From the Fund Manager's desk…

Gloom and Doom to Opportunities Galore!

Following the announcement of the FY2021-22 Union Budget, the leading index Sensex ended the day up 5%. This was the sharpest rise after any budget announcement in the last 10 years. While the impact of The Union budget may be visible only over a longer term, the sentiment can often be gauged by these movements. In this note, we take a look at the budget and other big reforms by the government recently that have led to such a change in mood.

The Steps taken by the Government – Union budget and outside of it

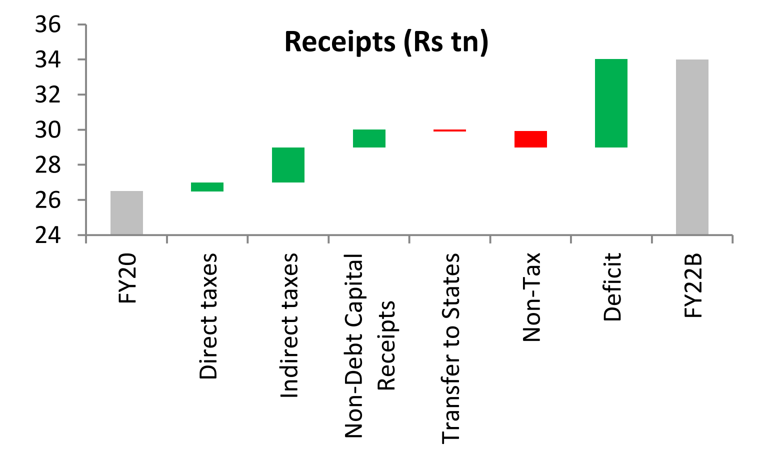
The government has already undertaken significant reforms to strengthen the supply side with prominent ones being **(1)** Reduction in corporate tax-rate, **(2)** Simplifying labour laws and **(3)** incentivizing domestic manufacturing through PLI schemes ***(Ref to Exhibit 1)***. It has continued its focus on supply-side reforms in the FY2021-22 union budget through **(1)** further incentivizing localization, **(2)** monetizing government assets, **(3)** creating better social infrastructure; and, **(4)** improving the health of the financial sector.

Exhibit 1: The PLI scheme is one such initiative to incentivize domestic manufacturing, schemes like this and others will have an impact in the longer run

Target segments	Incentives	Eligibility
Production-Linked Incentive scheme		
Mobile Phones (invoice value over above Rs15,000)	4-6% over 5 years	(1) Rs10 bn investment over four years, (2) sales of Rs40 bn in first year increasing to Rs250 bn in fifth year
Mobile phones (domestic companies)	4-6% over 5 years	(1) Rs2 bn investment over four years, (2) sales of Rs5 bn in first year increasing to Rs50 bn in fifth year
Specified electronic components	4-6% over 5 years	(1) Rs1 bn investment over four years, (2) sales of Rs1 bn in first year increasing to Rs6 bn in fifth year
Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS)		
Electronic components, semiconductors, specialized subassemblies and capital goods	25% on capex, including R&D	Investments in new units as well as expansion of existing units
Modified Electronics Manufacturing Clusters Schemes (EMC 2.0)		
Infrastructure base for electronics industry	50% of project cost, with ceiling of Rs700 mn for acre of land Cash	Electronics manufacturing companies with a commitment to purchase/lease a minimum of 20% of the land area and invest a minimum of Rs3 bn

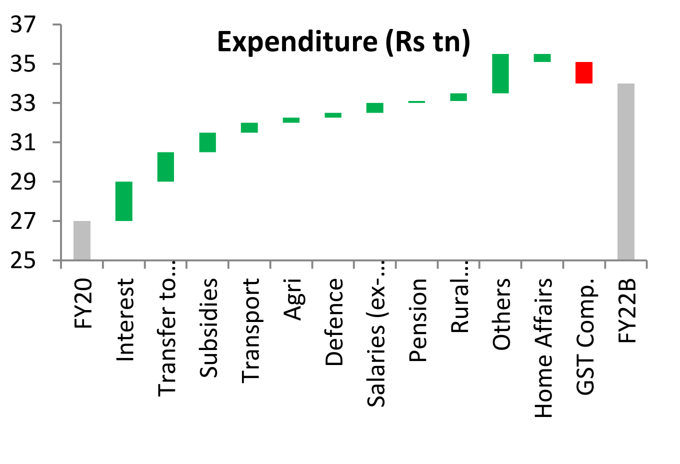
Source: Ambit Asset management

Exhibit 2: Receipts for FY22 expected vs the FY20 actual numbers (Assuming FY21 was a skip year)



