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India Market Strategy

Budget a positive for medium-term; growth disappointment near-term likely

Equity Strategy

India

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Budget FY16 does enough to meet expectations; Corporate tax cuts plan a +ve

The Union Budget met market and our expectations, in terms of reforms rhetoric, fiscal consolidation and also giving capex a boost. The pushback in fiscal consolidation – a 3% of GDP fiscal deficit in three years rather than two, with a 3.9% of GDP deficit in FY16 is no surprise. Revenue assumptions too seem more credible than in the past. The big surprise for markets was the corporate tax roadmap, which envisages a reduction in corporate tax rate from 30% to 25% over the next 4 years, starting FY17, along with reduced exemptions, and is almost as good as we could have hoped for (see Budget – Capex AND Consolidation). This, along with reduced custom duty on many inputs used in manufacturing, should aid competitiveness and facilitate a fuller inclusion of Indian industry in global production chains – supporting PM Modi's "Make in India" theme. Execution is now key, but the timeframes involved give some confidence that the govt is being realistic.

Capex shouldered by SOEs masks fiscal? RBI to continue monetary easing

The capex boost this time is also being aided materially through SOEs borrowing to spend. If we add this, effective fiscal consolidation is negligible. This might imply some additional pressure on debt markets, though the absolute amount is not large. The RBI may not be worried as this, along with the greater tax devolution to the states, supports a shift towards more efficient borrowing and spending. We believe the fiscal consolidation will be of sufficient quality to allow the RBI to ease policy in April. We expect another 100bps of cuts in repo rate in 2015. The comments in the budget speech and subsequently with regards to an official inflation target of 4% +/-2ppts are consistent with our expectations of 10 year government bond yields of 6.5% in circa 12 months (see 200bps lower interest rates in less than 2 years).

+ve Banks, Oil, trucks (Axis Bank, ONGC, Eicher Motors). –ve Consumption, ITC

Sectors and companies (e.g. banks, telecom, select MNC companies in Pharma/ Consumer) which currently pay peak tax rates can benefit from the proposed reduction in corporate tax rates over the medium term. Significant increase in proposed spend in road sector is positive for truck demand (Eicher Motors, Tata Motors). Removal of sub-limits under foreign ownership limits may help inclusion of some private banks in MSCI indices (Axis, IndusInd). SOE banks should benefit from the further governance reforms announced (SBI). Bankruptcy laws of international standards would facilitate quicker and higher recovery of bad assets – positive for all banks. Fuel subsidy provision of Rs300bn (-50 %YoY) lowers risk of fuel losses to be absorbed by oil SOEs (+ve ONGC). Increase in excise duty on cigarettes by ~15% and on micro-filters by ~25% is negative for ITC. Forecast revenue expenditure growth of only 3% in Budget is lowest in recent decades and coupled with service tax increases may hurt consumption near-term.

Remain directionally +ve but pace of growth recovery may disappoint markets

Fiscal stimulus through tax breaks or subsidies arguably have a more immediate impact on consumption and thus growth (e.g. 2009-10). A stimulus through capex is likely to take more time for its effect to be felt in growth numbers. We still worry about gradual growth recovery disappointing markets, even though markets have ignored these disappointments over the last 2 quarters. Despite this worry, we retain our positive stance given our expectation that the rate cycle will surprise markets and government's policies setting the stage for a robust medium-term growth environment. The focus of the market will now shift towards the Parliament Session for key legislations being passed – key is the land bill. We maintain our Nifty target of 9,600 for end-2015.

Figure 1: Sector wise provisions in Budget FY16

Sector	Budget provision	Sector impact	Company impact
Autos	Significant increase in proposed spend on the road sector from Rs 307.5bn to Rs 856.07 bn (however, severely reliant on NHAI raising addition resources of Rs 427bn in FY16 versus only Rs 30bn in FY15)	Positive impact on commercial vehicle (tippers) demand	Positive for Ashok Leyland, Eicher Motors and Tata Motors
	Raise customs duty on CVs from 10% to 40%	Negligible as no major CV imports in the country	
Banks/NBFCs	FII sub-limit under foreign ownership limits now done away with	Positive – Could facilitate inclusion of a few private banks in MSCI Indices	Axis, IndusInd and Yes Bank
	Bankruptcy laws of international standards in one year and special place for commercial cases in various courts	Eventually facilitate quicker and higher recovery of bad assets	Positive for all Banks
	SOE Banks reforms also picked up pace with creation of an autonomous bank board bureau which would eventually lead to setting up of holding cum investment company structure for banks	Steps towards solving SOE Banks governance issues	Positive for SOE Banks
	NBFCs with asset size of over Rs5bn are now under SARFAESI Act, 2002	While this would have no major impact on numbers for NBFCs, it would reduce time under arbitration by half and make recovery process smoother	No major impact for SHTF, MMFS, Cholamandalam
	Corporate tax rate over the next 4 years would be reduced from 30% to 25%	Effectively, tax rate would be lower by 1.9% yearly for three years and EPS higher by 2-3%	Positive for all Banks
	Capital infusion in SOE Banks planned only at Rs79bn for FY16 (vs Rs70bn infused in FY15).	While the amount is lower, we are not too worried as it highlights intention to either a) reduce stake below 51%, b) making these banks accountable/efficient and c) consolidation of smaller/inefficient banks	Near term negative for smaller and inefficient SOE Banks.
Consumers	Increase in excise duty on cigarettes by ~15%, increase in excise duty on micro-filters by ~25%	Negative	ITC
	Introduction of Gold Monetisation Scheme, Sovereign Gold Bond and development of an Indian Gold Coin	Neutral	Titan
	Excise duty abatement on RSP implemented for condensed milk (30%), iced tea (30%) and waters except mineral water and aerated water (35%)	Positive	Hindustan Unilever, Nestle, Tata Global
	Excise duty on leather footwear of RSP>Rs1,000 reduced from 12% to 6%	Positive for footwear companies	
	Increase in surcharge on corporate tax	Negative	ITC, Asian Paints, United Spirits and Nestle
Fertilisers/Agri	Increase in agricultural credit target by only 6%	Negative	All agri/fertilisers companies
	Increase in micro irrigation support	Positive	
	Urea subsidies flat YoY	Negative, may be implying no planned rationalization of urea prices	
	Increased emphasis on agri infrastructure	Positive	
Infra & Cap goods	Rs22bn increase in Budget support for housing, additional internal and extra-budgetary resources from HUDCO		
	Rs150bn increase in Budget support on the roads, additional internal and extra-budgetary resources from NHAI		
	Rs100bn increase in Budget support for railways		
	Establishment of National Investment and Infrastructure Fund to fund infra finance companies		
	Rs12bn earmarked for DMIC		
	Allocation of Rs2.5trn for defence sector		
	Rationalisation of capital gains regime for sponsers of REITs and INViTs		
	Reduction of custom duty on items used as raw materials, intermediates and components in manufacturing		
	Conversion of existing excise duty on petrol & diesel of Rs4/l into road cess		
	Reduction of tax on royalty & technical fee from 25% to 10%.		

