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INDIA

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Strategy

Union budget provides capex push amidst fading covid; combination of 'early cycle rise in interest rate' and 'nascent capex and profit cycle' conducive for equities while high valuations a constraint

Progressive union budget to augment the investment cycle further – Union Budget FY23 was pro-growth by being expansionary and provided a counter-cyclical fiscal policy with focus on capex while ensuring inclusive developments with the FY22 fiscal deficit revised upwards to 6.9% from the earlier BE of 6.8% and FY 23 fiscal deficit pegged at 6.4% for FY23. Clear focus on medium to long term development with the blue print of Amrit Kaal.

Quality of spending continues to improve: There is a clear focus on improving the quality of spending with FY23 capex spend budgeted at Rs 7.5 trn (YoY growth of 35% over the FY22 BE of Rs 5.5tn) with emphasis on infrastructure development. Also for the current year (FY22), the capex has been revised upwards to Rs 6 tn which implies a very strong pick up in capex in the last quarter of FY22.

- Revenue expenditure for FY23 budgeted at Rs 31.9 tn is muted compared to 29.3 tn for FY22 BE and flat as compared to the RE for FY22 at Rs 31.7 tn.
- All the major subsidies will have lower allocations for FY23 as compared to the RE of FY22 (Fertiliser Rs 1 tn ; Food Rs 2.1 tn and Petroleum Rs 58 bn)
- Overall expenditure rises to Rs 39.4 tn in FY23 BE from Rs 34.8 tn in FY22BE.

Revenue receipt expectations appear credible -

- Overall revenue receipt expectations are modest with gross tax / GDP expected to remain constant at ~10.7% in FY23 or Rs 27.6 tn (Corporate tax Rs 7.2 tn, Income tax Rs 7 tn, customs Rs 2.1 tn, union excise duty Rs 3.35 tn and GST Rs 7.8 tn).
- Disinvestment target has been revised to a modest Rs 650 bn compared to the FY22BE of Rs 1.75 tn.
- Non-tax revenue (largely dividends and telecom receipts) is budgeted at a modest Rs2.7trn for FY23 against a FY22BE of Rs 2.4 trn.

Higher gross market borrowing – Gross market borrowing for FY23 is expected to rise to Rs 14.95 tn as compared to Rs 12 tn in FY22 BE

Top picks and themes:

- **Rising 'investment rate' including digital infra** – L&T, NTPC, Power grid, Coal India, ONGC, Ultratech cement, Ashok Leyland, Bharti Airtel, Tata communications.
- **Channelising savings, insurance and credit growth** – SBI, HDFC Bank, Axis bank HDFC, SBI Life and ICICI Lombard general insurance.
- **Pent-up demand (including real estate)** – Tata Motors, TVS motors, Phoenix Mills and Greenpanel Industries.
- **Exports & staples –** Alkem, Dr. Reddy's, Gujarat Fluorochemicals, Infosys, and Dabur.

(Contd.)

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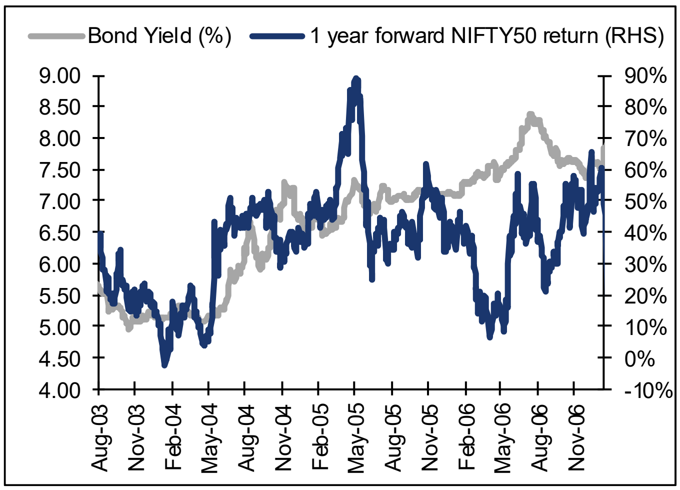
Early stage normalisation of interest rates accompanied by capex and profit cycle has not been negative for equities: Empirical evidence suggests that the current trend of 'normalisation' of interest rates in an environment of rising investment and profit cycle has not negatively impacted stocks (for example the period between 2003-2008). On the other hand, rising interest rates and impending withdrawal of liquidity have negatively impacted stocks in a declining investment and profit cycle (2011-2013). Our observation is that the current environment for profit and investment cycle resembles the early stage of the 2003-08 cycle while the interest rate cycle has just started to turn from the bottom.

