Markets were disappointed with the absence of any major policy initiatives to boost consumption and some adverse policy measures for capital markets – proposal to increase minimum public shareholding in listed entities to 35% (from 25%) and the levy of 20% on share buyback. In our view, markets possibly over-reacted to the proposal for increasing public shareholding while the budget proposal to bring share buyback under taxation, is certainly negative for the companies with huge cash pile on the balance sheet but have limited investment options to deploy the funds at incremental returns in excess of "Cost of Equity Capital". The absence of stimulus package for consumption was not a dampener as we see that Government is possibly trying to make a transition in the country's growth model – from consumption to investment led growth (will discuss in detail later in the note).

Increase in the minimum public shareholding in listed entities to 35%

The fear of excess supply entering the markets weighed on the stock price on Friday but we believe that the Regulator would provide reasonable time to the promoters to bring down their shareholding. In 2010, SEBI had given listed firms three years to meet the 25% 'minimum public shareholding' norm.

The proposed step could potentially attract large FPI inflows as the weightage of the companies in key global indices (like MSCI Emerging Markets Index) will increase with higher public float. Not only that, the higher public shareholding will bring wider ownership (which includes institutional investors), more market depth and better corporate governance standards.

Share Buyback under Taxation

The proposed step is to plug the loophole in the taxation policy. Companies have been using 'share buyback' route instead of Dividend, for distribution of profits to its shareholders to circumvent the Dividend Distribution Tax. We are not defending the policy measure since in our view, the levy of DDT (Dividend Distribution Tax) is a regressive provision in our Taxation structure. Government should not intervene in the capital allocation decision of the business entity. The tax anomaly, if continued, will bring down the fair value of the companies as the valuation model needs to capture the DDT while calculating Free Cash Flows.

SUBTLE CHANGE IN THE GROWTH MODEL?

While we may complain about the absence of stimulus package for consumption but this Budget has taken policy initiatives on "factors of production", to spur private investments. Are we seeing a change in our growth model – from consumption to investment led growth? It would be premature to suggest that but certain policy initiatives in this budget were intended to improve Gross Fixed Capital Formation –

Land – Review of archaic Tenancy laws, monetization of land assets with Public Sector Enterprises were few steps to bring down the cost associated with the land.

Labour – Government tried to bring some labour reforms in its previous tenure but could not succeed due to protest from Trade Unions. Budget 2019 talked about streamlining of prevailing 44 labour laws into 4 labour codes – wages, social security, industrial safety & welfare and industrial relations.

Capital – Budget has taken slew of measures on this front – raising external debt through Sovereign issuances (will help in moderation of domestic bond yields for corporates); introducing credit default swaps; deepening of corporate bond markets; providing partial credit guarantee on PSB's purchase of high rated pooled assets of NBFCs; suggesting increase in the FDI limit in sectors like aviation, media (animation, visual effects, gaming and comics) and Insurance; streamlining FPI limits; capitalizing public sector banks.

Over the last few years, we have seen rise in the Government spending on capex but the private sector has been lagging behind due to excess capacity & twin balance sheet problems (stress on the books of both Corporates & the lenders). We are now at the cusp of revival in the private investments and Government in this Budget has tried to give some impetus to this process.

DEVIL LIES IN THE DETAIL !

Despite enormous pressure to deviate from the fiscal prudence in the wake of growth concerns, Government stuck to the path of fiscal consolidation. Undoubtedly, the Fiscal Deficit target of 3.3% of GDP for FY 2019-20 deserves praise but the headline number conceals the ambitious assumptions made, to achieve the fiscal deficit target.

Budget is expecting a Net Tax revenue growth of 25% in FY20 (against 6% growth in FY 19). The numbers looks quite optimistic even if we discount the incremental tax revenue from hike in custom duty, excise duty and higher surcharge on wealthy individuals.

Government is again relying heavily on divestment proceeds (~ Rs. 1,00,000 Cr) and dividend from PSEs/ RBI (with major share ~ Rs. 90000 Cr is expected from RBI), in its budget estimates for non-tax receipts which is expected to grow at 27% in FY20.

On the expenditure side, the unsettling part is the steep rise in the revenue expenditure vis-à-vis capital expenditure. The revenue expenditure is expected to grow at 22% while the squeeze in the capex will lead to a modest rise in the capital expenditure at 11% in FY20

BUDGET IMPACT ON SECTORS

Automobile (excluding E-Vehicle OEM's) – Negative

- No policy measures to stem the demand crisis in the sector.
- Expected scrappage policy didn't find any mention.
- Hike in the excise duty and road cess on Petrol & Diesel, will further increase the total cost of ownership of vehicles running on fossil fuels.

Banking (PSB's) – Positive

- Recapitalisation of PSU banks by Rs. 70,000 Crore.

FMCG & Consumer Durables – Mixed Bag

- Cigarette excise duty was re-introduced however the impact is negligible. Positive for the cigarette companies.
- Hike in the import duty on Palm Fatty Acid Distillate (PFAD) and other fatty acids from 0% to 7.5%. Will adversely impact the margins of Soap companies.
- Increase in customs duty on split AC outdoor and indoor from 10% to 20%. Will impact companies like Havells for short term till its new capacity comes on stream next year

Infrastructure/ Building Materials – Positive

- Higher outlays for Roads
- Incentives for affordable housing in terms of incremental tax deduction

NBFC/ HFC's (Top Rated)– Positive

- Government to provide partial credit guarantee to the PSU banks for purchase (upto Rs. 1 tn) of high rated pooled assets of NBFC.
- Interest on bad or doubtful debts in the case of deposit-taking NBFC and systemically important non deposit-taking NBFC shall be booked on receipt basis, similar to scheduled commercial banks.
- Additional deduction of Rs. 1.5 lac (over & above INR 2 lac currently available) towards interest paid on housing loan borrowed before Mar-20, for buying affordable house up to Rs. 45 lacs
- Regulation of HFC's to move to RBI from NHB. The proposed change will restore the confidence of investors in HFCs

Technology – Negative

- Levy of 20% on Share Buyback – Setback for major IT companies (TCS, Infosys) which have huge cash on their balance sheet but don't have enough investment opportunities to deploy their funds.

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