Sector	Budget provision	Sector impact	Company impact
Oil & Gas	FY16 Govt fuel subsidy provision of Rs300bn (-50 %YoY)	Positive; also lowers risk and fuel losses to be absorbed by marketing oil SOEs	ONGC, Oil India; marketing oil SOEs
	Additional custom duty on petrol and diesel imports hiked from Rs2/ltr to Rs6/ltr on effective basis.	Negative	Marketing oil SOEs like HPCL, IOC that import part of petrol/diesel volumes
	Cut in custom duty for petchem raw materials	Negative	Marginally negative for Reliance Industries
Metals & Mining	Intention to turn key ordinances (land, MMDR, Coal Mines) into successful legislation is critical, but already known and in progress		
	Increase in the clean energy cess on coal (from 100 to 200 INR per ton) is a negative, but the largest producer (Coal India) passes this through to customers as per the FSAs		
	Increase in iron and steel import duty (from 10-15%) a potentially helpful measure against cheap imports to benefit domestic steel producers		
Pharma and Healthcare	Increase in tax incentives for health insurance	Positive - Potential benefit for corporate hospital chains	Apollo Hospitals
	Reduction in corporate tax rate to 25% (phased over 4-yrs)	Mixed. Positive for MNC pharma companies (who are at marginal tax rate) though reduction in tax incentives could negatively impact local pharma names over long term	
	Weighted deduction on R&D subjected to certain conditions	Marginal negative. While not material in near term, this could be first step towards enhancing conditions that need to be met to allow tax deduction	
	Reduction in tax rate to 10% on royalty income	Marginal positive	Most Indian pharma co.s
Power Utilities	Increase of Clean Energy Cess from Rs100 to Rs200 per tonne of coal	Negative	
	Electrification of all villages by 2020	Positive	
	Setting up 5 UMPPs of 4GW capacity	Positive	
Real Estate	Sponsors capital gains arising from transfer of shares in SPV in lieu of units in REITs to get tax concessions	Sentiment positive	DLF, Phoenix & Prestige large beneficiaries
	Rental income received directly by the REIT to be tax exempt		
	Distributed income of REIT to be taxed in the hands of unit holders		
	Tax concession for REITs will be effective from 1st April'2016		
Telecom	Revenues of Rs429bn provisioned from telecommunication services including license fees, one-time spectrum charges and spectrum auction	Neutral - We believe govt may be looking at auction of more spectrum (2100MHz, or 700MHz, probably) to achieve this target	All telecom stocks
	Service tax increased to 14% from 12.36%	Neutral - The telecom companies generally pass through the service tax to consumers	All telecom stocks

Source: Budget docs, UBS

Figure 2: Broad measures announced in the Budget

Capex	Budgeted increase in capital expenditure of 25% (average 5% in FY12-15), accompanied by 34% increase in capex expected by public enterprises (average 9% in FY12-15) – combined budget and SOE capex is forecast to increase by 30% (taking it to 4% as a percentage of GDP vs. 3.4% last year).
Corporate tax	Proposed to reduce corporate tax from 30% to 25% over next four years starting FY17 along with rationalisation of tax various exemptions and incentives
GAAR	Deferred GAAR by two years
Service tax	Increased service tax plus education cess from 12.36% to 14% to facilitate transition to GST
Housing	Housing for all by 2022 - 2mn urban and 4mn rural housing units. Increased budget support to urban housing by Rs22bn and support from HUDCO by Rs33bn. Housing for all envisages a total investment of Rs13trn by 2022, including through PPP

Source: Budget docs, UBS

Budget FY 16: Infra and inclusiveness

Edward Teather

Union Budget 2015-16 has probably done enough to meet high expectations. As with last July, this Budget was not presented as a unified framework – but the themes were clear enough: increased infrastructure spending, a simplified tax system plus enhanced financial inclusion and welfare for the lower income segments.

The pushback in fiscal consolidation – a 3% of GDP fiscal deficit in three years rather than two, with a 3.9% of GDP deficit in 2015-16 is no surprise. Likewise the sharp increase in capital spending is in line with expectations. Tax reform – lower rates but reduced exemptions introduced over several years – is almost as good as we could have hoped for. Outside infrastructure, the central government's spending is constrained by transfers to the regions – which should boost the efficiency of government spending.

We believe the fiscal consolidation will be of sufficient quality to allow the RBI to ease policy in April. The comments in the budget speech and subsequently with regards to an official inflation target of 4% +/-2ppts are consistent with our expectations of 10 year government bond yields of 6.5% in circa 12 months.

Execution is now key, but the timeframes involved give some confidence that the government is being realistic.

A new deficit trajectory, but will still be tight

The government has confirmed once again that it will meet the 4.1% of GDP deficit as planned in 2014-15. The deficit trajectory for the next couple of years has been pushed back as we (and the consensus) expected because the macroeconomic pressure to consolidate the fiscal accounts has been reduced. However, the government is still prudently undertaking to bring the fiscal deficit down over time.

Figure 3: New and revised Union Budget deficit trajectories

% GDP	2014-15	2015-16	2016-17	2017-18
Prior budget deficit trajectory under Fiscal Responsibility and Budget Management Act	4.1%	3.6%	3.0%	na
Revised trajectory proposed in Union Budget 2015-16	4.1%	3.9%	3.5%	3.0%

Source: Government of India, UBS

The government's gross tax revenue and asset sale assumptions in 2015-16 are robust. However, while the tax gains may make sense in the context of several revenue raising measures, the hoped for asset sales do look a little high to us. We understand the government intends to make strategic divestments of INR 285bn alongside divestment receipts of INR 410bn. However, we worry the government won't be able to push these deals through quickly enough. Instead we expect the government to find other non-tax revenues as was the case this year and perhaps to squeeze (already low) spending relative to budget. As such, we do think the government will achieve its 2015-16 budget deficit target of 3.9% of GDP, but it will likely be tight and will still rely too much on non-repeatable asset sales.