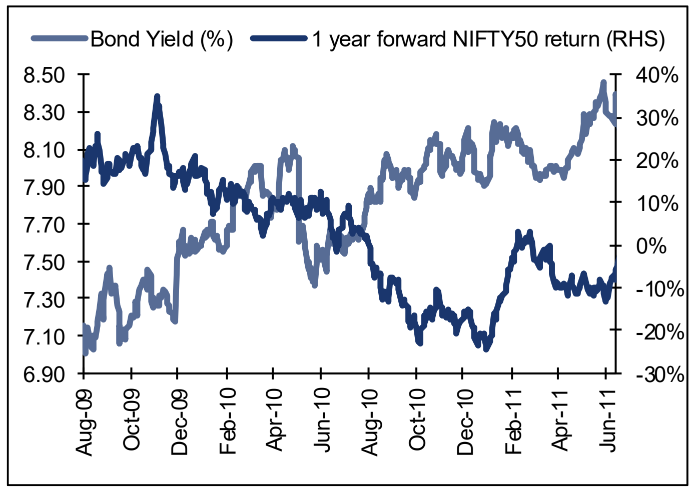
Rising interest rates accompanied by rising investment and profit cycle is not negative for stocks

Chart 1: Robust equity returns amidst rising yields (FY04-FY08) as profit and investment cycle rise



Source: Bloomberg, I-Sec research

Chart 2: Declining equity returns amidst rising yields (FY11-FY13) as profit and investment cycle fall



Source: Bloomberg, I-Sec research

Q3FY22 earnings largely in line so far compared to consensus estimates despite 'across the board' increase in costs which was mitigated by a combination of pricing action, product mix and improving demand.

High frequency data indicates growth momentum sustains – GST collection for Jan'22 is robust at Rs 1.4 tn, PMI-manufacturing continues to be in expansion zone at 54

Valuations remain high at 20.6x on a one year forward basis thereby constraining high returns expectations. However, stocks related to the capex cycle and related credit growth are in the nascent stage of a growth cycle and valuations are nowhere close to the euphoric valuations visible in the 'growth and low volatility' stocks in the market.

Budget implication – sector wise

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- Duty free scrap imports allowed for one more year.
- Countervailing duty is being permanently revoked on imports of Certain Hot Rolled and Cold Rolled Stainless Steel Flat Products, originating or exported from China

Impact: No impact

Logistics

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- Rail capital budget increased by 28%
- Road capital budget increased by 78%

Impact: +ve for road express logistics players TCI Express, Gati

Defence

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- Defence capital budget increased by ~13%
- Domestic defence spending allocated at 68% vis-à-vis 58% YoY, resulting in a potential increase of 32% for domestic defence capital spending
- Impact: Positive for BEL, HAL, BDL etc
- Space capital spending has been reduced and is down 9% YoY on BE basis.

Impact: Negative for Midhani

Healthcare

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- Overall healthcare expenditure increased by mere 0.2% to Rs860mn for 2022-23
- Reduced allocation towards COVID-19 vaccination, reduced to Rs50mn for 2022-23 against revised budget of Rs390mn for 2021-22
- Budget allocation on Department of Pharmaceutical increased to Rs22bn for 2022-23 from Rs8bn expected in 2021-22 largely due to production linked incentive (PLI) schemes for which allocation increased to Rs16bn from Rs2bn.
- For better access to quality mental health counselling and care services propose to launch ‘National Tele-Mental Health program’, under which 23 mental health institutions will be set up. (IIIT-B to provide tech support for the same)
- Open platform of digital health ecosystem for Universal health access and patient database and records will be rolled out.

Impact: We do not expect much benefit to the sector companies.

