25 February 2015

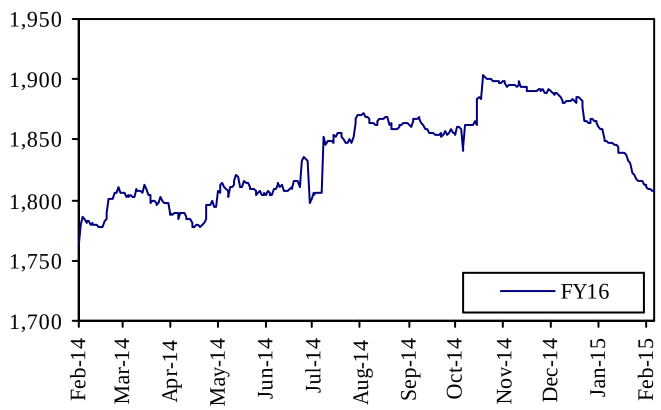
BUDGET 2015-16

TIME FOR ACTION

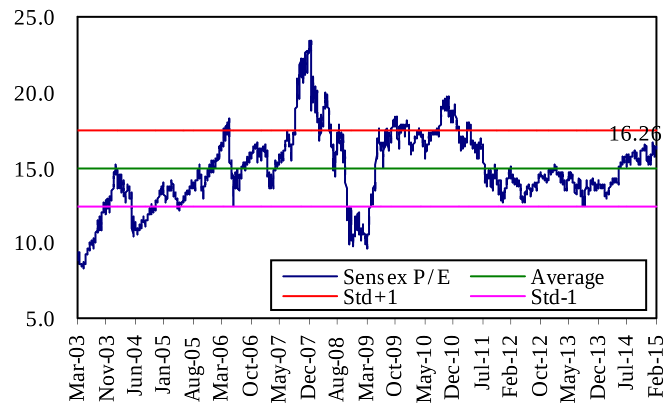
Since the time Mr. Narendra Modi assumed office, markets have moved up significantly on expectations of a Resurgent India. Expected dismantling of supply-side bottlenecks will enable the Indian economy to move towards its potential growth rate of 7%+. Mr. Modi has shown progress in terms of building the right team to deliver, moving ahead on infra areas like coal, working on India's foreign relations and on facilitating FDI, providing a roadmap for increased indigenisation in defence, etc. The RBI, after getting convinced that inflation is well within its comfort zone, has initiated the rate reduction cycle.

In terms of activity on the ground and boosting up of growth numbers, however, nothing much has happened. Expectations that corporate performance would improve from 2H have been largely belied. 3Q results have underperformed expectations and the outlook for 4Q is nothing rosier. Consensus earnings estimates have been steadily coming off while markets continue to rise.

Sensex Consensus EPS



Sensex P/E (1 yr fwd)



It is time that the government spelt out and implemented concrete measures to provide an immediate boost to the economy. Quick progress on the Land Bill and on Labour reforms is required. Ways of reducing layers of bureaucracy and the requisite time for approval and implementation of projects need to be spelt out. Investments in roads and infrastructure have to go up significantly. Employment generation measures for labour intensive sectors like textiles, etc. need to be delivered. Given the current state of the economy, the market also expects tax and other incentives that provide a boost to the entire corporate sector as well as to individual purchasing power.

The crash in crude oil prices has significantly reduced the subsidy burden and freed up resources for investment. The markets will look for immediate and judicious deployment of these resources now, towards infrastructure and social areas. At the same time, doing away with Schemes that have not proved effective and redeploying resources will help. Increasing share of states in overall revenues can provide more autonomy and flexibility of implementation.

Markets expect the Budget to deliver concrete measures to provide an immediate boost to the growth numbers. Anything short of this could cause the markets to give away.

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Key expectations from Budget 2015-16

The first full budget of the NDA government is expected to lay out the government's economic vision for the medium term. The economic objective of the government and the broad path it sets out will be extremely important from the point of view of understanding their vision and will be keenly watched by investors.

