K190 million Dominant Industry Player Levy (*DIPL*) which would otherwise have applied to BSP Financial Group has been repealed.
- BSP and the State will continue their legal action in relation to the constitutionality and application of the DIPL levied during the 2022 financial year and already paid by BSP. This has no impact beyond FY2022.
- BSP and KSL are listed on PNGX and as such it is important for investors in PNG to consider the impact of these changes on the post-tax earnings and consequently cash flows available for distribution by these companies.
- JMP Securities remains committed to supporting PNG investors with timely and relevant analysis and information. As always, our analysis is general in nature and does not represent investment advice or recommendations.

# State of Play

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**Papua New Guinea Commercial Banking Operations > 82% of total Group Net Profit Before Taxation in FY2021 – the latest full financial year (K1.25 bn of K1.53 bn)**



**Papua New Guinea Commercial Banking Operations > 81% of total Group Net Profit Before Taxation in FY2021 (K86.2 million of K106.0 million)**

# What we learnt: Differentiated Impact

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- In the short term the Additional Company Tax is likely to have a **greater negative impact on Kina Bank than on BSP.**
- Impact of 45% tax rate on commercial banking operations to BSP is **mitigated by the repeal of the Dominant Industry Player Levy** of K190 million.
- KSL (Kina Bank) was not subject to the levy and as such the increase in the applicable company tax rate from 30% to 45% results in an **immediate increase in income tax expense from 2023 of 50%.**
- As earnings grow over time, the progressive nature of the increased tax rate (45% vs. 30%), will result in **increases in the net taxation on the PNG banking operations of BSP in excess of the current 30% + DIPL.** However, given investors have already factored in the impact of the levy on BSP, the immediate rerating of the stock is likely to be less aggressive than for KSL.
- In addition, there is a **real possibility that BSP will be successful in its legal challenge to the 2022 DIPL.** This would potentially release K190 million (~40 toea per share) which **would likely be distributed to shareholders** as a special dividend. The timing and final outcome of any decision in respect of this issue is uncertain.

# Short Term: Immediate Net Cost to KSL

Based on a simplified arithmetic evaluation of the impact of the tax changes to BSP and KSL based on FY2021 Net Profits Before Tax from PNG banking operations (in effect assuming no increase in earnings when the Additional Company Tax provisions become applicable in 2023), we observed the following changes to notional Tax Payable and Net Profit After:



2021 PNG Bank Net Profit Before Tax:	K1,251 m
- 30% Tax	K375.3 m
- 45% Tax	K563.0 m
- 30% Tax + K190 m Levy	K565.3 m
Tax Rate Delta	(K2.3 m)