Banks & NBFC

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Capex expenditure stepped up sharply again – growth push to aid credit growth

- Capex expenditure is stepped up sharply again at 35% (over and above 35% for FY22 as well) from Rs5.5bn to Rs7.5tn.
- Higher capex to start re-leveraging of the system and aid financial systems credit growth – overall lending segment including leading banks SBI, Axis, HDFC, Kotak to benefit.

Budget provides impetus to growth – blueprint for AmrutKaal to steer economy for next 25 years and budget is drawn on that vision – BENEFIT: *in general for overall credit growth*

- Will be complimenting macro-economic growth focus with micro-economic welfare focus
- Sharp provision for increase of public investments and economy will benefit from multiplier effect. Big public investment for modern infrastructure and multi-modal approach
- Promoting digital ecosystem and fintechs amongst focused areas for the government.
- Public issue of LIC is expected shortly and other 2 are in process.

Credit facilitation for MSME: ECLGS extended by Rs500bn till Mar'23 earmarked for hospitality and related sectors – BENEFIT: *for SME focused banks and NBFCs*

- ECLGS has provided essential credit to 130k MSMEs
- *Hospitality and related services are yet to regain*
- *Considering these aspects, ECLGS will be extended upto Mar'23 and its guarantee cover will be extended by Rs500bn to Rs5tn with additional amount being earnmarked for hospitality and related sectors,*
- CGTSME revamped and additional credit of Rs2tn for micro and small enterprises

Further push towards affordable housing growth – benefit Affordable housing financiers

- Allocated Rs480bn for housing projects under PM Housing Scheme.
- All land and construction related approvals to be fast tracked.
- Will work with regulator to reduce cost of intermediaries.
- Digitisation of land record on national record to boost investment in real estate.

Digital banking

- Propose to introduce digital rupee using blockchain technology to the regulator starting FY23 – *benefit fintechs, digital savvy banks*
- Digital banking, digital payment and fintechs will be encouraged to reach every nook and corner
- *Proposed to set up 75 banking units in 75 districts of the country.*

North East infra and social development – *social infra should aid Bandhan Bank*

- PM development to north east – it will fund infrastructure and social development it will not be substituted to current central schemes, allocation of Rs15bn initially.

NARCL have commenced their activities –IDRCL structure will be positive for the banking sector (in general) and PSU banks (in particular)

- NARCL-IDRCL structure will be positive for the banking sector (in general) and PSU banks (in particular).
- Resolution of the proposed Rs2trn of legacy stressed assets will lower GNPLs by >2% and estimated realisable value of 18% will lead to provisioning write-back of Rs360bn (>35bps of advances) over the period.
- Through successful execution of phase-1, one can expect near term NPA reduction of >1% and NPA recoveries equivalent to 10bps of system credit. *Leading PSU banks have highlighted that 0.9-1.3% of advances will be offloaded to NARCL in phase-1 (SBI - Rs200bn, PNB – Rs79bn, Union – Rs78bn, BoI – Rs35bn, Central Bank – Rs27bn).*
- Recoveries of 18-20% suggests 6-8% boost to operating profit or 1.5-2.5% accretion to networth (pretax).

No mention of PSU Bank in the budget with respect to recap or privatisation status

Automobiles

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- Focus on e-Buses further with procurement by STUs to continue and scale up
- Come out with battery swapping policy in order to facilitate efficient charging mechanism and save time of commuters with constraint for space
- Come out with interoperability policy in order to make the swapping mechanism smoother and easier for consumers
- Come out with special mobility zones with zero fossil fuel policy
- Incremental duty of Rs2/ltr to be imposed on unblended fuel to promote ethanol blending and reduce dependency on crude oil import.
- 30% increase in budgeted capex of government would in turn boost manufacturing and job creation in the longer run. Near term benefit would be more for commercial vehicles with focus on infrastructural activities.
- Removal in ADD and CVD on stainless steel, bars of alloy wheel, high speed steel etc. to help companies manage inflated domestic metal prices partly.

Implication: Government being open to interoperability between players in terms of swapping is a new development. Ashok Leyland, Tata Motors, M&M to benefit from aspect of boost to CV demand. We believe, contours of interoperability policy would be important to analyse, prior to making any conclusion for the 2W EV space. Job creation through enhanced capex spending would have its indirect impact on personal mobility segments with a lagged effect.

