

GST-An investors perspective

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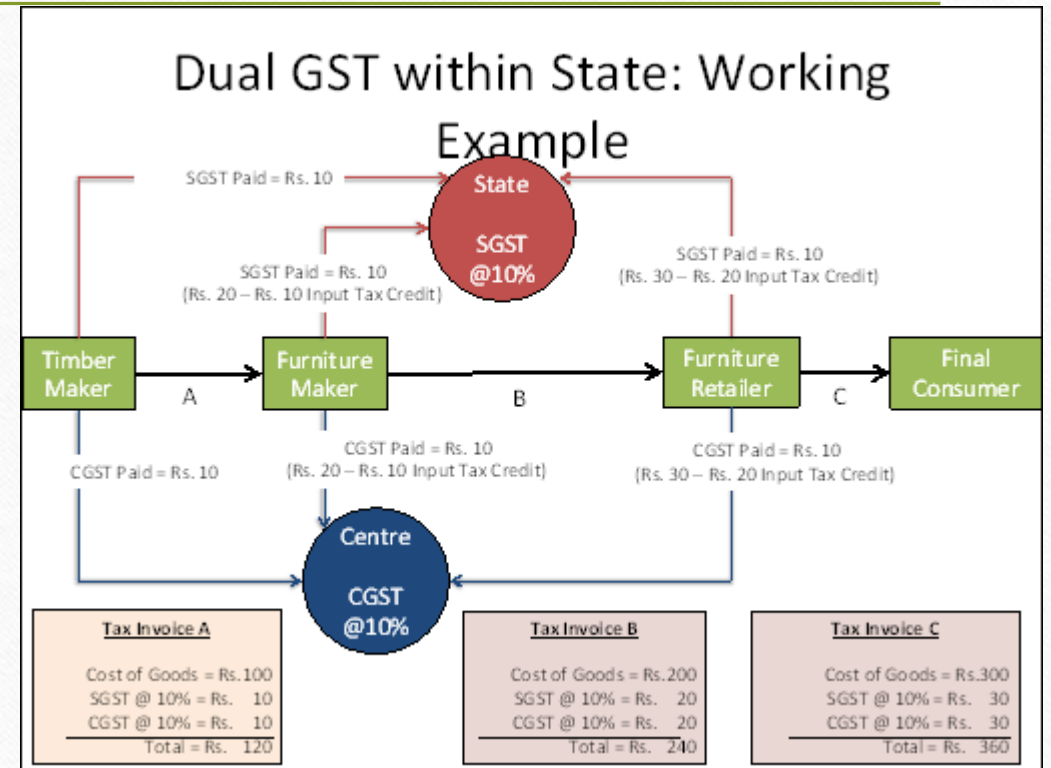
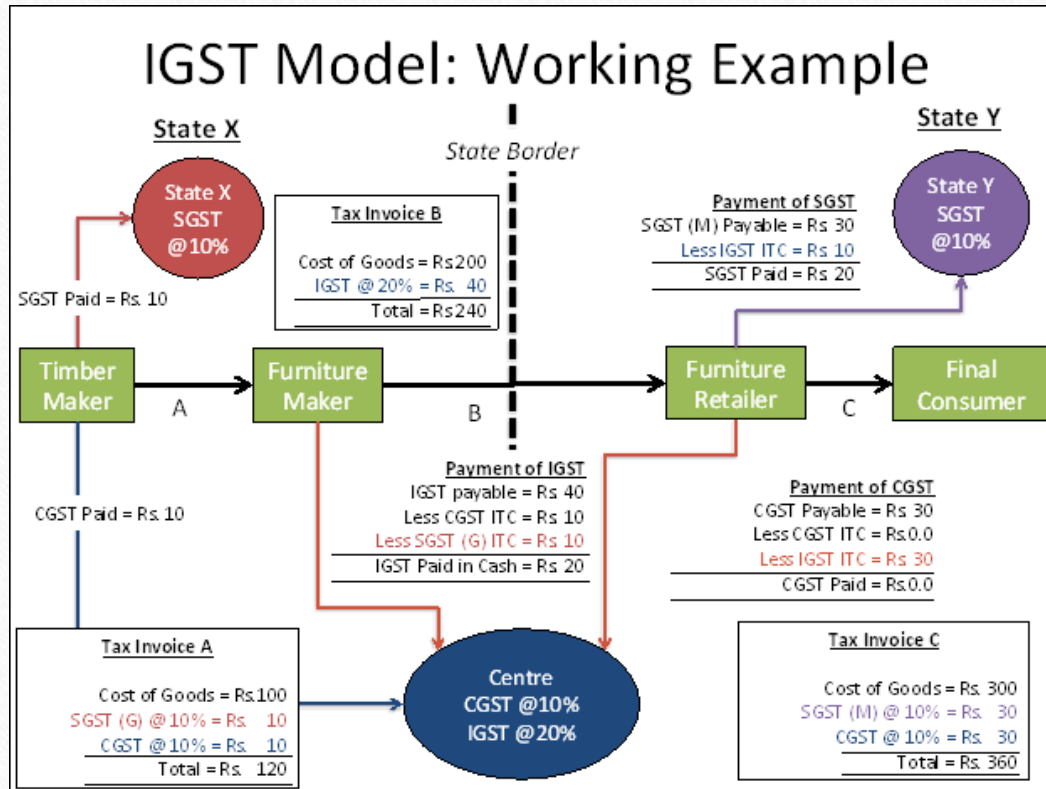
At Value Investors Meet 19 Feb 2017