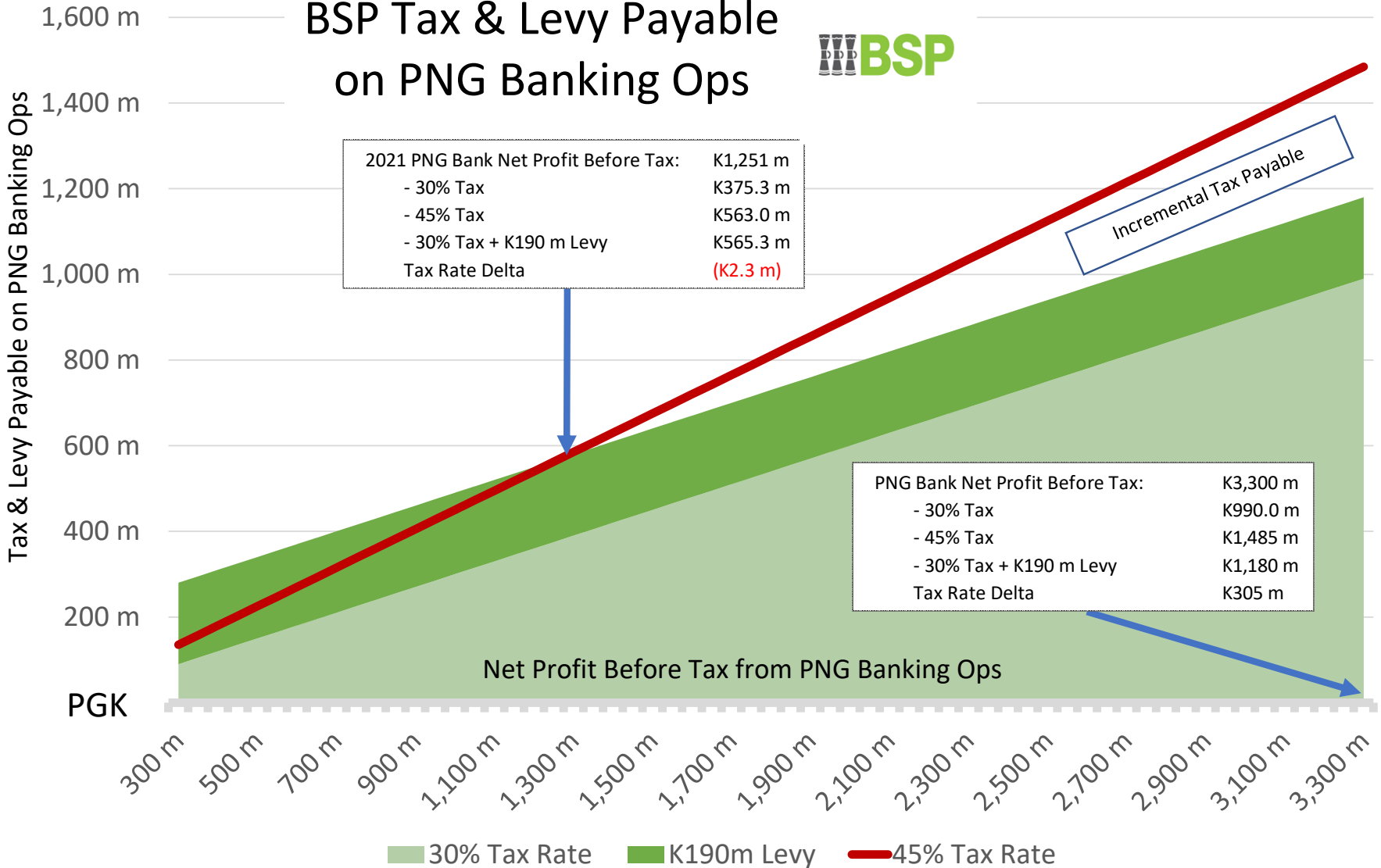


2021 Kina Bank Net Profit Before Tax =	K86.2 m
- 30% Tax	K25.8 m
- 45% Tax	K38.8 m
Tax Rate Delta	K13.0 m

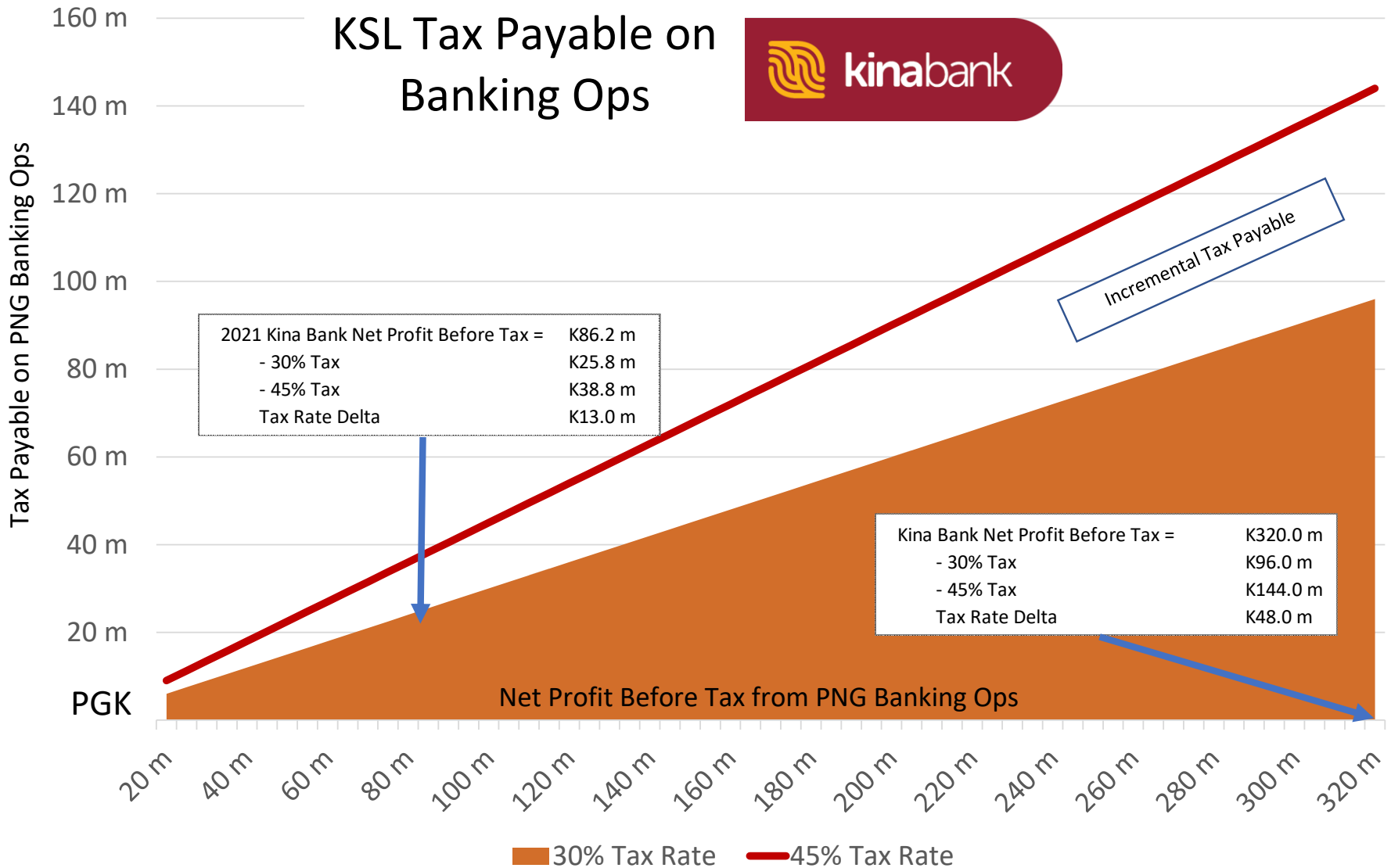
The above analysis applies the 2023 National Budget tax framework to the FY2021 reported Net Profit Before Tax from PNG Commercial Banking Operations in PBNG by BSP and KSL. FY2021 is the most recent audited full-year results disclosed by both BSP and KSL. It is for illustration purposes only.

# Impact on BSP of Additional Company Tax

## BSP Tax & Levy Payable on PNG Banking Ops



# Impact on KSL of Additional Company Tax



# Medium Term: Net Cost to All Banks

Assuming continuing growth in profitability for both BSP and KSL in the medium and long term, the Additional Company Tax provisions in the 2023 National Budget will have negative impact on post-tax profits and cash flows available to shareholders in both companies:



## Assumed Notional Future Net Profit Before Tax

from PNG Commercial Banking Ops	K3,300 m
- 30% Tax	K990.0 m
- 45% Tax	K1,485 m
- 30% Tax + K190 m Levy	K1,180 m
Tax Rate Delta	K305 m



## Assumed Notional Future Net Profit Before Tax

from PNG Commercial Banking Ops	K320.0 m
- 30% Tax	K96.0 m
- 45% Tax	K144.0 m
Tax Rate Delta	K48.0 m

The above analysis illustrates the impact of the changes to company tax laws at an undetermined time in the future. The example is for illustration purposes only.

