ANANDRATHI

India I Equities

Budget

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Budget FY10 – A Preview

Lofty expectations, ground realities

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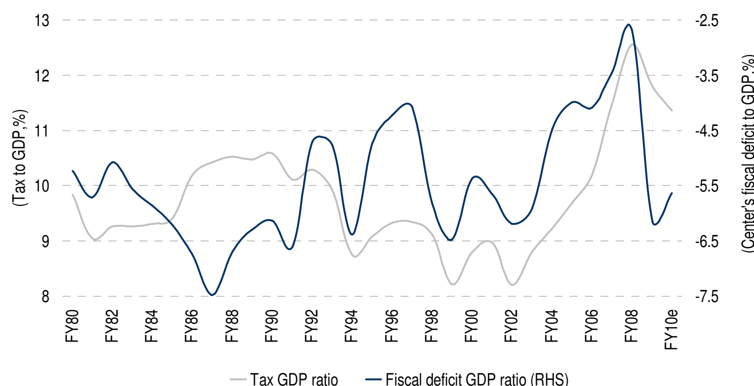
- **High budget expectations are usually belied.** While reforms will indeed get a leg up from the new UPA government sans the Left, it is unrealistic to expect one budget to deliver everything. A high fiscal deficit will also limit legroom. History suggests Indian equities' performance pre and post budget is usually reverse.
- **Tax relief? How about some tax hikes instead.** We expect no major changes in direct tax rates. FBT/STT will likely stay, with some tinkering, due to their revenue significance. Excise duties will be increased selectively while hike in import tariffs to be broad-based.
- **Sectors that may get sops.** Expect increased social sector allocations. More incentives for private sector in infrastructure sectors. Extension of STPI benefit for exporters. There could be interest subsidies in select areas like housing, infrastructure and exporters. Hopefully, the government will pick up the tab, rather than banks.
- **Fiscal deficit will not get any worse.** Expenditure control has never been the forte of the government. Vote on account revenue calculations were a tad too conservative, so there will be some upside there. Divestment receipt target will likely be higher as well. Overall the fiscal deficit will remain within expectations range, a positive.
- **Positive impact sectors –** Agri-related, IT Services, Capital Goods, Metals, Real Estate. **Negative impact sectors –** Autos, Banks, Oil

Trend in tax revenues and fiscal deficit



Source: Anand Rathi Research.

Budget plays – key stocks

Positive	Bharat Electronics, DLF, HDFC, Hindustan Zinc, IDFC, Infosys, L&T, M&M, RIL, TCS, Unitech
Negative	BPCL, HPCL, IOC, ITC, Maruti, PNB, SBI

Source: Anand Rathi Research.

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Expected sector-specific measures and stock impact

Sector	Budget Expectation	Impact	Companies
Agro-Chemicals/Products	1. Tax holidays/incentives to be given to greenfield plants to increase domestic fertilizer-production capacity. 2. Boost to irrigation in the Accelerated Irrigation Benefit Programme (AIBP).	⇑	Positive - Chambal Fertilizers, Coromandel Fertilizers, Nagarjuna Fertilizers, Jain Irrigation, United Phosphorous
Automobiles	1. Excise-duty reduction of 4-6% to be partially rolled back. 2. Extension of the additional depreciation on new CV. 3. Lowering/Abolish additional duty of Rs15,000-20,000 on PVs 4. Agro centric policies	⇓	Positive - M&M Negative - All other auto companies
Banks/Financial Services	1. Interest subsidies / ceiling rates for certain loan categories 2. Reduction in lock-in period for FDs (Sec 80C) 3. De-regulation of the small savings rate 4. Tax breaks for housing / infrastructure lenders 5. Priority sector lending status for housing loans up to Rs3m	⇓	Negative - All banks Positive – All banks / deposit taking NBFCs Positive - All banks / deposit taking NBFCs Positive - Infra/housing lenders-IDFC,PFC,HDFC,LIC HF
Capital goods	1. Ext. of Sec.80-IA beyond FY10 2. Increase in Infrastructure & Defence spend	⇑	Positive - L&T, BHEL, Crompton, Bharat Electronics, Power Grid, NTPC
Cement	1. No hike in excise duty. 2. Increase in Infrastructure & Housing spending	⇑	Positive - ACC, Ambuja, Grasim, Ultratech, India Cement, Shree Cement
Consumer	1. No increase in excise duty 2. Increase in abatement rate. 3. Increase in MSP	⇔	Positive - Colgate, HUL, Britannia Negative - ITC
Hotels	Seeking industry status & rationalizations of taxes	⇔	Positive - Indian Hotels
Metals	1. Implementation of National Mineral Policy(NMP) recommendations 2. Reversal of Excise duty on steel (from 8% to 12%) 3. Import duty hike on steel (from 5% to 15%) 4. Road map for stake sale of PSUs	⇑	Positve - Sterlite, Hindustan Zinc, NALCO, Tata Steel, SAIL, JSW
Oil & Gas	1. Income-tax exemption to gas producers 2. Roadmap for de-regulation of retail oil prices / transparent subsidy-sharing both unlikely 3. Customs duty on crude and increase in duty on petro-products	⇓	Positive - RIL,ONGC,GSPC Negative - HPCL,BPCL
Real Estate	1. Incentive for affordable housing 2. Increase in interest on housing loan deduction from Rs0.15m to Rs0.3m (Sec. 24 – Income tax act)	⇑	Positive - DLF, Unitech, HDIL, Ackruti
Technology	1. Ext. of STPI for 3yrs 2. Introduction of Multi-purpose National Identity Cards (MNIC) 3. Increase in SSA allocation 4. Use of IT/ITES in e-governance	⇑	Positive - All IT outsourcing companies, Bartronics, Educomp, Everonn, Rolta, Infotech Enterprise.
Telecom	1. Announcement of expected proceeds from 3G/BWA spectrum auction 2. Plans relating to utilisation of Universal Service Obligation (USO) funds. 3. Imposition of a cess on diesel	⇔	Neutral – Bharti, RCOM, Idea, TTML

Source: Anand Rathi Research

Budget FY10 - Lofty expectations, ground realities

High expectations have been built about a reforms push given the thumping victory of the Congress-led UPA coalition and the absence of any Left influence. However, the government will be hugely constrained by an already high fiscal deficit. We think the budget itself will be unable to live up to these lofty expectations, even as longer-term reform/deregulation shift still materializes.

Budget sops will likely be focused on infrastructure, housing, exporters, defence and agriculture sectors. Interest subsidies may be a widely used tool. Expect no income tax cuts. Some excise duties were already cut as part of the economic stimuli and may at best be left unchanged. Low inflation and revenue objectives raise the possibility of a reversal of some of the import tariff cuts on commodities that were done in 2008 to control price rise. Market's hopes on FBT/STT relaxation may also fall victim to revenue considerations.

History suggests that high budget expectations are never met. In 11 out of the last 14 years, equity market performance pre and post budget have been in opposite directions. Strong up move in equities this year (not all due to budget expectations) makes us negative on the budget's likely market impact. We suggest continued profit-taking, shift out of high beta to defensives until the budget.

The equity market's take

It will be a closely monitored event. As it is, every Union Budget is a closely watched event as it lays out the government's revenue and expenditure plans and gives direction to the government's economic vision. It will be more so this year, as there are high hopes of a major step up in reforms initiatives by this UPA coalition which is without the Left influence for the first time. Despite 10% correction since mid last week, much ahead of the global peers, Indian equity indices are up 40% since 1 Apr '09 and 20% since the election results started coming in.

Isolating budget impact often difficult. Equity markets are volatile pre and post the budget, with expectations garnered from the existing macro-economic and political environment being built in. Measuring its impact on the markets is an inexact science.

Divergent pre and post budget market performance. We have measured the pre- and post-budget impact of the past 14 budgets since 1995-96 (excluding the interim budgets) on the Indian equity market with different time horizons (90 day, 30 day and 7 day) (see Fig 1). Main trends are below:

- With the exception of three (out of 14) years, market movements prior to and post the announcement have been in opposite directions. In FY96 and FY97, the market continued to fall prior to as well as after the announcement of the budget while in FY07, the market rose both before and after the announcement of the budget
- More often than not the equity market starts building up positive expectations in the run-up to the budget, and largely reverses direction

after the budget is presented. It appears that the build-up of over expectations in the run-up to the budget gets deflated after the budget.

- On a net (pre plus post) basis, the impact of the budget on the equity market has more often been negative than positive.