For discussion purpose only

Outline

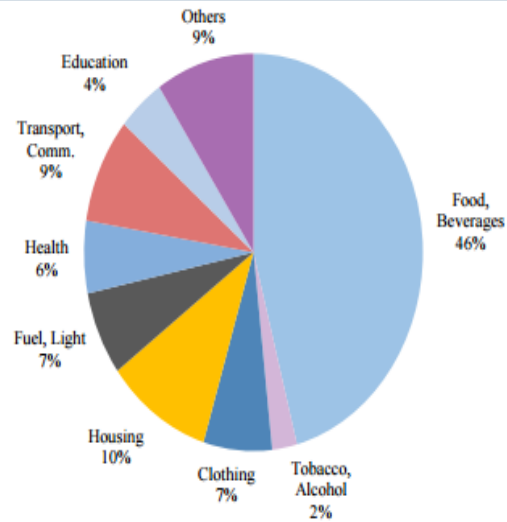
- GST Working Example
- GST impact on Inflation
- State finances overview/compensation
- GST Benefits-Overview & Analysis
- Other points under GST
- How to react as an investor?

GST Working Example (Source: GST FAQs)



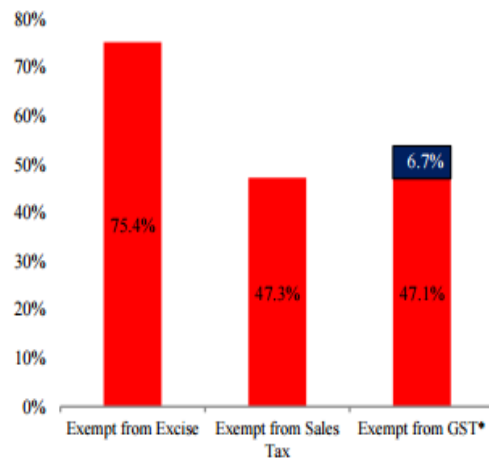
GST Impact on Inflation

Figure 4: Food, rent and clothing have high weight in CPI



Source: CMIE

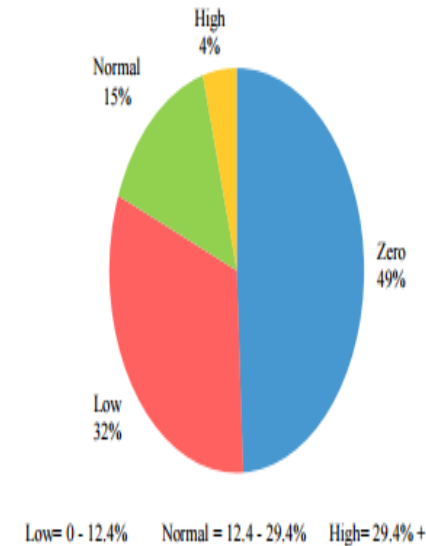
Figure 5: A large part of CPI is exempt from Excise/VAT



* Items exempted from both excise and sales tax, to which are added alcohol, tobacco, petroleum products

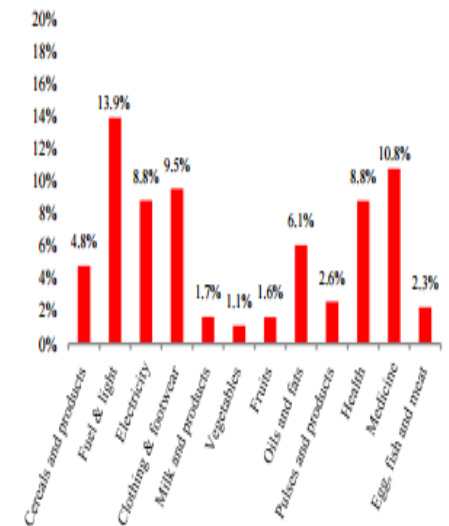
Source: CBEC, State Governments, Estimates

