Union Budget FY10

Paradigm Shift?

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- The Budget has been a non-event for the last many years.
- The government could, however, use this opportunity to carry out bolder reforms, given the strong mandate.
- The main issue, which needs to be addressed, is on fiscal deficit.
- A few measures that could help rein in fiscal deficit and improve growth rates are:
  - Divestment
  - Subsidies
  - Infrastructure
  - 3G and BWA/WiMAx auctions
  - Capital account convertibility
- The government should use the Budget to do more than offering mere tax sops and launch new schemes.
- Given the political compulsions and the inability of the UPA government to carry out reforms in its last term, investor expectations are moderate.
- Equity markets could take direction if the Budget addresses issues mentioned above. If not, it will be like earlier years, a non-event.

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The most keenly awaited event by markets post-election results is Union Budget FY10. The Budget will be presented by Finance Minister Pranab Mukherjee on July 6. This report seeks to address budget expectations and implications for investors. We shall analyse in this report, how the government could act over a period of time, if not immediately, as most of the simpler reforms have been implemented over the last two decades. Going forward, a road-map to bolder reforms would be a prerequisite to take India on a higher growth trajectory.

Most investors, who have witnessed various governments at the Centre over a period of time, believe that bolder reforms would be difficult to implement, given the fact that recent governments have been swayed by coalition politics. We believe that the Congress party has the best mandate in about two decades to carry forward the reform process. Indian politics, in our view, is in the midst of a paradigm shift, led by the Congress, with the emergence of a new generation of electorate, who are looking at politics from a different perspective.

"It is undemocratic that the Congress is still led by a Gandhi… But it is a fact of life in India that success in politics depends on who you know or related to. I want to change the system," said Rahul Gandhi, aptly summing up the political mood.

It is mundane to discuss proposed tax changes in the Budget. However, we have a section on expectations in various sectors as well as industry wish-list for the current budget at the end of this report. Significant changes have occurred in the duty structure and taxes over the last 18 years of reforms, and most changes, going forward, can only be marginal. Investment themes and recommendations on sectors and stocks did not change post-announcement of budgets for the past many years. There could be changes, which could positively benefit a sector in the ongoing reform process. But the road-map is well known and discounted. Hence, the Budget has been called a non-event for the last many years. However, given the strong mandate, the government could use this opportunity to carry out bolder reforms. The main issue, which needs to be addressed, is on fiscal deficit. A few measures that could help rein in fiscal deficit and improve growth rates are given below:

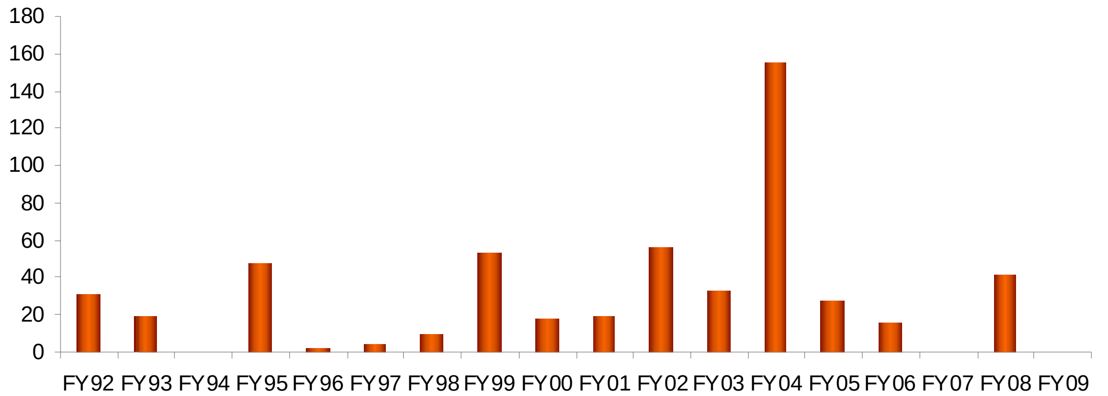
- Divestment
- Subsidies
- Infrastructure
- 3G and BWA/WiMAx auctions
- Capital account convertibility

We discuss each of these issues in detail below, highlighting why it needs to be addressed, as well as what can be expected on each one of them.

