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Union Budget 2021-22

More than "no negative is positive"

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Is it only "No Negative is a positive" for markets or is there more in this budget

We believe the Budget 2021 does check many boxes in terms of much needed growth impetus for economy. We will discuss some these positives hereunder

- The biggest positive is change in thinking from a very conservative & slave to tight fiscal deficit target to **expansionary policy** by liberalizing deficit targets for quite a long term. The FM has budgeted the FD (fiscal deficit) at 6.8% of GDP for FY22 & targets for 4.5% of GDP according to FRBM Act extended till FY26. In our view such long term view provides continuity in expansionary fiscal policy for at least next couple of years.

- **No new tax is a good news for common people**. Increased overall expenditure will be funded by borrowings & not raising taxes. Although higher borrowings will mean higher interest rates & higher inflation which will be borne by common man but at least the fear of being burdened with another tax (something like Covid tax) is not there.

- Other refreshing change in government financials is indirect financing of government agencies like FCI etc which were hitherto funded by off-balance sheet items has now been incorporated in budget itself. This change will make **government finances more transparent** & provide much comfort to credit rating agencies.

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- In the budget FY22, **Infrastructure** was one of the key focus areas with all round thrust on each sub-segment like roads, railways, ports etc. A big positive for Infra sector was creating institutional framework for funding infra projects by setting up a Development Financial Institution(DFI). Issuance of zero coupon bonds , Debt Financing by FPI's in InVIT's and REIT's etc will also help in financing infrastructure sector. Further, there is special thrust on monetization of assets to unlock value and bring in additional funds for various infrastructure projects. In our opinion spending on infra can provide much needed impetus to sustainable growth of overall economy.

- In budget for the year following the year marked with Covid it is but natural to expect focus on public **healthcare**. Government has increased outlay on healthcare from 1.8% of GDP to 3% of GDP. The increase in healthcare expenses will encompass entire chain including diagnostics, hospitals, vaccines etc. There is a one- time allocation of Rs. 35,000 crores for covid vaccination.

- Much awaited **scrappage policy** was announced which can help both in controlling vehicle pollution as well as provide big growth driver to automobile industry. The details of this policy are still not known but there is huge potential to boost growth in this sector. Some estimates suggest that there are about 51 lakh Light motor vehicles (LMV) are more than 20 years old & about 17 lakh Medium & heavy commercial vehicles (MHCV) are older than 15 years.

- **Bad bank for NPAs & recapitalisation of PSBs** - The FM has announced setting up of a asset reconstruction company which will manage non- performing assets of banks. In Covid hit era banks have witnessed sharp increase in NPA which in any case were deteriorating even before pandemic. RBI has also estimated significant increase in total NPAs for banks. All banks stocks have been under immense pressure on impending restructuring & recognition of NPAs. Hence it was expected that FM will do something to clean up the bank books. According to new setup NPAs from banks will be culled into a separate entity an Asset Reconstruction Companies (ARC). This move will help banks free up capital for further lending. In our opinion public sector banks (PSB) stand to benefit more from this as their books are more ridden with NPAs, private banks have been regularly clearing their books in the last few years. However the bad bank will help all the banks. Additionally, government has proposed to provide Rs 20000 cr as capital for PSBs. We believe this amount is insufficient given the stress from NPAs with these banks. The government will also privatise 2 public sector banks & 1 general insurance company in FY22.

- **Increase in FDI in insurance from 49% to 74%:** The government has increased foreign investment in insurance sector up to 74% along with clarity on management control of these insurance companies. In our view this is a huge positive for the sector as large capital investment is required in this sector especially in view of high under-penetration of insurance in our country.

While many steps have been taken which can provide impetus to growth, there are a few heads where the budget did not meet expectations.

A few them are as follows:

- Increase in Capital expenditure in FY22 over revised estimates of FY21 is almost stagnant from Rs 34.5 lakh cr in RE FY21 to Rs 34.83 lakh cr in BE FY22. We believe the government has front ended the expenses in FY21 itself hence very little increase in FY22. However Covid hit economy needed some extra & innovative means to expedite growth.