We think the budget will be watched for clarity on fiscal consolidation; boost to "Make in India" and thrust to manufacturing and infrastructure with special emphasis to clean energy and other growth oriented reforms. Since "Sabka saath sabka vikaas" is the fundamental tenet of the government, we expect social and rural thrust to continue without any major dilution.

We think investors will keenly look for some bold steps taken in the budget. In case these steps fail to meet market expectations, markets could take a severe beating in the short run.

Key steps likely in budget for Acche Din

Sharp jump in plan expenditure: We think that the budget will provide for a sharp jump – around 20% in plan expenditure over the revised estimate for FY15 (which is likely to be substantially lower than the BE. We expect the RE for FY15 at Rs 5.2 trillion against Rs 5.75 trillion budgeted). Also, we expect the capital expenditure to rise within plan expenditure.

Meaningful reduction in subsidies: We expect next fiscal's subsidy burden to reduce sharply from 2.1% of GDP in the current year to 1.5% of GDP for FY16. This entails absolute reduction of subsidy by around Rs 470 bn (mostly due to sharply lower oil subsidy with the assumption that crude stays at an average of US$ 70). Overall subsidy is expected to moderate to Rs 2.1 trillion in FY16 from Rs 2.6 trillion in the current fiscal year.

Outlay for Infrastructure will be increased significantly: The budget is expected to raise spend on roads, rails, irrigation, ports and other infra sectors. We expect the infra spend to rise by around Rs 500 bn to around Rs 2.6 trillion. The rise is likely to take infrastructure spend from 1.5% of GDP, in FY15, to around 1.8% of GDP next fiscal. The major revenue boost to aid infrastructure is likely to come out of savings from subsidy (oil subsidy) and the hike in excise on diesel and petrol (which is likely to yield an incremental Rs 500 bn in FY16).

Incentivizing "Make in India": With the government's policy thrust on "Make in India" we expect some tax benefits to greenfield projects especially in labour intensive industry. This could be in the form of lower MAT (currently 18.5%) or longer tax holidays, etc. Some other bold incentives here could provide an added boost.

Tax reforms: Expect Service tax to be hiked to 13/14% from the present 12%. This is likely because the budget is likely to focus on GST and raising Service/Excise duty will be in sync with getting GST to around the revenue neutral rate of 25%.

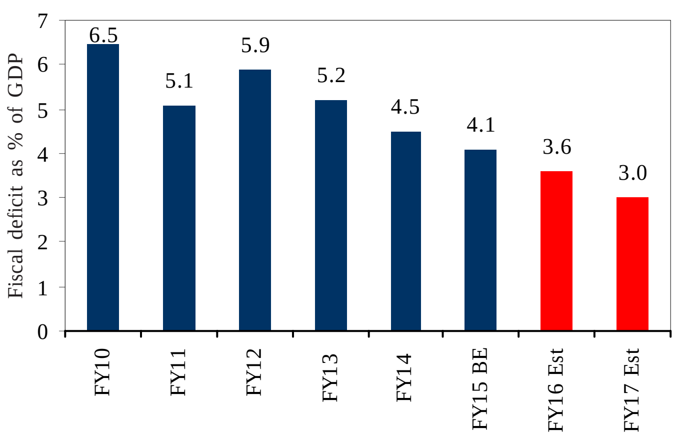
Expect marginal changes, if any, on direct taxation.