Figure 6: Only 15% of CPI is taxed at a "normal" rate



Source: CBEC, State Governments, Estimates

Figure 7: Low average tax rate on most large categories



Source: CBEC, State Governments, Estimates

<http://www.cbec.gov.in/resources//htdocs-cbec/gst/cea-rpt-rnr.pdf>

State finances overview/Compensation

- All data from RBI study [State Finances : A Study of Budgets-Apr16](#). Numbers used are FY15-16(RE) and all % below as % of revenue receipts which is 20,11,890 crores.
- 70% revenue receipts are tax revenues of which 46% directly collected by state, and 24% devolved from Centre.
- Of 46%, following taxes not in GST
 - Property Tax 6%
 - State Excise(mostly alcohol)-5%
 - Vehicle Taxes-2%
- Of 24%, following taxes not in GST
 - Income Tax on companies and individuals-14%
- Hence, excluding 27% of revenue receipts(or 40% of tax revenues) outside GST, only 43% of revenue receipts at risk
- However, states will be compensated 100 per cent for loss which is directly attributable to GST implementation for a period of five years. Base line is 2015-16, yet no clarity on revenue growth rate projections method.
- FY17 compensation estimate is 50,000 crores which is **around 2.5% of the state revenue receipts, or 5% of impacted revenue base**

GST Benefits-Overview & Analysis

Sample framework from Motilal Oswal

Exhibit 1: Sector-wise impact of GST

Sector	Change in Tax rate	Availability of Input credit	Unorganized to organized	Supply Chain Management	Overall
Auto - Batteries	●	●	●●●	●	●●●
Consumers - Retail	●	●●●	●	●	●●●
Logistics	●	●	●●	●●	●●●
Media - Multiplex	●●●	●●●	●	●	●●●
Auto - Two wheeler/ Four wheeler	●●	●	●	●	●●
Consumers: FMCG – Ex Alcohol and cigarette	●	●	●	●	●●
Capital Goods: Light Electrical	●	●	●●	●	●●
Media - Pay TV Distributor	●	●	●	●	●●
Cement	●●	●	●	●	●●
Metals	●	●	●	●	●
Pharma	●	●	●	●	●
Capital Goods: Industrial	●	●	●	●	●
IT	●	●	●	●	●
Media - Pay TV Broadcasters	●	●	●	●	●
Textiles	●	●	●	●	●
Telecom	●	●	●	●	●
Auto - CV	●	●	●	●●	●●
Media - Print Media	●●	●	●	●	●●
Consumers - Cigarette	●●●	●	●	●	●●●

Highly Negative: ●●●; Negative: ●●; Slightly Negative: ●; Neutral: ●; Slightly Positive: ●; Positive: ●●; Highly Positive: ●●●

<http://www.motilaloswal.com/site/rreports/636089488096796044.pdf>

Anti Profiteering Clause- curbs margin expansion-change in tax rate

- Many company valuations price in EBITDA expansion due to ‘pricing power’ even if GST rate reduces(eg FMCG)
- However, Clause 163 of Model GST law states that
- *The Central Government may by law constitute an Authority, or entrust an existing Authority constituted under any law, to examine whether input tax credits availed by any registered taxable person or the reduction in the price on account of any reduction in the tax rate have actually resulted in a commensurate reduction in the price of the said goods and/ or services supplied by him. **Return to days of price control??***

<http://www.livemint.com/Opinion/hXzUdJlsSzwBynLEJ4sETJ/>

[GST-antiprofitereing-measures-necessary.html](http://www.livemint.com/Opinion/hXzUdJlsSzwBynLEJ4sETJ/GST-antiprofitereing-measures-necessary.html)

Seamless input credit under GST?

- **The most critical cause of failure of GST will be in the transference of responsibility and liability of tax remittance to the customers of a supplier** ([Section 16\(11\)\(c\)](#)). Basically, the law postulates that if a particular supplier has failed to comply with the law correctly – by furnishing the correct returns ([Section 27\(3\)](#)) and/or making the correct payment ([Section 27\(2\)](#)) – then its' customers cannot avail the input credit, and if given, it will be reversed
- New suppliers, SMEs and/or those with poor compliance scores-at a disadvantage. Expect payment terms to worsen for these entities
- Unlike TDS where payer's failure does not revoke credit, such step is here
- http://mirror.tallysolutions.com/Downloads/GST_Representation.pdf

