Union Budget 2009

A lost opportunity

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Conclusions

- Against the backdrop of heightened expectations, the first budget of the new UPA government turned out to be quite an insipid one. It failed to endorse investors' confidence that the government will use its strong mandate to usher in new policies, so badly required to remove structural bottlenecks to growth. The fiscal largesse will no doubt help buoy up near-term growth, led by a further acceleration in consumption momentum, but much more could have been done. It was a wasted opportunity, in our view.

- With revenue assumptions being aggressive (an example being a 20% increase in budgeted corporate tax collections), there is a risk of further slippage in the FY10 budgeted fiscal deficit, in our view. On the expenditure side, the near 38% increase in capital outlay is welcome, but at just over 2% of GDP, it may not move the needle much. It is fair to expect further steepening of the yield curve. We also worry that RBI's maneuverability on the monetary policy management side will be constricted, as a consequence.

- Given the big jump in rural spend and the second tranche of credit of pay arrears, consumption will remain the principal driver of real growth in FY10. We hope that the monsoon does not play truant. All sectors linked to consumption, such as FMCG, autos and proxies like cement, will be the ones that will do relatively well. The upward bias in the rupee will likely lose steam in the short term and this, along with the extension of tax holiday by another year, should have a positive rub-off impact on software.

- Key beneficiaries – BHEL, Maruti, Hero Honda, Bajaj, ITC, HUL, Colgate, HCLT, FTech, Jain

- Key losers – Cipla, Sterlite, Dabur, Bharti

Key direct-tax proposals

- Major tax rates kept unchanged, the 10% surcharge removed for non-corporate tax payers (individuals had to pay surcharge if their total annual income exceeded Rs1m), education cess of 3% remains unchanged
- FBT abolished (generated Rs85bn during FY09); MAT rate raised to 15% from 10%, but MAT credit can be carried forward for 10 years instead of seven years earlier; Commodities Transaction Tax abolished
- Personal income tax slabs widened by Rs10,000 (Rs15,000 for senior citizens)—to result in modest tax saving of Rs1,000-1,500 per person per year
- Sunset clause for export profits under sec 10A and 10B extended by one more year (exemption valid till FY11)
- 100% deduction for investments in cold chain facilities or warehousing for storage of agricultural/dairy produce or laying and operating cross-country natural gas or petroleum pipeline network.
- Scope of 150% weighted deduction on in-house R&D widened to cover almost all manufacturing businesses
- New Income Tax Code to be put up for public discussion within 45 days, to be put up for parliamentary discussion during the winter session
- Tax holiday under sec 80IB extended to profits earned from commercial production of natural gas from blocks awarded under NELP VIII only

Key indirect-tax proposals

Customs

- No change in peak customs duties – maintained at 10%
- Duty of 5% re-imposed on set-top boxes, customs duty on LCD panels for manufacture of LCD televisions reduced to 5% from 10%
- Duty on permanent magnets used in wind-operated electricity generators reduced from 7.5% to 5%; duty on bio-diesel reduced to 2.5% from 7.5%
- Duty on import of gold doubled to Rs200/10g for bars and coins and to Rs500/10g for other forms of gold. Similarly duty on silver doubled to Rs1000/kg

Excise

- General CENVAT rate remained unchanged at 10%
- Specific excise duty on large/utility cars with engine capacity above 2,000cc reduced by Rs5,000 to Rs15,000; duty on petrol-driven UVs reduced to 8% from 20%
- Duty on naphtha reduced to 14%, duty on diesel blended with up to 20% bio-diesel fully eliminated
- Duty on PTA, DMT, polyester chips, manmade fibre and yarn increased to 8% from 4%
- Ad-valorem component of duty on branded petrol and diesel eliminated; entire duty will now be specific in nature
- Duty on branded jewellery eliminated from 2% currently

Service tax

- Service tax would be levied on following services:
    - Transport of goods by rail, coastal cargo, inland waterways
    - Legal services (except services provided to/by individuals)
    - Cosmetic/plastic surgery

