BWR Pre-Budget Expectations
BWR expects Union Budget to provide a boost to Investments and Savings

The Union Budget 2020-21, to be presented on 1 February 2020, is expected to announce appropriate measures to restore the economic growth and to set a clear roadmap for achieving the ambitious USD 5 trillion economy by 2025. Amidst the current slowdown in the economy evident from the 11-year low GDP estimates of 5%, the approach to the economic policy for the next year needs to be genuine and realistic. The challenges faced by the economy particularly on the demand side envisages more measures but shortfall in revenue so far, (than the targeted budget estimates) comes as a big hindrance. Out of certain measures announced recently to revive the economy, the sharp reduction in corporate tax makes India one amongst the low corporate tax rate countries.

The reduction in tax rate and lower economic growth impacted government’s tax revenue. Lower revenue generation restricts room for huge stimulus, whereas the economy can do with a booster shot. It looks like the government will adhere to fiscal consolidation path as it has already curtailed expenditure for the fourth quarter of the 2019-20. The Prime Minister’s Office (PMO) has also cautioned the Ministry to not to set over-ambitious tax and fiscal deficit targets. Hence the task of the Finance Minister has become more challenging, and she has to be very careful while making the budget allocations to the existing schemes as well.

This special report on BWR Pre- Budget Expectations encompasses analysis of the current macro scenario and the challenges that arise in balancing the fiscal deficit target. With regard to sectors the requirements to propel demand and consumption and expected measures are outlined in the report which are key for reviving growth momentum. We have included a few major sectors like BFSI, Infrastructure, Automobiles, Power, Telecom, Steel and Real Estate since their contribution to economic growth as well as for creating employment play a crucial role.

Most of the industry specific demands have been addressed by the Finance Minister in her announcements since August 2019, like recapitalization of banks and measures to address NBFCs liquidity crisis, auto sector related proposals and reduction in corporate tax rates etc. These measures are expected to have an impact gradually. The amendments made in IBC law enabling the resolution of finance companies and the SC verdict on the resolution of Essar Steel case has been positive in terms of releasing the locked-up funds in stressed assets. The government is expected to continue amendments to various laws to provide ease of doing business. Much of the focus is on what the Budget 2020-21 offers to bring the economy on a growth track quickly to attain the USD 5 trillion economy by 2025.
State of the Economy and Budget Expectations

Decelerating GDP growth and investments, weak demand conditions, stagnant exports, liquidity crunch in the financial sector, shortfall in revenue collection, renewed concerns on inflationary pressures in addition to ongoing geopolitical tensions have emerged as the major challenges for the government before formulating its financial plan for 2020-21. The slowdown in auto sector adversely hit manufacturing activity (which reported 1% contraction and hit eight quarter low during Q2 2019-20) and Capacity utilisation (CU) in the industrial sector which has fallen to 68.9% in Q2 of FY20 - the lowest since 2008. Growth in bank credit has remained muted particularly to industries during the current fiscal so far which is evident in the slowdown in industrial production and eight core sectors performance. As per the advance estimates by the CSO, the economy is projected to grow by 5% in real terms during the fiscal 2019-20. The IMF is the latest international agency to revise the growth of the economy downwards to 4.8% from the earlier estimate of 6.1%. This is the slowest growth in a decade, hence hopes on budget proposals to improve the economic conditions assumes utmost importance.

The sharp deceleration in economic activity has prompted swift and serious action by the government, and it has already announced a number of administrative, financial and social reforms. Amongst them reduction in corporate tax rate to 22% (effective rate is estimated at 25.17%), from 30% earlier is the major one. Amalgamation and upfront capital infusion of Rs 70,000 crore into public sector banks has helped to improve banks liquidity position, whereas other measures for NBFCs and auto sectors etc., are yet to have their impact. The upcoming Union Budget is likely to take stock of the measures announced so far and provide better insight and clarity on their impact on the economy.

