ArihantCapital
Generating Wealth

Pre-Budget Note
July 02, 2019

Budget Preview (FY19-20)

Budget to hang in balance between fiscal prudence and populism

Key Budget Expectations

- **Fiscal deficit to be maintained at 3.4% of GDP**
- **Expansionary budget needed to avert further slowdown**
- **Government is expected to announce some relief measures to revive the agriculture sector and rural economy**
- **Focus will also shift to incentivize private sector investments which have seen a sharp slowdown after the NBFC crisis**
- **In absence of large tax revenue, a buoyant stock market can help meet Rs 90K cr of dis-investment target set at interim budget**

Arihant Top Picks for Pre-Budget

- **Bajaj Auto**
- **Ramco Cements**
- **Sunteck Realty**
- **Shakti Pumps**

First Budget for the first woman finance minister of India

India's first woman Finance Minister Ms. Nirmala Sitharaman will have her task cut out in the upcoming budget which is to be presented on July 5, 2019. Some of the key challenges pertaining to tighter fiscal deficit amidst a backdrop of weak rural demand, tapering GDP growth and fragile consumer sentiments will need to be addressed. We believe, government may manage the fiscal prudence through revival in the government spending which may offset the steep fall seen in the private sector investments.

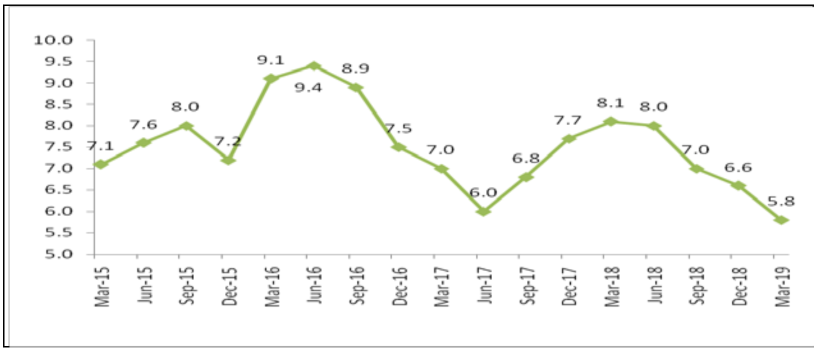
A strong mandate and second term for Modi pins high hopes on reforms

With a strong mandate in place, stakes are high and street is hopeful that the ministry will deliver a capitalist budget in order to revive the private sector demand which has seen a sharp decline post the NBFC crisis. However, we believe the budget will be a fine balance between fiscal prudence and populist measures which could be undertaken to revive the overall demand. Focus will also shift to incentivize private sector investments which have seen a sharp slowdown after the NBFC crisis. Initiatives like increasing the MSP may provide a much needed breather to the farmers. Agriculture (15%-18% of GDP) has witnessed a significant slowdown due to rainfall deficit and drought like situation in key agrarian states and the government is expected to announce some relief measures to revive this sector.

Broad-based slowdown in Indian economy calls for relief measures

The Indian economy is suffering from a broad-based slowdown – consumption has tapered off, industrial activity has remained subdued and the SME segment has been struggling ever since the introduction of GST. GDP growth in the January-March quarter has slumped to a five-year low of 5.8%, relegating India behind China. Unemployment touched a 45-year high of 6.1% of total labour force in 2017-18. Private investment is weak due to over-leverage, government spending has slowed down and consumption, the only engine of the economy that has been running, has started showing fatigue. The external situation is bleak too. Unlike the tailwind of low crude prices in Modi's first term, crude oil is on an uptrend this time. There is a global slowdown, while the US and China are locked in a trade war.

Exhibit 1: India's GDP Growth Trend (%)



