UNION BUDGET ANALYSIS

FY16 – 17

ALPHA RESEARCH

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INDEX

3 - 4
- Marcroeconomic Analysis
- Focus Areas in Budget, Key Reforms

5
- Fiscal Balance Analysis

6 - 7
- Key Highlights

8
- Debt Market

9 -14
- Equity Market - Sectoral Analysis

15 - 16
- Impact Analysis

MACRO-ECONOMIC BACKDROP:

Economic Survey shows India's economic growth has been robust in 2015-16 as in 2014-15. A quick snapshot is below –

Growth Factors

- Moderation in Inflation.
- Govt. fiscal consolidation measures.
- Expenditure incurred towards building infrastructure.

Challenges

- Worsening global economic landscape.
- Risks arising out of currency re-adjustment in Asia.

Steps to be taken

- Promoting competition
- Investing in health and education
- Focus on agriculture

Prime focus area of Union Budget has been to provide enhanced allocations in the much needed areas:

Focus Area

- Infrastructure
- Social Sector Schemes
- Recapitalization of Banks

Constraints

- Higher outgo on pay and pension post seventh pay comission and OROP

Keeping in mind the key focus areas, following are the important reforms planned:

Reform	Impact
Bankruptcy Bill	Improve credibility & assist development of corporate bond market
Aadhar Bill	Targeted Subsidies
RBI Act	Give statutory basis to monetary policy framework which will bode well for independence of the central bank
Reforms in FDI policy in Insurance and Pension, ARC, Stock Exchanges	Enable higher FDI inflows into these sectors
Amendments in the SARFAESI Act 2002 to enable the sponsor of an ARC to hold up to 100% stake in the ARC and permit non institutional investors to invest in Securitization Receipts.	ARCs will help absorb some pressure that banks face

FISCAL BALANCES:

Receipts

- The govt. has been experiencing slowdown in growth rate of total receipts.
- Growth rate in total receipts has moderated from 11.9% in FY14 to 5.3% in FY15 and 7.3% in FY16(RE) and is expected to increase to 10.8% in FY17(BE).
- Govt. collected higher receipts in FY16 than it budgeted owing to higher tax collection.

Disinvestment

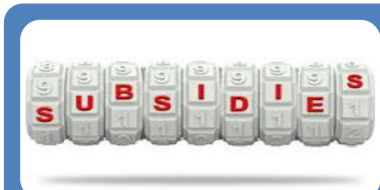
- Target for FY17 is set at Rs. 56,500 cr, of which Rs. 20,500 cr is to be collected through startegic disinvestments.
- In FY16, govt was only able to achieve 36% of the projected target at the start of the year.

Spectrum Sale

- Govt in FY 13, FY14, FY15 could not meet the target to be earned through sale.
- While in FY16, centre earned Rs. 57,384 cr in FY16 (RE) while it was budgeted for Rs. 42,866 cr.
- GoI has projected to earn Rs. 98,995 cr in FY17

Gross Borrowing Program

- Borrowing program is expected to increase by 2.5% in FY17(BE).
- Govt is projected to borrow Rs. 6,00,000 cr.
- However adjusting for repayments net borrowing amount to Rs. 4.25 lakh cr.



Subsidies

- The expenditure on major subsidies is projected to decline from 2% of GDP in FY15 to 1.8% of GDP in FY16(RE) and further to 1.5% of GDP in FY17(BE)
- Interest subsidy is expected to increase by 12.4% FY17(BE). High interest subsidy may be attributed towards govt. initiative to ease loan burden of farmers through interest subvention.

KEY HIGHLIGHTS:

Infrastructure

- Total outlay for infrastructure - Rs. 221,246 cr.
- To approve nearly 10,000 kms of National Highways in 2016-17.
- Amendments of Motor Vehicles Act to open up the road transport sector in the passenger segment.

Agriculture & Rural Sector

- Allocation of Rs. 35,984 crore towards Agriculture and Farmers' welfare.
- A dedicated Long Term Irrigation Fund will be created in NABARD with an initial corpus of about Rs. 20,000 crore.
- The target for agricultural credit in 2016-17 will be an all-time high of Rs.9 lakh crore.
- Rs.38,500 crore allocated for MGNREGS.
- 100% village electrification by 1st May, 2018.
- Rs.9,000 crore allocation for Swachh Bharat Abhiyan.