Figure 4: Key Union Budget projections and UBS forecasts

% GDP	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15 (BE)	2014-15 (RE)	2015-16 (BE)	2015-16 (UBS)
Total receipts	9.7	9.4	10.6	8.7	9.1	9.3	9.8	9.2	8.6	8.5
Revenue receipts	9.6	8.8	10.1	8.3	8.7	8.9	9.2	8.9	8.0	8.1
Tax revenue (net of states)	7.9	7.0	7.3	7.0	7.3	7.2	7.6	7.2	6.5	6.5
Gross tax revenue	10.8	9.6	10.2	9.9	10.2	10.0	10.6	9.9	10.2	10.2
Non-tax revenue	1.7	1.8	2.8	1.4	1.4	1.8	1.7	1.7	1.6	1.6
Recovery of loans + asset sales	0.1	0.5	0.5	0.4	0.4	0.4	0.6	0.3	0.6	0.4
Total Expenditure	15.7	15.8	15.4	14.5	13.9	13.7	13.9	13.3	12.5	12.4
Revenue expenditure	14.1	14.1	13.4	12.7	12.3	12.1	12.2	11.8	10.8	10.8
Interest payments	3.4	3.3	3.0	3.0	3.1	3.3	3.3	3.3	3.2	3.2
Subsidies	2.3	2.2	2.2	2.4	2.5	2.2	2.0	2.1	1.7	1.7
Defence expenditure	2.0	2.2	2.0	1.9	1.8	1.8	1.8	1.8	1.7	1.7
memo: revenue expenditure ex-subs., int., defence	6.4	6.4	6.2	5.4	4.9	4.7	5.1	4.6	4.2	4.1
Capital expenditure	1.6	1.7	2.0	1.8	1.6	1.7	1.8	1.5	1.7	1.7
Key Fiscal ratios										
Gross tax	10.8	9.6	10.2	9.9	10.2	10.0	10.6	9.9	10.2	10.1
Revenue Deficit	4.5	5.2	3.2	4.4	3.6	3.1	2.9	2.9	2.8	2.7
Primary Deficit	2.6	3.2	1.8	2.7	1.8	1.1	0.8	0.8	0.7	0.7
Fiscal Deficit	6.0	6.5	4.8	5.7	4.8	4.4	4.1	4.1	3.9	3.9
State fiscal deficits	2.4	2.9	2.1	1.9	2.3	2.2				

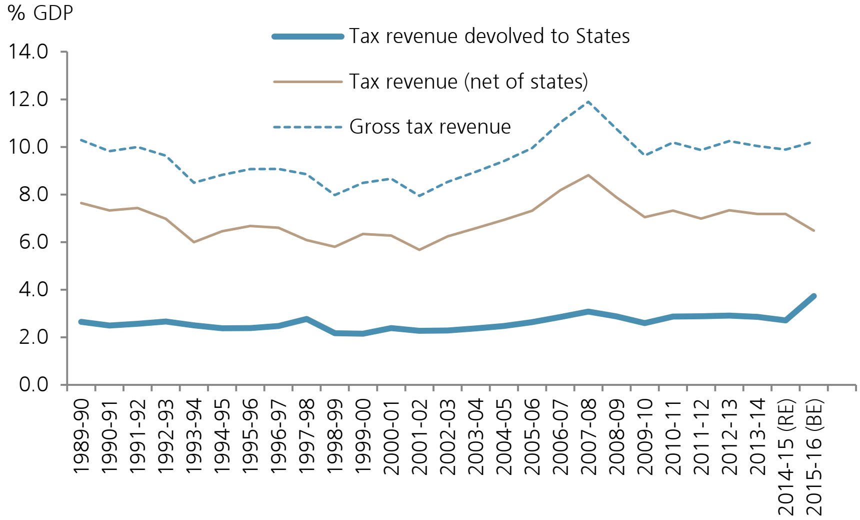
Source: Government of India, UBS estimates BE = Budget estimate, RE = revised estimate

Devolutionary squeeze

The government assumes 8-8.5% yoy real GDP growth in 2015-16 (quite a jump from the projected 7.4% yoy real GDP growth in 2014-15 and 7.5% in Q4 2014) and nominal GDP growth of circa 12%. However, the budgeted 16% yoy growth in gross tax revenues may still be consistent with somewhat lower GDP growth. Tax revenues will be lifted by i) an increase in the service tax rate to 14% from 12.36%; ii) a full year of revenue from recent excise duty hikes; iii) a corporate tax surcharge increase and iv) a higher income bracket tax surcharge.

Despite this, the revenues available for the centre are budgeted to grow just 1% due to a substantial jump in the revenues made available for the States. The unprecedented increase, as Finance Minister Jaitley puts it, is to empower the States with more resources (Figure 5). Devolution of funds to India's States makes sense on efficiency grounds. Local leaders will have a better grasp of local spending needs than central government bureaucrats. The move is also consistent with Prime Minister Modi's rhetoric on empowering State governments and partnership with the same – it may also help the States embrace GST.