Aviation

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- No impact of reduction in ATF customs duty
- The earlier custom duty was 10% but airlines enjoyed exemptions which made it net 5%. As such, budget has simplified it and there is no impact. Secondly this was on imports. Anyways imports were very less

White Goods & Durables

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Particulars	Customs Duty - Earlier	Customs duty - revised	Benefit to company
Single or multiple loudspeakers	15%	20%	Manufacturing companies - Amber, Dixon
Headphones and earphones	15%	20%	Manufacturing companies - Amber, Dixon
Smart Meters	15%	25%	Manufacturing companies
PCBA for Smart meters	10%	20%	Manufacturing companies

Agriculture

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Particulars	Customs Duty - Earlier	Customs duty - revised	Benefit to company
Rock Phosphate	5%	2.5%	Fertiliser companies
Fertilizers (other than Ammonium Sulphate, Ammonium Nitrate, Sodium nitrate, Potassium Sulphate, Minerals or Chemical fertilizers of NPK)	10%	7.5%	Fertiliser companies
Urea Subsidy (Rsmn)	Rs759300 (FY22)	Rs632220 (FY23)	Lower subsidy may impact Fertiliser companies
Nutrient based Subsidy (Rsmn)	Rs641920 (FY22)	Rs420000 (FY23)	Lower subsidy may impact Fertiliser companies

Building material

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Budget announcement	Implications	Impact on stocks
In 2022-23 , 8mn houses will be completed for the identified eligible beneficiaries of PM Awas Yojana for both rural and urban areas and an allocation of Rs480 bn has been done for it	Positive for affordable or mass market building material products	Positive for branded plumbing pipe players (Supreme, Astral, Finolex) and also mildly positive for other branded building material categories like tiles, sanitaryware & faucets and wood panel segments
Jal Jeevan Mission to achieve Har Ghar Jal (piped water supply) allocation of Rs600 bn. The government wants to cover 38 mn households in 2022-23.	Positive for pipe manufacturer	Positive for pipe manufacturers like Supreme Industries, Astral Ltd and Finolex Industries.
Concessional tax rate of 15% for newly incorporated domestic manufacturing companies doing commencement of manufacturing/production extended by one year to 31st March,2024.	Positive for the building material companies doing expansion	Expected beneficiaries include Greenply Industries and Century Plyboard.

Cement: Positive – Beneficiary of higher government capex – execution is the key

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- Capex outlay has been stepped up sharply by 25% YoY from Rs6tn (FY22RE) to Rs7.5tn in FY23 (BE). Outlay in FY23 is likely to be 2.9% of the GDP.
- Effective capital expenditure with the investment taken together with provision made through grant is budgeted at Rs 10.68tn in FY23 which will be 4.1% of the GDP.
- The Budget outlay for the Ministry of Road Transport and Highways has risen 68.5% to Rs1.99tn (from Rs1.18tn in FY22).
- The government-run National Highways Authority of India’s budgetary outlay in the coming fiscal is set to rise by 133% to Rs1.34tn from Rs573.5bn in FY22.
- Allocations to the government’s flagship scheme for rural roads - PM Gram Sadak Yojana - have risen to Rs190bn in FY23, from Rs150bn in FY22BE.
- National highway network to be expanded by 25,000 kms in FY23 under PM GatiShakti masterplan.
- In FY23, 8mn households will be completed as beneficiary under the PM Awaz Yojna. Rs480bn is budgeted on PM housing scheme in FY23 almost similar to FY22RE.
- **Top picks –** UTCEM, ACEM, SRCM

