श्री LAKSHMISHREE

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"WISE SPENDING IS PART OF WISE INVESTING AND IT'S NEVER TOO LATE TO START."

From Managing Director's Desk To Readers

Debt Mutual Fund Tax Change: Throwing Out The Baby With The Bathwater

If the noise on social media is anything to go by, the passing of the Finance Bill 2023 with its amendments has spelt the end of debt mutual funds. Thanks to an amendment in Finance Bill 2023, slipped in without a preamble, gains arising from the sale of 'specified mutual funds', are to be taxed as short-term at the taxpayer's marginal rate of income tax. These include all schemes which do not hold more than 35 per cent in equity shares of domestic companies; hence, debt funds, gold funds, international funds and certain hybrid funds will suffer.

Before the amendment was passed, gains from these funds were taxed as capital gains; with anything booked before 36 months being short-term, taxed at one's income tax slab. But, gains booked after 36 months were considered long-term, with the benefit of indexation available.

Indexation is adjusting the purchase price of long-term assets to reflect the impact of inflation or long-term price rise in the economy. It neutralises the impact of inflation.

The passing of the Bill now implies that this benefit has been taken away from investors of debt mutual funds_and all other mutual funds that don't have a domestic equity component of more than 35%. This will hurt roughly half of the Rs 40 trillion assets under management with the domestic mutual fund industry.

The objective may have been to end the tax arbitrage between bank fixed deposits and debt mutual funds, thereby pricing credit risk accurately. Fixed deposit investments have no inflation protection, even if held for a long period, as returns are in the form of interest on original capital. There is one school of thought which says that debt funds take on market risk and hence, gains must be taxed differently. However, the reward for taking market risk, lies in higher return. Long term fixed deposits also carry inflation risk just like long term debt funds.

The problem lies in the short-sightedness of the amendment, which fails to address the larger issue of varied capital gains tax rates across different assets, which, investors grapple with. Plus, it somehow includes a whole lot of other, unrelated funds within its scope of application.

An uneven playing field

While attempting to create a level playing field with fixed deposits, it now becomes a more uneven field compared to other capital assets like domestic real estate and physical gold. Why would investors hold gold in the fund form instead of physical gold, given that the latter has the benefit of indexation on gains despite the underlying asset being the same?

It also adds to the turmoil by including a variety of other types of funds under the same umbrella, thanks to how the amendment defines specified mutual funds. Gold and international equity funds, for instance, don't invest in the same type of capital assets as fixed deposits, hence, question of tax arbitrage doesn't arise in the first place.

Not to mention that now investing in real estate where gains are indexed for taxation and insurance policies where the payout at maturity is tax exempt also gain a leg-up over debt mutual funds. The government's approach to this issue resembles throwing out the baby with the bath water, and policy makers seemed to have missed the mark completely. Investor ire notwithstanding, experts are saying that the corporate bond market stands to be adversely affected too.

The need of the hour is to remove multiple layers of short and long-term capital gains across different assets and make it uniform for all. Listed equity is taxed at 10% after one-year, real estate is taxed at 20% with indexation after two years and unlisted debt is taxed at 30% after three years.

As an aside, adding to the chaos is the illogical internal mutual fund categorization; all non-domestic equity funds should not be clubbed together for taxation purposes. There is also no apparent rationale in discouraging long-term investments in international equities which, now become relatively less lucrative as a choice for the domestic investor looking to optimise returns through diversification.

Long term benefit or short-sighted change?

For individual investors, it is always better to consider an investment choice on the basis of its risk-return balance and other features like flexibility, cost, liquidity and transparency. A tax advantage is not in the manufacturer or investors' control as it is defined by the government and hence, should not be a guiding factor. Nevertheless, it always has been so. In fact, very often governments use tax incentives to guide investor money in one direction and this happens in capital markets worldwide.

Regardless of the merits of tax incentives, for goal-oriented investing, one has to remain focused on investment options that stand tall on their own merit rather than with the help of a tax crutch. For high net-worth investors who use surpluses simply to optimize returns, the removal of tax benefits is a bigger blow. Having said that, this move is removing the tax 'crutch' and simultaneously pushing funds in the deep end to drown. It's not just the mutual fund managers who will bear the brunt, but investors too may be inclined to make inefficient choices by moving long-term money into bank fixed deposits and even illiquid real estate.

Some experts are calling it a win for the banking lobby over mutual funds. Given the direction set by the new income tax rules and tax resets announced in the budget speech, it's clear that the policymakers want investment securities to stand on their own merit.

What's unclear is the motive behind this amendment, without a well thought through attempt to bring uniformity to both short and long-term capital gains across assets, thus, making the tax pasture an even more uneven playing field.

Salil Shah

Managing Director

Lakshmishree Investments & Securities Pvt. Ltd.

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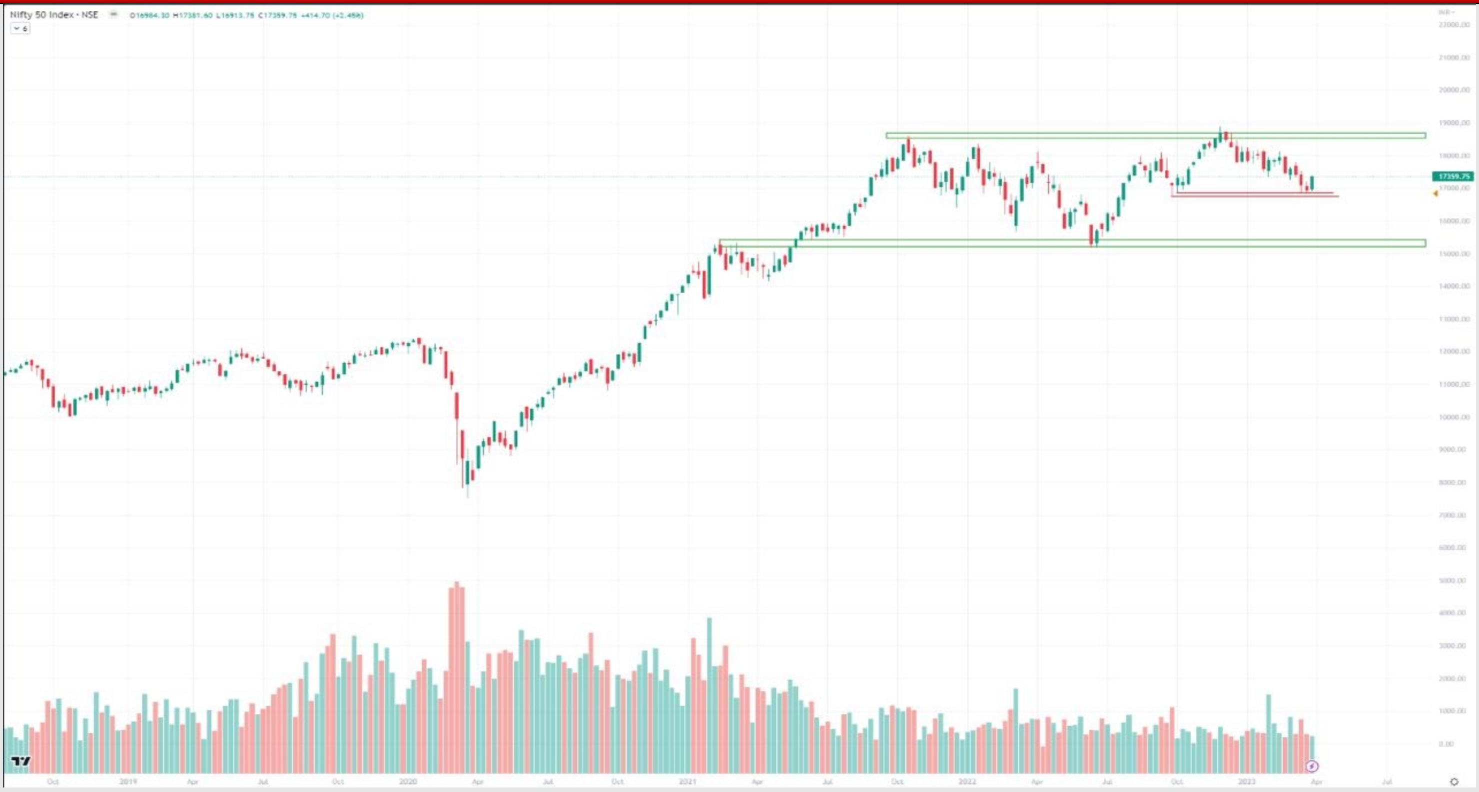
Look What Our Research Analyst Has To Say...