Fig 1 – Change in Sensex pre- and post budget

	90D pre	30D pre	7D pre	7D post	30D post	90D post
1995-96	-12.9	-3.0	-2.3	-0.9	1.9	-2.9
1996-97	-5.4	-7.5	-5.4	-1.4	-3.6	-8.7
1997-98	26.3	3.6	6.2	6.1	0.3	2.0
1998-99	-5.4	7.2	2.3	-7.7	-9.7	12.1
1999-00	16.2	-1.8	-3.6	12.8	11.2	16.7
2000-01	18.0	2.1	-7.4	2.6	-7.5	-23.1
2001-02	6.2	0.3	-1.3	-4.7	-15.1	-11.9
2002-03	8.4	7.5	-0.2	3.6	-2.6	-11.3
2003-04	1.7	1.4	-0.7	-4.0	-5.1	-3.6
2004-05	-8.3	7.3	0.5	-1.8	0.9	13.4
2005-06	7.7	4.6	2.7	2.5	-5.0	-0.1
2006-07	18.0	5.1	2.0	3.4	9.0	4.7
2007-08	-5.5	-9.0	-8.8	-2.8	1.0	12.1
2008-09	-9.2	-1.0	1.3	-9.1	-6.9	-7.2
2009-10	-12.9	-3.0	-2.3	-0.9	1.9	-2.9

Note: For 2009-10, changes are measured with reference to 18 June'09, 90-day pre data relates to 1 Apr'09 and 30 day data relates to 18 May 2009.
Source: Bloomberg, Anand Rathi Research

Juggling priorities

Somber backdrop. The Union Budget 2009-10 (FY10) will be presented on 6 July 2009. The backdrop could not be any worse: the world's worst recession since the 1930s, a slowing Indian economy, rising unemployment, severe deterioration in government finances, a vast liquidity overhang, and uncertainty about when the economy will turnaround.

Government priorities. Though government priorities are clear-cut – promote growth, make it more equitable, provide help to sections adversely impacted by the slowdown, restore fiscal prudence, bridge the gap between soft and hard infrastructure – how it will manage to juggle the disparate priorities is the question.

Balancing act. The above-mentioned priorities for the Budget FY10 are often at loggerheads with each other. For example, while stimulating headline growth, equitable growth generally falls by the wayside, at least in the medium-term – headline growth entails greater inequality (by increasing the share of profit/investable surpluses), while equitable growth aims for the opposite. Similarly, fiscal prudence means expenditure control and/or increase in government revenue, while a pro-growth policy amidst a global recession requires fiscal laxity. We thus expect the Indian government to chart a narrow path down the middle of these conflicting economic and political priorities.

What key measures do we expect? We expect the Union Budget FY10 to include:

- No broad-based tax cut and some rollbacks, especially custom duties
- Major increase in social sector spending
- Special focus on sectors negatively impacted by the global recession

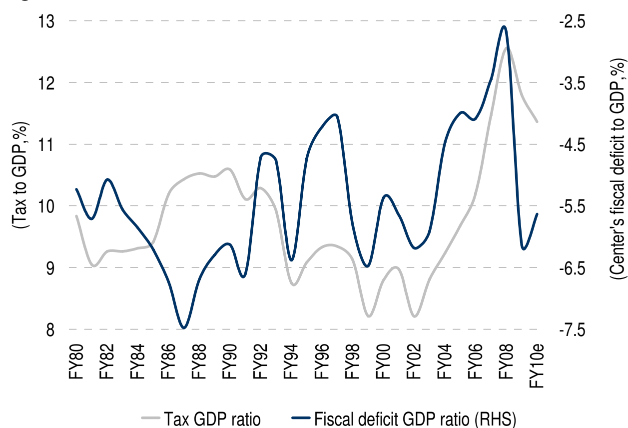
such as exports and SMEs (small and medium enterprises)

- Measures to channel credit to specific sectors at 'affordable' rates
- Major incentives for private sector participation in infrastructure
- Strong focus to recast defence and intelligence set ups
- Road maps (but little immediate concrete action) for the goods and services tax (GST), divestment in public sector units, and
- Promotion of e-governance

Expenditure – Measured profligacy

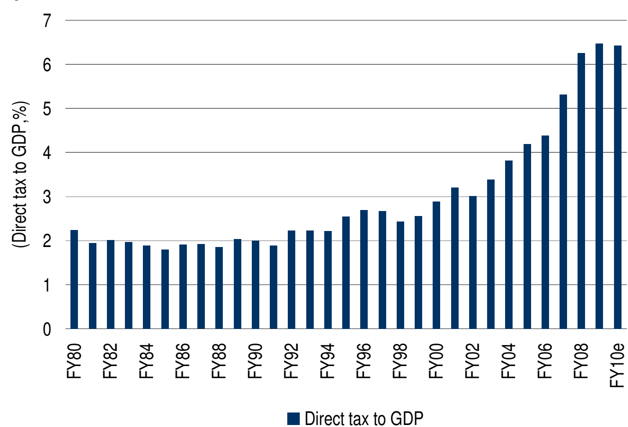
Tax buoyancy led to fiscal consolidation. Expenditure control has never been the government's forte. Even the fiscal consolidation witnessed over FY02-FY08 was due to rising tax revenues rather than expenditure control (see Fig 2). Sharp improvement in direct tax – personal income and corporate income tax – collection (see Fig 3) helped narrow the fiscal deficit. In FY09 and probably in FY10, a sharp increase in expenditure would be to blame for the fiscal deterioration.

Fig 2 – Rising tax revenue led to fiscal consolidation



Source: Government of India, Anand Rathi Research

Fig 3 – Sharp rise in contribution of direct taxes



Source: Government of India, Anand Rathi Research

High expenditure growth likely in FY10. The jump in expenditure in FY09 was partly cyclical – the stimulus packages and the rise in fertilizer and fuel subsidies (a major part of these subsidies are off-budget items)

following the sharp run-up in international commodity prices. On the other side, there are committed costs – interest payments on public debt, salaries of public servants and politically sensitive subsidies – that cannot be reduced. In addition, the hike in public servants' salaries and loan waivers for farmers pushed government finances further into the red in FY09. In FY10, expenditure growth should remain high because of the deferred payment schedule for both salaries and waivers.

Social sector spending to rise. The political take of the decisive election verdict is that voters endorse the social spending policies (such as the National Rural Employment Guarantee Act [NREGA] and farmers' loan waiver). We thus expect the government to continue to increase social sector spending under flagship projects such as the NREGA, the Bharat Nirman programme (project for rural infrastructure formation), the National Rural Health Mission (rural basic healthcare programme), the Sarva Shiksha Abhiyaan (project for primary education), the Aam Admi Bima Yojana (life insurance cover for landless households), the Rashtriya Swasthya Bima Yojana (medical insurance cover for unorganized sector workers living below the poverty line), the Indira Gandhi National Old Age Pension scheme, and the Jawaharlal Nehru National Urban Renewal Mission (basic infrastructure and services for the urban poor).

Infrastructure development to be a key focus. Within infrastructure, the focus is likely to be on electricity, roadways (specifically rural connectivity), ports, airports, irrigation and urban infrastructure. Besides increasing direct investment in infrastructure (with focus on rural connectivity, irrigation and urban infrastructure), the government would also want more private participation, with public-private partnership (PPP) and viability gap funding, wherever appropriate, as the preferred mode. We also expect other measures to boost infrastructure investment, such as, mining linkages for coal power plants, facilitating land acquisition for road projects, setting up appropriate regulatory arrangements and market microstructures (eg, in power trading) and facilitating funding at 'reasonable' rates.

Agriculture expenditure to rise. The government would heighten focus on agriculture in a bid to serve two key purposes – for inclusive growth and for national food security at affordable prices. Apart from an increase in public investment in agriculture, the likely measures in the budget for agriculture are: more crops under the minimum support price (MSP), selective hikes in the MSP, farm-gate procurement under the MSP, improvement in the rural marketing network (by building all-weather roads, better storage facilities) and ensuring minimum market price for acquisition of agricultural land for infrastructure/other non-agricultural use. In addition, mechanisms are likely to be put in place to ensure adequate institutional credit to agriculture at reasonable rates. Furthermore, special packages are likely to be announced in the budget to support plantation crops and ancillary agriculture activities.

Heightened threat perception to raise defense spending. Defence is an area where expenditure should increase substantially as the government plans to modernize defence and police forces. We, however, expect that there would not be a major increase in capital expenditure (to revamp defense hardware) in FY10. The push during the current fiscal year would more be on the revenue expenditure side.

Fiscal stimulus from interest rates rather than fiscal policy. The continued infirmity of domestic real sector growth, global recession and ambiguities about the growth outlook should limit the extent to which the

government can raise taxes and other levies. Therefore, given the precarious fiscal situation and the large structural component in the fiscal deterioration, we do not expect the expenditure policy to be used significantly for providing further stimulus. These coupled with the existing ambitious market borrowing programme of the government should lead to the use of monetary rather than fiscal policy to provide further stimulus to the economy.

Monetary measures from the budget. Despite being largely outside the scope of direct government action, the budget is likely to indicate certain indirect monetary measures. We expect the budget to include: a cut in administered rates at which the government directly mobilizes funds from the public (through schemes such as post office deposits and public provident fund); setup a mechanism for banks to lend with some ceiling rates to specific sectors and activities such as agriculture, infrastructure, small and medium enterprises, exporters, education and affordable housing. The differential between these rates and the 'market' rates may be partially/fully provided by the government directly.

Revenue – Tax hikes, rather than cuts?

Prior tax cuts may not be fully rolled back. The previous stimulus measures had included cuts in excise, customs and services tax rates, which together cost the government over Rs500bn in revenue. Given the tight spot the government is in, we do not expect these measures to be fully rolled back though tinkering could happen, especially on indirect taxes.