Disinvestment

The Indian government first announced its intention to divest up to 20% of government equity in select public sector enterprises (PSEs) in favour of public sector institutional investors in FY92. This has since been relaxed, and the government has now decided, in principle, to list profitable PSEs on domestic stock exchanges and to selectively sell a minority stake in listed, profitable PSEs while retaining at least 51% of shares along with full management control, so as not to disturb the 'public sector' characteristic of these companies. A total of 40 companies, excluding banks, have been listed on stock exchanges, and the government has raised INR534bn so far. The total market capitalisation of these companies is about INR13tn. If PSU banks are included, the figure would be INR16tn.

Receipts from divestment (INRbn)



Details of listed PSEs

Company	Govt Stake (%)	Net Profit (INRm)	Market Cap (INRm)	Amount raised if Govt stake reduced to 51% (INRm)
O N G C	74.14	167,017	2,391,260	553,338
MMTC	99.33	1,755	1,811,250	875,377
NTPC	89.50	82,013	1,748,863	673,312
NMDC Ltd	98.38	43,724	1,605,708	760,784
B H E L	67.72	31,382	1,098,923	183,740
S A I L	85.82	61,646	676,560	235,578
I O C L	80.35	29,496	670,418	196,768
Power Grid Corpn	86.36	16,020	503,798	178,143
GAIL (India)	57.34	26,015	367,859	23,322
Hind.Copper	99.59	2,465	278,491	135,319
Power Fin Corpn	89.78	13,552	222,208	86,172
Natl. Aluminium	87.15	12,723	216,810	78,377
Neyveli Lignite	93.56	11,528	213,069	90,682
Mangalore Ref.	88.57	11,925	165,562	62,201
B P C L	64.26	7,359	159,799	21,189
Rural Elec Corpn	81.82	12,721	130,302	40,159
Container Corpn	63.09	8,197	127,383	15,401
H P C L	51.11	5,750	107,311	118
Bharat Electron	75.86	8,085	103,192	25,654
M T N L	56.25	2,156	71,726	3,766
S C I	80.12	8,139	55,218	16,080
Engineers India	90.40	2,136	49,754	19,603
R C F	92.50	1,580	43,308	17,973
BEML Ltd	54.03	2,256	39,123	1,185
Natl. Fertilizer	97.64	975	36,057	16,817
HMT	98.88	(420)	34,902	16,711
C P C L	67.29	(3,973)	28,814	4,694
S T C	91.02	813	24,564	9,831
F A C T	98.11	(1,910)	17,384	8,190
Dredging Corpn	78.56	1,548	16,240	4,476
Andrew Yule & Co	94.42	185	15,424	6,697
ITI	92.98	(6,307)	12,845	5,392
Maharashtra Elektrosmelt	99.12	363	9,954	4,790
Balmer Lawrie	65.70	869	7,166	1,053
I T D C	89.97	365	6,725	2,621
Hind.Organ.Chem.	58.61	136	2,590	197
Madras Fert.	85.27	(1,349)	2,022	693
Balmer Law. Inv.	59.67	140	2,016	175
Scooters India	95.38	(225)	1,161	515
Bharat Immunolog	59.25	(27)	786	65
Total		**560,822**	**13,076,543**	**4,377,157**