Its has been an oversold market for almost 5 months and we have ended the month on a positive note. 3 Weeks of breadth is also oversold and has give a breakout on the last trading session of the month. Hence for the 1st 2 weeks of April we are very bullish on he index with a strong view of 17750.Above that the index will extend gains to 17950. On the downside march lows of 16850 zone will be a major support for the bulls. Any dips around the said zone will be opportunities to open aggressive longs.

Some Lessons From The SVB-Led Financial Crisis

The incipient banking crisis in the aftermath of the Signature Bank and Silicon Valley Bank (SVB) failures seems to have been averted for the moment because of multi-pronged and swift action by different players working together. The US regulators and government reassured depositors by guaranteeing all deposits, not just the $250,000 originally guaranteed by the FDIC. A bunch of big US banks have stepped in to help out the First Republic Bank, which seemed to be headed for trouble. And according to reports, New York Community Bank will take over the failed Signature Bank.

In Switzerland, the UBS Group AG took over its ailing rival Credit Suisse AG with the Swiss government promising to chip in $9 billion to cover losses that UBS may incur because of the takeover. In the UK, HSBC UK Bank Plc has taken over the ring-fenced Silicon Valley Bank UK (the UK arm of SVB) for a grand sum of 1 UK Pound. Regulators and governments in the west are meanwhile keeping a hawk eye on small and medium regional banks which could be vulnerable.

In India, despite some initial skittishness, there seems be little danger of the domestic banks being in any kind of danger specifically caused by the SVB failure.

Of course, no one can tell if the SVB failure fallout has been actually averted fully or if more bad news will hit the global banking system tomorrow. Investors of AT1 bonds_of various banks are only now waking up to the fact that they are no better placed than equity holders – and that is leading to fresh nervousness. But at the time of writing this column, it seems that the domino effect of further banks collapsing in US and UK seems to have been stemmed for the nonce.

It is therefore a good time to look hard at the failures of SVB, Signature and others and see if there are any big lessons one can learn from them. There are several lessons in fact....

Cheap and easy money pushed by central banks to help governments save the economy from one crisis is invariably the reason for the next one. The 2008 crisis could trace its roots back to the easy and cheap money flood that was released to help the US economy recover from the dotcom crash of 1999-2000. The dotcom bubble itself was the result of cheap funds being available in plenty. The current problems can also be traced back to central banks across the world lowering interest rates to record levels and ensuring plenty of liquidity to help their respective economies recover from the COVID pandemic.

Central banks often think they can help an economy from a recession by lowering interest rates aggressively and ensuring high liquidity in the system. It does seem to work initially – but invariably it leads to the next problem the moment it tries to tighten liquidity and increase interest rates.

But can any major recession be combated and a country's economy recover without plenty of cheap money being thrown at the problem? Quite possibly, the answer is no. But the problem starts when the central banks think it is their job to fix all the economic problems that the government of the day needs to fix. Monetary policy has limited tools to help in an economic recovery and central banks invariably don't know when to stop once they start pouring out the money.

It invariably leads to asset bubbles and high inflation and when the central bank tries to remedy that with higher interest rates, the next round of financial problems begins in the system.

The only remedy to stop this cycle seems to be a far more measured approach in both opening the cheap money financial tap as well as closing it. But that is something that is easier in theory than in practice.

The second lesson is that it is still the way the bank is managed that makes all the difference. Silicon Valley Banks problems started because it did not hedge its interest rate risks. And it was too narrowly focused on a single sector. Other banks that got into trouble invariably had poor risk management strategies. This is true in 2023 as it was in 2008 – and even earlier.

If one were to look at banks in the US and Europe, almost all of them are sitting on significant mark to market losses because of the recent sharp interest rate hikes. However, many of the big and stable banks were and are in a position to ride out the higher interest rate regime without collapsing like SVB or Signature Banks. It is always the weakest and most badly managed banks that start collapsing when the environment changes.

Is there a way out to ensure these issues can become less frequent through better regulation? Globally, regulations to prevent such problems have focused on how much money the bank keeps in safest bonds and how much cash and easily encashable assets it holds. In the SVB case, it is now clear that holding tons of low interest safe treasury bonds is of no use if the interest rate regime changes. There is little a regulator can do under some circumstances.

Perhaps regulators need to keep a closer eye on the operations and operating models of all banks under their watch. This is of course easier said than done. Even in India, where the RBI has been particularly vigilant, it has failed to prevent the collapses and near collapses in individual cases. Yes Bank got into trouble right under the central bank's nose – despite being a pretty big and visible bank and not an obscure regional bank. In the US, regulation is far more lax compared to India – one reason why the global financial problems invariably have started with one US bank getting into trouble initially. So perhaps it is the US which now needs to think hard and find solutions about how it can regulate its banks better.

The Western World seems to be taking some banking lessons from Indian history – and they might be the wrong lessons. One thing different between the US government and regulator reaction in the SVB collapse aftermath from their reaction in 2008 is clear. This time, the US has talked about protecting depositors and ensuring they do not get hurt – unlike in 2008 when the focus was on prevent bank collapses by rescuing bondholders and other bank investors.