Figure 5: States' share of Union tax revenues has been increased

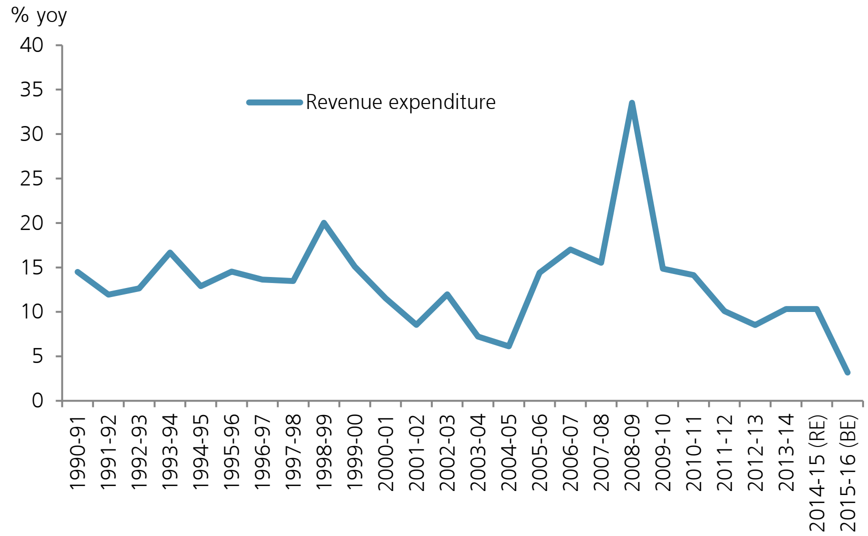


Source: UBS, Indian Government

The upshot of the lower revenue growth for the central government is that spending growth is constrained. Although the pressure here is lifted a little by the high projected asset sales of INR 695bn in 2015-16, that may be a tall order given the 2014-15 divestment target of INR 634bn was undershot – the revised estimate for this fiscal year is INR 314bn.

Budget 2015-16 has revenue expenditure growing 3%, with subsidies down 9%, defence and interest payments up 11% and other spending essentially flat on the year. If realised, that would be the lowest revenue expenditure growth rate in recent decades. Perhaps because of this, the Finance Minister announced that if revenues surprised on the upside, at least some of the additional funds would be directed to social spending rather than to budget deficit reduction.

Figure 6: Revenue expenditure forecast to slow



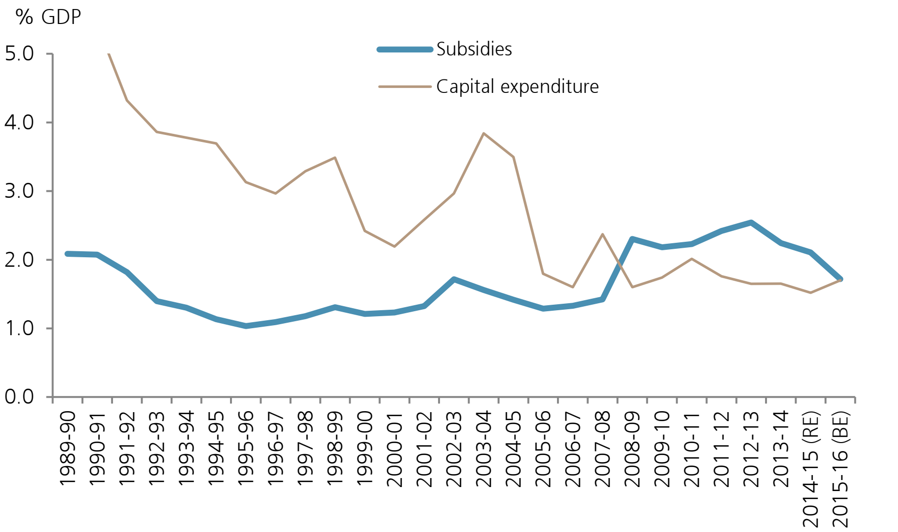
Source: UBS, Government of India

Switch to infrastructure spending from subsidies

The Union Budget devoted considerable space to lifting investment spending.

- Direct capital spending in Budget 2015-16 is to rise by 25% yoy. A marked increase, it is less than the 35% we assumed in our budget preview note. However, this is partly accounted for by increased transfers of funds to the States which may spend on infrastructure directly. Capital expenditure under the Budget is to rise from 1.5% of GDP in 2014-15 to 1.7% in 2015-16. Moreover the Finance Minister hinted at further increases for a 0.5ppts of GDP gain in coming years.
- A National Infrastructure and Investment Fund is to be started with the aim of providing capital to infrastructure finance companies outside the central government which will then add leverage for a larger impact.
- Plug and play infrastructure projects where all the clearances and linkages will be in place before the project is awarded by auction.
- Tax free infrastructure bonds to directly finance road, rail and irrigation projects.
- Corporatisation of ports, so as to improve performance and resource utilisation.
- An increase in planned capital spending by Public Enterprises of 34% or INR 808bn (although stated in budget documents this sits off the central government's balance sheet and could be for commercial reasons as well as government policy).

Figure 7: Lower subsidies to fund higher capital expenditure



Source: UBS, Government of India

The switch in outlays towards infrastructure will be partly funded by reduced expenditures on subsidies. However, the message in the budget was that subsidies would continue in principle (i.e. food, fertiliser, fuel) with the efficiency of delivery enhanced by cash transfer programs. Nonetheless, the potential for efficiency gains is significant as we have highlighted in prior research (click here). In 2015-16 the decline in subsidy outlays is entirely due to a lower fuel subsidy burden.

Figure 8: Union Budget subsidy expenditure projections

INR bn	2012-13	2013-14	2014-15 (BE)	2014-15 (RE)	2015-16 (BE)
Subsidies	2571	2546	2607	2667	2438
(% GDP)	2.5	2.2	2.0	2.1	1.7
-all fertilizer	656	673	730	710	730
-food	850	920	1150	1227	1244
-petroleum products	969	854	634	603	300
-other subsidies	96	99	93	99	164

Source: Government of India BE = Budget estimate, RE = revised estimate

Tax and ease of doing business reform

The tax and business environment proposals included a number of moves that we hoped for in our budget preview document and that we thought would be taken positively by investors because of their implications for productivity.

- **GST:** GST is expected to improve productivity by supporting a common Indian market. A number of tax changes were proposed in Budget 2015-16 as part of the movement towards GST. Union Budget guidance is 1 April 2016 for the introduction of GST.

- **Broaden the tax base:** Corporation tax is to be reduced from 30% to 25% over four years starting in 2016-17. Corporate tax exemptions to be reduced at same time (the current effective rate of corporation tax given exemptions is estimated to be 23%). The aim is for higher tax revenue as the tax system becomes more efficient and the tax base broadens as a result. Bringing sections of the large informal economy into the formal economy as part of this process is a potentially important dynamic for Indian productivity and headline GDP growth. However, execution is key if the result is not merely going to be lower corporate tax receipts. Here Mr Jaitley's decision to implement the reform over four years starting 2016-17 is reassuring, in the sense that it suggests implementation will not be rushed.