- Gross borrowings at Rs 12 lakh cr are much higher than market expectations of about Rs 8 lakh cr. The high amount of borrowings has potential to crowd out other borrowers as a result interest rates are likely to go up. Higher debt also means higher inflation risk. In effect this means interest rates have bottomed out & RBI will not have much scope of cutting rates further.

- Asset monetization at any significant level is likely to spill over to future years hence it may be a good idea for long term but in short term it may not be implemented. It is to be noted that it is not easy for any government in India to sell any asset in view of strong political & social opposition.

- Disinvestment target of Rs 1.75 lakh cr is too conservative especially in view of the fact that most of the target of last year has not been met & that has been rolled over to FY22. IPO of LIC, sale of BPCL, SCI & Concor are roll overs from previous year.

- Imposition of Agri Infra Development Cess: Government has imposed a new cess called Agri Infra development cess on many agricultural commodities, petrol & diesel etc. Although an equivalent reduction of excise & customs duty has been implemented which means there is no net impact on consumers. We are yet not clear the real motive behind this restructuring but we believe this is unnecessary distraction.

Conclusion: We believe the budget has delivered on expectations of increased spending on infrastructure & healthcare along with some relief on compliance in terms of tax issues, returns filings by senior citizens, ease of investing for NRI etc but it does fall slightly short on any big bang idea to revive overall economic growth. While “no negative news is good news” overrides the budget FY22, much needed focus on increased spending shall help overall economic growth.

What is there for investors now?

- We have always believed that budget speech has usually short term impact on markets. After initial reaction for budget day or at most 1 or 2 days after budget, the market comes back to fundamentals. Q3FY21 earnings season is underway & is progressing very well consecutively after Q2FY21. We believe earnings revival of corporate India is here to stay

- Post this budget, we can conclude economy facing sectors like infra/capital goods, roads, ports, cement, construction etc may witness uptick. In our note “Outlook 2021” released by us in December 2020, we had mentioned this theme & these sectors as preferred sectors to play for next few months. We remain bullish on Capital goods stocks like L&T, Timken & cement stocks like Shree Cement, ACC etc.

- Formation of bad bank & overall growth impetus will drive stock prices in banking stocks. We are bullish on private sector banks & large NBFC like HDFC bank, ICICI Bank, Bajaj Finance, Chola Investment Finance etc

- Increased FDI in insurance companies will keep insurance stocks buoyant. We are bullish on HDFC Life, ICICI Lombard

In healthcare we have a large list of our preferred picks mentioned elsewhere in this report

Detailed analysis of budget FY22 provisions on specific sectors & our preferred picks are given in following pages

- National Infrastructure Pipeline (NIP) was launched with 6,835 projects, which is now expanded to 7,400 projects. Around 217 projects worth Rs. 1.10 lakh crores have been completed.

- For Infrastructure financing, a Development Financial Institution has been set up with seed capital of Rs. 20,000 crores.

- Total capital expenditure outlay has increased from Rs. 4.39 lakh crores to Rs. 5.54 lakh crores.

Road

- More than 13,000 Kms length of roads at a cost of Rs. 3.3 lakh crores has already been awarded under Rs. 5.3 lakh crores Bharatmala Pariyojna Project of which 3,800 Kms. have been constructed and by March 2022, the government will award another 8,500 Kms and complete an additional 11,000 Kms. of National Highway corridors.

- Estimated outlay of Rs. 1.18 lakh crores for ministry of road, transport and highways of which Rs. 1.08 lakh crores is for capital expenditure.

Urban infrastructure

- A new scheme under Urban infrastructure will be launched at a cost of Rs. 18,000 crores to support augmentation of public bus transport services. The scheme will facilitate deployment of innovative PPP models to enable private sector players to finance, acquire, operate and maintain over 20,000 buses.

- A total of 702 kms. of conventional metro is operational and another 1,016 km of metro and RRTS is under construction in 27 cities. 'MetroLite' and 'MetroNeo' are the two new technologies which will be deployed to provide metro rail systems at much lesser cost with same experience, convenience and safety in Tier-2 cities and peripheral areas of Tier-1 cities.

- Urban Swachh Bharat Mission 2.0 will be implemented with a total financial allocation of Rs. 1.41 lakh crores over a period of 5 years from 2021-2026.