Only minor changes in direct tax likely. We expect the economic slowdown to lead to a deceleration in personal income (especially in the higher income groups) and corporate profitability in FY10. This, in turn, should impact direct tax collection. Although on the lower end India's personal income tax structure is more progressive than those of most emerging market economies, the maximum tax rates on both corporate and personal income are in line with the global trend (see Fig 4). Against this backdrop, any significant reduction in direct tax rates during the forthcoming budget looks unlikely. Some relatively minor changes might be proposed in the budget, such as, special dispensation for specific groups (eg, senior citizens), removal of tax deduction at source on interest income from bank deposits for non-business income earners and increase in tax exemption on interest/principle payment for housing loans.

Fig 4 – Direct taxation structure – A global comparison

	Corporate tax (%)	Personal tax (%)	Times per capita income at which max. tax rate applicable on personal income (x)
Australia	30	45	3
Canada	38	29	3
China	25	45	84
India	30	30	8
Indonesia	30	35	14
Korea	25	35	4
Malaysia	26	28	12
Philippines	35	32	9
Russia	24	13	5
Singapore	18	20	7
Thailand	30	37	37
United States	35	35	7

Source: World Bank, Anand Rathi Research

Major revamp of FBT and STT unlikely. In our view, the government will not adopt any measure that would significantly reduce any existing revenue stream. Since FY06, the Fringe Benefit Tax (FBT) and Securities Transaction Tax (STT) together have accounted for 12-13% of overall personal income tax collection (see Fig 5). Given this, we expect no change in the FBT or the STT. Change could come in the form of simplification of FBT norms to reduce companies' compliance burden. From a revenue generation perspective, a significant reduction/removal of STT is linked to raising the rates of short-term capital gains tax and/or reintroduction of long-term capital gains tax. The latter, however, is likely to be more unpopular among the financial market participants and therefore status quo on STT seems to be the more likely outcome.

Fig 5 – FBT and STT contribute significantly to tax revenue

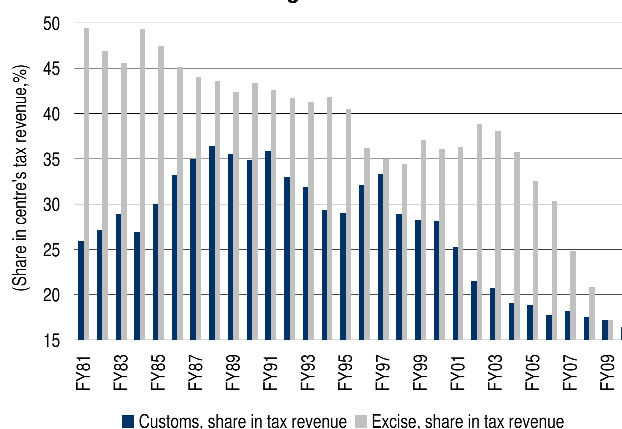
	(Rs billion)		Growth (%)		% of income tax	
	FBT	STT	FBT	STT	FBT	STT
FY06	48	26	..	333.3	8.6	4.6
FY07	53	46	10.4	76.9	7.1	6.1
FY08	71	86	34.0	87.0	6.9	8.4
FY09	85	55	19.7	-36.0	6.9	4.5
FY10	102	63	20.0	14.5	7.5	4.7

Note: FBT: Fringe Benefit Tax, STT: Securities Transaction Tax.
Source: Government of India.

Hike in excise rates likely. One of the election promises of the Congress has been the introduction of the Goods and Services Tax (GST) by April 2010. Full-fledged introduction of GST would mean the abolition of all indirect taxes (apart from customs duty) levied by the Centre, state and local authorities. The transition from the current indirect tax regime to GST, therefore, would require a considerable revamp of the excise rates and it is conceivable that the budget for FY10 may frontload a part of the transition to GST. The process, however, is likely to increase rather than decrease excise rates for three reasons:

- In recent times there has been a substantial reduction in the mean ad valorem rates – from 16% to 14% in the FY09 budget, from 14% to 10% in Dec '08, and from 10% to 8% in Feb'09
- At the current level, the mean excise tax is lower than the rate for services tax. These rates would need to be broadly equalized under the GST
- The share of excise in total Central government tax revenue has fallen from 39% in FY02 to 17% in FY09 – and this is expected to fall further in FY10 (see Fig 6).

Fig 6 – Share of indirect taxes show significant decline



Source: Government of India, Anand Rathi Research

Excise hikes likely to be largely selective. While the cut in basic and special excise duties during FY09 have been largely across-the-board, the hikes in the forthcoming budget are likely to be more selective. In particular, income sensitive consumption such as high-end consumer durables, automobiles and branded FMCG products are likely to face rate hikes. Duties on crude oil and petroleum products, pan masala and tobacco products, too, are likely to witness hikes. In addition, it is likely that some of the special duties on excise tax such as education cess, secondary and higher secondary education cess, and national calamity contingency duty would be hiked. We also expect the introduction of a special cess on excise to fund social sector/infrastructure spending.

New cesses likely to be introduced. Similar to the cess on petrol and diesel for national highway development, a cess for infrastructure development may be introduced on certain infrastructure facilities like electricity, airports and seaport.

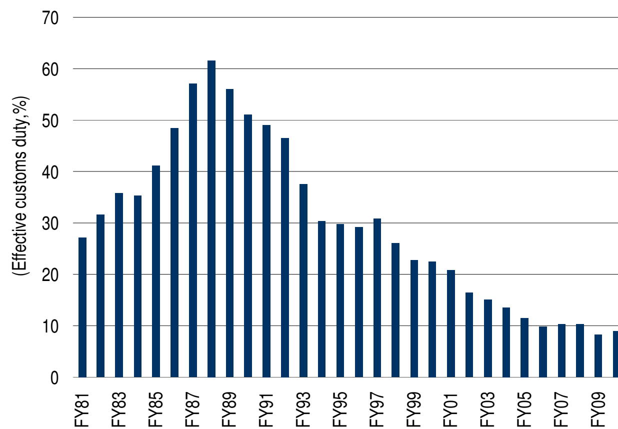
Some hikes in import duties likely. In a bid to pursue a more outward-oriented development strategy, India has progressively reduced customs duties (import duties) since the late-'80s. The effective average customs duty has declined from over 60% in the late '80s to less than 10% in recent years (see Fig 7). In line with this, the share of customs collection in the Centre's overall tax collection has fallen significantly (see Fig 7). In the FY10 budget, however, we expect a substantial hike in customs duties for the following reasons.

- During FY09, first in a bid to control inflation and later as part of fiscal stimulus measures, customs duties on various products were cut. Part of these cuts, especially those which were introduced to soften domestic inflation (such as on crude and petroleum products, edible oil and metals) are likely to be rolled back in the FY10 budget
- With the expected hike in excise duties and other indirect taxes and cesses, various forms of countervailing duties, which are part of customs duties, would need to be hiked
- Customs duties in most products are levied on an ad valorem basis. The substantial decline in most global commodity prices (from the peak of early FY09) means a substantial fall in per unit customs duty. To compensate for the resulting fall in customs collection, the ad

valorem rates are likely to be hiked for various products

- With the sharp slowdown in global trade, various countries are following protectionist strategies to discourage imports. Within the multilateral framework of global trade under the World Trade Organisation (WTO), bilateral customs tariff escalation against such countries by India is not permissible. Therefore, a more likely action would be to hike customs duties.

Fig 7 – India has cut effective customs rate significantly



Source: Government of India, Anand Rathi Research

Hike in customs duty likely to be broad-based. Unlike the excise rate hike, which is likely to be more selective, customs duty hikes are likely to be more across-the-board. With the exception of limited items, such as export-related imports, a broad-based hike in customs duty during the current budget is likely.

Services tax base likely to be broadened. The introduction of GST would require a uniform/largely flat tax rate on goods and services. Currently, Central excise rates on goods are, on average, 2 percentage points lower than the services tax rate. On the contrary, while goods are subject to state taxes, states cannot tax services. On the balance, in the course of introducing the GST, overall indirect taxes on services may go up. In the interim (including the FY10 budget), however, we expect a hike in services tax, if any, would be more modest than the hike in excise rates given that cuts in services tax rates under the stimulus package was more modest than the excise duty rates. The upper limit for the hike in services tax during the FY10 budget seems to be a roll back to a 12% rate that prevailed until Feb '09 when the rate was cut by 2 percentage points. We, however, expect that the coverage of services under the tax net could be enlarged during the FY10 budget. It is possible that the budget would make all services taxable barring a small negative list (such as basic education and healthcare services).

The overall fiscal situation

Expenditure likely to exceed vote-on-account calculation. We expect expenditure in the FY10 budget to substantially exceed the interim budget figures with respect to explicit subsidies and plan expenditure (see Fig 8). In most other areas, the built-in expenditure changes over FY09 as presented in the interim budget are largely in line with our expectations and we expect the continuation of the same in the FY10 budget.

