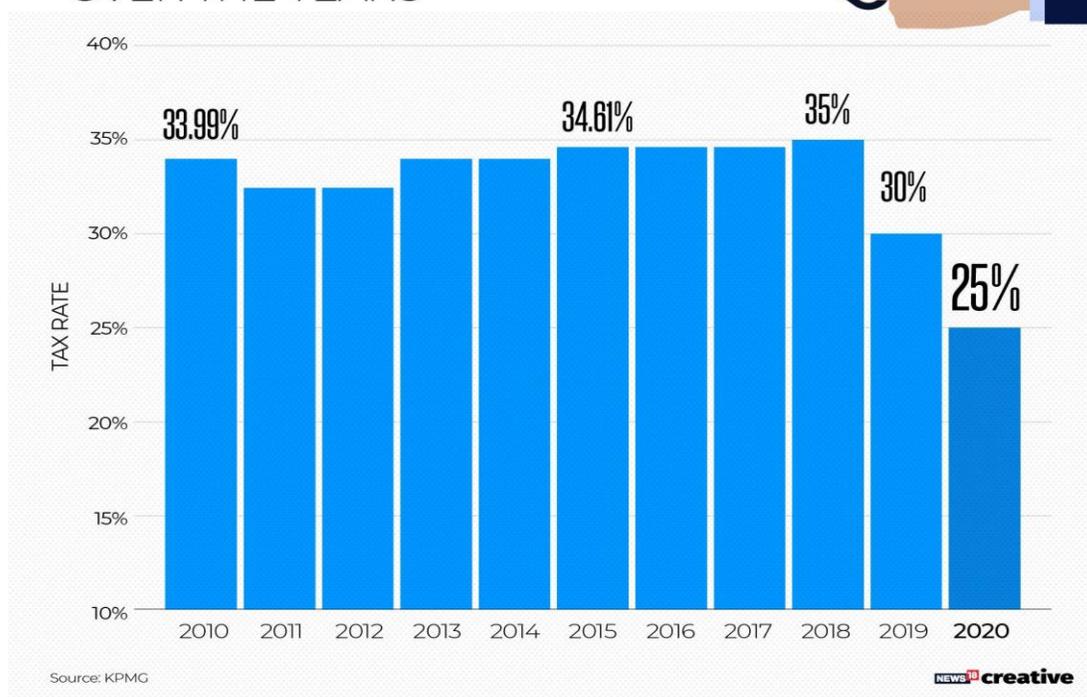


CORPORATE TAX IN INDIA

OVER THE YEARS



AN ABOUT TURN ON SENTIMENT

Monetary Policy

Rates cut 110bp over the last 12 months, with another meeting in October.

Fiscal Reform

Government cuts corporate tax by close to 10% to 25%

Monsoon

Rainfall was over and above expectations and bodes well for rural wealth. Over 60% of India lives in a rural location.

ANOTHER REFORM

THE GOVERNMENT CUTS CORPORATE TAXES

The Government of India cut corporate taxes from 30% (34.3% including surcharge and cess) to 22% (25.2% all inclusive) on Friday 20th of September 2019. This was announced during market hours and saw one of the strongest rallies ever posted, with the Nifty 50 rising 5.3% by the end of the day.

The estimated US\$20bn impact should boost sentiment in Corporate India which apart from a one-time increase in profitability, should also lead to a turn in consumption and a boost for investment / manufacturing.

This reflects a shift in the Government's thinking from fiscal discipline to towards a pro-growth culture. Monetary policy has been cut by 110bp over the past year and now this fiscal reform, along with a good monsoon, should be positive for stock market sentiment.

GROWTH BOOST

A FOCUS ON MANUFACTURING

BOOST THE “MAKE IN INDIA” INITIATIVE

In order to attract fresh investment in manufacturing and thereby provide a boost to ‘Make-in-India’ initiative of the Government, any new domestic company making a new investment in manufacturing, will have an even lower rate of tax.

ATTRACT INVESTMENTS FROM OVERSEAS INVESTORS

For new manufacturing companies, a tax rate of 15% (17% all inclusive) would apply for companies which are incorporated on or after 01.10.2019 and commence production on or before 31.03.2023.

MAKE INDIAN COMPANIES COMPETITIVE GLOBALLY

This time the Government is extending the benefit of lower tax rates only to those corporations which will not seek to take up exemptions and incentives. This is essential to improve compliance and widen the tax base through a more level playing field for all tax-payers. Lower taxes will create a disincentive to tax evasion.

COMPANIES INCENTIVE TO INVEST AND FOCUS ON REVISING CONSUMPTION

The Finance Minister, Nirmala Sitharaman has also clarified (announcement was made earlier) that the incremental surcharge announced on LTCG (Short Term Capital Gains) and STCG (Short Term Capital Gains) on the 5th of July would be withdrawn.

INVESTMENT LIKELY TO CREATE A BOOST IN EMPLOYMENT

In India, it is mandated that companies with turnover of over A\$200m or profit of over A\$1m must spend 2% of their profit on Corporate Social Responsibility (CSR). The definition of CSR was expanded to include government programs like education and investment funds which should again be a positive for stock markets.



STOCK MARKET IMPACT

- Most brokers have raised their earnings estimates by 7-8% for FY20 and FY21.
- Potentially this could kick start the private capex cycle and make India global cost competitive, providing a boost to exports and boost foreign direct investment
- Boost consumption leading into the upcoming festive season (Diwali)
- Provide some upside risk to GDP forecasts for FY20 (which had recently reduced to around 6%)
- The impact of this move will be an increase in the fiscal deficit towards 3.8% from the current forecast of 3.3% of GDP and rising bond yields (which may impact the RBI's attitude towards cutting rates).
- Companies can use the tax cuts to deleverage balance sheets, price-cuts / marketing promotions, higher payouts to shareholders and higher capex spending. All are positive for markets

The Nifty (India's bellwether stock market Index of the 50 largest free float companies) rose 5.3% in response to the announcement.

Post the election outcome the market peaked at 12,088 on June 3rd. However, a poor budget outcome which showed no signs of fiscal stimulus, rising taxation on investors and an initially poor monsoon led to significant weakness in markets. The Nifty fell to 10,704 on Thursday September 19th – a fall of 11.4%.

Monetary policy was seen by the markets as a blunt tool as transmission into the banking system and liquidity remained weak due to poor sentiment. Additionally, the automobile industry (7% contribution to GDP) was extremely weak, suffering falls of 40% relative to the same time last year as purchasers hesitated with the potential of lower prices in the future and weak overall sentiment.

The tax cuts are likely to be most positive for Banking / Financials, Manufacturers and Consumption companies. However, Information Technology and Pharmaceutical Companies will benefit least as most of the revenue comes from offshore.

It's times like this in Indian markets that having an active strategy allows for a far bigger pay-off. The Index weighting in Manufacturing is high in Automobiles, but not in areas like Capex, Engineering and Construction. With positive sentiment now underpinning, we expect to see a significant move in mid and small cap companies which have been left behind in the last 18 months.

The India Avenue Equity Fund is well poised to capitalize on a re-rating of these companies. We should also benefit from our high exposure to Private Banks and our lower exposure to Technology companies.

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