Source: Ministry of Finance, Arihant Research

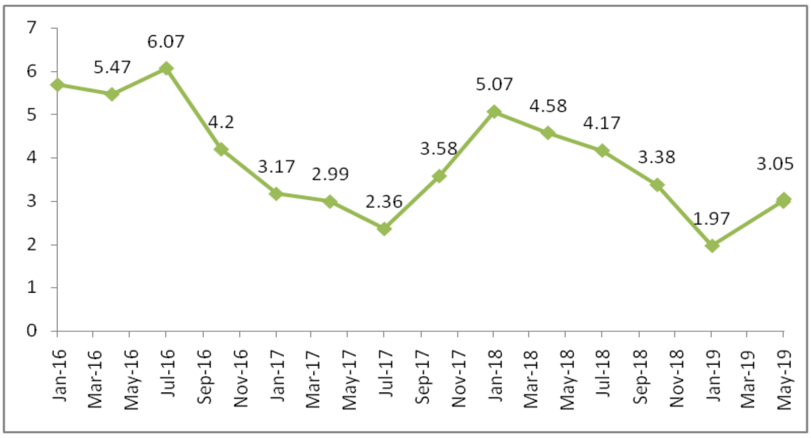
Budget at a glance

Particulars (Rs Bn)	FY18	FY19 (RE)	FY20E (BE)
1. TOTAL REVENUES (A+C)	**15,509**	**18,228**	**20,802**
Tax revenue (A)	**12,425**	**14,844**	**17,050**
Gross Tax revenue (B) (i+ii)	**19,192**	**22,390**	**25,407**
Direct Tax (i)	**10,020**	**12,000**	**13,800**
-Income Tax	4,308	5,290	6,200
-Corporate Tax	5,712	6,710	7,600
Indirect Tax (ii)	**9,172**	**10,390**	**11,607**
Total GST	4,426	6,439	7,612
-Central GST (CGST+IGST)	3,799	5,539	6,600
-Compensation cess	626	900	1,012
Others	4,746	3,951	3,995
Less: Trf to state	6,767	7,546	8,357
Non-Tax Revenue (C)	**3,084**	**3,384**	**3,752**
-Dividends	914	1,193	1,361
-Telecom	321	392	415
-Disinvestment	1,000	800	900
2. TOTAL EXPENDITURE (iii+iv)	**21,420**	**24,572**	**27,842**
Revenue (iii)	18,788	21,411	24,479
Interest payments	5,290	5,876	6,651
Police, pensions	4,013	4,388	4,613
Subsidies	2,244	2,992	3,342
- Food subsidy	1,003	1,713	1,842
- Petroleum subsidy	245	248	375
- Fertiliser subsidy	664	701	750
Development related	5,691	6,576	7,542
Others	1,550	1,579	2,331
Capital (iv)	2,631	3,162	3,363
Defence	904	940	1,034
Development related	1,727	2,222	2,329
FISCAL DEFICIT (1-2)	**5,911**	**6,344**	**7,040**
NOMINAL GDP	**170,951**	**188,407**	**209,132**
Fiscal Deficit (%)	3.46	3.37	3.37

Only silver lining – inflation is under control

Amidst overall slowdown in economy, one encouraging fact is that inflation is presently well under control. India's central bank, the Reserve Bank of India (RBI), has put the path of Consumer Price Index-linked inflation (CPI inflation) at between 3% and 3.1% in the first half of this fiscal (H1 FY20) and between 3.4% and 3.7% in the second half of this fiscal (H2 FY20).

Exhibit 2: India CPI Trend



Source: Ministry of Finance, Arihant Research

Tax shortfall led to spending cut

The government's gross tax revenue collections grew by a meagre 8% in FY19 (against RE of 17%). Over last 10 years, this is the largest miss relative to RE. Despite tax shortfall, the government managed to contain its fiscal deficit to 3.4% of GDP, by resorting to a sharp spending cut of ~Rs 1.5 trillion (0.8% of GDP). While part of spending was transferred off balance sheet, spending in the rural and social sectors was also cut significantly.

Fiscal deficit to be maintained at 3.4% of GDP

The government is most likely to stick to its 3.4% fiscal deficit target for FY20 set at interim budget. The fiscal deficit target was revised to 3.4% of the GDP by the government in the interim budget from 3.3%. In FY19, the government was able to meet its 3.4% fiscal deficit target through a severe cut in its spending, which resulted in the Q4FY19 GDP growth slowing down to a five year low of 5.8%.

Outlook – expansionary budget needed to avert further slowdown

If the fiscal deficit target is maintained at 3.4% of GDP as outlined in interim budget, then expenditure growth will likely be around nominal GDP growth which means government will spend much lesser amount in development. However to avert further slowdown of the economy, spending should take priority especially in infrastructure and rural spending. In absence of large tax revenue, a buoyant stock market can help meet Rs 90K cr of dis-investment target set at interim budget, which will help in containing the fiscal deficit and bring down the overall revenue shortfall.