Some upside for government revenue as well. The revenue calculations in the interim budget need to be adjusted for the excise and services tax cuts that were implemented after the presentation of the interim budget. Subject to these revisions, our government revenue estimates are largely in line with the figures in the interim budget. The areas where our estimates vary from the interim budget calculations include:

- Customs revenue. In the interim budget the government estimated a modest rise in customs revenue in FY10. Despite our expectation of a substantial rise in customs rates, we expect customs collection to decline noticeably in FY10 due to the current subdued conditions for world trade
- Non-tax revenue. While the interim budget had anticipated a large jump over FY09 in non-tax revenue excluding interest, dividend and profit income, we expect significant upside from the interim budget calculations due to revenue share from new oil and gas facilities, 3-G spectrum auction and seigniorage due to printing of money (and thereby RBI profit)
- Divestment. The interim budget had a figure of only Rs11bn as divestment proceeds in FY10. With the surprise decisive verdict in favor of the Congress/UPA, it now looks likely that divestment would gather momentum in FY10 and that estimate might be increased many fold.

Unchanged budget fiscal deficit. Although we expect the budget to show higher expenditure and revenue than in the vote on account, we expect the budget fiscal deficit to remain unchanged at 5.7% of GDP. The overall central deficit including off-budget items is likely to be 7.5% of GDP. In line with these estimates, we do not expect any major revision in the market borrowing programme of the Central government.

Fig 8 – Further fiscal deterioration likely to be limited

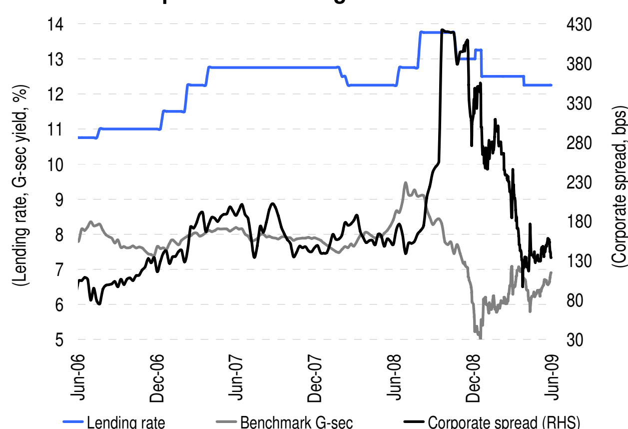
(Figures in Rs billion, ratios in %)	FY07	FY08	FY09	FY10BE	FY10AR
Total receipt	5,789	7,399	8,710	9,532	10,234
Revenue receipt	4,344	5,419	5,622	6,096	6,584
Total tax receipt (gross)	4,735	5,931	6,279	6,713	6,728
Share of state, UT	1,223	1,536	1,620	1,737	1,749
Tax receipt for Centre (net)	3,512	4,395	4,660	4,976	4,978
Personal income tax	751	1,026	1,226	1,354	1,385
Corporate income tax	1,443	1,929	2,220	2,442	2,486
Customs duty	863	1,041	1,080	1,102	994
Excise duty	1,176	1,236	1,084	1,106	1,127
Services tax	376	513	650	689	715
Other tax	126	186	20	20	20
Non-tax receipt	832	1,024	962	1,120	1,605
Interest	225	211	190	190	200
Dividend and profit	293	345	397	370	405
Other non-tax	314	468	374	560	1,000
Capital receipt	1,445	1,980	3,088	3,437	3,650
Net market borrowings	1,104	1,318	2,620	3,086	3,100
Disinvestment of PSUs	5	388	26	11	200
Receipts from small savings etc.	52	-74	61	183	150
Recovery of loans	59	51	97	97	100
Other capital receipt	224	297	284	59	100
Total expenditure	5,834	7,127	9,010	9,532	10,197
Non-plan expenditure	4,135	5,077	6,180	6,681	6,848
Revenue expenditure	3,722	4,209	5,618	5,997	6,153
Interest payments	1,503	1,710	1,927	2,255	2,175
Defence	517	542	736	869	920
Explicit subsidies	571	709	1,292	1,009	1,163
Others	1,131	1,247	1,663	1,864	1,895
Capital expenditure	413	867	562	683	695
Loans and advances	15	16	17	8	15
Defence	338	375	975	548	550
Others	60	477	-430	128	130
Plan expenditure	1,699	2,051	2,830	2,851	3,349
Revenue expenditure	1,424	1,736	2,417	2,483	2,865
Central plan	1,026	1,197	1,716	1,763	2,060
States plan	399	539	700	720	805
Capital expenditure	274	315	413	368	484
Central plan	218	238	325	321	383
States plan	57	77	88	47	100
Gross fiscal deficit	1,426	1,269	3,265	3,328	3,313
Revenue deficit	802	526	2,413	2,385	2,435
Primary deficit	-77	-441	1,338	1,073	1,138
Oil bonds	241	353	713		450
Fertilizer subsidies	225	280	950	500	600
Consolidated fiscal deficit centre	1,891	1,902	4,928	3,828	4,363
Gross fiscal deficit (% of GDP)	3.5	2.7	6.1	5.7	5.7
Consolidated fiscal deficit centre (% of GDP)	4.6	4.0	9.3	6.5	7.5

Note: BE: Budget estimate, AR: Anand Rathi Research estimate.
Source: Government of India, Anand Rathi Research.

Sectoral impact of the budget: An overview

Easing of lending rates to aid the corporate sector. We expect that the budget would keep the government's market borrowing programme largely in line with the estimates given during the interim budget. This is likely to soothe the government securities market. Considerable narrowing of corporate spreads since late-2008 also indicates market risk appetite is back to the historic average level (see Fig 9). We expect the measures in the budget to nudge credit market rates down. All these factors would simultaneously improve the availability of borrowed funds and reduce the borrowing cost for the corporate sector. This would eventually be earnings accretive for the non-financial corporate sector.

Fig 9 – Interest cost of corporate sector to go down



Source: Bloomberg, Anand Rathi Research.

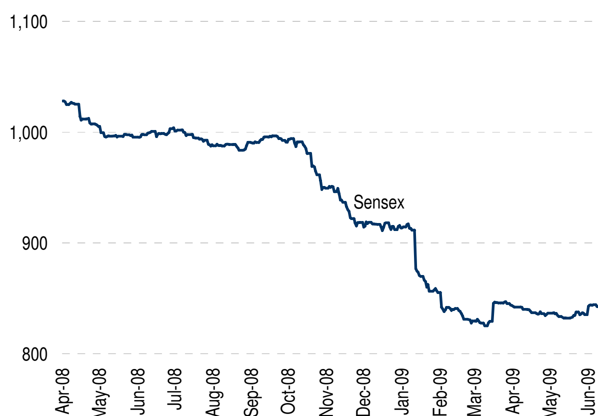
Policy posturing key for confidence, earnings upgrades. Since early Mar '09, Indian equities have risen 65%. Earnings upgrades have begun, although yet very marginal. So far, earnings growth forecast for FY10 is still in negative territory, making valuations look quite stretched (see Fig 10 - 13). Whether a good budget triggers a faster earnings upgrade, thereby providing the market a prop to stay at higher levels, will be important for the market over the next three months. Based on our expectation of budget measures, the direct impact of budget measures on earnings forecasts will be limited. Whether the budget can help earnings upgrades by adding to the recent resurgence of confidence through policy posturing and long-term initiatives will be keys to watch.

Fig 10 – Nifty50 valuations @ 4251

Year to 31 Mar	FY06	FY07	FY08	FY09	FY10e	FY11e
EPS Growth (%)	11.1	42.2	34.6	-2.9	-2.8	17.0
PE (x)	31.7	22.3	16.6	17.1	17.6	15.0
EPS Growth (ex Oil & Gas, %)	12.0	49.4	35.8	-2.3	-5.9	12.1
PE (x, ex Oil & Gas)	34.5	23.1	17.0	17.4	18.5	16.5
Div Yld (%)	1.2	0.9	1.6	1.9	1.5	1.5
PBV (x)	8.7	6.6	4.7	4.0	3.2	2.8
ROE (%)	22.4	19.2	20.5	23.3	18.6	15.4
EV/EBITDA (x)	21.3	22.9	17.5	13.2	11.3	11.1

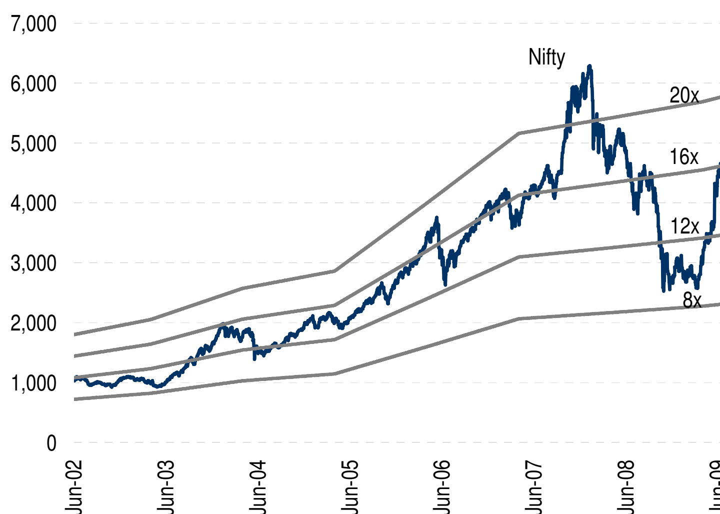
Source: Bloomberg, Anand Rathi Research.