Unorganized to organized theme

Exhibit 22: Product pricing divergence between organised/unorganized

Home building segments	Market size	Organised share	Organised market size	*Price difference (organised vs unorganised)	Price difference explained by				
	(₹ bn)	(%)	(₹ bn)	(%)	Production costs	**Taxes	Labour payments	A&P/ others	
Light Electricals	379	67%	254	30%	9%	8%	6%	7%	
Paints	314	65%	204	13%	1%	3%	1%	8%	
Tiles	210	40%	84	30%	8%	6%	5%	11%	
Pipes	120	65%	78	25%	12%	10%	0%	3%	
Plyboards	150	30%	45	25%	5%	12%	4%	4%	
Sanitaryware	30	48%	14	20%	4%	9%	3%	4%	

Source: Ambit Capital research, management meetings, Note: * As a percentage of market prices of organised players, ** Most important component of the price difference is excise duties

*Not all the price difference is due to tax. Some will still remain
 *Parallel economy will not disappear in the short term, and where inputs are tax free (agriculture) or imported without IGST (Smuggled), this issue will continue to persist. So unorganized to organized theme issue

http://reports.ambitcapital.com/reports/Ambit_Economy_Thematic_GSTOverhyped_20Aug2015.pdf

SCM savings under GST?

- B2C mass segments-TAT and supply norms entail multiple depots/warehouses. While transit time will reduce IFF checkpoints abolished, demand norms will not fall.
- Further, it is required to pay tax at each movement (except for job work transfers). Credit can be utilized lower down the chain during the actual sales. As the payment requirement is upfront now, working capital requirements for companies is going to increase

Other points under GST

Ease of doing business?-Dual Control, Transition needs

- The states to administer taxes on 90% of the taxpayers (incl service) with annual turnover up to Rs1.5cr and the Centre to control the remaining 10%. On taxpayers above the threshold, Centre & States to equally share the power.
- Also, multiple registrations are necessary for branches situated in different states-similar to VAT rather than service tax centralized registrations
- ‘Cross Default’-Cascading impact of dual control on compliance score, SCNs.
- • A huge IT system needs to be set up, tax collectors trained and companies brought up to speed on a levy that experts say will force them to overhaul business processes from front to back
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Losers from GST-some examples

- If the immediate impact of GST is that it will compress supply chains (by making them efficient through either lower transport time or optimal location of warehouses etc.)=> inventory destocking.
- Informal sector employment compression without social security net-Expect more agitations for reservations and/or government jobs. Formal sector unlikely to absorb due to automation/higher efficiency.
- Existing logistics investments in hubs-stranded?-Bhiwandi??
- Investments in areas no longer offering industrial incentives-Baddi, Daman?-erosion in land values already visible
- Exporters with duty drawback(Cenvat vs Non Cenvat) giving super normal profits

Inter-Sector value migration

- Need to think carefully about value migration-Not always obvious. Example
 - Fabric manufacturing in India is largely carried out through the SSI sector, where many of the companies operate under the composite scheme of taxation (applicable with turnover of up to Rs 1.5 crore). ITC cannot be claimed on purchases from suppliers under composite scheme. With GST on yarn, the apparel manufactures would prefer to deal with GST-compliant fabric suppliers to avail ITC .
 - Gujarat Gas will be a residual beneficiary from GST being implemented in the ceramic/tile structure in Morbi Gujarat. With high taxation earlier and many unorganised players not properly paying taxes, they used to prefer coal over gas as a cash purchase to under report production. With rationalisation of tax structure, these players would have less incentive for the current practice; hence, they could go towards gas, which is a superior fuel in terms of product quality and plant maintenance. This would drive demand for industrial PNG supplied by Gujarat Gas
 - If print media ad revenues are taxed, ability of the print industry to pass on the tax burden to readers is limited in an era where print is increasingly becoming less competitive viz-a-viz digital media

Consumer behavior resistance to GST benefits

- As per Edelweiss distributor survey, they do not expect jewellery demand to shift to organised players due to GST as sales are driven by: a) relationships; b) Large players range is not that good and new designs come with a lag; and c) bargaining power is low
- Most people ask for bills as they want guarantee cards. Hence, not much impact on electronics in urban centres

How to react as an investor

How to react to GST

As a trader

- Anticipate GST Council decisions and do trades(eg LONG ITC)
- Build in valuations even before the tariffs/rates schedule is known
- Take a stance on FCF expansion with incomplete information on anti profiteering & working capital

As an investor

- WAIT for the complete Bill and schedules to be finalized
- Analyze the pros & cons
- Check company plans for GST transition-preparedness is key
- Do not forget other ongoing projects(eg DFC, renewable energy push) which may complement or offset the impact of GST