Foreign Investment

- Upto 49% in insurance and pension under automatic route.
- Upto 100% in asset reconstruction companies under automatic route.
- Enhanced limit of 15% (from 5%) for foreign entities' investment in Indian stock exchanges.
- FPIs investment limit in listed Central public sector enterprises to increase to 49% (from 24%).

Corporate Bond Market

- LIC to set up a fund for providing credit enhancement to infrastructure projects.
- Investment basket for FPIs to include unlisted debt securities and pass through securities.
- RBI to develop a framework for an electronic platform for the repo market.

Financial Sector Reforms

- Allocation of Rs. 25,000 crore towards recapitalisation of Public Sector Banks.
- General Insurance companies owned by the Government to be listed on the stock exchanges.

Tax Reforms

- No change in rate of personal income tax.
- Additional tax at the rate of 10% of gross amount of dividend declared by companies will be payable by the recipients (individuals, HUFs and firms) receiving dividend in excess of Rs. 10 lakh per annum.
- Surcharge to be raised from 12% to 15% on persons, other than companies, firms and cooperative societies having income above Rs. 1crore.
- Securities Transaction tax in case of 'Options' is proposed to be increased from 0.017% to 0.050%.
- Imposing of cess called KrishiKalyan cess @0.5% on all taxable services, levying of infrastructure cess of 1% on small petrol, LPG, CNG cars, 2.5% on diesel cars of certain capacity and 4% on other higher engine capacity vehicles and SUVs, increasing excise duty on various tobacco products from 10% to 15%
- 'Clean Energy Cess' levied on coal, lignite and peat renamed to 'Clean Environment Cess' and rate increased from Rs. 200 per tonne to Rs. 400 per tonne.

Tax Reforms (ctd.)

- Distribution made out of income of SPV to REITs and INVITs having specified shareholding will not be subjected to Dividend Distribution Tax, in respect of dividend distributed after the specified date.
- Any transfer of units in merger or consolidation of plans of a mutual fund scheme shall be exempt from capital gains tax.
- The services provided by mutual fund agent/distributor to a mutual fund or asset management company will now be taxed under forward charge, with effect from 01.04.2016.
- Lower the corporate tax rate for the next financial year for relatively small enterprises i.e companies with turnover not exceeding Rs. 5 crore (in the financial year ending March 2015), to 29% plus surcharge and cess.
- Deduction of additional interest of Rs. 50,000 per annum for loans up to Rs. 35 lakh sanctioned in 2016-17 for first time home buyers, where house cost does not exceed Rs. 50 lakh.

DEBT MARKET:

The budget had provided a boost to the domestic corporate bond markets. Various measures have been announced to deepen and strength the corporate bond markets. These measures will make the bond market an attractive alternate source of funding and investment at a time when the formal banking sector is stressed.

The RBI is to issue guidelines to encourage large borrowers to access a certain portion of their financing needs through the bond markets. Assuming large exposures are Rs.100 crore and above, even if 10% of these are to migrate to the corporate bond markets , the incremental funds raised in the bond markets would be Rs.4 lakh crore over a period of time.

Given lower government borrowing expectations -

- Monetary policy expectation: RBI is expected to cut policy rates by 25-50bps; CPI inflation expected to range between 5-5.5% in FY17
- Net market borrowing lower in FY17BE; bodes well for lower G-sec yields; Net market borrowings at 80% of fiscal deficit as compared to 82% last year
- Introduction of the Monetary Policy Committee: The Finance Bill outlines the setting up of the Monetary Policy Committee with six members – three from RBI, three from the government, with the RBI Governor having the casting vote.