This brings back memories of the Indian bank nationalisation when then Indian Prime Minister Indira Gandhi decided to take over private banks to save depositors.

Sure, the mechanism of a backstop fund to guarantee bank depositors that their money is safe is very different from the government taking over the operations and ownership of a private bank. But the underlying principle is the same.

The issue is that while it helps depositors – and certainly no one can argue that they should not protected from inept bank management and greedy bank bondholders and shareholders – it also creates a moral hazard. Once bank CEOs know that depositors have a safety net guaranteed by the government, there is nothing preventing them from acting even more recklessly unless there are strong regulations in place and there is a regulator with the wherewithal to keep a close eye on them.

In India, no public sector bank has failed – the government will not allow that. But far too many were/are inefficient and loss making and needed recapitalisation with tax payer money. They were also responsible for most NPAs that started building up because of lax risk assessment protocols and poor risk management skills.

Digitisation has made bank runs much easier and regulators and governments need to wake up to the new danger. Even in 2008, a bank run would stretch over several days or even weeks. For the average depositor, moving money from one bank to another required some effort.

In 2023, SVB depositors needed only to go to the bank's website and transfer their entire or almost the full amount to another bank. In most banks, a depositor could do the same using even the bank's mobile bank.

This doesn't leave much time for the bank, its investors, the regulator or the government to take action. In most cases, a panic run on other banks will start even before the government or regulator can announce any measure.

There is no way of preventing the next crisis. At most, one can only keep a closer eye on banks – again something easier said than done.

Anshul Jain

Research Analyst

Stocks To Watch

1. GAIL

GAIL (India) Limited

GAIL (India) Limited is India's leading natural gas company with diversified interests across the natural gas value chain of trading, transmission, LPG production & transmission, LNG re-gasification, petrochemicals, city gas, E&P, etc. It owns and operates a network of around 14,617 km of natural gas pipelines spread across the length and breadth of country.

It is also working concurrently on execution of multiple pipeline projects to further enhance the spread. GAIL and its Subsidiaries / JVs also have a formidable market share in City Gas Distribution. In the Liquefied Natural Gas (LNG) market, GAIL has significantly large portfolio. GAIL is also expanding its presence in renewable energy like Solar, Wind and Biofuel.

Particulars

Bloomberg	GAIL IN
Equity Shares (m)	6,661
Market Cap.	Rs. 680.5 billion
52 Week Range H/L	116/ 83
1, 6, 12 Rel. Per (%)	3/ 23/ 7
12M Avg Val	Rs 1,581 million

Shareholding Pattern

	Dec -22	Sep-22	Dec-21
Promoter	51.5%	51.5%	51.5%
FIIs	18.7%	20.4%	20.2%
DIIs	23.7%	21.7%	23.0%
Public/Other	6.1%	6.4%	5.3%

Income Statement

Y/E March (INR b)	FY 21	FY 22	FY 23E	FY 24E	FY 25E
Net Sales	567.4	916.5	1,535.7	1,369.5	1,391.8
Change (%)	-21.1	61.5	67.6	-10.8	1.6
EBITDA	64.5	138.3	79.8	133.5	134.2
% of Net Sales	11.4	15.1	5.2	9.7	9.6
Depreciation	19.1	21.1	24.4	25.4	25.8
Interest	1.6	1.7	3.3	2.1	2.3
Other Income	20.0	20.5	21.5	22.6	23.7
EO Items (net)	0.0	0.0	0.0	0.0	0.0
PBT	63.9	135.9	73.6	128.6	129.8
Tax	15.0	32.3	18.5	32.4	32.7
Rate (%)	23.4	23.7	25.2	25.2	25.2
Reported PAT	48.9	103.6	55.1	96.2	97.1
Adjusted PAT	49.0	102.9	55.1	96.2	97.1
Change (%)	-26.1	111.9	-46.9	74.7	0.9

Balance Sheet

Y/E March (INR b)	FY 21	FY 22	FY 23E	FY 24E	FY 25E
Share Capital	44.4	44.4	66.6	66.6	66.6
Reserves	421.7	511.5	554.7	630.2	706.4
Net Worth	466.1	555.9	621.3	696.8	773.0
Loans	59.9	63.5	69.9	76.9	84.6
Deferred Tax	45.0	47.7	47.7	47.7	47.7
Capital Employed	571.0	667.1	738.8	821.3	905.2
Gross Fixed Assets	591.4	638.5	781.6	881.6	981.6
Less: Depreciation	234.7	255.8	280.2	305.6	331.4
Net Fixed Assets	356.7	382.7	501.4	576.0	650.2
Capital WIP	119.0	130.7	87.6	87.6	87.6
Investments	105.5	136.3	136.3	136.3	136.3
Current Assets					
Inventory	26.0	30.2	50.5	45.1	45.8
Debtors	44.9	83.7	140.2	125.0	127.1
Cash & Bank Balance	13.6	20.8	62.6	58.2	69.5
Cash	12.1	13.7	33.2	28.9	40.2
Bank Balance	1.5	7.2	29.4	29.4	29.4
Loans/ Adv. & Other Assets	67.3	79.0	79.0	79.0	79.0
Current Liabilities & Prov.					
Liabilities	148.5	181.2	303.7	270.8	275.2
Provisions	13.6	15.1	15.1	15.1	15.1
Net Current Assets	-10.2	17.3	13.5	21.4	31.1
Application of Funds	571.0	667.1	738.8	821.3	905.2

Cash Flow Statement

Y/E March (INR b)	FY 21	FY 22	FY 23E	FY 24E	FY 25E
OP/ (Loss) Before Tax	63.9	135.9	73.6	128.6	129.8
Depreciation	19.1	21.1	24.4	25.4	25.8
Interest Charge	1.6	1.7	3.3	2.1	2.3
Tax Paid	-12.8	-32.0	-18.5	-32.4	-32.7
(Inc)/ Dec in Working Cap.	22.2	-29.7	45.6	-12.2	1.6
CF from Op. Activity	80.6	89.5	128.3	111.5	126.9
(Inc)/ Dec in FA & CWIP	-49.8	-59.2	-100.0	-100.0	-100.0
Free Cash Flow	30.9	30.4	28.3	11.5	26.9
(Pur.)/ Sale of Investments	-10.7	-4.6	0.0	0.0	0.0
CF from Inv. Activity	-38.6	-46.1	-100.0	-100.0	-100.0
Interest Charge	-3.2	-3.2	-3.3	-2.1	-2.3
Inc/ (Dec) in Debt	4.6	3.6	6.4	7.0	7.7
Dividends Paid	-22.4	-39.9	-11.9	-20.7	-20.9
CF from Fin. Activity	-35.4	-41.8	-8.8	-15.9	-15.6
Inc/ (Dec) in Cash	6.6	1.6	19.5	-4.4	11.3
Add: Opening Balance	5.5	12.1	13.7	33.2	28.9
Closing Balance	12.1	13.7	33.2	28.9	40.2

Our Take...