Arihant Pre-Budget Picks

Automobile: Bajaj Auto (CMP: Rs 2827; Target: Rs 3631; Research Call: Accumulate)

- With expectation of GST cut in the budget to alleviate the pain of the automobile sector as well as expected sops for the rural economy from government, Bajaj Auto will be a key beneficiary with rising market share in the motorcycle market.
- In FY19, the company has gained ~200bps market share in motorcycle market on account of price disruption in entry level motorcycle market.
- Over the medium term, we believe, Bajaj Auto's market share gains will continue, led by new product launches. We have estimated revenue/EBITDA/PAT CAGR of 10%/11%/14% over FY19-21E period.
- Despite the slowdown in automobile sector, Bajaj Auto managed to report strong export sales in June, which has more than offset its muted domestic sales.

Cement: Ramco Cements (CMP: Rs 784; Target: Rs 853; Research Call: Hold)

- In the upcoming budget there is a possibility of GST cut on cement to revive the infrastructure activities and kick start the private capex cycle in the country after almost a decade of lull. Also government's focus on affordable housing will drive the demand going forward for the cement industry.
- There has been a recovery in the cement industry in last few months on the back of some demand recovery and volumes have also started picking up at a good pace.
- For cement industry demand growth stood at 9%-10% in Q419, taking growth to 10% in FY19. The industry saw a 13.6% YoY increase in volume to 275.7 MT in FY19.
- Cement companies have also taken price hikes in last few months, sensing a pick-up in demand going forward. Especially in Southern region the price hikes have been steepest. Ramco being a southern player benefits the most from these price hikes. Also despite June being a lacklustre month due to monsoon, prices have held up quite well, which augurs well for the margin of the cement players.
- Ramco witnessed strong double digit volume growth both in southern and eastern markets due to strong demand in all the segments viz., retail, infrastructure and affordable housing. Sales volume grew by 20.6% YoY to 3.3mt in Q4FY19 , while for FY19 volume grew 19.3% YoY to 11.1MT

Real Estate: Sunteck Realty (CMP: Rs 435; Target: Rs 569; Research Call: Buy)

- In the upcoming budget government will put more thrust on the affordable housing to revive the real estate sector.
- Over the past few quarters Sunteck has shown increasing traction in its collection as well as pre-sales volume in its key projects. For FY19, Sunteck has done pre-sales of Rs 12bn (+105% YoY) and collections of Rs 6.6bn (+25% YoY).
- Sunteck is now focussing on building a premium commercial and retail portfolio of 3 mn sq ft (approximately) in Oshiwara District Centre (ODC), about 1.5-2 msf in and around BKC, and ~1 mn sq ft in Naigaon; a total of over 6 msf. For this, the company is planning an investment of Rs 5,000 crore over the next four years.
- The value that Sunteck would create through its commercial and retail portfolio is close to USD 2 bn, which will further strengthen its cash flows and accelerate the growth of the company.
- We believe going forward, Sunteck's robust sales momentum coupled with strong execution of its ongoing projects would help the company to register 28.6% revenue CAGR and 27.6% PAT CAGR over FY19-21E period.

Industrial Machinery/Capital Goods: Shakti Pumps (CMP: Rs 402; Target: Rs 465; Research Call: Accumulate)

- For FY20E, tenders are already out for 2 lakhs pump-sets amounting to Rs 45 bn. In 5th July Budget, the company expect some decision on the 'KUSUM' Project rollout and expect some orders within few months.
- Shakti Pump is market leader in energy efficient solar pumps with more than 50% market share and posted impressive FY19 results with 25.2% YoY revenue growth and 29.3% YoY growth in PAT with stable margin of 16-18%.
- The company has around Rs 1.5 bn of order book at the end of Q4FY19 and aiming for a revenue growth of 25% for FY20E with stable margin around 18%.
- The company is aiming for a turnover of Rs 5000cr (~10x of FY19 sales) in next five years and will be a key beneficiary of the 'KUSUM Project' of Government.
- With more than 25% YoY revenue growth and stable margin of ~18%, Shakti is on the right path to achieve its targeted growth. We are positive on Shakti and have an Accumulate Rating.

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Stock Rating Scale

	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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