Government Finances Under Pressure

Sops comes with both benefits and consequences. With the cut in corporate tax rate, the Government’s tax revenue has moderated significantly as is evident from the shortage of revenue generation as reported by Controller General Accounts (CGA) available for the period April to November 2019. Post the cut in corporate tax rate, revenue from Corporation Tax has contracted sharply by 12% and 24%, respectively during October and November 2019 over the corresponding months of the previous year. The government has collected total corporate tax of Rs 2.89 lakh crore so far (April to November), which is 37% of the full-year target of Rs 7.66 lakh crore. Cumulatively, the corporate tax revenue shrunk by 1% compared to corresponding period last year.

Income tax collections increased by only 7% during the same review period, to Rs 2.68 lakh crore which is nearly half of the budget target set for the full fiscal. Gross tax revenue is on a decline for the consecutive four months since August and the cumulative tax revenue increased by a mere 0.8% during April-November 2019 vis-à-vis 2018. This is around 47% of the full year budget estimates. In addition, there is a shortfall in gross goods and services tax (GST) revenue collection as well which grew by only 4.3% during April-December 2019 vis-à-vis 2018. Altogether, it is estimated that the shortfall in tax revenue collections from the budget estimates could be as much as Rs 2.5 lakh crore of which after considering the tax devolution the centre’s shortfall could be as much as Rs 1.7 lakh crore.

The lower tax collection combined with the lower estimate of nominal GDP growth would mean that the government is likely to miss the fiscal deficit target of 3.3% of the GDP for the current fiscal by a substantial margin. The nominal GDP growth is estimated at 7.5% as against the assumption made in the last budget of 11%. With this automatically the fiscal deficit will increase by 0.1% to 3.4%. In absolute terms, India’s fiscal deficit for the April to November 2019 period crossed the 2019-20 budget target of Rs 7.04 lakh crore to Rs 8.08 lakh crore. Amidst the shortage of revenue collections on the back of slowdown in the economy in addition to the stimulus measures announced so far, the government is likely to breach the fiscal deficit target of 3.3% in the current fiscal despite the RBI’s surplus transfer of Rs 1,76,051 crore.

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January 2020
Union Government Accounts (Rs in crore)

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<tr>
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<th>2018-19</th>
<th>2019-20</th>
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<tr>
<td></td>
<td>RE (in the last budget)</td>
<td>Budget Estimates</td>
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<tr>
<td>1. Revenue Receipt</td>
<td>1,729,682</td>
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<td>1.1 Gross Tax Revenue</td>
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<td>1.3 Non-Tax Revenue</td>
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<tr>
<td>2.1 Revenue Expenditure</td>
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<td>2.2 Capital Expenditure</td>
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<td>338,085</td>
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<td>3. Revenue Deficit</td>
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<td>485,019</td>
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<tr>
<td>4. Fiscal Deficit</td>
<td>634,398</td>
<td>703,760</td>
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GDP at current prices* 19,010,164 21,100,607 20,442,233

Fiscal Parameters As percentage of GDP

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<tr>
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<th>2018-19</th>
<th>2019-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Revenue Receipt</td>
<td>9.1</td>
<td>9.3</td>
</tr>
<tr>
<td>1.1 Gross Tax Revenue</td>
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<td>1.2 Tax Revenue Net to Centre</td>
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<td>1.3 Non-Tax Revenue</td>
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<td>2. Total Expenditure</td>
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</tr>
<tr>
<td>2.1 Revenue Expenditure</td>
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<td>2.2 Capital Expenditure</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>3. Revenue Deficit</td>
<td>2.2</td>
<td>2.3</td>
</tr>
<tr>
<td>4. Fiscal Deficit</td>
<td>3.4</td>
<td>3.34</td>
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* GDP for BE 2019-20 is projected estimate over the RE of 2018-19. 2019-20 so far is Advance estimates by CSO
RE: Revised Estimate, BE as per the Budget 2019-20
Note: Fiscal deficit figure shown in monthly accounts during a financial year is not necessarily an indicator of fiscal deficit for the year as it gets impacted by temporal mismatch between flow of non-debt receipts and expenditure up to that month on account of various transitional factors both on receipt and expenditure side, which may get substantially offset by the end of the financial year.