EQUITY MARKET:

Sectoral Impact –

Budget Proposals	Impact on Industry
Auto	
• **Introduction of infrastructure cess a. 1% for small Petrol/LPG/CNG cars; b. 2.5% for small diesel cars; c. 4% for mid-size, large cars and SUVs.** • **1% luxury tax on cars costing Rs. 10 lakh or more.** • **Sum of Rs.38,500 crore allocated for MGNREGA**	• The prices are expected to increase for four-wheeler passenger vehicles and thereby denting a demand to certain extent. Nonetheless, the demand for other passenger vehicles such as two wheeler segment is likely to show an uptick due to further increase in income linked to substantial allocation of funds under MGNREGA.
Auto Ancillaries	
• **Nil custom duty and 6% excise being extended on parts of electric vehicles and hybrid vehicles which was earlier available upto 2016**	• This is likely to encourage the auto ancillaries manufacturers to invest in the hybrid/green technologies.
Airlines	
• **Tools and tool kits being exempted from Basic Customs duty, CVD and SAD when imported by MROs for maintenance, repair and overhauling [MRO] of aircraft subject to certification by the Directorate General of Civil Aviation.** • **Exemption from excise duty being extended to tools and tool kits when procured by MROs for maintenance, repair, and overhauling [MRO] of aircraft subject to a certification by the Directorate General of Civil Aviation**	• This is expected to reduce cost of MRO specifically for airlines which do self-handling of MRO activities.
Airports	

• **Proposal to develop 160 non-functional airstrips with support of state government.** • **Proposal to develop 10 out of 20 defunct airstrips.**	• The proposal is expected to have a positive impact on the sector, as this will result in improving regional connectivity and should result in total investment of around Rs.15,000-Rs.17,000 crore towards airport infrastructure development over the long run.
Banking & Financial Services	
• **Capital infusion of Rs.25,000 crore in PSU banks in 2016-17**	• Given the deterioration in capital adequacy levels of PSU banks (due to decline in asset quality and hence profitability), this amount would be inadequate to meet the capital needs of PSU banks which are in need of not just growth capital but capital to comply with Basel III norms.
• **Steps taken for deepening of the corporate bond market**	• Encouraging large borrowers to meet a portion of their financing needs from the bond market will ensure reduction in banks' exposure to large borrowers and thereby reduce the risk of a chunky exposure facing stress. • Setting up of a dedicated fund under LIC of India to provide credit enhancement to infrastructure projects will assist in raising of funds by infrastructure companies thereby providing a boost to the sector which contributes significantly towards asset quality problems in the banking sector.
• **Sponsor of an ARC to hold up to 100% stake in the ARCs.** • **100% FDI in ARCs will be permitted through automatic route.** • **Foreign Portfolio Investors (FPIs) will be allowed up to 100% of each tranche in securities receipts issued by ARCs subject to sectoral caps.** • **Complete pass through of income-tax to securitization trusts including trusts of ARCs. The income will be taxed in the**	• Will enable ease of capital infusion in ARCs from promoters / sponsors. • Will ease entry of global funds specializing in distressed assets seeking to invest in ARCs in India. • May attract HNI investors / funds having an appetite for securitization receipts issued by ARCs. • Provides clarity on taxation with respect to ARCs

hands of the investors instead of the trust. However, the trust will be liable to deduct tax at source.	
Cement	
• **Total outlay for infrastructure Rs.221,246 crore proposed in the budget. Allocation of Rs.55,000 crore for Roads & Highways Sector.** • **Measures to boost construction sector, promote affordable housing (including exemption of service tax on construction of affordable houses upto 60 square metres). and rural development**	• Higher outlay and focus on infrastructure, housing and rural development are likely to boost the cement demand.
Coal	
• **Clean Energy Cess is increased from Rs.200 to Rs.400/ tonne of coal to finance clean environment initiatives.**	• The increase in clean energy cess of Rs.200/tonne of coal is likely to garner Rs.17,300-17,500 crore yearly for the exchequer. The impact on the coal and lignite industry remains neutral as cess increase is fully pass-through to end-consumers (in regulated sectors like power).
Construction	
• **Total outlay of Rs.221,246 crore planned for infrastructure in 2016-17.** • **A dedicated Long Term Irrigation Fund to be created in NABARD with an initial corpus of Rs.20,000 crore for implementation of irrigation projects under Accelerated Irrigation Benefit Programme (AIBP).** • **NHAI, PFC, REC, IREDA, NABARD and Inland Water Authority to be permitted to raise additional finances of Rs.31,300 crore through bonds in FY17 for infrastructure spending.** • **A Public Utility (Resolution of Disputes) Bill to be introduced for resolution of disputes in infrastructurerelated construction contracts, PPP and public utility contracts.**	• The continued focus of the government on infrastructure development through increased allocation towards roads, railways irrigation, ports, etc, would be beneficial for the construction industry. Also, focus of the government on building affordable houses will augur well for the industry. • Measures taken for faster resolution of issues in projects under PPP model and window for renegotiation of terms of the agreement will encourage participation of private sector through this model.