Power

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Key Budget Announcements	View Post Announcement
• Imposition of BCD of 25% on import of solar cell and 40% on import of solar modules. • Energy transition and climate change: Low carbon development strategy is a commitment of the government. Energy efficiency and saving to be promoted. It will facilitate capacity building and energy management. • To reach 280GW of solar capacity by 2030; additionally Rs195bn will be allocated for the PLI scheme for solar manufacturing. • 5-7% of bio-mass pellets to be co-fired in thermal plants resulting in CO_2 savings of 38mnte annually. • Four pilot coal gasification and conversion of coal to chemicals projects to be set up. • Concessional tax regime of 15% for newly incorporated domestic manufacturing companies extended to 31 Mar'24. • Graded duty structure proposed as part of phased manufacturing program for smart meters. Also, BCD on smart meters and PCBs have been increased • Battery swapping policy to be released since charging infrastructure requires larger land parcels. Energy as a service will be promoted. Private sector will be encouraged to develop EV charging facilities.	• BCD and increase in PLI allocation is a big positive for the domestic solar manufacturers. • There is a clear push toward higher renewables adoption beyond solar as well, with the announcement of bio-mass firing and coal gasification projects. • Government's intent is to expedite transition to a green energy economy, which provides thrust to the long-term growth of the sector. • There is a significant push from the government on installation of smart metering. Graded duty structure and higher BCD on smart meters will help increase domestic production capacity and availability for the ambitious Rs3trn smart metering scheme. • All the mentioned reforms will lead to higher capex in the power sector especially towards "Green & Clean Infrastructure building". Hence, capex in the sector to increase meaningfully. • **Our top picks are NTPC, Coal India, Power Grid, Tata Power and Genus Power. All the solar manufacturing PLI scheme applicants will benefit from the announcements.**

Infra/Industrials

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Key Budget Announcements	View Post Announcement
• PM Gati Shakti national master plan: It is a Rs100trn plan focusing on seven key sectors – roads, railways, ports, airports, mass transport, waterways and logistics infra. It will also include infrastructure development by state governments. National Infrastructure Pipeline plan will be aligned along with this plan. • Master plan for expressways: Expected to be released soon. 25,000km expansion of highways targeted by FY23, with Union Government financing of Rs200bn. Unified logistics interface to be implemented. • Ken-Betwa river link project: The total allocation for the river linking project is Rs446bn. • Rs600bn allocated for providing access to tap water to 38mn households. • 8mn affordable houses will be completed at Rs480bn under PMAY in FY23.	• Gati Shakti and allocation on expressways aim at building an integrated infrastructure around all modes of transport. This will provide a multi modal boost to key modes of transport, especially roads and railways. • Investment in roads and transport has gone up 50% to ~Rs2trn and railway allocation has gone up by 14% to Rs~2.5trn, with 38% increase toward construction of new lines, thereby benefiting key players in transmission EPC, civil infra, digital automation and smart services. • Investment toward affordable housing and clean water projects is positive for players in the rural infrastructure space. • **We expect the key beneficiaries to be L&T, KEC, Siemens, Honeywell and Techno Electric.**

Market valuations snapshot

Chart 3: Nifty marginally below +1SD on forward PE

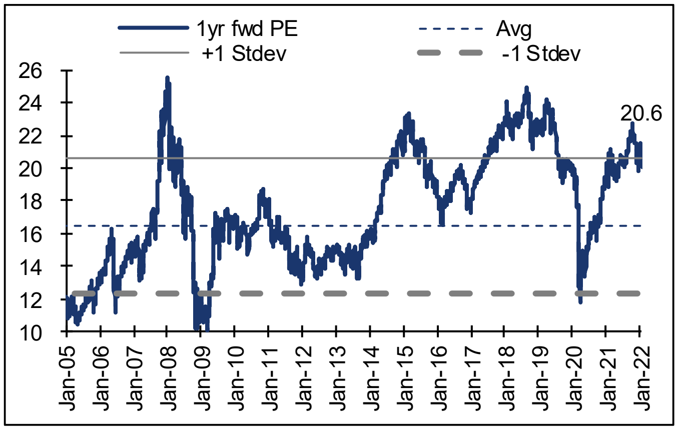


Chart 4: CAPE remains above +2SD

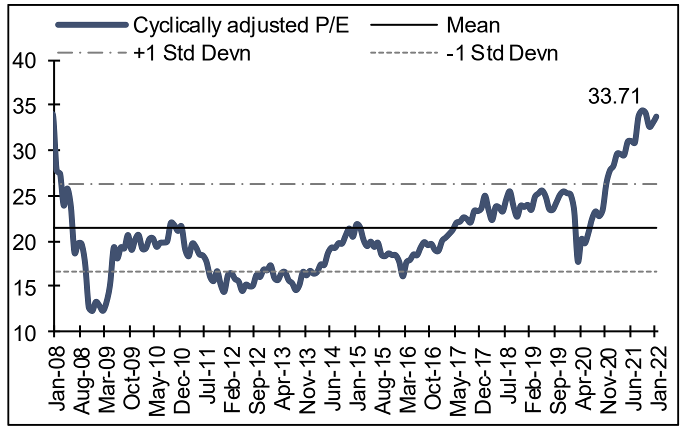


Chart 5: Nifty forward PE (ex-ante)