Source: Budget Documents, www.cga.nic.in, CSO, BWR Research

The additional funds the government received by RBI is Rs 86,051 crore over and above the budgeted Rs 90,000 crore for the fiscal 2019-20. In addition, to make up revenue collections the Union Cabinet on 20th November 2019 approved the sale of government’s stake in blue-chip oil firm BPCL, shipping firm SCI and inland cargo mover Concor, as well as decided to cut shareholding in select public sector firms below 51%. Besides, the government announced to sell its entire holding in THDC India and North Eastern Electric Power Corp Ltd (NEEPCO) to state power generator NTPC Ltd. However, according to Department of Investment and Public Asset Management (DIPAM), Rs 18,094.59 crore has been obtained through disinvestment proceeds during 2019-20 so far, as against the BE of Rs 1.05 lakh crore. So, with the delay in strategic sales so far, the government may announce to collect another Rs 1 lakh crore in the upcoming budget from the disinvestment of state-owned firms.

The budget expected to carry array of measures to revive the economy on the back of renewed stagflationary concerns and twin balance sheet crisis. At the same time poor tax revenue collections have left the government with limited spending room to address issues plaguing the Indian economy. The slowdown Indian economy is facing currently is not just a cyclical downswing but also, though mainly, a structural slowdown; it is based on weaknesses in both consumption as well as investment demand but poor investment demand being fundamental; apart from demand strains, there are also supply constraints; and both the domestic economy as well as the external sector are showing weak growth. Hence, the economy needs both counter-cyclical monetary and fiscal measures as well as structural drive in policy.
After the corporate tax cut there is growing clamour for personal income tax rate cut. In particular, small businesses which pay tax at individual income tax rates find themselves paying the tax at a higher rate than large corporations. The report of the Committee on Direct Taxes Code (DTC) is also with the government which, according to press reports has recommended substantial overhaul of the structure. The approach of the government should be to increase the disposable income in the hands of the people, by granting tax reliefs to boost demand. Thus, some rationalisation of tax brackets and rates are expected though the revenue considerations may not permit substantial reduction.

Provide incentives for the installation of more cold storage/ warehousing facilities to support agriculture produce from unpredicted events and set up a committee for overseeing the fair price in case of bumper production.

If the average medium-term rate of inflation is taken as 5 % to 6% (rather than 4%), then the saving rates on postal saving/bank deposits, etc., at about 7% to 8% per annum appear realistic. The RBI’s attempt to force banks to reduce lending rates with every reduction in repo rates without a policy on an appropriate interest rates structure of deposit and lending rates may not yield the desired result.

Monetary authorities should focus on bank credit expansion in right quantity and for right sectors. Existing unregulated lending rate structures of banks are allowing for high interest costs for bank borrowers, particularly for productive enterprises. Some prescription of minimum and maximum lending rates linked to cost of bank deposit rates plus administrative cost of banks should be introduced.

Much of the burden of fiscal adjustment has had to be borne by capital expenditure. At a time when substantial increase in capital expenditures is warranted fiscal space has posed serious constraints. Perhaps, the government may have to revise the deficit target upwards for the current year in view of the dire need to augment capital expenditures. Increasing expenditure on public projects to create employment and public assets also is the need of the hour.

Calibrating counter-cyclical fiscal policy requires fiscal expansion. It should take a fresh look at the policy of fiscal deficit targets and allow for gentle increases in Government borrowings to finance larger public investment and social expenditures. However, as recommended by the Article IV Consultation paper by the IMF that the government should be transparent and include off-budget liabilities in providing the estimates for the deficit. Even if the government seeks to take some leeway from the fiscal targets, it would be prudent to report the deficit estimates in a transparent manner to include off-budget liabilities and then set a credible fresh consolidation path in the medium-term fiscal policy statement.

The cut in corporate tax rates and reduction in the policy rate largely on the supply side to revive the investment climate by making the cost of borrowing low and saving more after tax profits for further investment. Now is the time for interventions on the demand side to increase consumption and investment demand. This would require increase in public spending and new investments from public enterprises.