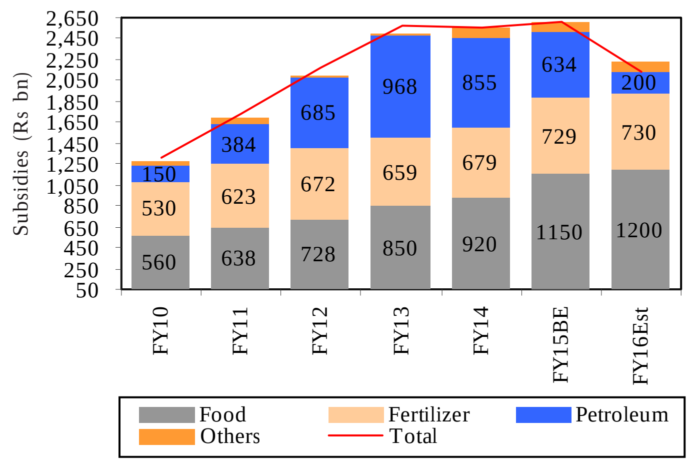
Credible fiscal roadmap

We expect the government to stick to its medium term fiscal objective of 3.6% fiscal deficit in FY16 and 3.0% in FY17. We expect government to meet its 4.1% fiscal deficit target for the current year with plan expenditure cuts.

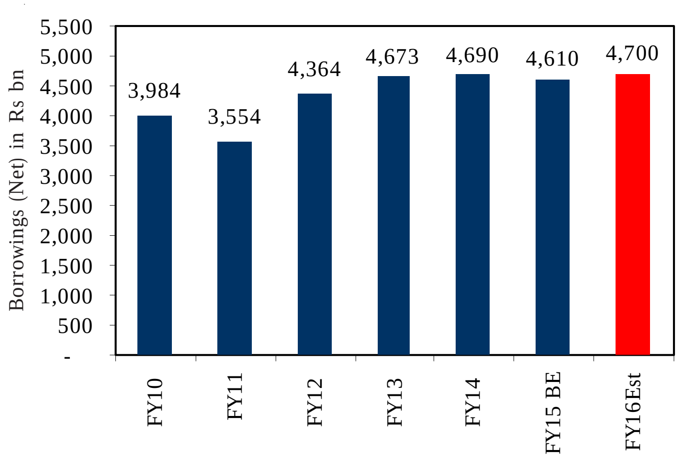
In keeping the fiscal deficit roadmap, the quality of the budget numbers will be the key. If we get meaningful reduction in subsidy, etc. it will be a big boost for markets. On the revenue front, it would make sense to keep direct tax revenues marginally over the nominal growth rate for it to look realistic. Here, the new GDP base will help the government to project a nominal GDP growth of around 13.5-14% (8.0% GDP growth + inflation). This will look realistic in terms of projections.

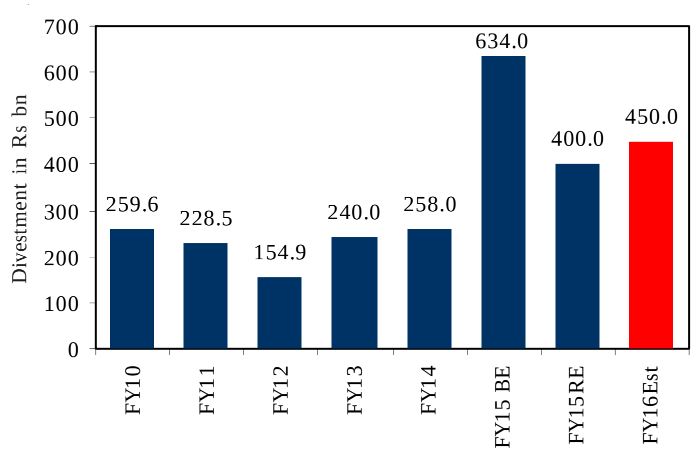
Some Budget graphs





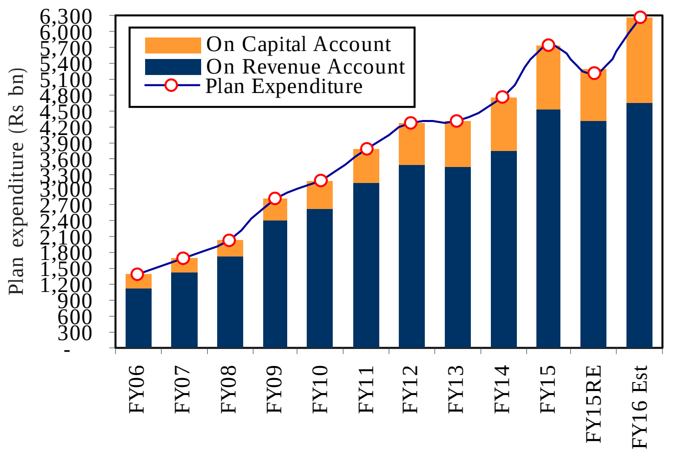
We think medium term fiscal targets will be unchanged.