- **Customs duties:** Reduced duty on some 22 items so as to reduce manufacturing costs in several sectors. This is not revolutionary but policy in this direction should at the margin help integrate India with global production chains and is consistent with Prime Minister Modi's 'Make in India' theme.

- **Reduce the number of laws and controls:** An expert committee is to prepare draft legislation where multiple prior business permits and permissions can be replaced with a pre-existing regulatory mechanism. This is exactly the sort of 'minimum government, maximum governance' policy steps we want to see.

Financial inclusion and balance sheet repair

The Budget proposed a number of measures to support financial inclusion and an improvement in financial conditions.

- A Micro Units Development Refinance Agency Bank which is to support micro lending to small enterprises.
- The introduction of a comprehensive Bankruptcy Code – something the RBI has been calling for. Should help facilitate repair balance sheet repair, freeing up funds to support new lending and underpinning a bottoming out of the credit cycle.
- Several measures to encourage the monetisation of gold holdings, potentially bringing savings into the conventional financial system.
- Accidental and natural death insurance to be offered at low cost
- A retirement savings scheme

Implications for the RBI – rate cuts still coming

This Budget appears to have taken a number of leaves from the RBI's hymn book. The Finance Minister confirmed agreement with the RBI on a Monetary Policy Framework and that the RBI Act would be amended this year to provide for a Monetary Policy Committee. Additionally, although Mr Jaitley's speech suggested the Framework states an objective of keeping inflation below 6%, post budget comments implied a CPI inflation target of 4% +/-2ppts is in the pipeline. The Budget also proposes to create a Public Debt Management Agency. This should remove pressure on the RBI to manage bond market liquidity as part of its role hitherto as the government's debt issuer and is very much part of the RBI's wish list. The RBI will also welcome progress on a revised Bankruptcy Law as well as the above measures on financial inclusion.

We believe the RBI will be able to assert that the form of this Budget counts as "quality consolidation" – a condition Governor Rajan put on further policy rate cuts. As such we continue to expect gradual policy rate reductions in coming RBI policy meetings, starting with 7 April. We look for another 100bps of RBI policy rate cuts in calendar year 2015. This, and the commitment to CPI inflation of 4% +/- 2ppts should help bring long term rates down consistent with our projection of 6.5% 10-year government bond yields in early 2016. Ultimately the disinflation process should be rupee positive, although we see modest downside risks for the INR against the USD in the context of the latter's anticipated strength in 2015.

Strategy – market implications

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Directionally positive with near-term worries around growth disappointment

Will the overall package help drive markets further up? Overall we think it met market and our expectations, in terms of reforms rhetoric, fiscal consolidation and also giving capex a boost. The only positive surprise from the Budget was the proposed corporate tax cuts over next 4 years. We still worry about gradual growth recovery disappointing markets, even though markets have ignored these disappointments over last 2 quarters. Despite this worry, we retain our positive stance given our expectation that rate cycle will surprise markets (we forecast 10-y at 6.5% early 2016) and government's policies setting the stage for a robust medium-term growth environment.

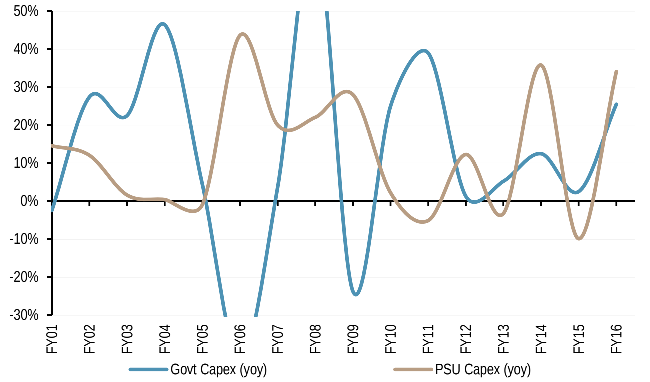
Markets will likely look for catalysts to sustain valuations – government's ability to pass key legislation in Parliament will be the key. Amongst these, the land acquisition bill will be a key test in terms of government being able to use its political capital to push through key reforms. Our view is that they would be able to (see Reforms - the politics and the economics).

We maintain our Nifty 2015-end target of 9600.

Capex boost as expected…shouldered also by SOEs

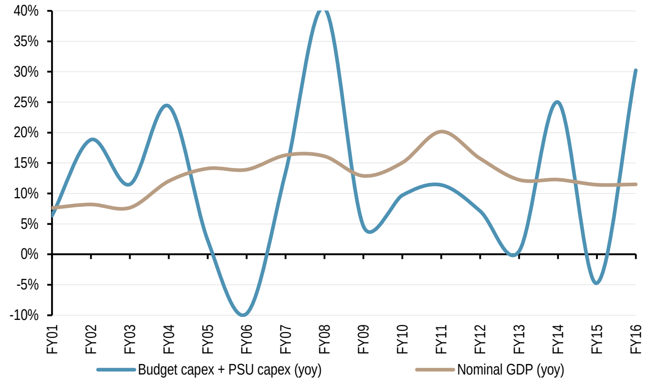
The budgeted increase in capital expenditure is at 25% (average growth in FY12-15 was just 5%). This is further accompanied by an increase in the capex expected by the public enterprises of 35%, vs. 9% average growth over FY12-15, including which the combined budget and PSU capex is expected to increase by 30% (taking it to 4% as a percentage of GDP vs. 3.4% last year). In the context of a possible nominal GDP growth of 11-12% in FY16, these numbers are positive.