	• Availability of credit enhancement for infrastructure projects will improve credit rating and facilitate investment at lower cost.
Consumer Durables	
• **Increased in duty of PCBs for manufacture of computers/mobile phones** • **Reduction in custom duty on magnetron of capacity of 1KW to 1.5 KW used for manufacture of microwave ovens**	• Likely to result in increase in cost which if passed on to consumers may affect demand for these products • Likely to result in decrease in cost of these products
Engineering & Capital Goods	
• **100% village electrification by May 1, 2018, with Rs.8,500 crore provided for Deendayal Upadhayaya Gram Jyoti Yojna (DDGJY).** • **Mobilization of additional finances upto Rs.31,300 crore by NHAI, PFC, REC, IREDA, NABARD and Inland Water Authority through bonds.** • **Total investment in the road sector of Rs.97,000 crore** • **Total investment in railway infrastructure of Rs.1.21 lakh crore** • **100% FDI through FIPB route in marketing of food products manufactured in India.**	• Budgetary allocation for FY 2015-16 under DDGJY would result in increased demand for power transmission and distribution equipment. • This could help mobilize much needed long-term funds for the associated sectors such as roads and power, which could translate in order inflows for equipment manufacturers. • Increased investment in the sector would result in more order inflow for road construction equipment manufacturers. • Investment in railway infrastructure would translate in orders for railway equipment manufacturers. • This is likely to boost the demand for food processing machinery
FMCG	
• **Increase in excise duties on cigarettes, tobacco.** • **Increase in excise duty on mineral water and aerated water containing added sugar**	• Hike in excise duty if passed on to the end consumers could marginally impact demand for cigarettes and other tobacco products. • Increase in excise duty would lead to marginal decline in demand for these products.

IT & ITeS	
• **Benefits of Section 10AA to new SEZ units available for units which commence activity before March 31, 2020.** • **100% deduction on profits for 3 out of 5 years for start-ups setup during April 2016 to March 2019.**	• For IT companies, expansion and hence growth coming from SEZ by setting up delivery units in SEZ, which provide tax benefits on profits, could help save tax. • Most start-ups suffer losses in initial years. Hence, the move for 100% tax deduction on initial years' profits may not be of any major significance. As such MAT will apply.
Mining and Minerals	
• **The schedule rate of clean energy cess, levied on coal, lignite and peat, is being increased from Rs.200 per tonne to Rs.400 per tonne which will come into effect immediately. The clean energy cess is also renamed as clean environment cess.** • **Propose to scrap export duty on low grade iron ore.**	• Neutral–The increase in the clean energy cess is passed on to the end-user industry. Hence, the impact of increase stands neutral on the industry. • Positive – This move will help the exporters to stay competitive as globally the iron-ore prices have fallen by close to 40% and in case of lower grades (below 58% Fe content) to a decade low.
Oil and Gas	
• **The exemptions from customs duties on specified goods imported for petroleum exploration.** • **Incentivise gas production from deep-water/ultra deep-water areas.** • **Withdrawal of deduction u/s 80-IB of Income-tax Act for production of mineral oil and natural gas**	• This shall make cost of exploration cheaper for upstream companies, especially at times when crude prices are at all-time low. • In favor of upstream companies, as such sites bear higher cost of exploration and lower probability of reserves than off-shore fields. • Shall affect performance of exploration companies as current output prices are historically low and cost of exploration remains high.
Pharmaceuticals	