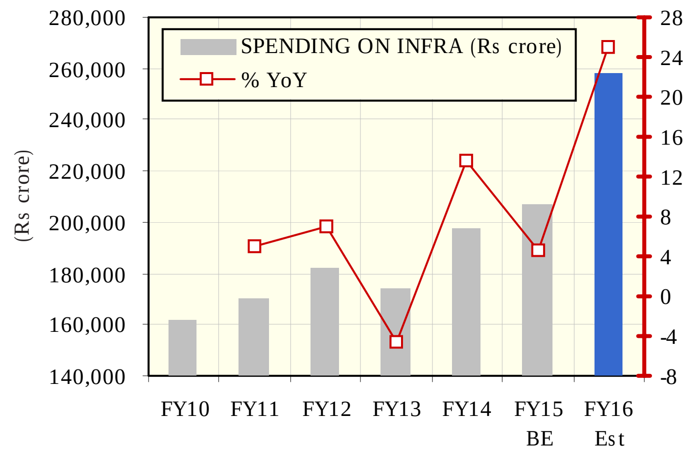


Plan expenditure expected to rise sharply. We expect capital spending, within plan expenditure, to rise by 60% YoY. Overall, infra spend is likely to rise by 25% in FY16 over revised estimate for FY15.

Plan expenditure



Infra spending in Budget



Other key budget expectations

- Boosting investment through innovative ideas; for e.g. infra bonds with bullet payment.
- List of centrally sponsored schemes to be cut and in line with the recommendations of 14th finance commission states to get a larger share of income which will in return transfer central schemes to states.
- Easing tax compliance and introducing some reforms.
- Defer GAAR.
- GST roadmap to be clearly outlined.
- Financial savings boost through increase in 80C limit, etc.
- MAT on SEZ's likely to be reduced.
- Cess for Swach Bharat could be introduced.
- Affordable housing is likely to get special mention and possibly tax incentives, etc.

Sector expectation

Sectors		
Agrochemicals and Seeds	• Gradual steps towards Urea decontrol with a roadmap for upward revision in farmgate prices and narrowing the gap between NBS fertilisers and Urea.	Positive for industry and reduce subsidy outgo for the Government
	• Increase in subsidy for FY16 and its timely payment. In FY15, it was set at Rs 729 bn.	Positive
	• Revision in Urea policy on production beyond cut-off limit.	Positive
	• Excise duty on pesticides be reduced from 12.36% to 8.0% and non-uniform VAT structure on pesticides across states be removed.	Positive for agrochemical companies
	• Rationalise the duty structure of raw materials for manufacture of fertiliser. Currently some raw materials attract higher custom duty than finished fertiliser.	Positive for fertiliser industry
	• Interest subvention scheme for providing short-term crop loans to farmers at 7% interest p.a. to be continued in FY15-16. Additional subvention of 3% be available for farmers who pay on time.	Positive
	• Increase in allocation for irrigation projects or any such project which helps to increase yields.	Positive
	• Increase in allocation for rural schemes.	Positive
Auto	• Roadmap for GST implementation.	Auto sector as a whole is expected to benefit. Will be more beneficial to SUV manufacturers (M&M, Maruti) and organised players in the replacement market
	• Excise Duty Reduction/Rationalisation.	Complete Auto sector will be benefited, if excise duty is reduced
	• Incentives for Electric Vehicles.	Will be positive for M&M (Reva)
	• Extension of investment allowance of 15% for investment above Rs 25 crores (which is expiring by 31st March 2015).	Most of the Auto and Auto ancillary companies
	• Correction of Inverted duty structure between Tyre and Natural Rubber.	All domestic tyre companies.
Aviation	• To declare the civil aviation sector as 'core infrastructure'.	Unlikely
	• Notify ATF as a declared good with uniform 4% sales tax all over India.	Unlikely
	• Abolish the discriminatory 5/20 rule.	Negative for existing players
	• Provide support/relaxation for tier 3-4 airports to expand regional connectivity.	Positive for sector
	• Reduction in airport charges and other related charges e.g. MRO, etc.	Unlikely