Railway

- The government has provided a sum of Rs. 1.10 lakh crores, for Railways of which Rs. 1.07 lakh crores is for capital expenditure.
- Increase the modal share of Rail In freight from current 27% to 45%.
- 100% electrification of broad-gauge routes by 2023.

Power

- Scheme for Power distribution companies to be launched with an outlay of Rs. 3.05 lakh crores over five years.
- Power customers to be provided with choice of Discoms by removing monopoly of discoms in all cities.

Ports

- Seven projects worth more than Rs. 2,000 crores will be developed in Public Private Partnership mode in FY22.

Petroleum & Natural Gas

- Ujjwala Scheme has benefited 8 crores households will be extended to cover 1 crores more beneficiaries.

- The government will add 100 more districts in next 3 years to the City Gas Distribution network. A gas pipeline project will be taken up in Union Territory of Jammu & Kashmir.

Asset Monetization

- NHAI and PGCIL each have sponsored one InvIT that will attract international and domestic institutional investors. Five operational roads with an estimated enterprise value of Rs. 5,000 crores are being transferred to the NHAI InvIT. Similarly, transmission assets of a value of Rs. 7,000 crores will be transferred to the PGCIL InvIT.

- Railways will monetize Dedicated Freight Corridor assets for operations and maintenance, after commissioning.

- Airports will be monetized

- Other core infrastructure assets that will be rolled out under the Asset Monetization Program are: (i) NHAI Operational Toll Roads (ii) Transmission Assets of PGCIL (iii) Oil and Gas Pipelines of GAIL, IOCL and HPCL (iv) AAI Airports in Tier II and III cities, (v) Other Railway Infrastructure Assets (vi) Warehousing Assets of CPSEs such as Central Warehousing Corporation and NAFED among others and (vii) Sports Stadiums.

Existing Scenario	Proposal	Impact
Total Capital Expenditure – Rs. 4.39 Lakh Crores	Total Capital Expenditure – Rs. 5.54 Lakh Crores	Positive for all economy facing sectors like roads. Capital equipment manufacturers, engineering companies etc
Projects under NIP – 6.835.	Projects under NIP – 7,400 crores.	Positive

Overall positive for L&T, Siemens, ABB, Cummins, Timken, Cement stocks, IRB infra, Dilip Buildcon, KNR Construction, NCC, REC, PFC, PowerGrid, etc

Our Preferred Stocks:
- Larsen & Toubro
- Timken
- Polycab

- Outlay on Healthcare increased from Rs. 94,452 crore to Rs. 2.24 lakh crores growth of 137% over last year.
- Health expenditure has increased from 1.8% to ~3% of GDP.
- The Government has allocated Rs. 2,217 crores towards *'Clean Air'* in 42 urban centres with 1 million + population.
- PM Atma Nirbhar Swasth Bharat Yojana is proposed to be launched with an outlay of Rs. 64,180 crores over next 6 years.
- Supplementary Nutrition Programme and Poshan Abhiyan to be merged and launched as Mission Poshan 2.0
- Government has allocated Rs. 35,000 crores towards Covid vaccine programme.
- Government to launch Jal Jeevan mission to provide universal water supply with outlay of Rs. 2.87 lakh crores over 5 years.

Healthcare Contd....

Existing Scenario	Outcome	Impact
Total Health Outlay – Rs. 94,452 crores	Increased by 137% to Rs. 2.23 lakh crores.	Positive
Health Expenditure 1.8% of GDP	Health Expenditure increased to ~3% of GDP	Positive

Increased thrust on healthcare will benefit entire chain in the sector including hospitals, diagnostics, manufacturers of healthcare equipment/disposable articles

Preferred Stocks:

- Poly Medicure.
- Thyrocare.
- Apollo Hospital.

Sector Analysis - Banking & Financial Services

- Asset Management Company is proposed to be set up to consolidate and take over existing bad debt of banks.
- Government proposes to amend Insurance act to increase FDI limit from 49% to 74% in insurance companies and allow foreign ownership with safeguards like majority of board of directors to be resident Indian.
- Government has proposed disinvestment and strategic sale of 2 public sectors banks and 1 general insurance company along with IPO of Life Insurance Corporation of India.
- The Government has allocated Rs. 20,000 crores towards capitalization of public sector banks.
- Extending Income Tax rebate on interest of Rs. 1,50,000 for affordable home loans till March 2022.
- Enhanced agriculture credit target to Rs. 16.5 lakh crores in 2021-22.
- 'Securities Market Code' to be launched by merging SEBI act, Depositories act, and Government securities act.