• **Weighted deductions for R&D proposed to be revised to 150% from April 1, 2017 and 100% from April 1, 2020.** • **Tax rebate of 10% on earnings from global patent filings.** • **Tax rate of 10% (as against 35%) on income from majors who have ability to compete on global level. worldwide exploitation of patents developed and registered in India.**	• This will serve as a big impediment for the companies involved in the new drug development, which generally involves huge R&D expense. This will discourage companies to invest further and slow down the research activities. • These initiatives marginally off-set the set back of reduced deduction of R&D. However, this is likely to benefit few pharma majors who have ability to compete on global level.
Real Estate	
• **100% deduction for profits to an undertaking in housing project for flats upto 30 sq. metres in four metro cities and 60 sq. metres in other cities, approved during June 2016 to March 2019 and completed in three years** • **Deduction for additional interest of Rs.50,000 per annum for loans up to Rs.35 lakh sanctioned in 2016-17 for first time home buyers, where house cost does not exceed Rs.50 lakh** • **Exemption from service tax on construction of affordable houses up to 60 square metres under any scheme of the Central or State Government including PPP Schemes** • **Distribution made out of income of SPV to the REITs having specified shareholding will not be subjected to Dividend Distribution Tax (DDT)** • **Extend excise duty exemption, presently available to Concrete Mix manufactured at site for use in construction work to Ready Mix Concrete (RMC)**	• The measures undertaken to promote affordable housing will positively impact the developers engaged in affordable housing development. • Extension of excise duty exemption to RMC will reduce the overall cost of construction. • Removal of DDT in case of REITs (which has been a demand from the industry) will help the companies with completed commercial properties to raise capital.
Steel	
• **Increased outlay aggregating 2.21 lakh crore towards infrastructure including railways and road.** • **Clean environment cess on coal increased from Rs.200 per tonne to Rs.400 per tonne to finance clean environmental initiatives.**	• Positive for steel companies which are currently reeling under subdued end-user industry demand. • Negative impact on domestic steel players which utilise coal for their captive power generation.

IMPACT ANALYSIS:

MACRO ECONOMIC INDICATORS:

- GDP growth in FY16 is projected to increase to 7.6%, from 7.2% in 2014-15, mostly driven by growth in the industry and the sustained high growth in the services sector.
- Low levels of inflation have come to prevail owing to the decline in commodity prices viz. crude oil and confidence in price stability has improved.
- Despite falling exports, a declining import bill helped trade deficit decrease to $ 106.8 billion in Apr-Jan'16 period this fiscal.
- Saving and investment have not shown improvements.
- The rupee has depreciated vis-à-vis the US dollar, like most other currencies in the world, although less so in magnitude and at the same time appreciated against a number of other major currencies.

DEBT MARKET:

Budget was a Positive surprise for the Debt market

Fiscal Deficit Targets for GoI

	Target in Budget 2016-17	Target in Budget 2015 – 16
2015 – 16	3.9%	3.9%
2016 – 17	3.5%	3.5%
2017 – 18	3.0%	3.0%
2018 – 19	3.0%	NA

Despite all possible global and domestic concerns on growth the Government was able to meet 3.9% fiscal deficit target for FY16 Government is committed to walk a tightrope and will stick to its fiscal deficit target of 3.5% in FY17 and has projected 3% fiscal deficit target for FY18 and FY19. Hence, government will borrow less creating a space for further monitory easing.

- Global rating agencies gives lot of importance to fiscal prudence. Government sticking to its fiscal target may be perceived positively by global rating agency which may result in rating upgrade and positive outlook.
- RBI may reward the government by giving a rate cut.
- Since the fiscal deficit is under control and therefore, as and when the bulk supply is gone, bonds will start following the fundamentals and the yields will ease significantly from current market yields.

EQUITY MARKETS:

Budget ensures control over the fiscal and the overall macro environment –

- While Indian markets will still be impacted by global developments, domestic factors would support the market.
  - Bankruptcy Code.
  - Expected earnings growth for FY17E ~15%.
  - Outlook on the Monsoons which could be a key boost for rural sentiment.

As global volatility stabilizes, we expect FII flows to resume in India

Recommend regular and disciplined investment in equities – Investors should look at a mix of large and midcap funds for 3-5 years horizon.

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