Sectors		
Banking	• Given the importance of MSME sector to our GDP, we expect some special incentives to be announced for the sector, which indirectly could aid banks in increasing their scope of lending and contain asset quality.	Likely; Positive
	• Incentives/scheme for housing, especially low cost housing which could drive housing loan demand.	Likely; Positive
	• Comprehensive plan for capital infusion in PSU banks (either for next year or for 3-5 years).	Likely; Positive
	• Tax incentive or break on callable term deposits and reduce lock-in for tax eligible Term deposits from 5 years to 3 years to bring them at par with ELSS schemes.	Positive though not likely
	• Higher tax relief on provisions for bad loans in the books as compared to existing 7.5% under sec 36 (1) (viia) of the IT Act.	Positive though not likely
	• Increase TDS limit of Rs 10,000 on interest paid to depositors.	Positive though not likely
	• Incentive/tax break for infrastructure sector, including other measures such as widening permissible assets for IDFs. We expect special incentives for renewal energy space (solar) to revive the sector and thus generate credit demand/ address asset quality issues.	Likely; Positive
	• Renewed impetus on agri financing/financial inclusion and digital banking for PSBs.	Neutral
	• Higher tax rate for insurance companies from current 12.5% as they are now turning profitable.	Negative
Cement	• Excise duty to remain unchanged.	Neutral
	• The government's focus toward affordable housing, smart city and higher allocation for infrastructure development schemes (like JNNURM, Bharat Nirman and PMGSY) would boost the demand for cement and building products.	
Engineering & Capital Goods	• Increase budgetary allocations for Sub T&D upgrade schemes (IPDS, DUGJY)	Positive for Medium-low voltage T&D equipment suppliers & EPC contractors
	• Renewables incentives - 10 yr tax holidays for wind power, solar parks & equipments	Positive for equipment manufacturers & EPC companies
	• Incentive schemes and interest subvention scheme for capital goods export	Positive for sector
	• Transportation - 1) Increased PPP for railway, metro rail & HSR; 2) increased outlay for rolling stock by IR, 3) acceleration in DFC	Positive for rolling stock & EPC companies
	• Thrust on smart cities (3-4 cities along DMIC) & Manufacturing clusters	Positive for sector
	• Water & irrigation - Increased budgetary allocation for Ganga Action Plan	Positive for VA Tech Wabag, Praj, L&T
	• Gas grid under PPP route	Positive for sector
	• Defence - +20% outlay & incentives for Make in India	Positive for defence equipment manufacturers
	• Continuation of technical upgradation fund (TUFs) with increase in outlay	Positive for LMW
FMCG and Retail	• Increase in excise duty on cigarette of ~10%.	Negative for ITC
	• Increased allocation to MGNREGA and other rural schemes.	Positive for the sector
	• Reduction in customs duty on gold.	Positive for Titan