Source: Ambit Asset Management, Budget Documents

Exhibit 3: Expenditure for FY22 expected vs the FY20 actual numbers (Assuming FY21 was a skip year)



Source: Ambit Asset Management, Budget Documents

FY2021-22 Union Budget Key Message for Investors

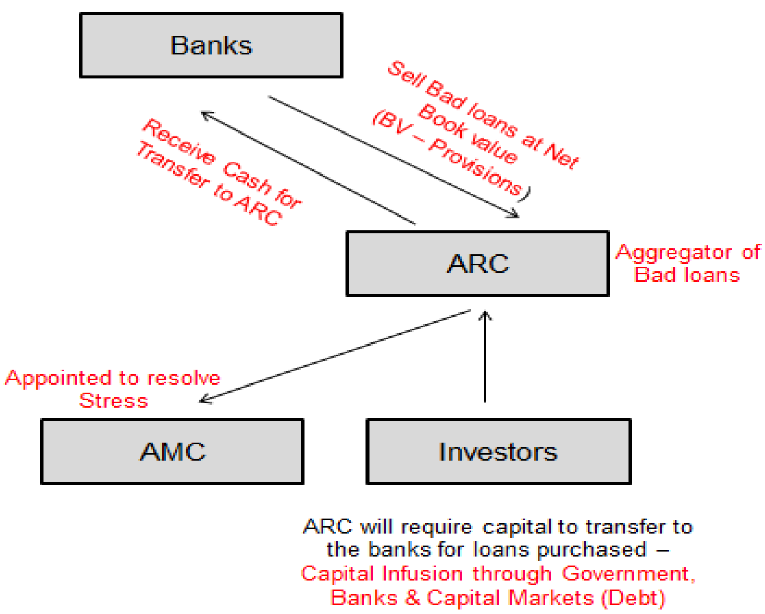
The FY2022 union budget rightfully focused on growth and accordingly, relaxed the government's medium-term fiscal consolidation targets

1. EXECUTIVE SUMMARY:

A. STRONG FOCUS ON GROWTH:
a. Capex Over OPEX - Government has deliberately chosen the path of capex (Capital Expenditure) vs. opex (Revenue Expenditure) for longer term gains. Revenue expenditure on FY20 base is up 24.5% & capex is up 65%.
b. Increased Healthcare expenditure – Increased allocation towards healthcare expense in light on the COVID-19 pandemic. This also includes allocation towards the vaccination programme
c. **Rs 1.75Lac Cr Divestment target** – Increased focus in this budget which is very much achievable considering the avenues to achieve the same (BPCL, Air India, Airports in Tier 2&3, Pipeline Infrastructure of GAIL, LIC IPO etc.)
d. Encouraging foreign investment in Insurance Sector – Increased FDI limit to 74% from current 49%. This will provide insurers with growth capital while attracting large foreign companies in the sector to India.
e. **Reforming the Banking Sector – (1)** Rs200bn towards PSU Bank recapitalization (INR200bn) **(2)** Proposal to privatize two Public Sector Banks (PSBs) **(3)** Proposal to set up an ARC (Asset Reconstruction Company or Bad Bank) ***(Refer to Exhibit: 4)*** and Development Finance Institution for Infra financing with a lending portfolio of Rs5tn over 3 years with a proposed budget of Rs200Bn.
f. **Rural Spending continues to be robust:** Rural growth spending at 10% CAGR over FY20-22E, Rural spending is overall budgeted to normalize as the boost from COVID-19 related interventions to fade away but compared to FY20 levels, the agriculture & farmers welfare spending would be up by 30% in FY22.