The management of GAIL highlighted that owing to supply disruptions from GMTS and record-high LNG prices, performance was adversely impacted across all segments in FY23. The company's PATA plant was operating at just 50% capacity and had to shut down briefly in Oct'22.

However, the supply situation now seems to be improving with Sefe (formerly GMTS) nominating two cargos each in March & April. Additionally, GAIL purchased 122mmscmd of gas from IGX (at USD16-17/mmBtu) and will also be bringing eight LNG cargos from the US.

The management is also quite positive on PNGRB's revised tariff of INR58.6/mmBtu, although it was less than GAIL's proposal of INR68/mmBtu. The next tariff review is expected to be after three years, although GAIL could go back to PNGRB for tariff revision before that as well.
The management expects the tariff hike to offer an incremental revenue of INR18-20b on the current volumes.

The PATA plant is now running at full utilization. Additionally, global LNG prices cooling to ~USD12/mmBtu should help register robust financial results, after posting losses for the past couple of quarters. GAIL gas volumes are also set to increase to 6.5mmscmd in FY24 from 5.5mmscmd in 9MFY23, driven by CNG station additions. The company added 19 new CNG stations in 9MFY23.

Outlook & Valuation

The decline in LNG prices is a boon for GAIL. We expect its transmission volume to rise to 117mmscmd in FY24 from 107mmscmd in FY23. The petrochemical plant is also running at optimum utilization currently. GAIL is currently trading at 7.1x FY25E EPS of INR14.6 and 4.1x FY25E EV/EBITDA.

We value the company at 9x adjusted FY25E EPS and add the value of investments to arrive at a TP of INR147. We reiterate our **BUY** rating on the stock.
Key downside risks to our target price would be a rise in LNG prices and/or a poor economic outlook, which would adversely affect natural gas demand.

2. INDIGO

Connecting 88 airports in 10 countries InterGlobe Aviation Limited is one of India's leading airline. The principal activities of the Company comprises of air transportation which includes passenger and cargo services and providing related allied services including in-flight sales. The Company operates its flights under the IndiGo brand.

IndiGo primarily operates in India's domestic air travel market as a low-cost carrier. As of November 2022, IndiGo operates more than 1,600 daily flights to 101 destinations, 75 in India and 26 abroad. Its main base is located in Delhi, with additional bases in Bengaluru, Chennai, Hyderabad, Kolkata, Mumbai, and Kochi.

Market Data

Bloomberg	INDIGO IN
Equity Shares (m)	385
Market Cap.	Rs. 719.2 billion
52 Week Range H/L	2,194/ 1,513
1, 6, 12 Rel. Per (%)	4/ 3/ 2
12M Avg Val	Rs 1,694 million

Shareholding Pattern

	Dec-22	Sep-22	Dec-21
Promoter	71.9%	71.9%	71.9%
FIIs	17.8%	18.1%	18.6%
DIIs	8.3%	7.8%	4.7%
Public/Other	2.0%	2.2%	1.9%

Income Statement

Y/E March (Rs Mn)	FY 21	FY 22	FY 23E	FY 24E	FY 25E
Total Income from Operations	1,46,406	2,59,309	5,56,043	5,14,389	5,56,791
YoY Change (%)	-59.1	77.1	114.4	-7.5	8.2
EBITDAR	2,550	8,466	82,615	1,27,357	1,39,402
Margin (%)	1.7	3.3	14.9	24.8	25.0
Depreciation	46,987	50,680	51,241	53,840	57,306
EBIT	-47,241	-45,331	29,093	71,030	79,403
Int. and Finance Charges	21,420	23,580	31,036	31,143	31,342
Other Income	10,363	7,249	15,017	15,145	15,308
PBT	-58,298	-61,662	13,074	55,032	63,370
PBT after EO Exp.	-58,298	-61,662	13,074	55,032	63,370
Tax	0	0	3,291	13,851	15,950
Tax Rate (%)	0.0	0.0	25.2	25.2	25.2
Reported PAT	-58,298	-61,662	9,783	41,180	47,420
Change (%)	Loss	Loss	LP	320.9	15.2
Margin (%)	-39.8	-23.8	1.8	8.0	8.5

Balance Sheet

Y/E March	FY 21	FY 22	FY 23E	FY 24E	FY 25E
Equity Share Capital	3,849	3,853	3,853	3,853	3,853
Total Reserves	-3,140	-64,205	-54,422	-13,242	34,178
Net Worth	709	-60,353	50,569	9,389	38,030
Total Loans	2,27,862	2,89,554	2,90,554	2,91,554	2,91,554
Capital Employed	2,28,571	2,29,201	2,39,984	2,82,165	3,29,584
Gross Block	2,95,336	3,70,682	4,39,448	5,13,478	5,88,561
Less: Accum. Deprn.	1,07,181	157861	209102	262942	320249
Net Fixed Assets	1,88,155	2,12,821	2,30,346	2,50,536	2,68,313
Capital WIP	664	1,193	7,773	9,089	9,352
Total Investments	72,902	80,326	80,326	80,326	80,326
Cur. Assets, Loans & Adv.	1,68,023	1,64,261	2,01,531	1,98,677	2,49,120
Inventory	3,164	4,081	4,339	3,547	3,825
Account Receivables	2,192	3,329	4,037	3,735	4,043
Cash and Bank Balance	1,12,271	1,01,164	1,26,806	1,30,017	1,74,814
Loans and Advances	50,396	55,686	66,348	61,378	66,438
Current Liab. & Prov.	2,01,172	2,29,400	2,79,991	2,56,463	2,77,527
Account Payables	15,561	31,519	23,738	19,406	20,928
Other Current Liabilities	1,64,171	1,84,635	2,56,253	2,37,057	2,56,598
Provisions	21,440	13,246	0	0	0
Net Current Assets	-33,149	-65,139	-78,461	-57,786	-28,407
Application of Funds	2,28,571	2,29,201	2,39,985	2,82,165	3,29,585

Cash Flow Statement

Y/E March	FY 21	FY 22	FY 23E	FY 24E	FY 25E
OP / (Loss) before Tax	-58,298	-61,662	13,074	55,032	63,370
Depreciation	46,987	50,680	51,241	53,840	57,306
Interest & Finance Charge	11,057	16,331	16,019	15,998	16,034
Direct Taxes Paid	0	0	-3,291	-13,851	-15,950
(Inc)/ Dec in WC	-3,752	21,360	40,693	-17,464	15,418
CF from Operations	-4,007	26,710	1,17,736	93,555	1,36,177
CF from Operating incl. EO	-4,007	26,710	1,17,736	93,555	1,36,177
(Inc)/ Dec in FA	-67,206	-76,352	-77,077	-75,346	-75,346
Free Cash Flow	-71,213	-49,642	40,659	18,209	60,831
(Pur.)/ Sale of Investments	22,092	-7424	0	0	0
Others	10,363	7,429	15,017	15,145	15,308
CF from Investments	-34,751	-76,527	-62,059	-60,202	-60,038
Inc/ (Dec) in Debt	68,605	61,692	1,000	1,000	0
Interest Paid	-21420	-23580	-31036	-31143	-31342
Dividend Paid	0	0	0	0	0
CF from Fin. Activity	42,735	38,713	-30,036	-30,143	-31,342
Inc/ Dec of Cash	3,977	-11,105	25,641	3,211	44,797
Opening Balance	1,08,294	1,12,271	1,01,166	1,26,806	1,30,017
Closing Balance	1,12,271	1,01,166	1,26,806	1,30,017	1,74,814

Our Take...