Figure 9: Capex growth – budget and PSUs



Source: Budget docs

Figure 10: Combined capex growth vs. nominal GDP



Source: Budget docs

Negative near-term consumption boost – growth recovery gradual and may disappoint

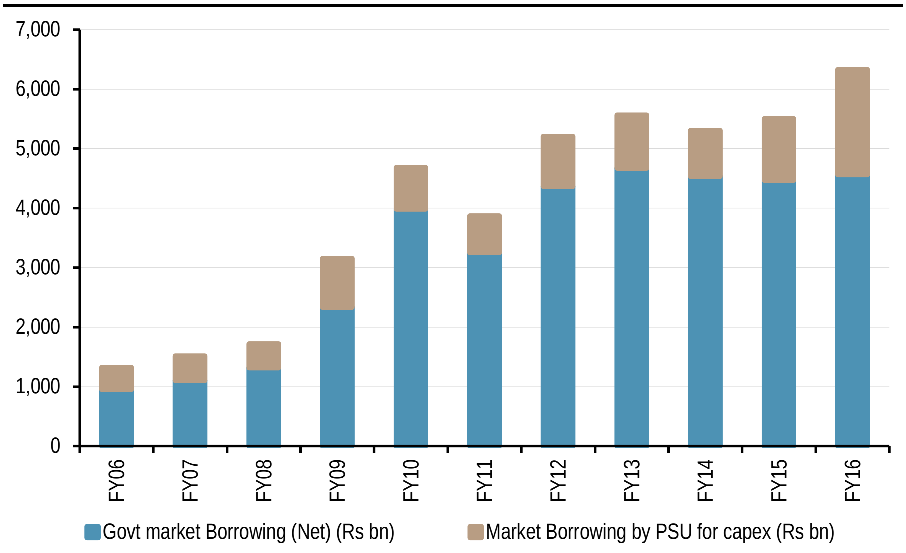
Unlike fiscal stimulus through tax breaks or subsidies, which arguably have a more immediate impact on consumption and thus growth (e.g. 2009-10), a stimulus through capex is likely to take more time for its effect to be felt in growth numbers.

Spending on subsidies is forecast to be down 9%, overall revenue expenditure growth is budgeted at just 3%. Service tax rates have been increased (to 14% form 12.36%) which will marginally be a dampener for consumption. The tax incentives announced on health, pensions etc incentivise savings. We thus reiterate our view that the pace of growth recovery may yet disappoint vs some of the higher expectations on the street.

Fiscal consolidation also aided by SOEs shouldering capex boost

Over 50% of the capex by public enterprises is expected to be funded through domestic market borrowing by these entities vs. 40% in the past. The combined potential borrowing by both the SOEs and the Central Government is thus higher than last year, rather than no increase as suggested by just the budget borrowing number. This might imply some additional pressure on the debt market, though the absolute amount is not very large. It does imply no fiscal consolidation effectively, but rather a shift towards more efficient borrowing and spending. We don't think this would affect RBI's views in any significant manner.

Figure 11: Combined market borrowing still higher



Source: Budget docs

Reduction in corporate tax rate – will have sector/stock implications

The Budget proposes to reduce the Corporate Tax rate from 30% to 25% over the next 4 years, beginning FY17. This step may be viewed as a positive by markets, as we had previously highlighted (see Budget – Capex AND Consolidation), since it provides a roadmap on lowering taxes over the next few years. This would facilitate a fuller inclusion of Indian industry in global production chains and aid competitiveness – supporting "Make in India" initiative.

The potential decline in government revenues from the lower corporate tax rate can be made up with accompanying rationalisation and removal of various kinds of tax exemptions. These exemptions currently result in the effective tax rate being lower (at 23% as highlighted by the Finance Minister) than the headline tax rate.

Sectors and companies (e.g banks, telecom, select MNC companies in Pharma/ Consumers) which currently pay peak tax rates can benefit from this in the medium term. The impact on companies which currently enjoy exemptions will depend on details of planned rationalisation.

Figure 12: Planned decrease in corporate tax rate from 30% to 25% can be offset to an extent by lower exemptions

	Rs bn		% of corporate tax receipts	
	FY14	FY15	FY14	FY15
Total Exemptions	911	984	23.1%	23.1%
Investment alowance/capex/infra devt	488	527	12.4%	12.4%
SEZ	189	204	4.8%	4.8%
R&D	76	82	1.9%	1.9%
Deduction other than infra devt undertakings	67	73	1.7%	1.7%
Backward area	73	79	1.9%	1.9%
Others	18	20	0.5%	0.5%
MAT	334	360	8.5%	8.5%
Net Exemptions	578	624	14.6%	14.6%
Total Corporate tax receipts	3,947	4,261		

Source: Budget docs, UBS

These measures would however, not be applicable in FY16 and the headline tax rate has been kept unchanged for the year (and an increase in the surcharge by 2%).

Budget impact by sectors

Banks and NBFCs

Vishal Goyal, Ishank Kumar

Budget FY16 impact: Positive for Private Banks, NBFCs and efficient SOE Banks, mixed for smaller SOE Banks

- Bankruptcy laws of international standards to be brought out in FY16. In our view this will enable banks to change management control of stressed assets which would eventually aid quicker and higher recovery of bad assets. Special place for commercial cases in various courts is another step towards facilitating faster recovery in our view. Positive for all banks.
- FII and FDI sub-limits within the overall foreign ownership limits now done away with. Positive for Private Banks like Axis Bank, IndusInd bank and Yes Bank. This could lead to these banks being included in MSCI indices as they were constrained on account of FII sub-limit.
- Creation of an autonomous Bank Board Bureau for appointing SOE Banks CEO is another important piece of SOE reforms aimed at improving SOE Bank governance structure. This could eventually lead to setting up of a holding cum investment company for Banks, on the lines of P J Nayak Committee report. Positive for all SOE Banks.
- Capital infusion in SOE Banks planned only at Rs79bn for FY16 vs Rs70bn infused in FY15 (of which around Rs45bn was for three large SOEs). While the amount is lower and is negative in near term, we are not too worried about it as it implies one or some of three things: Either Govt. intends to reduce its stake in SOE Banks to below 51% at some stage; or they are putting pressure on these banks to improve profitability; or consolidation of smaller and inefficient banks could be considered at some stage. Medium term negative for smaller and inefficient SOE Banks
- NBFCs with asset size of Rs5bn+ are now brought under SARFAESI Act, 2002. While this should have no major impact on numbers for NBFCs (SHTF, MMFS, Cholamandalam in our coverage), it should reduce time under arbitration by half and make recovery process smoother.
- Effective Tax Rate for FY16 increased to 34.6% from 33.99% (EPS impact of 1%). Corporate tax rate over the next 4 years would be reduced from 30% to 25%, which would imply effectively tax rate reduction of 1.9% yearly and could increase EPS by 2-3%. We are yet to factor this into our forecasts.

Sector and stock implications

Removal of FII sub-limit would be immediate positive for banks constrained on account of that sub-limit, namely Axis, IndusInd and Yes Bank. Budget also focused on banking reforms like robust Bankruptcy law in a year, separate places for commercial cases in various courts, both of which should help quicker recovery of bad loans. SOE Banks reforms also picked up pace with creation of an autonomous bank board bureau which should eventually lead to setting up of holding cum investment company structure for banks. Though planned SOE capital infusion is lower and is negative in near term, it highlights govt. intention to either a) reduce stake below 51%, b) make these banks accountable/efficient or c) consolidation of smaller/inefficient banks.