Fig 11 – Earnings upgrades have started to trickle in (Sensex FY10 EPS)



Source: Bloomberg, Anand Rathi Research.

Fig 12 – Nifty forward PE bands



Source: Bloomberg, Anand Rathi Research.

Fig 13 – Nifty PBV

Source: Bloomberg, Anand Rathi Research.

Sectors

Agro-chemicals/products

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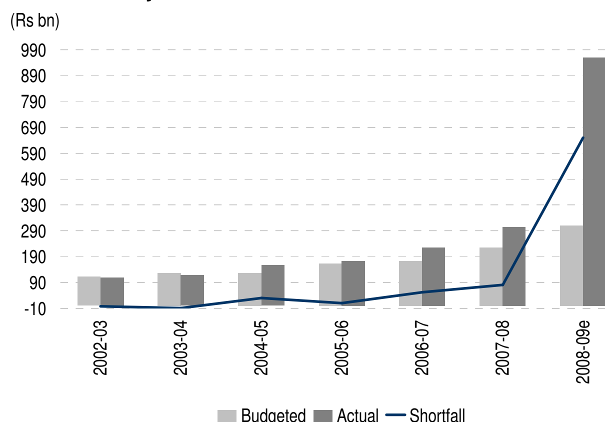
The subsidy on fertilisers is a contentious issue, allocations being less than actual subsidies in a year – a huge burden on government. The target of 4% growth in agriculture in the 11th Five-Year Plan urgently requires further impetus.

Fig 14 – Fertilizer subsidy



Source: Anand Rathi Research

Expectations

We expect some tax holidays/incentives to be given to greenfield plants to increase domestic fertilizer capacity.

We do not expect changes in the policy regarding the subsidy. Nevertheless, we expect a greater allocation for subsidies on fertilizers.

More funds could be allocated to The National Food Security Mission to increase production of rice, wheat and pulses.

Irrigation could get a boost through The Bharat Nirman and Accelerated Irrigation Benefit Programme (AIBP).

Impact on the sector

A higher fertiliser subsidy in cash (not bonds) means that fertiliser companies would then require much less working capital. This would lower their interest burden and boost profits.

Raising the minimum support prices of foodgrains would benefit farmers and give them an incentive to grow more. Employment opportunities too would increase. This indirectly benefits the fertilizer sector.

By raising the maximum retail price on fertilizers, the subsidy necessary would be smaller, and the burden to government reduced.

Companies affected

If implemented, these expectations would be beneficial to Chambal Fertilizers, Coromandel Fertilizers, Nagarjuna Fertilizers, Tata Chemicals (fertilizer division), Rashtriya Chemicals & Fertilizers and other major PSU fertilizer corporations.

Positive for Advanta India, Kaveri Seeds, United Phosphorous, Rallis India, Jain Irrigation.

Autos

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The economic stimuli in Dec '08 and Feb '09 provided a boost to the auto sector. Key positives were the reduction in excise duty, accelerated depreciation on CVs, lower interest rates and more easily available financing. Continuation of such measures would benefit the entire automobile sector. Additionally, the agro-focus of the government would be positive for M&M, which we expect to be a major beneficiary of the budget.

Fig 15 – Expected measures and impact

Expectations	Impact on the Sector	Companies affected
Maintaining lower excise duty / Partial rate hikes from lowered levels	Neutral / Negative	Entire auto sector
Extending the depreciation benefit for CVs	Neutral	Ashok Leyland, Tata Motors
Lowering / abolishing the additional excise duty on PVs with engine capacity more than 1,500cc	Positive	M&M, Tata Motors
Agro-focus	Positive	M&M

Source: Anand Rathi Research

Expectations

- Domestic volumes have been lower recently in segments like passenger vehicles, while M&H CV volumes witnessed a sharp decline. In view of this, we expect the excise-duty reduction of 4-6% to be retained at least partially for the coming year, particularly in these segments and in two-wheelers.
- Depreciation benefit on the purchase of new commercial vehicles should be extended beyond Sep '09 (till when CVs purchased can avail of this benefit).
- An additional duty of Rs15,000-20,000 is now levied on PVs with engine displacement of over 1,500cc. The budget may abolish or lower this.
- We also expect the focus on developing the rural economy to continue.
- We expect continuation of the focus on infrastructure development and measures to ease credit availability.

Impact on the sector

- Keeping the excise duty at reduced rates for the year would maintain the cost of acquiring a new vehicle at lower levels. On the other hand, a rollback/dilution of the stimuli would dampen demand and be negative for the sector.
- Extending the depreciation benefit would continue to benefit the CV segment, although sustainable demand recovery would depend on economic growth and greater availability of freight.
- Lowering / abolishing the Rs15,000-20,000 additional excise duty on passenger vehicles above 1,500cc engine capacity would benefit UVs and cars in the executive segment and above, but this positive would be set-off by partial roll-back of the lowered excise duty.
- Investment in infrastructure and easing of credit availability would also be beneficial for the sector.

Companies affected

- If the lower excise duty rates are continued in FY10, the benefit would be felt across the auto sector and vice versa. Measures for infrastructure development and easier credit availability would be beneficial for the sector.
- Lowering of additional duty would benefit M&M's and Tata Motors' UV range. Extending the depreciation benefits on CVs would benefit Tata Motors and Ashok Leyland.
- The budget focus on agriculture and rural development would be encouraging for M&M's farm-equipment segment. It would also benefit UVs like Maxx (which are used in mofussil areas) and Hero Honda, which is very strongly rural-oriented. Maruti Suzuki, which is widening its countryside reach would also benefit, though to a lesser extent.

To sum up, we expect the biggest beneficiary from the budget to be M&M.

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The key measure expected to have a negative impact on the sector is lending at some ceiling rates to specific sectors and activities – agriculture, infrastructure, SMEs, exporters, education and affordable housing. The companies expected to be affected are all banks, especially PSU banks.

Key measures expected to have a positive impact on the sector are the de-regulation of the small savings rate, reduction in the lock-in period for FDs qualifying for tax deductions and tax breaks for infrastructure and housing lenders. The companies expected to benefit from these are all banks, and infrastructure/housing lenders - IDFC, PFC, HDFC, LIC Housing Finance.

Fig 16 – Expectations from the Budget

	Current	Expected
Ceiling rates for certain loan categories	None	Agriculture, infra, SMEs, exporters, education, affordable housing
Reduction in lock-in period for FDs to qualify for tax benefits	Five years	Three years
Raise the ceiling for TDS on FDs	Rs10,000	Rs15,000
De-regulation of the small savings rate	Regulated	Market- determined
Tax exemption for housing / infrastructure lenders	Up to 20% of profits derived from projects	Up to 40% of profits derived from projects
Priority sector lending	Housing loans up to Rs2m	Housing loans up to Rs3m

Source: Anand Rathi Research

Expectations

- A mechanism for banks to lend at some ceiling rates to specific sectors and activities such as agriculture, infrastructure, small and medium enterprises, exporters, education and affordable housing. The difference between these rates and the 'market' rates may be directly provided by the government, partially or fully.
- Relaxation in the lock-in period for fixed deposits, from five years to three years, to qualify for tax benefits under Sec 80C. The ceiling for TDS on fixed deposits could also be increased.
- De-regulation of the small savings rate
- Tax breaks to housing finance/ infrastructure lending companies: up to 20% of profits derived from such projects are exempt. This is expected to be raised to 40%.
- Lending by banks to power projects/NBFCs financing power projects, housing loans below Rs3m (currently Rs2m) is likely to be considered as priority sector lending.

Impact on the sector

- Banks would be nudged to reduce lending rates / adhere to ceiling rates for lending to focus sectors. Margins would be hurt, as the banking system has raised a large portion of its liabilities at high rates in the recent past.
- Relaxation in the lock-in period and/or ceiling for TDS on interest earned would increase the attractiveness of term deposits, and bring

them on par with other investment avenues.

- Any reduction in the small savings rate would give banks more flexibility to lower deposit rates, meaning lower cost of funds for banks, helping them protect their net interest margins to an extent.
- Tax breaks to infra / housing lenders would increase profitability and capital adequacy of housing / infrastructure lenders, encouraging them to further disbursements. Banks could also join in, if the PSL status is extended to housing loans up to Rs3m

Companies impacted

- Ceiling rates for certain loan categories would impact bank lending yields for all banks.
- De-regulation, of the fixed deposit lock-in clause and the small savings rate, would affect all banks positively.
- Tax breaks for lending to infrastructure / housing are expected to benefit HDFC, LIC Housing Finance, IDFC and PFC.

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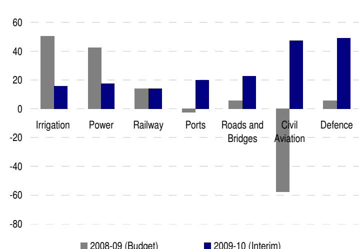
The government could re-introduce investment allowance for fresh capital acquisition and extend Sec 80 IA benefits beyond FY10. Spending on infrastructure and defence are expected to see a quantum jump.