Government finances - summary

(Rs bn)	FY07	FY08	FY09 (BE)	FY09 (Prov)	FY10 (BE)	Growth (% YoY) FY09	Growth (% YoY) FY10
RECEIPTS							
Revenue Receipts	4,344	5,419	6,029	5,447	6,145	0.5%	12.8%
Tax Receipts	3,512	4,395	5,072	4,477	4,742	1.9%	5.9%
Non-Tax revenue	832	1,024	958	969	1,403	-5.3%	44.7%
Capital receipts*	64	96	147	67	53	-30.1%	-20.3%
Total Receipts	4,408	5,515	6,176	5,514	6,198	0.0%	12.4%
EXPENDITURE							
Non-Plan Expenditure*	4,135	4,722	5,075	6,060	6,957	28.4%	14.8%
Plan Expenditure	1,699	2,051	2,434	2,755	3,251	34.3%	18.0%
Revenue Expenditure	5,146	5,945	6,581	7,917	8,972	33.2%	13.3%
Capital Expenditure*	688	827	928	898	1,236	8.5%	37.7%
Total Expenditure	5,834	6,772	7,509	8,815	10,208	30.2%	15.8%
Revenue Deficit	802	526	552	2,470	2,827	369.9%	14.4%
Fiscal Deficit	1,426	1,257	1,333	3,301	4,010	162.6%	21.5%
Revenue deficit (% GDP)	1.9%	1.1%	1.0%	4.6%	4.8%		
Fiscal deficit % GDP	3.5%	2.7%	2.5%	6.2%	6.8%		

Source: Budget documents, IIFL Research. *For FY08, excludes expenditure and revenue pertaining to transfer of RBI's stake in SBI to Central Govt, which is largely fiscal deficit neutral

Net tax revenue growth pegged at 6%, below nominal GDP growth of 10% – we think these numbers are aggressive, especially in view of the composition of tax revenue growth

Composition of government expenditure is vastly better than in FY09, with growth in capital expenditure far outpacing than in revenue expenditure

Revenue deficit and fiscal deficit will be higher than in FY09; however, adjusted for oil/fertiliser bonds, FY10 fiscal deficit will be lower than in FY09, but quite large nevertheless

Revenue breakdown

(Rs bn)	FY07	FY08	FY09 (BE)	FY09 (Prov)	FY10 (BE)	Growth (% YoY) FY09	Growth (% YoY) FY10
Tax Revenue							
Corporation Tax	1,443	1,929	2,264	2,138	2,567	11%	20%
Income Tax	862	1,195	1,383	1,244	1,129	4%	-9%
Customs Duties	863	1,041	1,189	998	980	-4%	-2%
Excise Duties	1,176	1,236	1,379	1,087	1,065	-12%	-2%
Service Tax	376	513	645	609	650	19%	7%
Other Taxes	15	17	18	20	20	20%	2%
Gross Tax Revenue	4,735	5,931	6,877	6,097	6,411	3%	5%
Devolution to states	1,203	1,518	1,788	1,602	1,644	6%	3%
Surcharge transferred to NCCF	20	18	18	18	25	0%	39%
Net Tax revenue	3,512	4,395	5,072	4,477	4,742	2%	6%
Non-Tax Revenue							
Interest Receipts	225	211	191	206	192	-2%	-7%
Dividends and Profits	293	345	432	387	498	12%	28%
Non-Tax Revenue of UTs	8	8	8	8	8	-4%	-3%
Other non-tax revenue	306	460	326	368	706	-20%	92%
Total Non-tax Revenue	832	1,024	958	969	1,403	-5%	45%
Total Revenue	4,344	5,419	6,029	5,447	6,145	1%	13%
Non Debt Capital Receipts							
Recoveries of Loans	59	51	45	62	42	21%	-31%
Other Receipts*	5	45	102	5	11	-88%	105%
Total Receipts*	4,408	5,515	6,176	5,514	6,198	0%	12%
Gross tax receipts (% GDP)	11.5%	12.6%	12.9%	11.5%	10.9%		
Non-tax revenue (% GDP)	2.0%	2.2%	1.8%	1.8%	2.4%		
Capital receipts (% GDP)	0.2%	0.2%	0.3%	0.1%	0.1%		

Source: Budget documents, IIFL Research. *For FY08, excludes expenditure and revenue pertaining to transfer of RBI's stake in SBI to Central Govt, which is largely fiscal deficit neutral

Corporate tax collection growth at 20% seems optimistic, 9% decline in income tax collection is largely due to elimination of FBT and surcharge

A 2% excise duty decline target is challenging in itself, given that effective tax rate would be significantly lower for most of the year, given the fiscal stimulus

Increase in dividends and profits is entirely from financial institutions (RBI/PSU banks/FIs) implying government is expecting higher dividend payouts from these

92% growth is due to Rs350bn being budgeted for 3G auctions. This is up from Rs200bn budgeted during the interim budget. Our Telecom analyst considers this target to be aggressive.