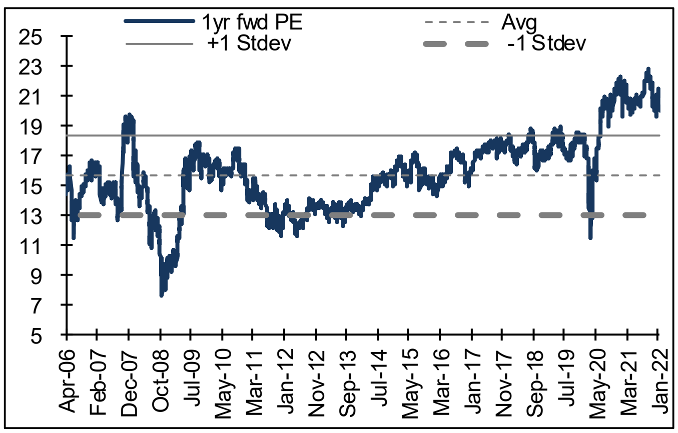


Chart 6: Nifty PB near LTA

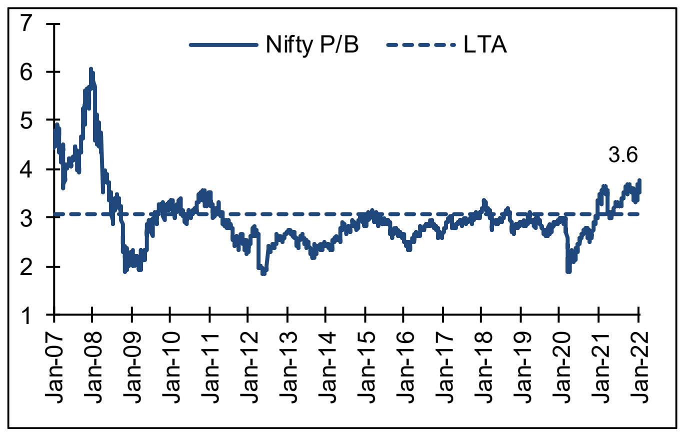


Chart 7: Market cap to GDP above LTA, reflects low trailing GDP

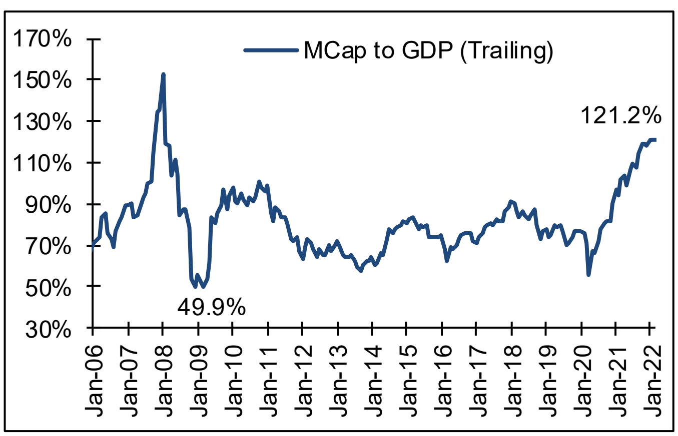
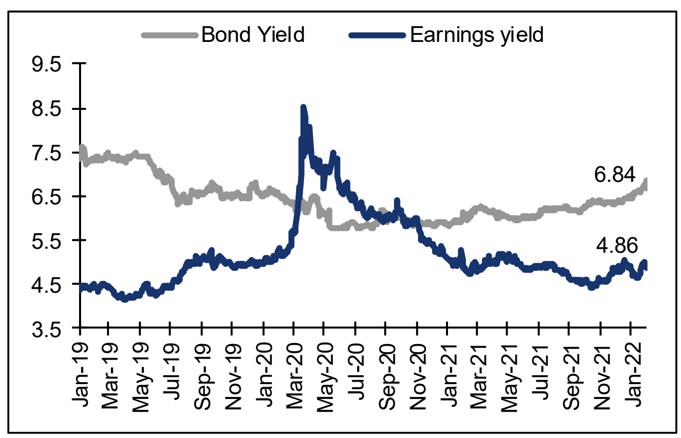
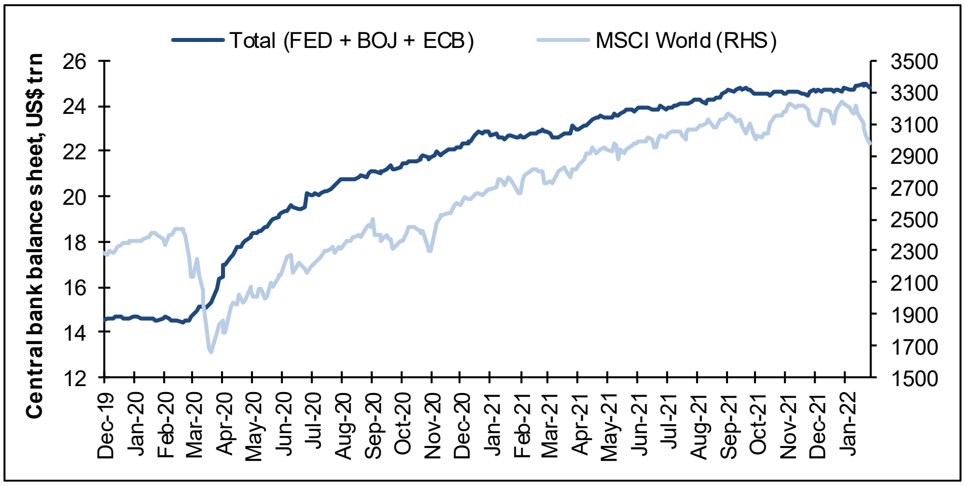


Chart 8: Bond and earnings yield spread



