From the Fund Manager's desk…

Government announces Corporate tax cuts – a booster dose for economy and investments!

- After a series of small incremental steps to revive the economy and restore optimism in the equity markets the government on Friday announced tax cuts from the prevalent base rate of 30% to 22% in addition to measures encouraging investments in manufacturing. These steps would act as a booster shot for the economy and the ball now lies in the hand of corporates whom it is now upto to utilise this stimulus wisely.
- These announcements are extremely positive for boosting investments in the manufacturing sector, in our opinion. While, Apple Inc has shown the way to the world with investments in India, we believe others are likely to follow suit as quickly as CY2020. In our opinion, this seems to be the next logical step to "Make in India", Government's flagship programme.
- It also signals the government's shift from 'fiscal prudence' to 'growth revival' which we feel is the need of the hour. These measures are also aided by a supportive monetary policy with substantial (110bps) rate cuts since Feb 19. A healthy monsoon is also likely to aid rural consumption.
- Amongst the various sectors - Private Banks, Consumer and Auto sectors will see maximum positive impact however IT companies would see no/low benefits.
- Although there will be only a one time impact on earnings for these companies, the positive cash flow impact will be permanent and this will not only lead to better financial position but also a permanent rerating for companies.

Exhibit 1: Key announcements by Finance minister on September 20th

Measure	Details
Tax cut for domestic companies	The Government has announced that all domestic companies shall now have the option to pay tax at the rate of 22% without any exemptions (vs the tax rate of 30% earlier). Including the surcharge, the effective tax rate now comes to 25.2% (vs 33% earlier). These companies will not be required to pay the Minimum alternate Tax (MAT) as well.
Incentive for manufacturing	Any new manufacturing company incorporated on or after October 2019 and making fresh investments will be liable to pay tax at the rate of 15% only. The effective tax rate for such companies including surcharge will be 17%. These companies too will not have to pay any MAT.
Reduction in Minimum Alternate Tax (MAT)	For companies which continue to avail exemptions, MAT now stands reduced to 15% (from 18.5% earlier).
Surcharge on Capital gains	Enhanced surcharge in this year's budget shall not apply on capital gains arising on sale of securities liable for Securities Transaction Tax (STT). This will also be applicable to Foreign Portfolio Investors (FPIs).
Rollback of tax on share buy back	For listed companies that have made a public announcement of buyback before July 5th 2019, it is provided that tax on buyback of shares in case of such companies shall not be charged.
Priority sector lending norms to boost exports	The Reserve Bank of India (RBI) has relaxed the priority-sector lending (PSL) rules for exporters, scrapping the turnover limit for an exporter to be eligible for such loans and increasing the sanction limit per borrower, to complement the government's efforts to boost the flow of credit and reverse the slide in outbound shipments in recent months.
GST cut	Finance Minister Nirmala Sitharaman on September 20 announced the reduction of GST rates on a slew of items. All rate changes would be effective from 1 October

Source: Ministry of Finance

Likely Impact on Government:

- Total revenue loss estimated at Rs1.45tn, which is 7% of expected gross receipts of the government for FY20. Additionally, what needs to be kept in mind is the Rs400bn likely shortfall in GST collection.
- So far till Jul'19, total gross receipts of the government amounted to ~Rs4tn (19% of FY20BE). Gross tax receipts of the government during Apr-Jul'19 amounted to Rs5.4tn (22% of FY20BE and a four year low).
- With already low pace of tax collection, this additional tax revenue foregone will put pressure on the government finances.
- Part of the shortfall has already been met through the additional annual receipts from RBI and disinvestment proceeds, but the fiscal deficit will likely be hit and some action will be needed on that front.
- The changes in corporate tax rate cut will ultimately lead to likely accelerated investment and help in recovery of the lost revenues in the long run. In the near term, government will likely make an effort to adhere to its fiscal consolidation plan with a potential cut in expenditure in the coming months.

Likely Impact on Corporates:

- These measures have the potential to kick start the economy over the medium to short term in our opinion. The exact quantum of benefits will be a function of how companies decide to utilize the benefits from the lower tax rates.
- De-leveraging of balance sheet, price cuts/higher promotions to consumers, higher payouts to shareholders via dividends and higher capex investments are some of the options available to capital allocators.
- FMCG & Auto will be likely to pass tax benefits to consumer to revive demand while Private Banks with a relatively high tax rate will gain big too.
- How an individual company apportions the benefits will decide the course of corporate earnings over the near term.
- The larger corporates do have an advantage over the MSME's as the latter are already under a lower tax bracket. This means market leaders such as Britannia, Hindustan Unilever and Nestle will have an advantage over smaller players such as Bajaj Corp and some of the larger ones like Marico which are already at a lower tax rate.
- Also, these measures will help increase competitiveness and accelerate a shift from unorganized to organized.

What does this mean for your Portfolio? Good news is that over 88% of portfolio companies across our 3 funds will benefit…

Exhibit 2: Companies that had an Effective tax rate >25.17% will benefit from the cuts

Ambit Portfolios	Portfolio companies that benefit	Biggest beneficiary (>35% ETR)	No impact (<25.17% ETR)
Emerging Giants	94%	Alkyl Amines, Canfin Homes, Music Broadcast, Sterling tools, TV Today network, Cera Sanitaryware	NA
Good & Clean	88%	Kajaria Ceramics, Lupin, PVR	PI industries, Torrent
Coffee can portfolio	93%	Berger paints, Bajaj Finance	Marico

Source: Ambit Asset management, Note: ETR= FY19 Effective tax rates used adjusted for outliers

Exhibit 3: Your portfolio stock weightages (ex-cash) distributed according to tax brackets

Tax bracket	Emerging Giants	Good & Clean	Coffee can portfolio
>35%	39%	18%	9%
32-35%	13%	43%	72%
25.17%-31%	42%	26%	13%
<25.17%	5%	13%	6%
Total	**100%**	**100%**	**100%**
>25.17	**95%**	**86%**	**94%**

Source: Ambit Asset management, Note: ETR= FY19 Effective tax rates used for calculations, Final tax rates used are average of our portfolio companies sector wise