- New scheme worth Rs. 1,500 crores to give financial incentive on Digital transaction to promote digital mode of payment.
- To improve financial Inclusion for schedule caste, schedule tribe and women, the government has proposed to reduce margin requirement from 25% to 15%.

Existing Scenario	Outcome	Impact
Insurance FDI limit – 49%	Insurance FDI limit – 74%	Positive
Recapitalization of PSU Banks -	Rs. 20,000 crores.	Less than expected but still Positive

Our Preferred Stocks:

- HDFC Bank.
- ICICI Lombard.
- Bajaj Finance.
- HDFC Life.
- Cholamandalam Finance.
- ICICI Bank.

- The government announced a voluntary vehicle scrapping policy, to phase out old and unfit vehicles.
- Vehicles would undergo fitness tests in automated fitness centres after 20 years in case of passenger vehicles, and after 15 years in case of commercial vehicles.
- There is immense potential in manufacturing heavy capital equipment domestically. The government propose to withdraw exemptions on tunnel boring machine and will attract a customs duty of 7.5%; and its parts a duty of 2.5%.
- The government is looking to raise custom duty on certain auto parts to 15% to bring them on par with general rate on auto parts.

Existing Scenario	Outcome	Impact
Custom Duty – 7.5%/10%	Custom Duty – 15%	Positive on domestic manufacturers of these parts

Our Preferred Stocks:

- Bajaj Auto
- Amara Raja Batteries
- Minda Industries

- To enable the textile industry to become globally competitive, attract large investments and boost employment generation, a scheme of Mega Investment Textiles Parks (MITRA) will be launched in addition to the PLI scheme.
- 7 such Textile Parks will be established over 3 years
- This will create world class infrastructure with plug and play facilities to enable create global champions in exports.
- The government intends to rationalize duties on raw material inputs to manmade textiles. They are now bringing nylon chain on par with polyester and other man-made fibres.
- The government have uniformly reduced the basic customs duty rates on caprolactam, nylon chips and nylon fibre & yarn to 5%. This will help the textile industry

Textiles Contd….

Existing Scenario	Outcome	Impact
Custom Duty – Caprolactum – 7.5%	Decreased Custom Duty – Caprolactum – 5%	Negative for GSFC
Custom Duty – Nylon chips – 7.5%	Decreased Custom Duty – Nylon chips – 5%	Positive for garment manufacturers
Custom Duty – Nylon Fibre & yarn – 7.5%	Decreased Custom Duty – Nylon Fibre & yarn – 5%	Positive for garment manufacturers

Our Preferred Stocks:

- KPR Mills
- Ambica Cotton

- The government has calibrated customs duty rates on chemicals to encourage domestic value addition and to remove inversions. Apart from other items, they are reducing customs duty on Naptha from 4% to 2.5% to correct inversion.

Existing Scenario	Outcome	Impact
Custom Duty – Carbon Black – 5%	Custom Duty – Carbon Black – 7.5%	Positive
Custom Duty – Bis-phenol A – NIL	Custom Duty – Bis-phenol A – 7.5%	Positive
Custom Duty – Epichlorohydrin – 2.5%	Custom Duty – Epichlorohydrin – 7.5%	Positive

Overall positive for Balkrishna Industry, Phillips Carbon Black, Goa Carbon, Rain Industries, Deepak Nitrite, Meghmani Organics, etc.

Preferred Stocks:

- Navin Flourine, PI Inds, Astec, SRF, Aarti Inds, Galaxy Surfactants etc

- Custom duty on gold and silver reduced to 7.5% to 12.5%, positive for Jewelry makers like Titan.

- Custom duty on steel products reduced to 7.5% , positive for OEMs and Automobile.

- Custom duty on copper scrap has been reduced from 5% to 2.5%, positive for copper recyclers and user industries. Stocks such Havells, Polycab, KEI Industries, Finolex cables, Crompton consumer, etc. could have a positive impact.

Thank You

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