Details of listed banks

Company	Govt Stake (%)	Net Profit (INRm)	Market Cap (INRm)	Amount raised if Govt stake reduced to 51% (INRm)
State Bank of India	59.41	91,212	1,112,945	93,599
Punjab National Bank	57.80	30,909	194,495	13,226
Bank of India	64.47	30,074	168,424	22,687
Bank of Baroda	53.81	21,639	154,832	4,351
Union Bank	55.43	17,266	109,358	4,845
Canara Bank	73.17	20,724	106,354	23,579
IDBI Bank	52.67	8,585	74,945	1,252
Indian Bank	80.00	12,453	56,859	16,489
Indian Overseas	61.23	12,793	46,444	4,751
Corporation Bank	57.17	8,928	44,079	2,720
Oriental Bank	51.09	9,054	43,644	39
Andhra Bank	51.55	6,530	42,583	234
Syndicate Bank	66.47	9,128	40,087	6,201
Allahabad Bank	55.23	7,686	35,803	1,514
UCO Bank	63.59	4,835	34,293	4,317
Central Bank	80.21	5,712	31,867	9,308
J & K Bank	53.17	4,098	24,670	535
State Bank of Travancore	75.00	6,078	24,050	5,772
State Bank of Mysore	92.33	3,130	23,652	9,775
State Bank of Bikaner	75.00	4,035	19,373	4,649
Vijaya Bank	53.87	2,625	19,357	556
Bank of Maharashtra	76.77	3,752	19,051	4,909
Dena Bank	51.19	4,227	16,406	31
Total		**325,473**	**2,443,569**	**235,340**

As can be seen from the above table, if the government decides to sell its stake in all listed companies while ensuring that its stake in them continues to remain over 51%, then at current market prices the government could raise INR4.4tn, excluding PSU banks. PSU banks can add another INR235bn. However, amounts that could be raised through divestment in PSUs, with low floating stock, like in case of MMTC and NMDC, could be significantly lower than what current market capitalisation indicate.

In the near term, the following companies could see disinvestment:

a) National Hydro-electric Power Corporation (10% stake).

b) Oil India Ltd (11% stake).

c) RITES Ltd (10% stake)

The financial performance of these companies is given below:

(INRm)	Sales	Profit
National Hydro-electric Power Corporation	26,719	11,390
Oil India Ltd.	71,397	21,663
RITES Ltd. *	6,607	1,038

** FY08*

We believe that the government could raise a total of around INR40bn from disinvestment of the above companies.

Unlisted PSEs, where the government could raise significant resources, include Bharat Sanchar Nigam Ltd (BSNL) [net profit of INR30bn in FY08], Coal India Ltd [net profit of INR25bn in FY08] and Rashtriya Ispat Nigam Ltd [net profit of INR19bn in FY08]. In addition, government owns seven insurance companies, the largest being Life Insurance Corporation of India, which has assets of over USD140bn and annual total income in excess of USD40bn.

As mentioned above, the potential amount that could be raised by disinvestment is huge. What is required is political will to get this through, given that prominent UPA allies are averse to disinvestment.

Subsidies

The government provides subsidies in numerous forms. The main subsidies relate to petroleum, fertilisers and food. These contribute significantly to fiscal deficit. Petroleum subsidies do not form a part of reported fiscal deficit.

Subsidies (INRbn)	Food	Fertilisers	Petroleum	Total	Fiscal Deficit	Oil Bonds	Deficit including oil bonds	Subsidies as % of Deficit
FY04	252	118	66	436	1,233	-	1,233	35
FY05	258	157	36	450	1,258	-	1,258	36
FY06	232	173	144	549	1,478	115	1,593	34
FY07	242	225	269	736	1,426	241	1,667	44
FY08	315	305	382	1,002	1,269	353	1,622	62
FY09	436	758	742	1,936	3,265	713	3,978	49

The extra-ordinary increase in petroleum subsidy in the last few years has made management of petroleum subsidies a difficult proposition, especially, in a period of high oil prices. We believe that petroleum subsidies would be the first to go, as fertilisers and food subsidies are relatively much more sensitive. Within petroleum subsidies, auto fuel and LPG subsidies, should be targeted. Kerosene, being the most sensitive petroleum product, should be the last to be de-regulated.