Sectors		
Food Retail	• Exemption from service tax on lease rentals of commercial properties (Currently 12.36%).	Positive for Jubilant FoodWorks, Westlife Development
Healthcare / Hospitals	• Grant of infrastructure status.	Unlikely
	• Service tax relaxation on treatment like cancer and on health insurance premiums.	Unlikely
	• Increase of exemption limit under section 80D for health insurance.	Positive for sector and would lead to increase in patient volumes in organized sector
	• Increase in Tax holiday from current five year to 10-year time frame under section 80-IB for private healthcare providers in non-metros for minimum of 50- bedded hospitals instead of current 100 beds.	Unlikely
Information Technology	• Clarity on Transfer pricing and roadmap to strengthen Advance Pricing Agreement.	Positive for sector
	• Any reversal / reduction of MAT for SEZ.	
	• Focus on higher education and skill development programmes.	
	• Allocation towards Digital India and E-governance projects.	
	• Clarity on Rs 10,000 cr start-up initiative announced by centre in last budget.	
Infrastructure	• Allowing tax benefits under section 80 IA even for upgradation of existing infrastructure projects.	Positive for maintenance projects
	• Removal of MAT for infrastructure companies / projects.	To improve cash flows for projects
	• Increased allocation under various schemes to augment infrastructure development (like JNNURM, Bharat Nirman, Pradhan Mantri Grameen Sadak Yojna).	To improve project awards and support infrastructure
	• Further relaxation in ECB norms.	To improve long term funding and reduce cost of debt
	• Steps towards creation of debt capital market for funding of infrastructure projects.	To improve long term funding
	• Support services of airport to be termed as infrastructure.	Positive for Airport Developers
	• Allowing issuance of tax free bonds for airport operators.	To help increase funding options
	• Increase in service tax.	Negative for Sector
Internet	• Tax clarifications as E-commerce companies struggle with issues relating to double taxation.	Positive for the sector
	• Clear roadmap for GST implementation.	
	• Allocation towards Digital India and E-governance projects which will lead to increase in internet penetration.	
	• Incentives on FDI in online retail will incentivise investments in e-commerce.	
Logistics	• Logistics sector to be granted industry status.	Positive for the sector
	• Multimodal policy for the domestic market.	
	• Continued privatization of container operation by Indian Railways.	
	• Implementation of GST.	
	• Access to ECB borrowing to fund capital expenditure plans of logistics firms.	
	• 100% FDI for e-commerce companies.	
	• Well-planned policy for e-commerce and online business.	

Sectors		
Media and Entertainment	• Entertainment tax to be subsumed in GST.	Positive for film exhibition, MSO & DTH companies
	• Cut in import duties on STBs/measures to encourage domestic manufacturing of STBs.	Positive for MSO & DTH companies
	• Bringing more services under services (print advertising, film exhibition) under service tax ambit.	Negative for print, film exhibition, but less likely
	• Inclusion of estimated proceeds for Phase III FM auctions could improve visibility.	Positive for FM radio companies (ENIL)
Metals	• Increase in steel import duty from the existing 7.5% to at least 15%. Possibility of Safeguard Duty on steel, to protect the interest of the domestic industry.	Positive for the whole sector
	• Removal of 2.5% import duty on coking coal.	
	• Extending the sunset clause on new power plants by another year.	
	• Differential export duty rates to be levied on low grade iron ore (Goan ore). This would make it economically feasible to restart exporting iron ore given Goan ore cannot be used in India.	Positive for Sesa Sterlite
	• Removal of 5% export duty on pellets.	Positive for JSPL, Godawari Power and other smaller players as the demand-supply gap would be bridged, thus bringing in some stability in pellet pricing
NBFC	• Increase in interest exemption on housing loans from 0.2 mn to 0.3 mn will drive demand for housing and mortgages.	Positive for HFCs
	• "Mission 2022: Housing for All"; thrust on affordable housing and incentives for housing for weaker section to create huge opportunity for housing finance.	Positive for HFCs
	• Compulsory Replacement of Commercial vehicle after 15 years to boost replacement demand.	Positive for CV financiers
	• Any policy initiative on gas price pooling including relaxation of central government taxes, provision for reimbursement of tax cut taken by States will be positive for stranded projects and infra lenders; will ease pressure on asset quality.	Positive for Power financiers
	• Tax relief on provisioning as per RBI guidelines at par with banks.	Positive for NBFCs
	• Long term tax free bonds for infrastructure and affordable housing.	Positive for HFCs and IFCs
	• Allowance of fund raising through ECBs to NBFCs.	Positive for AFCs
Oil and Gas	• Reintroduction of custom duty on crude oil.	Negative for OMCs, but would be passed on
	• Clarity on exploration in mining lease.	Positive for E&P sector, particularly Cairn India
	• Roadmap on shale gas.	Positive for the sector as a whole
Paints	• Reduction in import duties on key raw materials (titanium dioxide).	Positive
	• Clear roadmap and higher allocation for setting up smart cities.	Positive
	• Clear roadmap of incentives for MAKE IN INDIA initiative.	Positive
	• Roadmap to GST implementation.	Positive
	• Increased thrust on infra projects and roads.	Positive for Industrial paints