The management of IndiGo boasts of one of the highest fleet utilization rates in the world and expects it to further improve over the next couple of years. Over the past six years, the company has doubled the number of domestic destinations to 77, while the number of international destinations has tripled to 26.

In 3QFY23, the company operated 1,800 flights daily with On-Time Performance (OTP) of ~90% and its PAX stood at 22.3m. While the company forecasts strong overall demand in 4QFY23, yield is expected to reduce in the quarter due to seasonality. Nevertheless, it is still expected to remain above pre-covid levels.

As one of the fastest-growing aviation markets globally, India is estimated to require 1,100 passenger aircraft by 2027. The government is taking several initiatives to support the growth of aviation. It plans to invest USD11.8b over the next four-year period to construct new Greenfield airports and develop existing brownfield airports, increasing the number of airports to 220 by 2025 from its current 140.

In order to harness the expected demand growth, the company plans to increase its fleet size to 350 in FY24 from 306 in FY23, while also adding 10-15 new destinations (both domestic and international inclusive).

Strategic Priorities For The Company

The management assures a continued focus on affordable fares (supported by cost leadership with CASK of 3.31), OTP, courteous and hassle-free service (low cancellation rate of 0.2%), and an unparalleled network. The company intends to develop people, processes, and technology in line with its growing size. IndiGo is working to increase its international presence through strategic partnerships (codeshare agreement with Turkish Airlines) and loyalty programs.

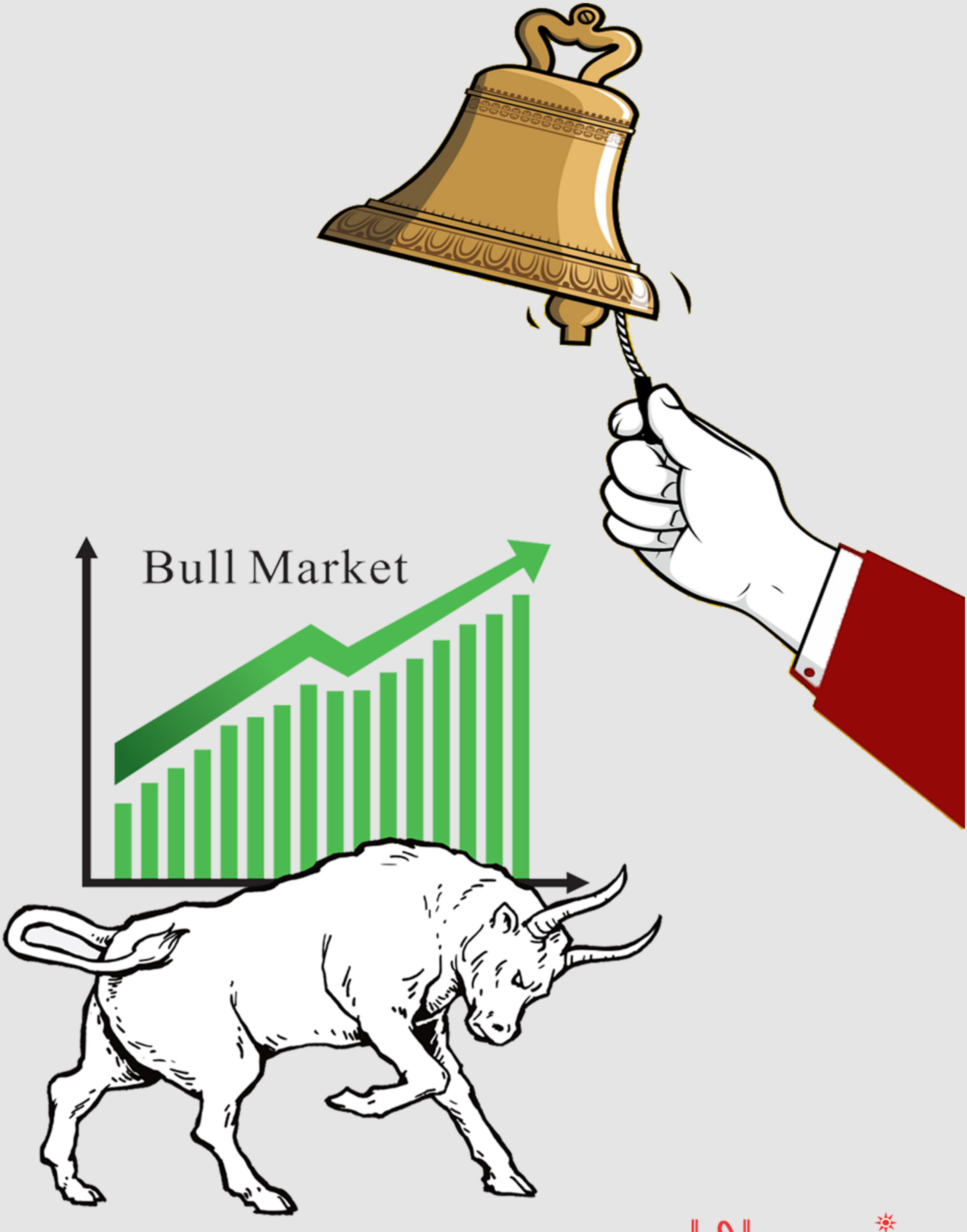
Outlook & Valuation

IndiGo's fleet consists of 302 aircraft, including 23 A320 CEOs, 160 A320 NEOs, 78 A321 NEOs, 39 ATRs, and 2 A321 freighters (it added another freighter in 3QFY23). The company has an order book for ~500 aircraft currently. Management has been taking several pre-emptive measures to increase its global brand awareness, as it expects to capture a bigger share of growth from its international market in the coming years (due to the lower base right now).

In the domestic market, the company is expected to face some headwinds due to the volatility in crude prices and forex. Further, competition in the sector is expected to intensify with the resurgence of Air India and the entry of a new player Akasa Air.

We value the stock at 7x FY25E EV/EBITDAR to arrive at our TP of INR 2,110. We reiterate our **Neutral** rating on the stock.