Amid early signals of economic recovery, it is necessary to take a review of public spending. It could be noted that during the first half of the year 2019-20, public administration was the main contributor to growth and the growth of GVA from the remaining sectors averaged just about 3%. Thus, retrenchment of government expenditure is likely to exert even more pressure and put risks in achieving the whole year growth of 5% estimated by the RBI. Sharp increase in public spending may require the government to abandon the fiscal deficit target. Therefore, some relaxation in fiscal deficit targets may be necessary, though, as mentioned earlier, greater transparency and credible adjustment path can help to soothe market fears. If the economic conditions improve in the next fiscal it will automatically help in managing the fiscal deficit targets to some extent. Thus, the government needs to be geared towards creating conducive conditions for increasing productivity in the economy and making up for the decline in investment growth in certain sectors of the economy.
Banking & NBFCs

Presently, most PSBs are well capitalised and have capital adequacy ratios well above the regulatory requirement. Some banks where the ratios are inadequate, are a part of the ongoing amalgamation process. Therefore, BWR does not expect any additional funding requirement from the government for PSBs in 2020-21.

On mergers, BWR expects the current PSB amalgamation to stabilise before government considers any further proposal of amalgamation.

On Corporate Governance, there has been concerns especially in the PSBs. Banks led by sole leadership for longer tenure are susceptible to risks. Changes in leadership on a periodic basis shall be reflective of the internal policies and systems of the banks. Robust and dynamic systems and processes are also critical in detection of frauds and avoid misuse of power of position. Budget may address this issue and may make some announcements on this front.

Government has taken steps to ease the liquidity crisis for NBFCs. One such measure announced in the last budget was the partial credit guarantee scheme. The government later extended the scheme till 30 June 2020 or till such date by which Rs 1 lakh crore assets gets purchased by the banks, which came as big sigh of relief for NBFCs. However, the banks still prefer to buy assets securitised by “AA” or higher rated NBFCs which does not serve the purpose of the scheme. BWR expects the government to address these issues by making the bankers to buy assets of lower rated (BBB) pools. We also expect that the government will further extend the eligibility of pools for securitisation which is currently for loans originated till 31 March 2019 and open a special window of funding from PSBs to address the funding issues faced by them.
Automobiles

- The major expectation of automobile sector from the government will be the announcement of incentive based scrappage policy. The move will result in old vehicles going off road and create demand for new ones, which is crucial for pick up in sales of commercial vehicles.
- Although GST rates are decided by the GST council, an indication towards rationalization of GST on automobiles in the budget will be a positive step for reviving sales. As all passenger vehicles and commercial vehicles sold in India to get expensive post implementation of BS-VI, GST rate cut will offset the price rise to some extent. Sequentially, the increased sales and higher prices will compensate the GST revenues loss.
- More measures are expected to encourage the adoption of electric vehicles. These measures can be in terms of rationalisation of import duties on components and parts, providing tax exemptions on loans taken for electric vehicles etc.
- Government should push for quick resolution of liquidity issues of NBFCs which will lead to more financing in the automobile space, and result in increase in commercial vehicle sales.

Telecom

- The sector has been demanding for reduction in license fee and spectrum usage charges for quite some time. Post the Supreme Court’s verdict on the Adjusted Gross Revenue (AGR) matter, this demand has again surfaced and some relaxation on this front is expected in the budget.
- Telecom companies (Telcos) are required to pay a 5% Universal Service Obligation Fund (USOF) levy which is used by the government to expand connectivity primarily in the unconnected rural areas. Since, the telcos have also expanded their rural network considerably over the last few years and a major chunk of the funds collected till date remain unutilised, the industry expects USOF levy to be put on hold. However, BWR does not expect the same as rural tele density is still at 57.28%, which needs to be increased to 100% by 2025 according to the government plans. A reduction in the USOF levy might ease the pressure on telecom players, hence it may be considered in the budget.
- Government aims the country to move to a fully digitised economy and 5G technology will play a major role in achieving the same. Therefore, some reduction in the custom duty applicable on telecom equipment is expected.
- GST input on telecom towers is currently not permitted which form a major part of telcos operational cost. While, Delhi High Court allowed input tax credit on telecom towers, the cumulative amount of Rs 36,000 crore to Vodafone Idea, Bharti Airtel and Reliance Jio is yet to be cleared. Even though, the decision on allowing input credit going forwards is yet to be taken by the GST council, budget is expected to provide some clarity on the matter.
Power

Government has been hinting at rollout of the new tariff policy and also the new version of UDAY dubbed as UDAY 2.0 for quite some time. Budget 2020-21 seems to be the right time for announcing both. While, the new tariff policy will allow the power suppliers to charge surcharge on delayed payments by the Discoms, UDAY 2.0 is expected to aim at improving operational performance of the Discoms along with penalties for missing the targets.