B. FISCAL CONSOLIDATION PLANNED IN A PHASED MANNER: Slow and Steady path to Fiscal Consolidation by targeting Fiscal Deficit of <4.5% by FY26 implies increased government spending ***(Refer to Exhibit: 8)*** They now plan to achieve Fiscal Deficit target of 4.5% of GDP by FY26 versus 3.1% by FY23 set earlier.***The government will seek to benefit by lower interest rates by taking up debt financing to fund some of its growth agenda.***

Exhibit 4: ARC / Bad Bank Operating Structure – A Big Reform in the Banking Sector



Source: Ambit Asset management

2. HIGHER TRANSPARENCY & REALISTIC TARGETS

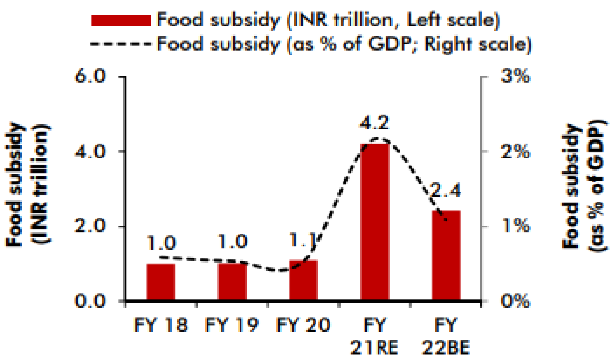
- **Off balance sheet funding revealed:** The government took a conscious decision to reduce the past dues to food and fertiliser subsidy, in effect reducing the off budget fiscal deficit. This explains higher than usual allocation to food subsidy in FY22 ***(Ref Exhibits 5 & 6 below)***

- **Realistic Revenue receipts & Disinvestment targets**

  Revenue receipts in FY21 are seen at Rs15.5trn, sharply down from the budgeted number of Rs20.2trn. In FY22, revenue receipts are budgeted at Rs17.8trn. As a % of GDP, revenue receipts in FY21 are likely to be ~8% (down from budgeted 10.4%) and remain largely flat at 8% in FY22.

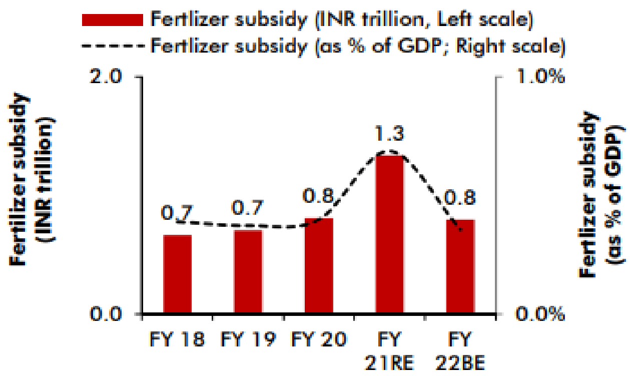
  The government plans to divest stakes in entities such as LIC, Concor, Air India, 2 public sector banks and a general insurance company in FY22. Budgeted revenue from disinvestment in FY22 is Rs1.75trn (down from FY21BE of Rs2.1trn, but sharply up from FY21RE of Rs320bn).

Exhibit 5: Government allocated high amounts to food and fertiliser subsidy…



Source: Ambit Capital research

Exhibit 6: …to clear all backlogs



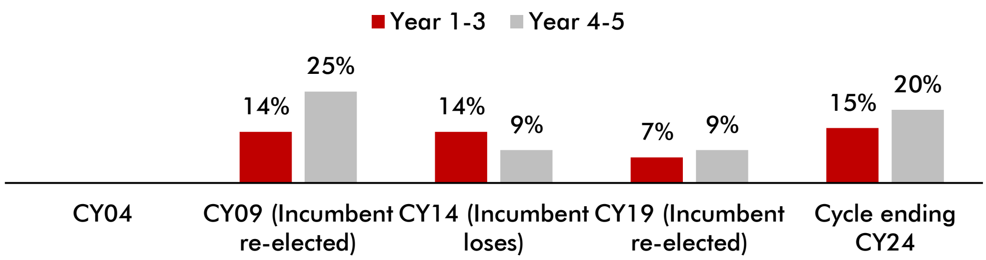
Source: Ambit Capital research

3. QUALITY & LIKELY SPENDING

- **Quality of spending improves**: For FY22, the government has budgeted Rs5.5trn towards capital expenditure. This marks an increase of 26% YoY over FY21RE and 34% YoY over FY21BE. Historically, revenue expenditure accounts for ~87% of total expenditure while capex accounts for 13%. Budgeted expenditure numbers for FY22 show revex at 84% while the share of capex to increase to 16% thus leading to higher Fixed capital formation (improving quality of expenditure).