This May Impact Your Investments!!



श्री LAKSHMISHREE
Gateway to your Financial Goals

Negative Cues Make 6 % Plus Growth A Distant Goal

The external environment for the Indian economy is worsening, with India's main trade partners seeing high obstacles, both old and new, staring them in the face. The internal environment has become highly uncertain with most weathermen anticipating a very hot summer with a likely return of El Nino affecting the south-west monsoon. This scenario, if it bears out, will augur ill for not just the Kharif crop but also nudge up energy demand. There is already a coal shortage.

What makes things worse is that the current negative outlook comes after a year of the Ukraine war with all its downside and two years of the COVID slowdown. So there seems to be an endless succession of negative developments, leading to the coining of a new term 'permacrisis', which does not foresee any likelihood of things looking up in the foreseeable future.

In view of all this, the big question that emerges is: how realistic is the world-beating the official projection of a 6 per cent plus growth rate in the financial year (2023-24) just set to begin? Not just that, the government expects to grow the economy from its present $3.5 trillion (2022-23) to $5 trillion earlier than the IMF forecast of 2026-27.

The external bad news is several fold. Both the US Federal Reserve and the European Central Bank appear to remain set on a course of raising interest rates to tame inflation. This will adversely affect already low growth rates which will in turn impact India's exports to these regions. UK and Sweden are in particularly bad shape, with their economies hovering on the edge of recession. China, a major global economy, has set itself a modest target of 5 per cent growth in the current year (2023) after clocking a miserable 3 per cent in the previous year. These countries are important for the growth momentum they impart to the Indian economy as the US, EU, UK and China together account for nearly half of India's total exports.

If external demand, not a major factor for the highly self-reliant Indian economy, is likely to fail to deliver, what is the state of domestic demand driven largely by consumption and investment? Household consumption, severely affected by the pandemic, is yet to fully recover, as indicated by the low sales volumes being clocked by FMCG companies. The MSME sector continues to struggle, which affects both its own output and the wage incomes of its workers. The anaemic state of the latter partly explains the low consumption with new income partly going towards replenishing savings for emergencies that were run down during the pandemic.

The investment scenario is brighter but only by a bit. The government has sought to maintain its investment momentum with substantial budgetary allocations. As more investment is needed to power high growth, the government is asking the private sector to do its bit. But it is not yet ready to do so as there is no emerging shortage of capacity in the face of burgeoning demand and hence no business necessity to invest in new capacity.

While all this does not make for a very optimistic scenario, what has queered the pitch further is the failure and closure of as many as three US banks triggered by the downing of shutters by Silicon Valley Bank (SVB), one of the 20 largest in the country. This is the biggest failure since the global financial crisis of 2008 and has spread a bit of panic across the world that it may be headed for another such crisis. SVB's borrowers are mainly tech entrepreneurs and India has been taking heart from the fact that it has been spawning a steady crop of startups with many of them reaching unicorn status. Rising US interest rates have caused investors who earlier had a stomach for high risk to tighten their purse strings. Consequently, India has been seeing its high-risk startups shedding staff in an attempt to stem the cash drain as there is no more easily accessible cash to burn.

But the saving grace is that the US appears to have responded to the situation well by declaring that the federal government will protect all deposits, even those exceeding the Federal Deposit Insurance Corporation's $250,000 limit. This was intended to nip in the bud any panic run on smaller banks across the country. For good measure president Biden has declared that the American people and American businesses have confidence that their bank deposits will be there when they need them. This will hopefully prevent panic and a run on smaller banks from spreading across the world. As if on cue, the Bank of England has announced that the giant HSBC will be taking over the UK business of SVB for a token one pound.

The good news for India is that Indian banks appear to be safe. An analysis by Jefferies has found that Indian banks are well placed in terms of the quality of deposits and the possible impact of mark-to-market losses in the held-to-maturity book. Thus, negative developments dominate but thankfully fall short of threatening to become catastrophic.

Key Impact of Debt MF changes on Different Sectors

The government has introduced amendments to taxation on debt mutual funds with debt MFs now being taxed at a marginal tax rate across tenures vs earlier benefit of long-term capital gains with indexation for debt investments >3 years. This is negative for MFs – Debt (ex-liquid) contributes 19% of AUMs and 11-14% of revenues. For Life insurers, there seems to be no change to the taxation proposed in the budget and the status quo remains with life savings taxed at a marginal tax rate (>Rs0.5mn of premiums) but tax arbitrage in favour of competing products such as MFs is gone now which at these valuations is a small positive for life insurers. NBFCs get a material part of their funding from MFs – the funding proportion from banks will go up. Marginally positive for bank credit/deposits.

The big change – Budget amendment- Taxation change on debt Mutual funds

- The budget amendment proposes to tax debt mutual funds at short-term capital gains rate which is the marginal tax rate irrespective of tenure.
- Earlier, investments in debt mutual funds >3 years were subject to long-term capital gain tax rate of 20% post indexation.
- With this change and the changes proposed in the budget on life savings products, there is no tax arbitrage left across debt instruments be its bank deposits, debt MFs or life insurance savings products.

Impact on Mutual funds – Moderately negative

- This is a negative for the MF industry having non-liquid debt AUMs of ~Rs8trn (19% of AUMs) – as the relative attractiveness due to tax arbitrage goes away.
- Liquid MFs of Rs6.6trn will not be impacted materially as they are anyways a short-term product and there is no material change in tax attractiveness.
- For AMCs under our coverage, revenue contribution from non-liquid debt products is 11-14%. We believe this is moderate to low impact as the bulk of the revenue/profitability for AMCs accrues from equity AUMs and non-liquid debt, AUMs are neither higher growth nor higher profitability segments.

Impact on Life insurers – Positive at the margin:

- There is no amendment to the tax changes proposed in the budget and hence the status quo remains with returns on incremental premiums >Rs0.5mn will be taxed at individual tax rate.
- While this will impact non-PAR savings sales vs pre-budget levels, the change in taxation for debt MFs now bridges the tax arbitrage and brings all debt products at par.
- So Life insurers from being a superior product pre-budget (no tax on debt savings) moved to be an inferior product post budget (full tax on premiums >Rs0.5mn) and now it is neutral as alternate debt investments are also taxed at a marginal tax rate.
- At these valuations, we believe this is a marginal positive for Life insurers. Link to post budget downgrade and recent upgrade on comfortable valuations

Impact on banks – small positive:

- Post the budget changes in insurance and amendment changes proposed for debt MFs, tax arbitrage vs bank deposits is gone.
- Earlier interest on bank deposits was taxed at the individual tax rate and debt MFs enjoyed LTCG of 20% with indexation and life savings products enjoyed tax-free returns.
- At the margin this is positive for banks but the quantum cannot be very high as the bank deposits' market size is Rs180trn vs total debt MF size of Rs8trn.

