Positive for consumer durables, pharma, auto firms; mixed bag for FMCG

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With the GST constitutional amendment bill passed by the Rajya Sabha, the roadmap for setting into motion the landmark unified tax has become clearer. The government hopes that GST will be up and running from April 2017. Several sectors will see major changes in their business dynamics. Here's a look.

Consumer durables

The passing of the goods and services tax bill is a big plus for the consumer durable industry as also for makers of building materials such as tiles, plyboard and sanitary ware.

First, by reducing the net tax outgo, the new tax regime will lower end-prices of products. Given, that all these industries are looking for a demand-push, the manufacturers are likely to pass on the price benefit. This will stoke revenue growth. Secondly, the GST regime will reduce the price differential between products of organised players and those of their competitors in the unorganised space. In tiles and ply boards for instance, the price difference between unbranded and branded goods is almost 10-15 per cent. So, as the new tax is implemented, more consumers may shift to branded products as the price difference reduces - this is a major advantage for players such as Kajaria Ceramics, Somany Ceramics, CeraSanitaryware and Greenply in the listed space.

The other plus of the new tax which players such as Havells India and Whirlpool of India have highlighted is that it will reduce their logistics and inventory handling costs. Share of roads in freight traffic in the country is 72 per cent, indicates the economic survey data of 2015. Thus, as GST replaces the central sales tax on inter-state sale of goods and several other levies, costs for manufacturers will come down. It will help companies save on investments in manufacturing facilities too. Currently, goods produced within a state attract lower tax than those produced outside. This forces companies to consider setting up of manufacturing facilities near all their different markets.

However, one thing that companies may have to watch out for is whether excise duty exemption zones continue to get that benefit. If not, some companies such as V-Guard

Industries and Bajaj Electricals which have manufacturing plants in excise free zones may see costs rise (impact will be lower if tax refund is allowed).

Pharma companies

The GST rollout is likely to push up prices of drugs as tax rates rise from existing 12-14 per cent to a higher GST rate which many expect to be around 18 per cent. But over the medium term, companies can possibly reduce the impact by streamlining their manufacturing, logistical and compliance operations.

Currently, many pharmaceutical companies are dealing with an inverted duty structure; excise duty on raw materials (input) is 12.5 per cent while that on finished dosage (output) 6 per cent, leading to accumulation of tax credits. A single GST rate for input and output may help correct this anomaly.
Implementation of GST is expected to benefit manufacturers by enabling credit claim for service tax paid. While currently credit is allowed on CENVAT and VAT paid on pharmaceutical raw materials, service tax levied on services such as shipping products is not allowed as credit. Upon GST, services will be considered value addition and thus credit for service tax paid can be claimed by manufacturers.

The location of warehouses set up by pharmaceutical companies in the past were based on tax rates charged by state governments. Most companies now operate through a cost and freight mechanism with depots in many states. After the implementation of GST, firms may modify this approach. As interstate transactions will become tax-neutral, their focus will shift to supply chain efficiencies. For instance, consolidation of existing infrastructure through setting up of large warehouse with regional distribution hubs can lead to better inventory management. As tax liabilities on interstate transactions are removed, product delivery speed will increase.

With GST, multiple forms will hopefully no longer have to be filled and filed with multiple authorities. So, compliance costs are also expected to reduce.

But pharma companies operating in tax-concession zones will need to watch out for whether GST does away with their tax breaks. Currenlty, to encourage regional development the government had provided tax holidays in select places such as Himachal Pradesh and Sikkim. Under GST, these area based exemptions could be done away with. Ergo: geographical advantages for companies to set-up manufacturing units in these states may not be available.

Auto firms

The rolling out of GST is expected to make cars and bikes cheaper. While excise duties on bikes stand at 12.5 per cent, excise on cars and utility vehicles (UVs) currently vary from 12.5 per cent to 30 per cent, based on the length of the vehicle as

well the engine capacity. Together with the Central Sales Tax, the National Calamity Contingency Duty, VAT and the newly introduced infrastructure cess in this year's budget, the total indirect tax incidence goes even up to 50 per cent for some cars and UVs. Assuming the standard rate could hover around the proposed 18 per cent and luxury cars/UVs are taxed at the proposed 40 per cent, this would result in neat savings for buyers.

Trucks will also see lower taxes but the overall improvement in efficiencies in inter-state movement for goods and quick turnaround time is expected to dent need for fleet expansion by truck operators. Hence the GST may be a negative for the truck industry initially.

Organised battery manufacturers such as Exide Industries and Amara Raja Batteries are also expected to benefit. As components such as batteries and tyres wear away after a few years of usage, they have sizeable replacement demand. At the same time, there is also a huge unorganised market attracting customers with lower prices compared to organised players. GST will introduce better compliance on the part of the unorganised players with respect to payment of taxes. This will in turn force them to pass on the costs to customers and will bring down the price differential.

FMCG sector

Most of the inputs that go into FMCG products in the personal care and household care space have a general excise duty rate of 12.5 per cent and a VAT around the same level. A standard GST rate below say, 25 per cent would give room for these companies to pass on at least part of the benefits to the consumers in the form of lower prices. Companies such as Marico and ITC may face higher tax incidence under a GST regime though. For Marico, the makers of Parachute Coconut Oil and Saffola, edible oil is an essential commodity and is exempt from excise duty currently. This will change under GST as it will be a merit good and probably be taxed at a rate lower than the normal GST rate. ITC too will see taxes on cigarettes going up. While it will be treated as a demerit good and taxed at the highest slab in the GST regime, current excise duties on cigarette may also continue.

Both auto and FMCG companies will also be able save on logistics costs, thereby leading to a favourable impact on margins. Logistics costs constitute 1-5 per cent of net sales for most of the companies.