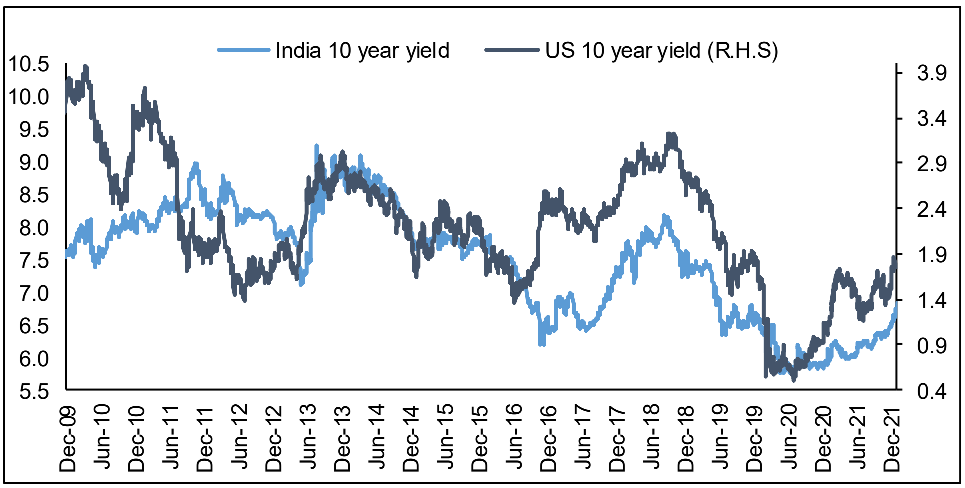
Source: Bloomberg, CEIC, I-Sec research

Chart 9:Top central banks to begin reducing the unprecedented QE unleashed post 2020



Source: Bloomberg, CEIC, I-Sec research

Chart 10: Bond yields relatively low from a historical perspective despite the expectation of liquidity normalisation, inflation spike and reversal of rate cut cycle