Impact on NBFCs:

- NBFCs/HFCs would have some reliance on their funding from mutual funds. With potentially lower inflows in debt MFs, NBFCs/HFCs may have to rely more on bank funding vs funding from MFs.

Digital India Act: We Need An Internet Law That Is Balanced, Proportionate And Regulates Effectively

Information Technology Act, 2000, was India's foundational law that sought to regulate the internet. But it was designed for the Web 1.0 era, which consisted of limited interaction with society at large, minimal community participation, and no contribution to economic services such as banking, finance, education, etc.

The internet back then was sparsely used for one-on-one interaction through email services that were quite basic in nature. Things have changed drastically in the last 20 years though. The internet now covers almost every aspect of our personal and professional lives. From staying in touch with friends to purchasing goods to receiving the next lesson online and watching movies, the internet is pervasive.

Keeping the Internet Safe, Vibrant

We are moving towards an automation-driven world, where AI models are penetrating every aspect of the technology we use. The internet has contributed immensely to our economy and made our lives easier, but it also comes with its own set of problems which are becoming harder and harder to tackle. This is why countries all over the world are revamping their internet laws, and India is no exception.

Be it the EU's Digital Services Act, the UK's Online Safety Bill or the Australian Online Safety Act, one common theme across these laws is greater regulation to meet the prevalent challenges on the internet. While regulation is necessary, we must be careful to not over-regulate the internet, and ensure that it is proportionate and risk-based.

As India is embarking on the journey, we must work towards evolving a framework that hits the sweet spot of adequate regulation to tackle internet-based harms, while preserving speech, user rights, innovation and business continuity. If we do it the right way, it could become a benchmark for other countries to follow.

And it must, as India's global leadership, driven by its G-20 presidency, is set to inform the new world order. In this new order, the future of the internet must be characterised by making it a safer place for everyone, while keeping it open and innovation-friendly.

Safe Harbour's No-Free Pass

Probably the most important regulatory aspect of the present-day internet, the safe harbour has been fundamental to keeping the internet open, allowing for new services to be deployed, thus ensuring the growth of the internet economy. It is often misunderstood that safe harbour gives intermediaries a 'free pass' and 'protects them' from liability. It doesn't.

What it instead does is provide users, people like you and me, the freedom to post whatever we want to, by providing a safe landing stage for our thoughts to be expressed online. Imagine a scenario where intermediaries arbitrarily start taking down content against the fear of getting prosecuted. Or start over-censoring content to save themselves from liability.

Safe harbour ensures that intermediaries will not be held liable for user-generated content unless and until they have actual knowledge from the court or the government about the illegality of such content. Which in turn protects users from unwarranted censorship. It is what allows countless websites to host user reviews. It allows users to share photos and videos on big social media platforms like Instagram and on the smallest blogs. And enables users to share speech and opinions everywhere, from vast conversational forums like Discord to the comment sections of the smallest newspapers and blogs. Any future law must ensure that safe harbour is respected and preserved, otherwise, its dilution will impact user rights and innovation on the internet.

Tackling Rising Online Harms

The proposed law, which has been called Digital India Act, aims to institutionalize an accessible and transparent adjudicatory mechanism and efficient grievance redressal process. This will be important to provide efficient remedies for rapidly rising online harms victims.

However, it is critical that these mechanisms undertake a risk-based approach and that timelines for response are determined as per the degree of harm. Considering the deluge of grievances received by intermediaries, it is important that the complaints are graded according to the severity of harm to facilitate a fair application of mind to every complaint and its judicious resolution.

While a limited time frame for acknowledging the grievances is reasonable to ensure accountability from the intermediaries, timeline for redressal should vary depending on the nature of the grievance.

Classify Intermediaries Carefully

The evolving nature of the internet and the emergence of different types of intermediaries has led to discussions around the need to classify platforms in different groups depending on their functions and accordingly delineate their roles and responsibilities.

While a graded regulatory approach is important, it is cardinal to deliberate on the feasibility of a straitjacketed classification, given the range of functions intermediaries performs.

The degree and range of online harms have amplified enormously with increased online interactions. These harms often vary in their nature and the kinds of threats posed. It is important to ensure that regulations consider all kinds of threats and that the responsibility is delineated based on the level of risk in each case.

Moreover, the co-regulatory business models and the principles of self-regulation have been found to be more sustainable models for maximising accountability without impinging upon innovation. The Reserve Bank of India, for instance, identifies greater self-sustained efforts by financial platforms as one of the criteria for reduced government control and hard regulations.

Harmonising Multiple Digital Laws

The new IT Act is envisioned as an omnibus legislation that will tackle a wide variety of challenges on the internet. Here, it is important to note that many of the concerns are already being regulated or are proposed to be regulated by the sectoral regulators of the specific sectors.

For instance, the Indian government is also in the process of enacting the Digital Personal Data Protection Bill, 2022 for regulating all data-related issues on the internet. Similarly, the Ministry of Corporate Affairs has recently constituted the Committee on Digital Competition Law with an aim to address competition law issues in digital markets. Accordingly, it is important that all these regulatory interventions are well coordinated and harmonised to avoid any implementational challenges.

The journey towards enhancing India's digital prowess through a robust legislative framework has begun. However, there is a long way to go before this process of enacting the Digital India Act is successfully completed. While minor roadblocks and uncertainties are bound to arise given the range of issues in the digital space, it will be important that all concerns are addressed through the current open and multi-stakeholder approach, which ensures that adequate opportunities are provided to all stakeholders and all concerns are addressed amicably.

Citibank's Exit: Not Easy To Do Business In India?

Exactly ten years ago, the late K C Chakrabarty who was then deputy governor of the Reserve Bank of India (RBI), had questioned the contribution of foreign banks in the country. Chakrabarty's grouse was that despite being around for decades, foreign banks haven't participated in the economy's development.

His lament is understandable when you note that the oldest foreign bank in India, Standard Chartered Bank that set up shop roughly 160 years ago, has only 100 branches and less than one percent share in the assets of the total banking industry. Fellow foreign lender HSBC has been making enough noise about going big in Indian markets but is yet to show any marked increase in market share.

But the foreign banks are fair-weather friends that enter a market, including India, to make profits. Contribution to the local economy is incidental. This brings us to US-based Citibank's exit from the retail business in 2022.

The Indian banking industry's assets have shown 9 % compounded annual growth rate (CAGR) in the past decade and profits have grown multifold, despite a debilitating bad loan cycle. That's the good part of the story. The industry is also one of the most heavily regulated in the world and the competition to get a lucrative slice of the retail market is intense, to say the least. The cost of regulatory compliance is high.