Consumers

Sunita Sachdev

Budget FY16 impact: Near-term dampening, long-term positive

- We think that the FY16 budget was positive for consumption from a long-term perspective, though near-term the measures may relatively be dampeners. Re-asserting the intent to implement GST from April'16 should be operationally positive for all consumer companies (subject to the neutralising tax rate agreed upon) except the liquor companies.
- Allocation to Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGA) was increased from Rs.330bn to Rs.347bn, and it could go up by Rs50bn (subject to Government's planned expenditure being met). This is intended to increase rural wages and compensate for the reduction of wages due to the MSPs not increasing materially.
- Weighted average increase in excise duty of ~16% and a particularly steep 25% hike in the micro-filter category. Cut and raw tobacco excise duty increased from Rs60 to Rs70/kg which could hurt affordability of beedis. Earlier the excise duty on chewing tobacco sachets was determined on the capacity of the packaging machine, now this rule has been amended to include the speed and other criteria to help account for unaccountable volume in the market.
- Gold: 1) Introduction of the Gold monetization scheme could be an incremental source of gold for jewellery makers. 2) Customs duty on gold was not reduced, as was earlier expected. 3) Development of a Sovereign Gold bond is expected to reduce gold coin sales subject to consumer acceptability.
- Addition of excise duty abatement on RSP for condensed milk (30%), iced tea (30%) and mineral and aerated waters (35%) is a positive for these categories.
- Reduction in excise duty from 12% to 6% on leather footwear having retail price greater than Rs.1000 per pair.
- Effective Corporate Tax Rate for FY16 has increased to 34.6% from 34%, which could impact FY16E EPS by around 1.5-2% all things remaining equal.

Figure 13: Change in excise abatement

Particulars	Prior	Current
Condensed milk	0%	30%
Iced Tea	0%	30%
Waters excluding mineral waters and aerated waters	0%	35%
Footwear	35%	25%

Source: Budget papers 2015-16

Sector and stock implications

This budget takes few measures which are long-term positive for consumer staples. These include a clear focus on improving social security, putting in place vocational training courses (to improve employability), apart from the healthcare & higher education focus.

We believe that increased tax collections from the chewing tobacco segment can help in reducing the dependence the government has on the cigarette companies.

Accountability and collections from the chewing tobacco segment (~28% share by volume of tobacco consumption) could improve, while increasing the excise duty on raw and cut tobacco from Rs60 to Rs70/kg. Overall making tobacco more expensive augurs well for the improvement in health and potentially reducing medical costs while also helping to prevent young consumers adopting these tobacco formats i.e. Beedis and chewing tobacco.

Oil & Gas

Ashish Jagnani

Budget FY16 impact: Neutral

No major surprises for oil & gas sector with expected duty on crude not levied. The key highlights for the sector are:

- The Govt's FY16 fuel subsidy budgetary provision of Rs300bn is down 50%YoY. No comments were shared on subsidy sharing policy with oil SOEs. We believe this could have following three scenarios:

(1) Govt is factoring higher FY16 oil prices at $70/bbl (vs current range of $58-60/bbl) and likely fuel subsidy of Rs400bn – with Govt absorbing 75% and upstream & marketing oil SOEs sharing 25%. *This we think would be negative for all oil SOEs (upstream and marketing).*

(2) Govt forecasts crude prices near $60/bbl and total fuel subsidy at Rs350bn; bearing 85% of the losses and 15% assigned to oil SOEs – *we think this would be more beneficial for upstream oil SOE and is in line with our subsidy sharing assumptions*.

(3) Govt factors LPG subsidy savings of Rs50bn from direct benefit transfer and lower oil prices of $60/bbl reducing FY16 fuel subsidy to Rs300bn – which would be entirely absorbed by the govt – *we think this would be positive for all oil SOEs*

- Additional Duty of Customs on Petrol & Diesel imports has been increased from Rs2/ltr to Rs6/ltr on effective basis from 1st March'2015. We think this could be marginally negative for marketing oil SOEs – which import part of their petrol/diesel needs given lower refining capacities vs marketing volumes

- Excise duty on petrol and diesel has been reduced by Rs4/ltr; however this has been offset by a similar increase on account of road cess charge. This results in no change on overall petrol & diesel retail prices.

- To encourage investment in chemicals & petrochemical sector, basic custom duty on a few petrochemicals raw materials has been cut in the range of 2.5%-5.0%.

Sector and stock implications

- **Upstream oil SOEs (ONGC, Oil India) to benefit positively** from – lower fuel subsidy in FY16E, higher govt budgetary subsidy provision and improved net-oil realizations

- **Marketing oil SOEs (HPCL, IOC) to be negatively impacted** by – increased additional duty of customs on petrol and diesel imports given their lower refining capacity and higher marketing volumes. Higher govt subsidy and steps to cut LPG losses should however help.

- **Reliance Industries neutral from budget;** Benefits from increased custom duty on petrol/diesel; however being an integrated petrochemical manufacturer will be marginally negatively impacted from cut in custom duty on raw-materials.

Pharma and healthcare

Hemant Bakhru

Budget FY16 impact: Neutral

- Increase in tax incentives for health insurance – limit of deduction enhanced from Rs15,000 to Rs25,000; and additional deduction for expenses on specified diseases and medical treatment of a dependant.
- Reduction in corporate tax rate to 25% over four years beginning FY17 though likely to be accompanied by reduction in some of the exemptions.
- Weighted deduction on R&D subjected to certain conditions 1) approval from Department of Scientific and Industrial Research (DSIR), 2) maintenance of separate books of account and 3) audit of these accounts.
- Reduction in tax rate to 10% (from 25%) on royalty and fees for technical services.

Sector and stock implications

- Boost to health insurance should entail benefit for the corporate hospital chains like Apollo Hospitals.
- Reduction in corporate tax rate will benefit MNC pharma companies though local Indian pharma companies (who mostly pay minimum alternate tax, MAT) are unlikely to see much benefit. For FY16, the tax rate will marginally go up due to hike in surcharge.
- Reduction in tax rate on royalty is marginal positive. Cipla, Glenmark and Lupin have relatively high royalty and fees though small (less than 2%) proportion of PBT.