Fertiliser subsidies were targeted as early as 1992, when di-ammonium phosphate (DAP) and muriate of potash (MOP) were decontrolled. However, DAP and MOP were subsequently provided flat-rate subsidies. Significant subsidy is provided on urea, which has led to undue use of urea, resulting in deteriorating soil fertility impacting crop yields. The subsidy provided on fertilisers should reduce, as natural gas has been made available to fertiliser units. Amit Rustagi, our Oil & Gas analyst (+91 22 4031 3434; amitr@antiquelimited.com) estimates that subsidies should fall by INR60bn, due to gas usage by fertiliser companies.

Infrastructure

The UPA government launched Bharat Nirman, a time-bound business plan for action in rural infrastructure, during its last tenure. Under Bharat Nirman, action was proposed in areas of irrigation, road, rural housing, rural water supply, rural electrification and rural telecommunication. The progress achieved on this initiative is given below:

Physical Performance

Component	Parameters	Target	Achieved	% Achieved
Rural Roads	Habitations (no.)	66,802	32,269	48
	New Roads (kms)	146,185	85,254	58
	Upgradation (kms)	194,132	155,040	80
Irrigation	Area ('000 hectares)	10,000	5,943	59
Telephone	Villages (no.)	66,822	56,030	84
Water Supply	Villages (no.)	603,639	657,749	109
Rural Housing	Houses (m)	6.0	6.3	105
Electrification	Villages (no.)	125,000	64,978	52
	Households (m)	23	4	18

It is evident from the table above that implementation has been below expectations, except on drinking water and rural housing. Targets have not been achieved on roads, irrigation, and electrification and telecommunication. The total expenditure incurred on this front has been estimated at INR1.1tn.

3G and BWA/WiMAx auctions

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Revenue opportunities from 3G and BWA/WiMAX auctions

The Ministry of Communications & Information Technology released 3G and Broadband Wireless Access (BWA) auction policy document in December 2008, and the auctions were proposed to be held in January 2009. But policy delays held back the process for 6 months while federal elections were held in the meantime. We believe that since liquidity conditions have begun to ease off, revenue prospects of 3G auctions have improved. The 3G policy also eases the foreign participation to maximise revenue potentials by providing foreign entities with flexibility to bid for spectrum on their own, and then transfer the same to an Indian subsidiary. The policy fixed the reserve price for 3G and WiMAX auctions at INR20.2bn and INR10.1bn, respectively. However, according to recent media reports, the finance ministry has proposed to double the respective reserve prices and also increase 2x5 MHz 3G spectrum blocks from 5 per circle (out of which one block circlewise is reserved for BSNL/MTNL) to 7 blocks per circle.

Stated objectives for auctions by government:

- Maximise revenue proceeds from auctions.
- Ensure efficient use of spectrum and avoid hoarding.
- Stimulate competition in the sector, promote rollout of 3G and broadband services, and help resolve congestion issues related to 2G.

Revenue potential from auctions:

The auction of 3G spectrum will be carried out in the 2.1GHz band. As per the December 2008 policy document, the average total paired frequency bandwidth to be auctioned on a pan-India basis is around 20MHz, which excludes spectrum reserved for BSNL/MTNL.

To understand the possible revenue potential from 3G auctions, we consider the average spectrum fees in USD per MHz per Pop (population) at which the paired 3G spectrum has been auctioned globally, which stands at around USD0.26, and for Asia in particular, this stands at USD0.21. Based on this, the 3G auction in India can generate revenues in the range of INR220-287bn. However, this can vary depending upon the annual spectrum charges payment for the 3G spectrum.

In case the proposed increase in blocks from 5 to 7 is taken into account, blocks available for private operators would be 6 per circle, and the spectrum allocation would be around 30MHz (up from 20MHz), and hence the revenue generation can be nearly INR330bn on the same lines.