Expenditure breakdown

Major Expenditure Heads	FY07	FY08	FY09 (BE)	FY09 (PE)	FY10 (BE)	Growth (%yoy) FY09	Growth (%yoy) FY10
Non-Plan expenditure	4,135	4,722	5,075	6,060	6,957	28%	15%
Revenue expenditure	3,722	4,209	4,484	5,565	6,188	32%	11%
Capital expenditure	413	512	591	495	769	-3%	55%
Interest	1,503	1,710	1,908	1,905	2,255	11%	18%
Defense	855	917	1,056	1,146	1,417	25%	24%
Subsidies	578	709	714	1,292	1,113	82%	-14%
Food	240	313	327	436	525	39%	20%
Fertiliser	262	325	310	758	500	133%	-34%
Petroleum	27	28	29	29	31	2%	8%
Others	49	43	49	69	57	61%	-17%
Plan expenditure	1,699	2,051	2,434	2,755	3,251	34%	18%
Revenue expenditure	1,424	1,736	2,098	2,352	2,784	35%	18%
Capital expenditure	274	315	336	403	468	28%	16%
Total expenditure*	5,834	6,772	7,509	8,815	10,208	30%	16%
Revenue expenditure	5,146	5,945	6,581	7,917	8,972	33%	13%
Capital expenditure	688	827	928	898	1,236	9%	38%
Total expenditure (% GDP)	14.1%	14.3%	14.1%	16.6%	17.4%		
Revenue expenditure (% GDP)	12.5%	12.6%	12.4%	14.9%	15.3%		
Capital expenditure (% GDP)	1.7%	1.8%	1.7%	1.7%	2.1%		
Plan expenditure (% GDP)	4.1%	4.3%	4.6%	5.2%	5.6%		
Non-plan expenditure (% GDP)	10.0%	10.0%	9.5%	11.4%	11.9%		

Source: Budget documents, IIFL Research. *For FY08, excludes expenditure and revenue pertaining to transfer of RBI's stake in SBI to Central Govt, which is largely fiscal deficit neutral

Non-Plan expenditure growth of 15% will be slower than the growth of Plan expenditure at 18%

Interest expense will be up, owing to high fiscal deficit and subsidies will be down, owing to lower fertiliser subsidies. Overall incidence of subsidies (incl oil/fertiliser bonds) will be even lower than these estimates

Quality of government expenditure will be markedly better in FY10 vis-à-vis FY09, as capital expenditure growth at 38% will outpace revenue expenditure growth at 13%

Big jump in social sector allocations

- 68% YoY rise in FY10 allocations for key flagship schemes
- More than doubling of allocation for NREGA from FY09 Budget estimates (44% rise from FY09 actuals)
- Additional 100bps interest subvention to farmers who have repaid earlier short-term crop loans on schedule (reducing effective interest rate to 6%)
- 75% increase in allocation to Accelerated Irrigation Benefit Programme

Scheme	FY08 Budget allocation (Rs bn)	FY09 Budget allocation (Rs bn)	FY10 Budget allocation (Rs bn)
Bharat Nirman	246	312	452
Jawaharlal Nehru National Urban Renewal Mission	55	69	129
National Rural Employment Guarantee Scheme	120	160	391
National Rural Health Mission	99	121	139
Total	**520**	**662**	**1,111**
Growth		27%	68%

Source: Budget documents

Budget impact by sector

Sector summary

- The increase in MAT rate cuts across a number of sectors, among them Pharma, Power, Real Estate and Telecom.