Real Estate

Ashish Jagnani

Budget FY16 impact: Positive

The Budget provided much required clarity on Real Estate Investment Trusts (REITs) tax-concessions. **The new tax proposals would however be effective from 1st April 2016;** but this much awaited clarity is positive for sentiment in the sector.

We think these revised tax concessions for REITs are quite encouraging and should help developers to monetize their high quality leased assets and provide the sector with much needed capital for growth. This should -1) attract long-term foreign capital, 2) enhance institutional funding, and 3) improve transparency in the real estate sector. The following are some of the key tax changes for REITs which we believe should encourage REIT listings in India over the next 2-3 years.

Figure 14: Comparison of existing and proposed changes in tax concessions for REITs in India

Existing tax regime	Proposed new tax provisions
In cases of Sponsors' when capital gains arise from transfer of assets/shares in SPV holding assets, the capital gains tax was deferred until the time of disposal of these units in REITs received in lieu of transfer of assets/shares in SPV	In case of Sponsors' capital gains arising from transfer of shares in SPV holding assets in lieu of units in REIT would get preferential capital gains benefits (ie 15% for short term capital gains, levy of STT, long-term capital gains being exempt) the same as they he would have got had Sponsors offloaded their SPV holding through an IPO
The rental income directly received by REIT was taxable at REIT level with no tax exemption; however rental income received at SPV level when passed through to the REIT as dividend and interest was exempt; subject to SPV paying dividend distribution tax	The rental income directly received by REIT shall be tax exempt; and rental income received at SPV level when passed through to the REIT as dividend and interest is exempt; subject to SPV paying dividend distribution tax
Dividend income distributed by the trust to the REIT unit holders was exempt	Distributed income of REIT to its unit holder shall be taxed in the hands of the unit holder @ 10% for resident unit holder and applicable tax rates for non-residents
The listed units of the REITs would be liable to STT, Short term capital gains tax @ 15% & exemption from Long term capital gains	No changes made
Capital gains generated by way of disposal of assets by the trust will be taxable in the hands of the trust, but exempt for unit holders if gains are distributed	No changes made

Source: Finance Bill, 2015

Stock implications

DLF, Phoenix Mills, Prestige seem large beneficiaries – We believe their large leased asset portfolio and growing rental income should help them take advantage of these tax concessions for REITs. However, with these tax concessions available from 1st April'2016 – material benefits in the form of 1) lower debt, 2) better valuations for assets could still be 2-years away.

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Source: UBS. Rating allocations are as of 31 December 2014.
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Apollo Hospitals Enterprise	APLH.BO	Neutral	N/A	Rs1,315.90	28 Feb 2015
Ashok Leyland	ASOK.BO	Sell	N/A	Rs69.75	28 Feb 2015
Asian Paints Ltd.	ASPN.BO	Buy	N/A	Rs818.35	28 Feb 2015
Axis Bank	AXBK.BO	Buy	N/A	Rs613.40	28 Feb 2015
Bharat Petroleum Corporation[4, 5]	BPCL.BO	Neutral	N/A	Rs745.45	28 Feb 2015
Cholamandalam Investment & Finance	CHLA.BO	Buy	N/A	Rs568.70	28 Feb 2015
Dish TV India	DSTV.BO	Buy	N/A	Rs84.95	28 Feb 2015
DLF Limited[4]	DLF.BO	Buy	N/A	Rs155.40	28 Feb 2015
Eicher Motors Limited	EICH.BO	Buy	N/A	Rs16,226.60	28 Feb 2015
HDFC Bank[2, 4, 5, 16]	HDBK.BO	Buy	N/A	Rs1,067.85	28 Feb 2015
Hindustan Petroleum	HPCL.BO	Sell	N/A	Rs619.85	28 Feb 2015
Hindustan Unilever	HLL.BO	Neutral	N/A	Rs909.80	28 Feb 2015
Indiabulls Housing Finance[20]	INBF.BO	Buy (CBE)	N/A	Rs623.15	28 Feb 2015
Indian Oil Corp.[5]	IOC.BO	Neutral	N/A	Rs332.05	28 Feb 2015
Infrastructure Development Finance	IDFC.BO	Neutral	N/A	Rs173.30	28 Feb 2015
ITC	ITC.BO	Buy	N/A	Rs361.25	28 Feb 2015
LIC Housing Finance[13]	LICH.BO	Buy	N/A	Rs478.65	28 Feb 2015
Mahindra and Mahindra Financial Services	MMFS.BO	Neutral	N/A	Rs247.55	28 Feb 2015
Maruti Suzuki India	MRTI.BO	Buy	N/A	Rs3,618.25	28 Feb 2015
Nestle India Ltd.[22]	NEST.BO	Buy	N/A	Rs7,001.60	28 Feb 2015
Oil & Natural Gas Corporation[1, 5]	ONGC.BO	Buy	N/A	Rs324.95	28 Feb 2015
Oil India	OILI.BO	Buy	N/A	Rs498.00	28 Feb 2015
Phoenix Mills	PHOE.BO	Buy	N/A	Rs385.85	28 Feb 2015
Power Finance	PWFC.BO	Buy	N/A	Rs293.10	28 Feb 2015
Prestige Estates Projects	PREG.BO	Sell	N/A	Rs285.75	28 Feb 2015
Reliance Industries[5]	RELI.BO	Buy	N/A	Rs866.25	28 Feb 2015
Rural Electrification	RURL.BO	Buy	N/A	Rs330.50	28 Feb 2015
Shriram Transport Finance	SRTR.BO	Buy	N/A	Rs1,216.30	28 Feb 2015
Tata Global Beverages	TAGL.BO	Buy	N/A	Rs155.05	28 Feb 2015
Tata Motors Ltd.[5, 16]	TAMO.BO	Buy	N/A	Rs593.65	28 Feb 2015
Titan Company	TITN.BO	Buy	N/A	Rs420.50	28 Feb 2015
United Spirits Ltd	UNSP.BO	Sell	N/A	Rs3,416.20	28 Feb 2015
YES Bank[2, 4, 13]	YESB.BO	Buy	N/A	Rs862.75	28 Feb 2015

Source: UBS. All prices as of local market close.
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