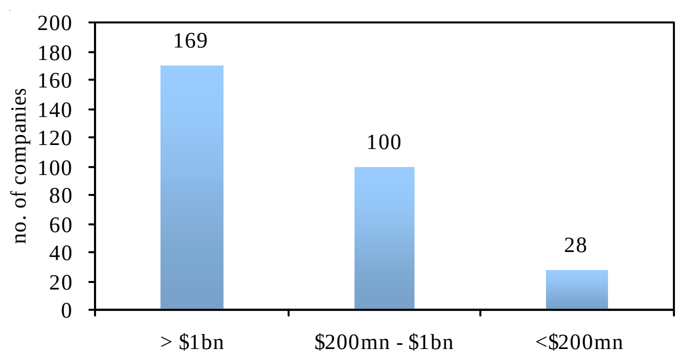
Sectors		
Paper	• Import duty be waived on wood logs (currently – 9.4%) and bamboos (currently – 36.1%) to meet the shortfall for raw material for manufacturing paper.	Positive
Pharma	• Increase incentives for the sector to promote indigenous R&D (higher weighted deduction for R&D spend, widen the scope of expenses which can qualify for weighted deduction of 200%).	Positive for the sector
	• Bring more imported drugs under life-saving category which can qualify it for zero duty status (to bring down local costs).	
	• Allocate higher resources for Healthcare sector (budgetary allocation for Govt. Hospitals/Primary Healthcare centre, Jan Aushadhi stores, Free medicine scheme, higher grant to state – FDA, etc.	
	• Rationalisation or reduction of Service tax, Excise and Customs duty on Healthcare services & life-saving drugs to achieve lower treatment cost for patients.	
	• Full exemption from Excise for all drugs under NLEM – Exempt clinical research and IP services from Service tax.	
Power Utilities	• Policy initiative on renewable to achieve commissioning of 100 GW solar by 2022 i.e. funding, tax benefits, exposure limits of banks.	Positive for renewable addition, equipment suppliers
	• Extension of tax holiday for project commissioning post 31st March 2015.	Positive for developer where capacity commissioning beyond 2015 (RattanIndia Power etc.)
	• Clarity on distribution side of Power Sector by providing extra funding to States to stream line distribution lines.	Positive for cash flow of State Electricity Boards
	• Monetary Incentives reimbursement to State Electricity Boards/DISCOMs on fulfilling Renewable Purchase Obligations and net metering purchase.	Positive for renewable players (Orient Green etc.)
	• Policy initiative on Gas price pooling including relaxation of central government taxes, provision for reimbursement of tax cut taken by States.	Positive for Torrent Power, Reliance Power
	• Reduction in MAT rate from current level of 20%.	Positive for the sector
	• Creation of a power sector fund in the budget to revive stalled and financially stressed power generation projects.	Positive for Adani Power, Tata Power

