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Promissory notes to the rescue

The textile sector in Pakistan has suffered considerable liquidity constraints in recent years due to delay in processing of pending refunds. Failure to clear refunds in a timely manner resulted in the amount pending rising up to at least Rs100 billion by conservative estimates. (Read: “Textile refunds- another circular debt?” published on January 09, 2019)

But the sector’s woes finally look to be resolved. In his speech regarding the Finance Supplementary (2nd Amendment) Bill, 2019 more popularly known as the mini-budget, the Finance Minister announced the issuance of promissory notes to clear the huge quantum of pending sales tax refunds.

The first batch of promissory notes is to be issued by February 14, 2019 and the Federal Board of Revenue has reportedly expedited issuance of refund payment orders (RPOs) of admissible sales tax refund claims.

Delving into the details, the promissory notes will be issued in a multiple of Rs100,000 and shall have a maturity of three years from the date of issuance. They will also carry a simple profit rate of 10 percent per annum.

The notes can be traded in the secondary markets and can also be taken into account for determining the Statutory Liquidity Reserve of a banking company. They will be accepted as collateral by the banks and will also be transferable by endorsement with the requisite procedure. The issuance will be done by a Note office established by the FBR for the purpose of payment of pending sales tax refunds.

These promissory notes are a good measure in giving the much needed relief to the textile sector as they will be tradable liquid instruments which can be used as collateral and are also transferable. This will allow textile companies utilise these for borrowing purposes and also relieve them of the burden of reliance on short term credit to an extent.

This method of using promissory notes also helps the government which has its own fiscal woes and would have otherwise had to borrow from banks directly to finance the payment of the Rs100 billion plus pending tax refunds for the textile sector. This will help ensure the fiscal deficit does not increase unnecessarily. Although, rumours are abound that the IMF might push for these promissory notes to be included in the fiscal deficit.

So what is the impact going to be on textile firms specifically? According to a research note by Ali Shah of Alfalah CLSA Securities, the major beneficiaries of the move will include Crescent Textile Mills Limited (CRTM), Kohinoor Mills Limited (KML), Masood Textile Mills Limited (MSOT), Colony Textile Mills Limited (CTM) and Hira Textile Mills Limited (HIRAT) due to their higher refunds outstanding relative to their market capitalisation.

Of course all export oriented firms are set to benefit from the move but certainly some will get more relief due to quantum of stuck refunds. The ball is now in the FBR’s court to implement the issuance of the promissory notes in a timely manner.