3G spectrum licence fee

Countries	Total licence fee(USDm)	Total MHz licensed	Fee/Pop/MHz in USD*
Australia	352	60	0.26
Belgium	419	60	0.41
Sweden	42	60	0.00
Malaysia	26	30	0.04
Singapore	150	60	0.37
Norway	45	60	0.17
Greece	377	60	0.54
Portugal	360	60	0.48
Spain	444	60	0.11
Average			**0.26**

*Total licenses fee per adult population per MHz adjusted with purchasing power parity (PPP) and duration for 10-year licence period.
Source: ITU

The auction of BWA/WiMax spectrum will be carried out in 2.3GHz and 2.5GHz bands. According to the December 2008 policy document, the average total unpaired frequency bandwidth to be allotted is 80MHz. Average spectrum fees for paired spectrum in USD per MHz per Pop for BWA auctions for Asia stands at USD0.04. This implies that revenue opportunities from BWA auctions in India could be nearly INR88bn considering unpaired frequency.

Capital account convertibility

We believe that the government will not initiate any steps towards capital account convertibility. Given the uncertain global environment, we believe that the government would maintain *status quo* on current regulations. An extract from the paper, Capital Flows to India, presented by Rakesh Mohan, Deputy Governor, Reserve Bank of India, on February 1, 2008, indicates the thought process within the Reserve Bank of India:

'*It is interesting to note that a number of empirical studies do not find evidence that greater openness and higher capital flows lead to higher growth (e.g., Prasad, Rajan and Subramanian, 2007). These authors find that there is a positive correlation between current account balances and growth among non-industrial countries, implying that a reduced reliance on foreign capital is associated with higher growth. Alternative specifications do not find any evidence of an increase in foreign capital inflows directly boosting growth. These results could be attributed to the fact that even successful developing countries have limited absorptive capacity for foreign resources, either because their financial markets are underdeveloped, or because their economies are prone to overvaluation caused by rapid capital inflows. Thus, a cautious approach to capital account liberalisation would be useful for macroeconomic and financial stability (Mohan 2008)*'

Sectoral expectations and impact

	Positive	Negative
Automobiles		
● Currently all vehicles (be it 2-wheelers, 3-wheelers, compact cars, commercial vehicles and buses) have an excise duty of 8% post the last CenVAT cut on February 24, 2009. We expect this rate to be unchanged in this budget.	Maruti Suzuki, Hero Honda, Bajaj Auto, Tata Motors	
● Larger cars and UVs have an excise duty of 20% + INR15,000 (for vehicles having an engine capacity between 1,500-2,000cc) and 20% + INR20,000 (for vehicles having an engine capacity of over 2,000 cc). We expect this differential excise duty to be reduced in this budget.	M&M, Tata Motors	
FMCG		
● Increase in excise duty on cigarettes by 7-8%	ITC	
Metals		
● Rollback of 4% excise duty on steel products		Tata Steel, JSPL, SAIL
● Hike in import duty on steel products by10-15%/imposition of safeguard duties on steel imports	Tata Steel, JSPL, SAIL	
● Imposition of export duty of 10% on iron ore exports		Sesa Goa
Media		
● Removal of import duties on set top boxes (4% special additional duty + 8% countervailing duty) for faster digitalization	DishTV,Hinduja Ventures, WWIL	
● Enhancement of FDI limits in media sector	Network18,Zee Group, NDTV Group,SunTV	
Oil & Gas		
● Extension of 7 year income tax holiday under Section 80IB to gas discoveries also.	Reliance and ONGC	
● Tax Holiday to E&P Companies to be enhanced to 10 years from 7 years	Reliance and ONGC	
● Infrastructure status for gas pipelines for infrastructure status	GAIL	
Retail		
● Grant industry status to the retail sector	Pantaloon Retail	
Telecom		
● Rationalise the multiple taxes and duties levied on the telecoms sector forming ~24-30% of the operators' adjusted gross revenue.	Bharti, RCOM, Idea, TTML, MTNL	
● Subsidy for rural telecom and broadband growth by way of lower duties or tax breaks	Bharti, RCOM, Idea, TTML, MTNL	