Sector	Impact	Key measures	Stocks affected: Positively	Stocks affected: Negatively
Agriculture	**Positive**	• Hike in agricultural credit, reduction in effective interest rate on short-term crop loans • Spending on irrigation projects to be increased by 75% to Rs350bn.	Jain Irrigation, Monsanto, Advanta, Kaveri Seeds, United Phosphorus	
Autos	**Positive**	• Increase in disposable income on removal of 10% surcharge on personal income tax and revision of IT slabs • Increased allocation for JNNURM positive for bus manufacturers	Maruti, Hero Honda, Bajaj Auto, Mahindra & Mahindra, Tata Motors, Ashok Leyland	
Banks & Finance	**Neutral**	• IIFCL to provide take-out financing for bank lending to infrastructure projects • Financial inclusion to be a key thrust area		
Cement	**Neutral**	• No change in excise duty; industry had raised prices in anticipation of an increase in excise duty. • Service tax to be levied on railway freight; the recent price hikes (we are yet to factor this in) to more than offset the increase in cost		
FMCG	**Positive**	• Rise in disposable income due to higher NREGA layout and removal of surcharge on personal income tax • Big positive for ITC as cigarette excise has been left unchanged after five successive years of increases	ITC, HUL, Marico, Colgate	Dabur
IT Services	**Positive**	• Extension of STPI tax benefits: minimal impact on larger vendors except HCL Tech (<5% of FY11ii EPS). Positive for smaller vendors (~10% upgrade in FY11ii EPS) • Fringe benefit taxes and excise duty on a portion of value of packaged software have been abolished. Would marginally reduce cost for all IT services vendors.	HCL Tech, Tech Mahindra, Patni, Infotech Enterprises; Other smaller IT vendors, BPOs	
Infrastructure	**Neutral**	• Infrastructure spending remains a priority, but 9% of GDP target pushed back by two years. • Measures to improve capita availability. Higher spending allocation mainly for urban infra and power T&D.	Urban infrastructure and power T&D, BHEL	
Metals	**Neutral**	• No increase in import duty on steel is a marginal negative for domestic steel companies. • Increase in MAT is negative for Sterlite.		Sterlite
Pharma	**Neutral**	• Widely expected benefits to boost R&D spent did not come through • Higher focus on private healthcare for BPL families can benefit hospital players	Apollo, Fortis	Cipla
Power	**Neutral**	• Higher allocation towards T&D segment a big boost for the supplier base		
Real Estate	**Negative**	• Absence of increase in income tax exemption limit on home loans fell short of expectation. Also, restriction to disallow allocation of more than one unit to a family in a housing project availing 80IB benefit would result in fewer developers availing these benefits • Removal of surcharge on personal income could create marginal incremental demand and STPI extension for one year only will support demand for SEZs.		
Telecom	**Neutral**	• Increase in disposable income a positive • Increase in estimate for 3G auctions proceeds to Rs350bn – ambitious, to say the least; re-introduction of CVD exemption on mobile phones for one year a modest measure		

Agriculture - Positive

Positive for Jain Irrigation, United Phosphorus, Finolex, Monsanto, Advanta, Kaveri Seeds

Focus on stimulating agricultural growth continues

- Target for agricultural credit raised to Rs3,250bn (up 13% from Rs2,870bn disbursed in 2008-09).
- Effective interest rates on short-term crop loans (paid on time) brought down by 100bps to 6% (from 7% earlier).
- Timeline for repayment of dues under the farm loan waiver scheme extended by a further 6 months (till Dec 2009).
  - should accelerate growth in all agricultural-input sectors, including seeds, agricultural implements, irrigation and fertilisers.
- Customs duty on rock phosphate cut to 2% from 5%; should make agricultural inputs (mainly fertilisers and pesticides) cheaper. Supports growth for fertiliser and crop protection companies (United Phosphorus).

Focus on spending on agriculture infrastructure remains high

- Spend under the flagship irrigation programme—Accelerated Irrigation Benefits Programme—hiked to Rs350bn (from Rs200bn last year). This should support growth for irrigation-focused companies, mainly Jain Irrigation, Finolex, IVRCL and Nagarjuna Construction.
- Outlay under Rashtriya Vikas Yojana hiked by 30% YoY (to Rs325bn from Rs250bn earlier).

Focus on rural infrastructure spending should support growth for companies levered to rural demand

- Spend under the National Rural Employment Guarantee Scheme (NREGS) hiked to Rs391bn (up 44% from Rs271bn actual expenditure during FY08-09 and up 144% from budgeted expenditure of Rs160bn during FY08-09).
- Total spend on Bharat Nirman increased by 45% YoY (to Rs453bn from Rs313bn during FY08-09).
- Total spend under the Prime Minister Gram Sadak Yojana (PMGSY) hiked by 59% YoY (to Rs120bn from Rs75bn during FY08-09).

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Auto – Positive

Positive for Hero Honda, Bajaj Auto, M&M, Ashok Leyland, Tata Motors, Maruti

Removal of 10% surcharge on personal income tax will increase disposable income

- Will result in a 5% increase in disposable income of individuals with income > Rs1 million—positive for Maruti.
- Increase in exemption limit in personal income tax by Rs10,000—positive for two-wheeler companies like Hero Honda and Bajaj Auto.