Source: Bloomberg, I-Sec Research

Table 1: High frequency data

Consumption Indicator	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22
Personal Loan growth	12%	12%	11.2%	12.1%	12.1%	11.7%	11.6%	14.3%	NA
4W growth	162.5%	119.3%	44.7%	7.6%	-41.2%	-27.1%	-18.6%	-13.3%	NA
2W growth	26.1%	4.0%	-2.1%	-14.6%	-17.4%	-24.9%	-34.4%	-10.8%	NA
IIP - Primary Goods.	15.8%	12.0%	12.4%	16.9%	4.6%	9.0%	3.5%	NA	NA
IIP Consumer Goods Durables	80.4%	28.0%	19.4%	11.1%	-1.9%	-3.6%	-5.6%	NA	NA
IIP Consumer Goods Non Durables	0.2%	-3.9%	-2.3%	5.9%	0.2%	0.9%	0.8%	NA	NA
Petrol Consumption	12.5%	5.6%	16.4%	13.1%	6.0%	3.7%	-0.7%	4.1%	NA
Nikkei India Services PMI	46.40	41.20	45.40	56.70	55.20	58.40	58.10	55.50	NA
CPI	6.30%	6.26%	5.59%	5.30%	4.35%	4.48%	4.91%	5.59%	NA
Passenger - all airports	564.3%	51.7%	125.8%	131.3%	82.7%	75.9%	71.2%	59.1%	NA
Foreign tourist arrivals	NA	NA	NA	NA	NA	NA	NA	NA	NA
GST Collections (Rs bn)	1,027	928	1,164	1,120	1,170	1,301	1,315	1,298	1,384
Consumer confidence index	48.50	NA	48.60	NA	57.70	NA	62.30	NA	NA

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Private final consumption exp real	6.42%	1.98%	-26.18%	-11.19%	-2.80%	2.66%	19.34%	8.61%	NA

Industrial Indicator	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22
Overall credit growth (fortnightly)	6.0%	5.8%	6.8%	6.7%	6.7%	6.8%	7.0%	7.3%	7.4%
Industry loan growth	0.78%	-0.27%	1.04%	2.25%	2.49%	4.14%	3.81%	7.60%	NA
CV growth	NA	NA	NA	NA	NA	NA	NA	NA	NA
Thermal plant Load factor	54.42	55.04	56.92	59.50	54.31	55.50	53.49	58.29	NA
IIP growth	27.6%	13.8%	11.5%	13.0%	3.3%	4.0%	1.4%	NA	NA
Core sector growth (%)	16.44	9.39	9.94	12.16	4.51	8.43	3.37	3.84	NA
Diesel Consumption	0.83%	-1.50%	11.35%	15.68%	0.42%	-5.41%	-7.64%	1.64%	NA
Power demand	6.3%	8.8%	10.5%	17.4%	0.4%	4.3%	2.2%	3.4%	NA
IIP Capital Goods	74.9%	27.3%	30.3%	20.0%	2.4%	-1.5%	-3.7%	NA	NA
Nikkei India manufacturing PMI	50.8	48.1	55.3	52.3	53.7	55.9	57.6	55.5	54.0
WPI Commodity price index	13.11%	12.07%	11.57%	11.64%	11.80%	13.83%	14.23%	13.56%	NA
Cargo - Air	150.92%	45.58%	35.16%	29.50%	14.91%	16.53%	6.16%	6.94%	NA
Cargo - all ports	33.0%	19.5%	6.7%	11.4%	0.4%	6.5%	-0.2%	-0.6%	NA
Freight traffic - railways	55.73%	27.09%	21.45%	20.03%	8.98%	20.58%	14.34%	8.32%	NA
Import Growth (%)	69.93%	97.44%	62.60%	53.72%	86.37%	56.85%	56.58%	38.55%	NA
Export growth (%)	68.28%	47.88%	49.74%	46.39%	22.63%	43.00%	27.16%	38.91%	NA
Trade Deficit (USD bn)	-6.54	-9.60	-10.77	-11.92	-22.67	-17.81	-22.91	-21.68	NA

Industrial Indicator	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Capacity utilisation	68.60	69.90	47.30	63.30	66.60	69.40	60.00	NA	NA
GFCF	2.43%	2.54%	-46.60%	-8.55%	2.59%	10.85%	55.26%	11.01%	NA

Source: CEIC, Bloomberg, I-Sec Research

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