As such, the cost of retail banking is high. Evidence of the same can be found in the surge in operating expenses of local banks that pursued retail customers in a big way. For instance, HDFC Bank's retail loan book has expanded by 14 % on a compounded annual growth rate (CAGR) basis in the past five years. The lender's operating expenses showed a 14 % CAGR. For smaller banks such as Kotak Mahindra Bank, RBL Bank, and IDFC First Bank, the operating expenses have surged as they scale up everything from the branch network to the technology platform for meeting retail demand. This, coupled with the intense competition, has reduced the appeal of retail banking for foreign banks.

Note that foreign banks dip their toes into new markets with the single goal of getting returns that justify spending capital there. That means catering to the segments that have high spending power and give more bang for every buck spent.

But India's banking rules had begun to force foreign lenders to enter markets they would otherwise not touch. In 2012, the RBI raised the priority sector lending target for foreign banks to 40 %, at par with local banks. In short, foreign banks had to ensure 40 % of their lending goes towards economically weaker areas and segments. Priority sector lending is a high-cost business with returns that do not justify them.

The other push from the RBI was to set up wholly owned subsidiaries in India in addition to the branch model that currently foreign banks have adopted. Except for Singapore's DBS Bank, there were no takers for the subsidiary model. It is evident that multinational banks don't see the need to pump in more capital without the outsized returns that emerging markets typically promise. A subsidiary model has a high compliance cost and requires a greater physical presence in the geography.

What fits into multinational banks' agenda is catering to affluent and wealthy retail customers. Indeed, Citibank's retail business clients were high beta ones. In other words, servicing such customers gave Citibank outsized returns compared with similar retail businesses of other banks. The profile has been one of the main attractions for Axis Bank to purchase Citibank's business. The 2008 financial crisis prompted the RBI to turn up the regulation on banks. It also prompted multinational banks to turn down their enthusiasm in spreading their business across geographies and focus on healing the home business.

That brings us to the other factor that has kept foreign banks from growing big in India: blessings from headquarters.

The 2008 financial crisis prompted foreign banks to take a hard look at their cross-border presence. Since capital had to be conserved on home ground, multinational lenders began to downsize their balance sheet. This explains why Barclays scaled down its India operations in 2012, Deutsche Bank sold its credit card operations to DBS in 2011 and UBS exited the market while Morgan Stanley surrendered its banking licence. Bank of America-Merrill Lynch and Standard Chartered Bank downsized in 2015.

The pandemic and the outcome of the ongoing Russia-Ukraine war have ensured that lenders continue to be frugal in their capital outlay. Note that many foreign banks have kept the investment banking business intact, which shows that the business is generating enough yield to justify the capital deployed. It is only the retail business that no longer seems to make sense to them. As a large category of banks vie for the retail pie, more foreign lenders may look to trim their Indian dreams, limiting their presence to investment and private banking.

Startup Street: Indian Start-Ups To Feel Tremors Of Silicon Valley Bank Collapse

Imagine this scenario. A bank as large as HDFC Bank. In its home country, the bank is the 16th largest, the favoured bank among tech start-ups many of whom have their money parked in it and has investments in many start-ups including in India. What more, it is rated in the top 20 Forbes best banks of 2022 and receives the award on March 7th.

And suddenly, the bank is shut down on March 10th!

This is exactly what happened with Silicon Valley Bank (SVB) in the USA, the largest bank to fail since the global financial crisis of 2008.

The upshot: Many start-ups with connections to funds and facilitators were staring at an uncertain future. One estimate says 60 per cent of well-known accelerator YCombinator's start-ups with India connections have accounts in SVB, because that was the go-to default option 'recommended'. This overweight concentration of funds in one single bank has become a Black Swan event; the repercussions are only now being felt.

No wonder the US Fed was compelled to act, to prevent contagion spreading not only in the start-up world, but to the US regional banking system.

SVB has business with close to half of all the venture-backed startups in the US and 44 percent of US venture-backed technology and healthcare firms which went public in 2022.

Take the case of SaaS companies particularly those who now have a US headquarters with an Indian subsidiary. Such firms usually keep funds to meet around three to four months for operating expenses and salaries in Indian bank accounts, while the rest is in accounts or deposits in SVB.

Undoubtedly, there are multiple ways this SVB collapse could have impacted such Indian start-ups and founders who have flipped their companies overseas (read USA) or have US focused operations:

1. The most direct impact would be on companies holding accounts at SVB – they are then not able to make payments towards salaries, creditors, statutory dues etc. This might mean sudden layoffs, cutback on expenditure towards product development, marketing etc and raise doubts on their very survival.

2. Clients of start-ups who have accounts in SVB would have been unable to access their funds to pay the start -up on time in turn negatively impacting their cash flows and survival.

3. Inability of funds (VCs /Pes), family offices, and high net worth individuals to access their accounts or losing money, which could impact their funding of start-ups.

4. SVB was also preferred by many Indian start-ups for its understanding of start-ups and flexibility; it was one of the few banks in the USA willing to work with Indian banks and also with Indian companies without employees in the USA. Its absence therefore can cause challenges for start-ups here focused on the US market.

5. In some cases, the founders themselves have their accounts in SVB; their losing money would have been disastrous on the personal front. This would have been a potential source of distress.

The SVB debacle would have impacted the banking system in the USA too. Investors such as Y Combinator, Founders Fund, Coatue Management had advised their portfolio startups to withdraw deposits from SVB. This kind of reaction has already spread panic and other banks too could get affected. In fact, Signature Bank has become the next casualty of the banking turmoil after SVB; New York state regulators closed it on Sunday, March 12.

Thankfully, the US Fed has realised the implications for systemic risk posed by SVB's collapse, which is why they decided to bail out all depositors, including uninsured ones in SVB and in Signature Bank, another bank facing similar issues. The Fed announcement that 'Depositors will have access to all of their money starting Monday, March 13', is therefore a huge relief as well as a confidence booster.

Nevertheless, the failure of SVB Bank can have an impact on the Indian start-up and funding ecosystem:

1. SVB has been a major investor / funder of Indian start-ups from 2003 and has often funded them even when others declined. InMobi, Snapdeal, Shaadi.com, PayTm, Carwale are some start-ups backed by SVB. Its collapse can impact funding into start-ups. It is likely that other venture capitalists or private equity funds with money in SVB may also be cautious. The possibility of the funding winter getting extended cannot be discounted.

2. There is likely to be a focused and long overdue discussion on the necessity for Indian companies to flip overseas merely because a YCombinator or overseas fund dictates it; in fact, YCombinator makes it a pre-condition! There have already been murmurs of discontent over this as this entails a lot of work and makes compliance onerous. Transfer pricing issues crop up frequently as also tax queries and scrutiny.

Indian investors and funds have been unhappy over the flight of talent, intellectual property, and value capture or realisation not happening in India. Often, early-stage Indian investors have been short-changed. Founders, investors and others with a stake in the entrepreneur ecosystem in India have been urging the Indian government to have a serious dialogue with such funds and accelerators, as also tweak Indian regulations to prevent such a loss. Needless to state, a pushback can be expected.

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