No rollback in excise duty; excise duty cuts on certain categories not material

- Excise duty on small cars, two-wheelers and buses to continue at 8%
- Specific component of excise duty on large cars/utility vehicles of engine capacity 2,000cc and above reduced from Rs20,000/vehicle to Rs15,000/vehicle—positive for Mahindra & Mahindra.
- Excise duty on petrol-driven trucks/lorries to be reduced from 20% to 8%, but a very small percentage of trucks are petrol vehicles, hence this measure will have a limited impact.

Focus on infrastructure and agriculture to continue

- Increased allocation to JNNURM and NHDP should result in increased demand for buses and CVs.
- **Service tax imposed on transport of goods by rail creates a level playing field as transport of goods by road is already subject to service tax – Positive for CV companies**
- Increased outlay for NREGS, lower effective interest rate on crop loans—positive for Hero Honda.
- Increased targets for agricultural disbursements—positive for tractor companies like Mahindra & Mahindra.

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Banking & Financials - Neutral

- Higher fiscal deficit projection of 6.8% of GDP in the current financial year raises possibility of firmer interest rates in the later part of the year.
- However, given the sharp decline in bank lending and deposit rates over the past few months, a rise of 50-100bps in interest rates is likely to have only a mild impact on investment and consumption-related demand.
- While liquidity remains comfortable for the time being, wholesale borrowing costs are expected to firm up during the busy season, when both private and government borrowing will pick up.
- Financial inclusion is likely to be a key thrust area, with the aim of improving accessibility of banking services across the country. Government banks are expected to focus on branch expansion, opening off-site ATMs and correspondent banking services.
- Measures to direct IIFCL (India Infrastructure Finance Company Ltd) to provide take-out financing for bank loans towards infrastructure will address ALM mismatch constraints faced by banks and allow for greater infrastructure funding. However, this falls short of directly allowing banks to raise long-term resources with tax-free sops.
- The extension of agriculture loan waiver scheme for large farmers by six months to 31 December 2009 is unlikely to be materially detrimental to the interests of banks. Anyway, the government reimburses this amount to banks.
- Lack of any announcement on raising of foreign holding limit in insurance and government banks came as a disappointment. However, these measures are independent of the budgetary exercise and may still come through in due course.
- The post-budget correction in bank stock prices would bring down valuations of private banks and finance companies to a more reasonable level. Government banks were anyway inexpensive. Our preferred picks are: **PNB, BOB, Union, SBI, Axis Bank, HDFC Bank** and **HDFC.**

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Cement – Neutral

No change in excise duty

- Our channel checks indicated that producers were expecting an increase in excise duty and some of the price hikes in the past one month in East, Central and North were in anticipation of a hike.
- We will upgrade our earnings estimates further if prices continue to rise.

Levy of service tax on rail freight

- Levy of service tax on rail freight is neutral as the same is MODVAT-able.

Focus on infrastructure and irrigation segments continues

- Increase in budget allocation for JNNURM by 87%, Accelerated Irrigation Benefit Programme by 75%, Bharat Nirman by 45% and NHDP by 23% are positive for cement demand. The 65% increase in allocation for Commonwealth Games preparation is marginally positive for North-based cement companies.
- Higher disposable income on account of removal of surcharge on personal income to increase loan-raising limit and hence, affordability of houses.

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FMCG – Positive

Positive for ITC, Hindustan Unilever, Marico, Colgate

Higher disposable income will lead to increase in FMCG consumption

- Allocation for National Rural Employment Guarantee Scheme increased by 44% over FY09 actual spend; this would directly lead to an increase in rural disposable income and spur consumption. HUL, Dabur, Colgate and Marico would be the key beneficiaries, as they derive 30-50% sales from rural areas.
- Interest rate on short-term crop loans repaid on schedule brought down by 1%, which would also improve rural disposable income.
- Removal of surcharge on personal income tax and raising of exemption limit will also increase disposable income.

ITC will benefit from no change in excise duty on cigarettes

- Absence of hike in cigarette excise is a positive for ITC, as it would help increase cigarette volume after two years of decline. FY04 was the last year when there was no increase in excise duty.
- ITC has already taken a 2-3% blended YoY hike in cigarette prices, anticipating an excise hike; this would now expand cigarette EBIT margins.
- Increased allocation for Commonwealth Games positive for ITC's Delhi hotel properties. Absence of increase in biscuits and paperboards excise also positive for the company.