Sectors		
Real Estate	• Re-introduction of interest subvention scheme for low cost housing.	To improve affordability; would ensure cheaper loans to end-users for affordable housing units
	• Increased tax break on home loan interest under section 24 (b) from the current limit of Rs 200k.	To ensure higher disposable income and lower effective cost of borrowing
	• Increased exemption limit under section 80C; to translate into increased limit for deduction of principal payment.	
	• Raising of tax slabs.	
	• Increased allocation of funds and insight into roadmap towards building of smart cities.	Long term growth driver
	• Thrust on affordable housing.	Increased allocation under various schemes and special incentives for affordable housing
	• Grant of Industry Status and setting up of regulator.	To bring transparency, accountability and cheaper means of finance
	• Infrastructure status to development of integrated townships.	To ensure cheaper means of finance and integrated developments
	• Industry seeking lower Minimum Alternate Tax (MAT) rate for SEZs; from current ~20% to ~10% for both units as well as developers.	To improve competitiveness for both units set up inside SEZs and developers
	• Favourable change in tax treatment for REITs; industry seeking removal of dividend distribution tax and LTCG on disposal of units by the sponsor for the purpose of REITs.	To make REITs more attractive/viable; REIT listing to ensure one more funding avenue for real estate developers
	• Increased service tax rate.	Negative for both housing demand as well as rental assets; if implemented cost of owning a house/leasing an asset to go up
Shipping/ Offshore Services	• Reviving of ports, revamping of infrastructure at many ports like Mumbai, Kolkata, etc.	Positive for the sector
	• Creation of dedicated facility for coastal vessel in all major ports and selected minor ports, road and rail linkages and connectivity to ports.	
	• Restructuring of all the major ports into corporate entities.	
	• Rapid development of coastal shipping and inland water transport.	
	• Execution and commissioning of the Sagar Mala project.	
Tea	• Access to easy financing with interest subsidy @5% on the applicable rate of interest be provided on funds borrowed by tea companies, earmarked for the activities related to plantations.	Positive for industry

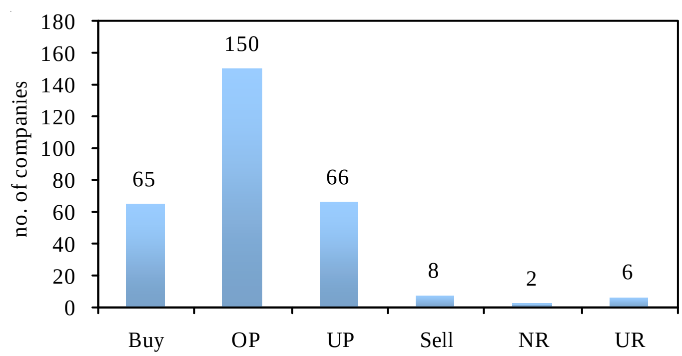
Sectors		
Telecom	• Considering 'Digital India' and 'Make in India' initiatives by the government of India, Telecom sector would be looking some clarity on rules regarding exemption of custom duty on telecom products manufactured in SEZ.	Positive for the sector
	• Industry expects rationalisation of tax rate on margins allowed to distributors.	
	• Industry expects clarity on indirect levies under proposed GST implementation.	
Textiles	• Extension of TUF scheme.	Positive
	• Increase in allocation of TUF scheme.	Positive
	• Re-introduction of interest rates subvention for exports.	Positive for Arvind, KPR Mill, Indo Count, Himatsingka, Vardhman
	• Benefits related to investment in innovation and infrastructure.	Positive
	• Excise duty on man-made fibre to reduce from 12% to 6%.	Positive
Travel and Tourism	• Rationalisation of industry's multiple tax structure.	Unlikely

B&K Universe Profile

By Market Cap (US$ mn)



By Recommendation



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BUY	>+20% (absolute returns)	>+25% (absolute returns)	>+30% (absolute returns)
OUTPERFORMER	+10% to +20%	+15% to +25%	+20% to +30%
UNDERPERFORMER	+10% to -10%	+15% to -15%	+20% to -20%
SELL	<-10% (absolute returns)	<-15% (absolute returns)	<-20% (absolute returns)

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