- **Pro-growth agenda to continue:** From FY23 onwards, we will see higher focus on spending as elections near, this is typical of election cycles whereby higher growth is seen in spending towards the end of the tenure**. (Ref to Exhibit 7)**

Exhibit 7: Governments spend higher in last 2 years of their election cycle vs. first 3 years, the best may yet be ahead in reforms and Central government revex spending

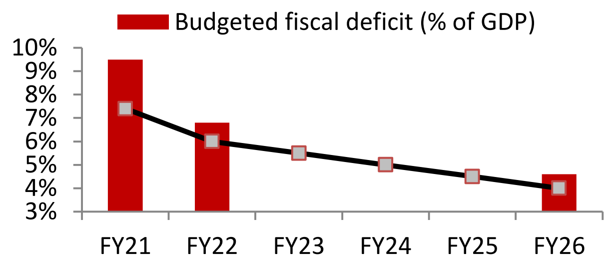


Source: Ambit Capital research, Union budget documents, Ambit Capital research, Note: 1. Year 1-3 refers to the first three financial years of the 5 year General Election cycle and Year4-5 refer to the two financial years leading up to the next General Election. 2. YoY growth rates are calculated as Average. 3. Year 4-5 in the CY24 category represents Ambit estimates

4. PRIORITISING GROWTH DESPITE LIMITATIONS

- **Budget was above estimates in terms of being expansionary.** The revised fiscal deficit (FD) target for FY21 is 9.5% of GDP, sharply higher from consensus estimate of ~7.5%.
- **Borrowing programme for FY22 lower than FY21**: Fiscal expansion would mean additional borrowing in FY21 at Rs800bn and FY22 gross borrowing remaining a bit elevated but lower than FY21 at Rs12trn. Given the excess liquidity in the banking system, the higher borrowing programme should not be an issue especially in an environment of higher government spending and foreign flows which can augment banking system liquidity further.
- The government plans to bring down FD to 4.5% of GDP by FY26. This implies average reduction of ~60bps in fiscal deficit during FY23-FY26.

Exhibit 8: The Budget is yet to formalize the FRBM glide-path



Source: Ambit Asset Management, Budget Documents

Exhibit 9: Debt funding-availing cheaply available credit

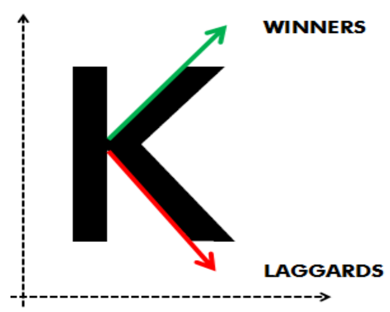
in Rs Bn	FY20	FY21 BE*	FY22 RE**	FY22
Fiscal Deficit	**9,337**	**7,963**	**18,487**	**15,068**
External Financing	87	46	545	15
Domestic Financing	9,250	7,917	17,941	15,053
Dated Securities (Net)	4,740	5,449	10,528	9,247
T-Bills (Net)	1,501	250	2,250	500
Small Savings	2,400	2,400	4,806	3,919
Cash Drawdown	50	(530)	(174)	714
Others***	906	559	348	531

*Source: Ambit Asset Management, * -Budge Estimates,, **- Revised Estimates, ***- Includes State Provident Funds, Internal Debts, Public Account*

5. KEY MESSAGE TO INVESTORS: DON'T MISS THE TRAIN AGAIN!

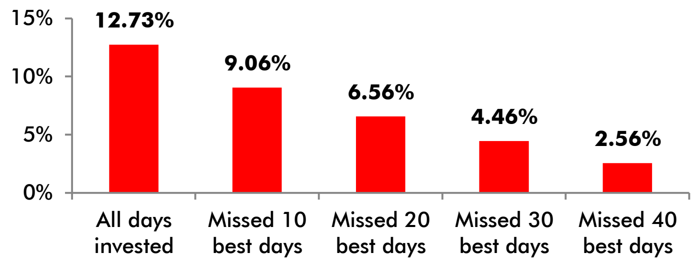
- In our humble opinion risk comes from not knowing what you do rather than volatility. That's why it is essential one follows the correct process in order to achieve a favourable outcome and one remains invested in equities as the best means of long term wealth creation. (Especially given falling interest rates of fixed and saving deposits).
- According to our analysis of Sensex returns from 1990-2020, missing the 20 best days of market movement in those 30 years would have reduced overall returns by half ***(Ref to Exhibit: 11)***. Hence, we would like to re-iterate our philosophy of **Time-In-The-Market rather than Timing the Market**.
- **The K-Shaped recovery *(Ref to Exhibit: 10)*** that we called out way back in June-2020 is playing out as Winners / Leaders increase their competitive advantage over Laggards. We believe that Top-Quality businesses will continue to outperform over the longer-run and subsequently generate huge investor returns. ***One must not risk missing out the next leg of growth over the coming decade by under allocating to equities. Start Investing!***

Exhibit 10: K shaped recovery to benefit our portfolio companies the most...