Fig 17 – Projected infrastructure spending in the 11th Plan (2008-12)

In billion rupees	FY08	FY09	FY10	FY11	FY12
Roads	518.2	547.9	592.0	683.7	799.7
Telecoms	313.8	381.3	485.9	616.5	786.9
Railways (incl. MRTS)	342.3	409.6	495.3	603.9	767.0
Irrigation (inclu. watershed)	275.0	359.2	471.9	622.7	804.3
Water supply & sanitation	193.0	227.8	273.2	332.7	410.6
Ports	124.1	148.2	173.7	199.8	234.1
Airports	52.1	55.2	59.0	66.5	76.9
Storage	37.8	41.0	44.5	48.2	52.3
Gas	27.1	30.0	33.3	37.0	41.1

Source: Planning Commission, Anand Rathi Research

Fig 18 – Growth in budgetary spend



Source: Budget documents, Anand Rathi Research

Expectations

- The government may re-introduce Investment Allowance, under Sec 32A of the Income Tax Act, on the acquisition of new capital equipment such as plant & machinery, new ships and aircraft.
- Increase in infrastructure spending (especially in electricity, rural roads, airports, sea ports and irrigation projects) with PPP and/or viability-gap funding being the preferred investment mode.
- Defence spending and spending on intelligence-gathering equipment to see a quantum jump.
- The government may also take a call on Sec 80 IA, which offers tax breaks for investment in infrastructure. This is applicable for projects that are underway till Mar '10, and is likely to be extended.

Impact on the sector

- Re-introduction of investment allowance would benefit the sector as acquisition of new capital equipment would become cheaper. This would spur demand for capital equipment. Companies with large capital expenditure programmes would benefit from lower taxation. This would lower the payback period for projects.
- Increased infrastructure spending would lead to robust orders to the construction sector as a whole. Power equipment manufacturers would benefit from the sharper focus on electricity generation.
- Increase in defence and intelligence-gathering spending to benefit defence-equipment suppliers, security and electronic surveillance companies.
- Section 80 IA being extended would boost infrastructure projects.

Companies affected

- Machinery suppliers like L&T, BHEL, Crompton, Thermax, Voltas, Cummins, Siemens, and ABB would benefit from the increase in demand for capital equipment.

- Sharper focus on electricity generation and transmission would benefit those like BHEL, L&T, and Crompton. Airport modernization and construction would lead to higher demand for HVAC services, which would benefit Voltas and Blue Star. The greatest benefit from higher infrastructure spending would accrue to construction companies especially L&T.
- Companies like Bharat Electronics, BEML, Dynamatic Technologies, Astra Microwave, and Zicom, would benefit from the increase in defence and intelligence-gathering-related spending.
- Extension of Sec 80 IA benefits would be helpful to all infrastructure companies like BHEL, L&T, NTPC, GMR, GVK, and Power Grid.

Cement

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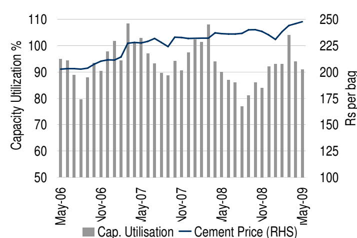
The expected thrust on infrastructure and affordable housing schemes along with a likely increase in the deduction limit for interest on home loans would be positive for all cement companies.

Fig 19 – Budget expectations

Expectation	Impact on the stock
Lower Excise-duty (8%) to continue	Neutral for all cement companies
Special focus on infrastructure and affordable housing	Positive for all cement companies
Increase in deduction limit for home loan interest	Positive for all cement companies

Source: Anand Rathi Research

Fig 20 – Cement prices ruling high



Source: Anand Rathi Research

Expectations

- Lower excise duty rates of 8% (reduced from 12% in Dec '08) to continue in order to boost consumption.
- Special focus on infrastructure development, through greater allocation for various schemes. Investment in roads (especially rural connectivity) and affordable housing schemes are expected to get a boost. Measures like easing of FDI norms for investment in affordable housing would stimulate demand.
- Increase in the deduction limit for interest on home loans.
- Lowering of customs duty on coal, from 5% now.

Impact on the sector

The excise duty rate, if increased, would be neutral for the sector as it may lead to an increase in cement prices given the present tight demand-supply equation. The special focus on infrastructure development and affordable housing and the increase in the deduction limit for home-loan interest would boost demand for cement.

Companies impacted

The thrust on infrastructure and the housing sector would be positive for all the companies. No change in excise duty would be neutral for them. Companies like India Cements which import a large quantity of their coal requirements would benefit from the reduction/abolition of import duty on coal.

Consumer Goods

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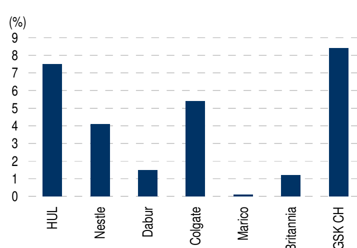
Retaining the 6% reduction in excise duty would help consumer goods companies improve realizations without affecting MRPs. The increase in excise duty on cigarettes would strike at cigarette companies. An increase in the minimum support price (MSP) would result in higher raw material costs for foods companies but would also raise rural consumption. We expect Colgate to be a major beneficiary.

Fig 21 – Budget expectations and possible impact on consumer companies

Expected Measures	Impact	Company
Retention of excise duty cut	Positive	HUL, Nestle, Colgate, GSK
Increase in MSP	Negative	Nestle, Britannia, GSK
Increase in excise of cigarettes	Negative	Cigarette companies
Increase in abatement rates	Positive	All consumer companies
Schemes for employment	Positive	All consumer companies

Source: Anand Rathi Research

Fig 22 – Excise as % of net sales



Source: Company, Anand Rathi Research.

Expectations

We expect the 6% excise-duty reduction (4% in the Dec '08 Stimulus Package I and 2% in the Feb '09 Vote on Account) to be retained for the year. Considering the drop in prices of major raw materials, abatement rates to calculate excise may increase. It is also expected that excise on cigarettes would be increased by 8% or more. We expect the government to take steps towards raising the minimum support prices.

Impact on the sector

As excise duty would continue at lower rates in the year, consumer goods companies would benefit. Reducing excise duty allows for improvement in realizations without changing the MRP. It also helps gain market share at the expense of unregulated manufacturers. A drastic rise in abatement rates would help consumer companies. The higher excise-duty rate on cigarettes (of 8% or more) would have a negative impact on the cigarette segment. The increase in minimum support prices of foodgrain would lead to higher raw material prices for foods companies. Nevertheless, it would also raise incomes of rural consumers.

Any steps towards expanding incomes of consumers (like rural employment, etc) would have a positive impact on the consumer goods sector. Investment in infrastructure would help improve the distribution network.

Companies affected

With lower excise duty rates for the rest of the financial year, we expect Hindustan Unilever, Nestle and Colgate to benefit (since they have been paying high excise duty). With higher minimum support prices, food companies like Nestle, Britannia and GSK Consumer Healthcare would be hit as their margins would be squeezed. An increase in levels of rural incomes would impact players with smaller SKUs or products suitable for rural consumers. We expect Britannia, Colgate and Marico to benefit the most from the rise in income levels of mofussil consumers.

Hotels

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Hotel sector seeking "industry" status and tax rationalization.

The hotel sector has been hard hit by the terrorist attack and the slowdown in the economy. It is expecting the government to announce a "stimulus" in the form of tax rationalization and award of "industry" status. At present, star hotels fall in the luxury segment and are taxed at multiple levels. They generate vast employment and open up fresh investment opportunities across the country. The luxury tax and VAT differ from state to state. This is then compounded by the additional charges hotels need to pay for the variety of services they offer. In addition to direct taxes, hotels incur regular costs on renewal of licenses for liquor, and other facilities they host.

Impact on the sector

If the government awards the sector "industry" status, it would have a spin-off effect on the entire sector. This would attract fresh investment by the existing as well new players. Essentially, this would generate greater employment. New capacity addition would check average room rentals, thereby increasing occupancy.

Companies impacted

Indian Hotels plans to contribute 15% of the new supply over the next three years. In FY09-10, it would add 12 new properties with ~1,500 rooms. It is also planning to reconstruct the "Sea-Rock" property with ~550 room capacity acquired in Jun '09 from ELEL Hostels and Investments for Rs6.8bn.

ITC has announced that it would invest Rs1bn to add 25 new properties across the country.

The others East India Hotels, The Leela, Taj GVK Hotels and Royal Orchid Hotels) have also announced expansion plans.

Overall the budge impact on the sector would be neutral as the Revpar and occupancy will take some time to look up.

Metals

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Expectations from the budget in regard to metals are the implementation of the National Mineral Policy (NMP) as well as clarity regarding the divestment roadmap. While the steel sector could be hit by a reversal of excise duty, the government may consider import duty shields to protect the sector from cheap imports. Clarity on PSU divestment could have a positive impact on Nalco, Sterlite and Hindustan Zinc.

Fig 23 – Budget expectations and impact

Expectations	Sector Impact	Company Impact
Roadmap for implementation of the National Mineral Policy	Will boost exploration and mining	Positive for all metal companies
Reversal of excise duty for steel products	Negative for the steel sector	Marginal impact on all steel players
Hike in import duty on steel products	Positive for the steel sector	To benefit primary steel producers (SAIL, Tata Steel, JSW Steel)
Clarity on government divestment	Speed up capacity expansions	Nalco is a strong candidate for divestment, given the government's 87.5% holding.