The budget may provide the Discoms access to low cost funding from Central Financial Institutions, to enable them to clear their pending dues to power producers. This will help in clearing all the past dues as future payments are already protected under the mandatory letter of credit mechanism.

The industry expects the government to bring captive renewable energy policy and give exemption from cross-subsidy and transmission charges for clean energy plants in the forthcoming budget.

Cross subsidization is the practice of charging higher prices to one type of consumer to artificially lower prices or subsidise for another group. Cross subsidy charges range from Rs.1.5 to Rs.2.0 per unit and transmission charges are 0.50 paise per unit. These charges push the per-unit cost of renewable energy to Rs.6.0 per unit which is more than Thermal Energy cost per unit in most cases.

There are many core infrastructure sector players, for example, cement manufacturers who are large energy consumers. They are eager to set up captive renewable energy plants beyond their factory boundaries if cross-subsidization and transmission charges are exempted.
Infrastructure

- The total investment in the infrastructure sector was proposed at Rs.4.56 lakh crores in FY20 as compared to Rs.5.97 lakh crores in FY19. It is expected that the current budget will propose to increase infrastructure spending by ~30% in FY21 to reach FY19 figures.
- Expected speedy implementation and spending on Bharatmala Pariyojana of 35,000 kms (Phase-I) of Rs.5,35,000 crores by 2022.
- More funds to be raised under Toll Operate and Transfer (TOT) model.
- More funds allocation to the Pradhan Mantri Gram Sadak Yojana (PMGSY), which is expected to improve rural road infrastructure.
- As per estimates, Railways require Rs.50 lakh crores between 2018-2030. Capital expenditure allocation for railways has been increased by 14% to Rs.1.58 lakh crores in FY20. Further allocation of Rs 1.5 to Rs 1.6 lakh crore would help to strengthen railway infrastructure, electrification of railway network and signaling process.
- Certain tax exemptions to issuers including banks for issuing infra bonds for setting up plants in rural / backward areas.
Real Estate

- Budget 2020-21 is expected to focus on the resolution of the gridlock that the sector finds itself in, characterised by stalled projects due to project delays, cost overruns and funding constraints; home buyers hurt by high real estate prices and risks; weak sales and high inventory; and highly leveraged developers and projects.

- To finance and complete the large number of stalled projects, the government earlier announced an Alternate Investment Fund of INR 25,000 Crore. Upcoming budget is expected to layout or announce the policy for the deployment of these funds, to speed up disbursals and deliveries of homes, and thus boost customer confidence and disposable income.

- To meet the overall housing demand and not just ownership, the budget is expected to announce a National Rental Policy the need for which was mentioned in the last budget. A rental policy would help address demand factoring in mobility and affordability, especially of the large and growing young working population. A robust policy can deploy unsold housing stock to meet real end use demand, open avenues for entry of alternate financing such as REITs, and improve financial sector’s asset quality as alternate financing for rent receivables substitute sticky developer loans.

- Further, we expect initiatives to improve affordability and disposable income - enlarging the ambit of affordable housing, and relief in personal income taxes including section 24 (on housing loan interest) – to primarily boost demand in the affordable and mid-segment categories.

- The budget may also address loan products which mitigate impact of construction and completion risk on the home buyer.

Expectations
- Policy framework for deployment of the Rs 25000 crore AIF, to complete stalled projects
- National rental/tenant policy
- Affordable Housing - Increase qualifying value/area
- Income tax relaxations – in tax slabs, 80C reliefs, and sec 24 for interest paid on home loans
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