Sectoral expectations and impact

Utilites & Industrials

	Positive	Negative
Ultra Mega Power Project (UMPP); Government to expedite bidding of tenders of UMPPs in Chhattisgarh, Karnataka, Maharashtra, Orissa and Tamilnadu.	Reliance Power, Tata Power, Lanco	
Bulk tenering of NTPC and DVC projects to be done in first 100 days	BHEL, L&T, NTPC	
Accelerated Power Development and Reforms Project Tendering of Transmission projects under private and PPP route to be expedited.	Reliance Infrastructure, KEC, Kalpatru,Jyoti, KEI, Voltamp,Power Grid	
Higher allocation for road projects	IRB, LT, Reliance Infrastructure, IVRCL	

Industry wish-list for Budget:

- Increase depreciation rates from 15% to 25%.
- Increase the threshold limit of tax exemption by INR50,000.
- Implement GST on April 1, 2010 at a single unified rate of 12%.
- Abolish fringe benefit tax.
- Reduce Central sales tax to 1%.
- Reduce customs duty from 5% to 0% on non-coking coal, petroleum coke and scrap of copper, zinc and lead.
- Reduce customs duty from 5% to 2% on naphtha and liquefied propane.

Snapshot of Government Finances

	Units	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10BE
Revenue receipts	INRbn	2,013	2,308	2,638	3,060	3,471	4,344	5,419	5,622	6,096
Tax receipt	INRbn	1,871	2,163	2,543	3,050	3,662	4,735	5,931	6,279	6,713
Direct Tax	INRbn	691	829	1,050	1,320	1,573	2,195	2,956	3,446	3,796
	% of GDP	3.0	3.4	3.8	4.2	4.4	5.3	6.3		
Indirect Tax	INRbn	1,180	1,333	1,494	1,729	2,088	2,540	2,976	2,833	2,917
	% of GDP	5.2	5.4	5.4	5.5	5.8	6.2	6.3		
Expenditure	INRbn	3,623	4,132	4,712	4,983	5,057	5,834	7,127	9,010	9,532
	% of GDP	15.9	16.8	17.1	15.8	14.1	14.1	15.1	-	-
Plan expenditure	INRbn	1,012	1,115	1,223	1,323	1,406	1,699	2,051	2,830	2,851
	% of Exp.	27.9	27.0	26.0	26.6	27.8	29.1	28.8	31.4	29.9
Non-plan expenditure	INRbn	2,611	3,018	3,489	3,660	3,651	4,135	5,076	6,180	6,681
	% of Exp.	72.1	73.0	74.0	73.4	72.2	70.9	71.2	68.6	70.1
Subsidies	INRbn	312	435	443	460	475	571	709	1,292	1,009
	% of Exp.	8.6	10.5	9.4	9.2	9.4	9.8	10.0	14.3	10.6
Defence	INRbn	543	557	601	759	805	855	917	1,711	1,417
	% of Exp.	15.0	13.5	12.7	15.2	15.9	14.7	12.9	19.0	14.9
Interest	INRbn	1,075	1,178	1,241	1,269	1,326	1,503	1,710	1,927	2,255
	% of Exp.	29.7	28.5	26.3	25.5	26.2	25.8	24.0	21.4	23.7
Revenue Deficit	INRbn	1,002	1,079	983	783	923	802	526	2,413	2,385
Gross Fiscal Deficit	INRbn	1,410	1,451	1,233	1,258	1,464	1,426	1,269	3,265	3,328
	% of GDP	6.2	5.9	4.5	4.0	4.1	3.5	2.7	6.1	5.5

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