Source: Anand Rathi Research

Expectations

We should see some headway by the government on implementing the National Mineral Policy recommendations. These recommendations aim to speed up exploration and the operations of mines. They seek to de-regulate aerial reconnaissance and reduce the time frame for environmental clearances. We also expect more clarity from the government regarding its divestment plans.

Given the recent run-up in prices of base metals, we do not, however, expect any further duty cuts or imposition of safeguard duties. Similarly, given the low domestic consumption, we do not expect any curb on exports.

Also, as concerns regarding inflation have eased, we expect a reversal of excise duty on steel – from 8% to 12%. The ministry may also hike import duties on steel – from 5% to 15% – to guard the sector against cheap imports.

Impact on the sector

Implementation of the NMP recommendations should give a fillip to the mining sector. It would speed up exploration as well as the lag between successful prospecting and the start of mining.

Partial reversal of excise duty on steel, to 12%, would be negative for the sector as the companies may not be able to pass through the entire hike in duty to the end-customer. This would strike at margins.

We also expect a hike in import duty on steel – from 5% to 15% – to safeguard domestic producers from cheap imports. This would benefit primary steel producers.

Clarity regarding the government's divestment plans would also speed up the capacity expansion plans of domestic players for it would enable quicker access to capital.

Companies affected

Implementation of the NMP recommendations should benefit all metals players due to higher private sector participation in mining.

Reversal of excise duty would hit all companies in the steel segment, for they may be unable to pass on the entire costs to end-customers.

An import duty hike should benefit the primary steel producers (SAIL, Tata Steel and JSW Steel) as they would be cushioned to some extent from a further fall in prices of steel.

The government has an 87.5% stake in Nalco. With the latter's ambitious line-up of expansion projects, it could be a candidate for some equity dilution.

A divestment roadmap could also throw some light on divestment of the government's minority stake in Balco and Hindustan Zinc. Such a divestment would be positive for Hindustan Zinc and Sterlite.

Oil & Gas

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While clarity on the income-tax benefit to natural gas producers would benefit RIL, the potential de-regulation of petro-product prices would be encouraging for the whole sector, including public and private companies. We see a high probability of the income tax benefit being extended to natural gas producers though de-regulation of petro-product prices might not occur.

Fig 24 – Possible winners / losers from Budget FY10

S. No.	Expectations	Likelihood	Winners	Losers
1	Income-tax exemption to gas producers	High	RIL, ONGC, GSPC	NA
2	Roadmap for de-regulation of petro-product price/ Transparent subsidy-sharing	Low	Oil PSUs	NA
3	Customs duty back on crude and higher on petro-products	High	Refiners	Marketers
4	Infrastructure status to the sector	Medium	Refiners	NA
5	Declared goods status to natural gas	Medium	IGL, GGL	NA
6	Cess on auto-fuels for road development	Medium	NA	Marketers

Source: Anand Rathi Research

Expectations

Key market expectations from the Budget for the oil and gas sector are (we expect No. 1 and 3 to be the most likely):

1. **Income-tax exemption might be extended to natural gas producers.** The Ministry of Finance might clarify the tax exemption available to exploration and production companies on hydrocarbon production from the NELP blocks. At present, natural gas producers have been excluded from availing of the seven-year tax holiday otherwise available to crude producers.
2. **Roadmap for de-regulation of petro-product prices or a more transparent subsidy-sharing mechanism may be announced.** The oil-marketing companies (OMCs) might be given some sort of pricing freedom on regulated auto-fuels (gasoline and gasoil) through a proposal in the budget, or a roadmap to achieve this might be announced. Alternatively, a more transparent mechanism of subsidy sharing by different stake holders – the government, upstream refiners and OMCs – could be outlined.
3. **Customs duty on crude oil and petro-product might be restored to pre-Jun '08 levels.** The customs duty on crude oil was reduced to 0% from 2.5% in June 2008 to give relief to the OMCs and end-users as crude prices reached levels of US$100 a barrel. Given that customs duty on crude was a huge source of revenue for the government, it might be brought back. Also, in order to continue the duty protection to the refiners, the duty on petro-products (auto-fuels) might be raised from 2.5% to 7.5% (pre-Jun '08 levels).
4. **The government might give "infrastructure status" to different segments of Oil & Gas.** The extension of infrastructure status could help companies avail of a ten-year income-tax holiday. This might include infrastructure status to
   - Oil and gas exploration
   - Cross-country pipelines for crude, gas and petroleum products
   - LNG import and re-gasification projects

- Crude and product import facilities

5. **The government might give "declared goods" status to natural gas.** This could end the use of different sales taxes applicable on natural gas in various states and reset them to a uniform 4%.
6. **The cess on auto-fuels for road development might be increased by Re1/litre.** The National Highways Authority of India, the main agency implementing/co-ordinating projects to build and improve highways, has suggested raising the road cess on motor fuels by Re1 a litre to mop up resources.

Impact on the sector

- **Extension of income tax holiday on gas production - Positive**. This would bring in the much-needed fiscal stability in the NELP regime, which was eroded last year as natural gas was excluded from the definition of 'mineral oil'. The tax holiday being extended even to firms finding natural gas during exploration would help obtain a good response to future rounds of NELP auctions.
- **De-regulation of petro product prices (partial/ complete) and transparency in subsidy sharing - Positive**. This would help remove uncertainty in the sector – especially for public sector units. Even private sector oil-marketing companies would benefit through a long-term call on the sector as more transparency or de-regulation is ushered in.
- **Increase in duties on crude and petro-products - Negative to Neutral**. If accompanied by a consequent increase in retail prices of the auto-fuels, this would be neutral for the OMCs. In case retail prices are not allowed to be increased proportionately, OMCs could suffer in the form of higher under-recoveries on retail sales. If the government only increases customs duty on crude but not on petro-products, refiners selling in India or the refining division of companies could suffer as duty protection is lifted.
- **Extension of "infrastructure status" to avail of a ten-year tax holiday - Neutral to Positive**. While this could be a feel-good factor for the oil and gas sector and would be favorable to end-consumers, we believe only small gains would accrue to those in the gas transmission business where returns would be overseen by the regulator. Thus any input cost or operational cost reduction would pass to end-consumers. Also, most of the production-sharing contracts for fresh NELP finds have an in-built seven-year tax holiday. Thus, incremental benefit to the E&P sector would be small. The infrastructure status could be beneficial to companies implementing new cross-country pipelines for crude and petroleum products and those putting in new crude and product import facilities (basically refiners).
- **Extension of "declared goods" status to natural gas - Positive**. No impact on the companies in the sector, though it could bring down the cost of natural gas to end-consumers. It could help city gas - distribution companies increase volumes as natural gas becomes more competitive to auto-fuels.
- **Cess on auto-fuels for road development - Negative to Neutral**. No impact on oil-marketing companies as long as the government passes on the higher cess to end-consumers by raising retail prices of auto-fuels to that extent. If the retail prices are not raised

proportionately the higher cess might have to be absorbed by the OMCs, raising under-recoveries.

Companies impacted

- **Extension of income tax holiday on gas production -** To benefit RIL - our valuation for RIL's D6 gas block incorporates the seven-year tax holiday being applicable to earnings from the fields. Other companies that might benefit are ONGC and GSPC, which would start producing gas from the NELP blocks in the next few years.
- **De-regulation of petro-product prices (partial/ complete) and transparency in subsidy sharing –** The move would be beneficial to PSUs like ONGC, GAIL, IOC, BPCL and HPCL. The extent of de-regulation or transparency would be the chief matter to watch out for.
- **Increase in duties on crude and petro-products –** OMCs might be negatively impacted if the higher duties are not passed on to end-consumers through retail price hikes of auto fuels. Refiners (including independent refiners like CPCL, MRPL) could be negatively impacted if only the duties on crude oil are increased/restored while the duties on petro-products are left untouched and thus the duty protection available to refiners is taken away. In such a case, while the marketing division of OMCs might not lose, refining margins would suffer.
- **Extension of "infrastructure status" to avail of a ten-year tax holiday -** Refiners impacted positively, E&P marginally. Infrastructure status would help the refiners – RIL, Essar Oil, IOC, BPCL and HPCL positively – while the others in the E&P domain only benefit to the extent of the seven-year tax holiday being extended to ten years. Utilities – gas transmitters GAIL, GSPL and LNG players like Petronet LNG – might not benefit as the benefit from the income-tax holiday might have to be passed on to end-consumers.
- **Extension of "declared goods" status to natural gas -** Gas distribution companies benefit – IGL, GGL may benefit as fuel conversion turns more economical. Though the real benefit might arise only when more gas is allotted to the gas distribution companies.
- **Cess on auto-fuels for road development -** IOC, BPCL and HPCL might be negatively impacted if the higher cess is not passed on to end-consumers.