# Dataset: 2021 BSP Profitability by Segment

<i>Analysis by segment</i>	PNG Bank 2021 PGK'MM	Offshore Bank 2021 PGK'MM	Bank Total 2021 PGK'MM	Non-Bank Entities 2021 PGK'MM	Inter segments 2021 PGK'MM	Total 2021 PGK'MM
<b>Income</b>						
Net interest income	1,295.0	272.3	1,567.3	32.5	1.1	1,600.9
Other income	574.8	201.1	775.9	30.0	(69.9)	736.1
Net insurance income	-	-	-	36.9	(1.8)	35.1
<b>Total operating income</b>	<b>1,869.8</b>	<b>473.5</b>	<b>2,343.2</b>	<b>99.4</b>	<b>(70.6)</b>	<b>2,372.0</b>
Operating expenses	(661.4)	(210.2)	(871.7)	(20.0)	2.8	(888.8)
Impairment expenses	42.9	4.6	47.5	(4.9)	-	42.7
<b>Profit before income tax</b>	<b>1,251.2</b>	<b>267.9</b>	<b>1,519.1</b>	<b>74.5</b>	<b>(67.8)</b>	<b>1,525.9</b>
Income tax	(372.5)	(63.6)	(436.2)	(14.5)	-	(450.6)
<b>Net profit after income tax</b>	<b>878.7</b>	<b>204.3</b>	<b>1,083.0</b>	<b>60.1</b>	<b>(67.8)</b>	<b>1,075.2</b>
Assets	21,191.0	8,853.2	30,044.2	1,991.6	(1,589.5)	30,446.3
Liabilities	(18,427.1)	(7,693.7)	(26,120.8)	(1,474.1)	943.6	(26,651.3)
<b>Net assets</b>	<b>2,763.9</b>	<b>1,159.5</b>	<b>3,923.4</b>	<b>517.4</b>	<b>(645.9)</b>	<b>3,795.0</b>
<i>Effective Tax Rate</i>	29.77%	23.75%	28.71%	19.41%		29.53%

We have assumed that the Additional Company Tax measures in the 2023 National Budget are applied to the PNG Bank operations of BSP only. We have used the 2021 reported segment results as a basis for our analysis. This is for illustrative purposes only. The Additional Company Tax measures will only be applied against FY2023 earnings from the PNG Bank segment. We make no forecast of these earnings. It is important to note that Tax Paid does not always equal Income Tax Expense in the Income Statement. Our analysis is aimed at providing a sense of the order-of-magnitude of the impact only.



# Dataset: 2021 KSL Profitability by Segment

<i>Analysis by segment</i>	Banking & Finance 2021	Wealth Mgmt 2021	Total 2021
	PGK 'MM		
Interest income	206.93	0.00	206.94
Interest expense	(29.62)	-	(29.62)
Foreign exchange income	66.32	(0.68)	65.63
Fee and commission income	58.39	30.95	89.34
Other Income	0.84	1.25	2.08
<b>Total External Income</b>	<b>302.85</b>	<b>31.51</b>	<b>334.36</b>
Other Operational Expenses	(177.43)	(8.00)	(185.43)
Provision for Impairment	(6.67)	0.15	(6.52)
Depreciation and Amortisation	(36.40)	-	(36.40)
<b>Total External Expenses</b>	<b>(220.49)</b>	<b>(7.86)</b>	<b>(228.35)</b>
<b>Profit Before Inter-segment Income</b>	<b>82.36</b>	<b>23.66</b>	<b>106.02</b>
Inter Segment Income	3.80	-	3.80
Inter Segment Expenses	-	(3.80)	(3.80)
<b>Profit before tax</b>	<b>86.16</b>	<b>19.86</b>	<b>106.02</b>
Income tax expense	(29.63)	(5.57)	(35.21)
<b>Net Profit After Tax</b>	<b>56.52</b>	<b>14.29</b>	<b>70.81</b>
Total Assets Employed	3,706.50	79.15	3,785.66
Total Liabilities	(3,206.69)	(2.35)	(3,209.04)
<b>Net Assets</b>	<b>499.82</b>	<b>76.81</b>	<b>576.62</b>
<i>Effective Tax Rate</i>	<i>34.40%</i>	<i>28.06%</i>	<i>33.21%</i>

KSL's commercial banking operations are currently carried on exclusively in PNG.

The 2021 Financial Year is the latest year for which full data is available.

We have provided analysis based on the hypothetical impact of the 2023 budget changes on the reported figures from 2021.

This is for illustrative purposes only. The Additional Company Tax measures will only be applied to FY2023 earnings.

Net Profit Before Tax from Banking & Finance Operations (which we assume are covered by the Additional Company Tax provisions in the 2023 National Budget

## REMEMBER:

Our examples are for illustration purposes only.

Past performance is no guarantee of future performance.

Always seek advice from your financial advisor before making investment decisions.

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