Source: Ambit Asset management

Exhibit 11: ...Staying invested allows us to maximize return + minimize risk post stock selection



Source: Ambit Asset management, Note: Sensex Returns from January 1st, 1990- March 31st, 2020

For any queries, please contact:

Umang Shah- Phone: +91 22 6623 3281, Email - aiapms@ambit.co

Ambit Investment Advisors Private Limited -

Ambit House, 449, Senapati Bapat Marg,

Lower Parel, Mumbai - 400 013

Risk Disclosure & Disclaimer

Ambit Investment Advisors Private Limited ("Ambit"), is a registered Portfolio Manager with Securities and Exchange Board of India vide registration number INP000005059.

This presentation / newsletter / report is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or to enter into any Portfolio Management agreements. This presentation / newsletter / report is prepared by Ambit strictly for the specified audience and is not intended for distribution to public and is not to be disseminated or circulated to any other party outside of the intended purpose. This presentation / newsletter / report may contain confidential or proprietary information and no part of this presentation / newsletter / report may be reproduced in any form without its prior written consent to Ambit. All opinions, figures, charts/graphs, estimates and data included in this presentation / newsletter / report is subject to change without notice. This document is not for public distribution and if you receive a copy of this presentation / newsletter / report and you are not the intended recipient, you should destroy this immediately. Any dissemination, copying or circulation of this communication in any form is strictly prohibited. This material should not be circulated in countries where restrictions exist on soliciting business from potential clients residing in such countries. Recipients of this material should inform themselves about and observe any such restrictions. Recipients shall be solely liable for any liability incurred by them in this regard and will indemnify Ambit for any liability it may incur in this respect.

Neither Ambit nor any of their respective affiliates or representatives make any express or implied representation or warranty as to the adequacy or accuracy of the statistical data or factual statement concerning India or its economy or make any representation as to the accuracy, completeness, reasonableness or sufficiency of any of the information contained in the presentation / newsletter / report herein, or in the case of projections, as to their attainability or the accuracy or completeness of the assumptions from which they are derived, and it is expected each prospective investor will pursue its own independent due diligence. In preparing this presentation / newsletter / report, Ambit has relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. Accordingly, neither Ambit nor any of its affiliates, shareholders, directors, employees, agents or advisors shall be liable for any loss or damage (direct or indirect) suffered as a result of reliance upon any statements contained in, or any omission from this presentation / newsletter / report and any such liability is expressly disclaimed. Further, the information contained in this presentation / newsletter / report has not been verified by SEBI.

You are expected to take into consideration all the risk factors including financial conditions, risk-return profile, tax consequences, etc. You understand that the past performance or name of the portfolio or any similar product do not in any manner indicate surety of performance of such product or portfolio in future. You further understand that all such products are subject to various market risks, settlement risks, economical risks, political risks, business risks, and financial risks etc. and there is no assurance or guarantee that the objectives of any of the strategies of such product or portfolio will be achieved. You are expected to thoroughly go through the terms of the arrangements / agreements and understand in detail the risk-return profile of any security or product of Ambit or any other service provider before making any investment. You should also take professional / legal /tax advice before making any decision of investing or disinvesting. The investment relating to any products of Ambit may not be suited to all categories of investors. Ambit or Ambit associates may have financial or other business interests that may adversely affect the objectivity of the views contained in this presentation / newsletter / report.

Ambit does not guarantee the future performance or any level of performance relating to any products of Ambit or any other third party service provider. Investment in any product including mutual fund or in the product of third party service provider does not provide any assurance or guarantee that the objectives of the product are specifically achieved. Ambit shall not be liable for any losses that you may suffer on account of any investment or disinvestment decision based on the communication or information or recommendation received from Ambit on any product. Further Ambit shall not be liable for any loss which may have arisen by wrong or misleading instructions given by you whether orally or in writing. The name of the product does not in any manner indicate their prospects or return.

The product 'Ambit Good & Clean Portfolio' has been migrated from Ambit Capital Private Limited to Ambit Investments Advisors Private Limited. Hence some of the information in this presentation may belong to the period when this product was managed by Ambit Capital Private Limited.

You may contact your Relationship Manager for any queries.