Real Estate

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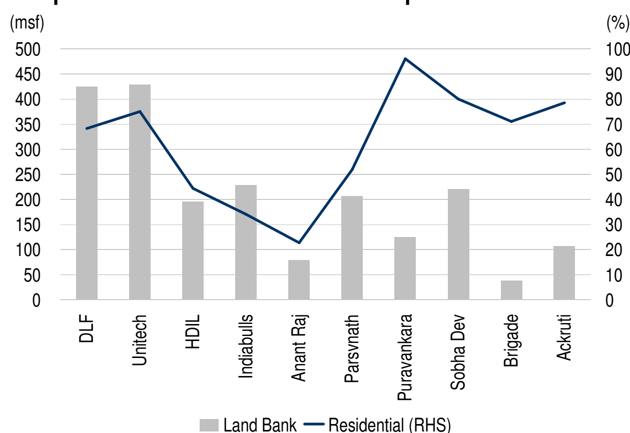
The real estate sector has seen supportive measures like allowing re-structuring of loans, reducing risk weights for commercial real estate, public sector banks' cutting home-loan rates in the sub-Rs0.5m and Rs0.5m-2m brackets and relaxing ECB norms for township projects. Also, the continuing thrust by the government under its 'Housing-For-All programme' and its emphasis on affordable housing would see more measures to boost the sector. Companies across the board would be positively affected; DLF, Unitech, HDIL would be key beneficiaries.

Fig 25 – Developers - Land bank vs residential exposure



Source: Anand Rathi Research

Expectations

Industry

- Exemption ceiling of interest paid for housing loans to be raised from Rs0.15m to Rs0.3m.
- Greater thrust on PPP projects in housing (eg, rental housing)
- Housing as a priority sector (increasing limit to Rs3m from Rs2m now)
- Reducing/exempting of service tax on rental income of commercial property (currently 12.36%).

Affordable housing

- Re-introduction of Sec 80 I(B) for affordable housing
- Exempting building materials and services from excise, customs and service taxes.
- Extra FSI for such projects

Impact on the sector

Increasing the amount of tax relief on home-loan-interest payments and lower interest rates would benefit home buyers as well as the industry.

Incentives for affordable housing and more PPP projects would render such projects viable for developers, thus addressing the housing shortage.

Companies affected

All budget measures would be beneficial to the property sector since most companies are focused on the residential segment.

Companies already leaning towards affordable housing (with the bulk of under-construction projects and planned projects skewed towards affordable housing) would be immediate beneficiaries. Unitech and DLF would be key beneficiaries.

PPP projects such as rental housing schemes would benefit companies with land in and around densely populated metropolises such as Mumbai, Delhi, Kolkatta, etc. Such schemes would be more positive for DLF, Unitech, HDIL, Akruti City, etc.

Technology

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The Software Technology Parks of India (STPI) clause may be extended; this would be positive for Indian IT. Increased spending in education, e-governance.

The Software Technology Parks of India (STPI) clause may be extended; this would be positive for Indian IT. This would also provide relief to tier-II players, who are cash-strapped and not prepared for SEZs.

Fig 26 – EPS impact due to extension of STPI clause

Companies (Rs)	FY11 EPS (pre)	FY11 EPS (post)	% chg
Infosys	94.8	97.8	3.1
TCS	53.5	56.3	5.3
Wipro	26.9	27.6	2.6
HCL Tech	17.8	18.9	6.3
Tech Mahindra	61.8	64.9	5.0
Mphasis	48.4	49.6	2.5
Allied Digital*	86.4	88.5	2.4
Bartronics**	47.8	47.8	-

*Source: Anand Rathi Research.*ADSL rate is expected to change from 20% to 18%; **Bartronics is in an SEZ so we do not expect any change in tax rate.*

Expectations – STPI extension

EoU benefits may be extended. Tax relief for export-oriented units is likely to be taken up in the budget to extend the sunset clause from 31 Mar '10 to 31 Mar '13.

Impact on sector

No sharp rise in tax rates in FY11, if implemented. The full tax rate on offshore profits would be deferred by three years – from FY10 to FY13. If the proposal is implemented, tax rates would be ~16% in FY10, then ~16% in FY11 (down from the earlier estimated 18-20%). Clearly, there would not be much of an increase in tax rates in the next three years starting Mar '10. This would give companies another three full years to increase exposure to SEZs.

Positive for Indian IT companies. While this would be beneficial for the sector, companies that are relatively less prepared (SEZ strategy) and that have higher revenue growth would benefit more. Tier-II players not yet prepared for SEZs would benefit. The EPS CAGR would increase and hence would be taken positively. Tier-II players would probably benefit more, but most of them are struggling operationally in a difficult macro-economic environment.

Companies impacted

Positive impact on IT Services – Infosys, TCS, Wipro, HCL Tech, Tech Mahindra, Mphasis and other outsourcing companies.

Expectation - Introduction of MNIC (Multi-purpose National Identity Cards)

The Central government is committed to having a central data base and has planned to implement the Multi-purpose National Identity project, currently in pilot mode in 12 districts. The project is expected to be completed in three years, with more than 1bn cards to be supplied. We expect the tender to be divided among three or four players, with each having to supply ~60m-80m cards p.a. Average realizations here would be much higher than SIM cards. The realization for 2G SIM cards is ~Rs30 each whereas MNICs can cost anywhere between Rs50-75 each. Hence, we expect a positive impact on Bartronics.

Expectation – Increased spending in education

The Sarva Shikshan Abhiyan (SSA) allocation is expected to be increased from Rs13.1bn to Rs15bn, a 14.5% yoy rise (last year, 23% increase). This would be in line with the pending "The Right to Education Bill, 2008". This seeks to provide every child of six to fourteen years with the right to free and compulsory education in a neighbourhood school until completion of elementary education. We feel this would open the road to more public-private partnership in education.

Companies impacted

Positive impact on Educomp, Everonn, NIIT, Aptech and Core Projects.

Expectation – Use of IT/ITES for e-governance

We expect the budget to throw up a roadmap to convert physical land records to electronic form over a period of time. The Right to Information (RTI) Act, 2005, makes it mandatory for all government departments to digitize physical documents so that information required by citizens could be provided to them within the stipulated time.

Using ITES for scanning, digitalization, retrieval of documents would prove to be beneficial to companies in the government vertical and provide document-management services. Companies in the geo-spatial arena present across verticals and providing services like imaging, photo-grammetry, map-making and finishing services to government would also benefit.

Companies impacted

Positive impact on companies providing geo-spatial services (Rolta, Infotech Enterprises) and document-management services (Vakrangee Software). For Infotech Enterprises, geo-spatial services provided 34.8% of its FY09 revenues. Rolta obtained 44.3% of its TTM revenue from geo-spatial services.

Telecoms

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We expect the government to announce expected proceeds from 3G/BWA spectrum auctions in the forthcoming Union Budget. The budget may also include plans relating to utilisation of universal service obligation (USO) funds to improve broadband connectivity in rural areas. Any imposition of a cess on diesel (to fund road/highway projects) would impact the margins of telcos (~20bps for every Re1/litre increase). The much-talked-about Bharat Sanchar Nigam IPO may also be included in the government's medium-term divestment agenda.

Expectations

- We expect the government to include estimated proceeds/receipts from 3G and BWA spectrum auctions in the FY10 Budget document. This would require prior agreement between the Ministries of Finance and Communications on issues such as reserve price and the number of spectrum blocks to be auctioned in each circle.
- To boost broadband connectivity in rural areas, incentives such as lower import duties, subsidies, tax exemptions, etc, may be announced; this may also be done through targeted utilisation of the surplus USO funds
- Imposition of cess on diesel fuel to fund infrastructure projects is a possibility
- Medium-term divestment agenda of the government may include an IPO of BSNL

Fig 27 – Impact of 3G/BWA auctions

	FY11e EPS		Target Price	
	Rs	%	Rs	%
Bharti	(4.2)	(7.0)	(36.2)	(4.0)
RCOM	(4.0)	(17.3)	(33.3)	(12.0)
Idea	(0.9)	(28.3)	(8.3)	(12.8)

Source: Anand Rathi estimates.

Notes:

[a] Only amortization, interest cost considered for PAT impact

[b] Assumed auction price (US$1bn/ US$500m for 3G/BWA) is fully written off for the impact on TP

[c] Assumed that Idea would not bid for BWA, and pay 50% of the all-India 3G fee for select circles

Impact on the sector

- We expect industry capex would balloon on the back of 3G/BWA auctions and subsequent deployment of networks. This would extend the FCF break-even of leading operators by one to two years.
- Higher utilization of USO funds would lower the operator capex/opex in rural areas, preventing a rapid dilution of financial returns
- While the increased thrust of infrastructure development (power, transportation) would be a long-term positive for the telecoms sector, in the near term, any increase in fuel taxes/prices (to fund development of roads/highway) could hit the margins of wireless telcos.
- A listing of BSNL could have mixed implications for the sector, depending on whether listing is accompanied with greater autonomy.

Companies affected

- A hike in fuel prices would be negative for operators that are well established in rural areas; for every Re1/litre hike in the price of diesel, we estimate a negative 20-bp impact on the wireless EBITDA margin of Bharti.

Appendix 1

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below.

Ratings Table

	Buy	**Hold**	**Sell**
Large Caps (>US$1bn)	>20%	5-20%	<5%
Mid/Small Caps (<US$1bn)	>30%	10-30%	<10%

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