FBT abolition positive for all FMCG companies, increase in MAT to impact Dabur

- All FMCG companies had FBT of 1.3-3.5% of PAT. Marico, Britannia, GSK Consumer will be the biggest beneficiaries, with 2.5-3.5% increase in PAT.
- Dabur's tax rate would go up from 12% to c15.5%, as the MAT rate has been increased. Other companies have tax rates higher than 15% and thus would not be affected.

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IT Services - Positive

Positive for HCL Tech, Patni, Tech Mahindra

STPI benefits extended – Positive:

- STPI tax benefits under Income Tax Act 10A/10B have been extended by one year, to 31 March 2011.
- While the benefits for larger vendors (except HCL Tech) would be minimal due to a considerable number of STPI units coming out of the 10-year tax free period, smaller vendors would benefit.
- Among the larger vendors, HCL Tech and TCS would be the primary beneficiaries. Among smaller vendors, Patni, Tech Mahindra, Infotech Enterprises are the prime beneficiaries.

Partial excise duty exemption on packaged software and abolition of FBT – marginally positive

- On the portion of value of packaged software that represents a ‘transfer of right’, excise duty has been exempted.
- Based on our discussions with company management, we understand that the impact on purchasing costs for IT services vendors would be minimal.
- FBT abolished, except on ESOPs.

Clarification of taxes for SEZ units

- 100% of profits from SEZ units would be exempted from income taxes – wef 1 April 2010. As such, some IT services vendors (including Wipro and TCS) that have not been providing for proportionate taxes on SEZ units may have to record contingent liabilities.

	Company's earlier estimate of effective tax rate for FY11	Likely effective tax rate for FY11 after the extension of STPI benefits	Upgrade in FY11 PAT
HCL Tech	28%	17%	15.3%
KPIT#	25%	15-16%	13.3%
Tech M	25%	15%	13.3%
Hexaware	25%	15%	13.3%
Patni	30%	22-23%	11.4%
Infotech Enterprises**	32-34%	26-28%	8.8%
TCS	22-23%	18-19%	5.1%
Mindtree	15-16%	12%	3.5%
Infosys*	20-22%	~20-22%	Negligible
Wipro	17-18%	~17-18%	Negligible

* has 15,000 employees in taxable STPI units in FY09

** has 2,000 employees in taxable STPI units in FY09

\# has 20% employees in taxable STPI units in FY09

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Infrastructure – Neutral

Positive for urban utilities and power T&D contractors, BHEL

- Increasing infrastructure spends remained a priority with the government. However, the target of boosting infrastructure spending to over 9% of GDP has been pushed back to FY14 from FY12 earlier. Allowing state governments to borrow an additional 0.5% of GSDP should help capital outlays by state governments.

Measures to improve capital inflow to infrastructure projects

- IIFCL can refinance up to 60% of bank loans for PPP projects over next 15-18 months.
- However, a tight fiscal situation would put upward pressure on interest rates.

Allocations to various infrastructure programmes – urban sector and power T&D witness major increases

- JNNURM (Jawaharlal Nehru National Urban Renewal Mission) allocation increased by 87% to Rs129bn.
- Allocation for APDRP increased to Rs20.8bn, 160% increase over FY09BE.
- Allocation for rural electrification programme (RGGVY) increased by 27% to Rs70bn.
- Allocation to NHAI for NHDP increased 23% over FY09BE.
- Provide additional Rs150bn over FY09BE for the Accelerated Irrigation Benefit Programme, up 75% YoY.
- Increased focus on development on national gas grid

Change in corporate tax rates is mildly positive

- MAT increased from 10% to 15% of book profits. Period allowed to carry-forward tax credit increased from 7 to 10 years. For infra asset owners, this would translate into only ~2% decrease in equity cash flows. Also, most concession documents include provisions for compensation for adverse changes in tax rates.
- Abolition of fringe benefit tax would result in an 1-3% increase in net profit.
- Weighted deduction of 150% on R&D expense would result in ~3% increase in BHEL earnings.
- Explanation to Sec 80IA excluding contractors from availing tax benefits under the section further strengthened.

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Metals – Neutral

Custom duty on steel kept unchanged

- Import duty, especially on steel, was expected to be increased from 5%. Absence of an increase in customs duty is a negative for domestic steel companies.

Increase in MAT rate will be negative for Sterlite

- Sterlite's subsidiaries BALCO and Sterlite Energy and Vedanta Alumina, an associate company, pays tax at MAT rate. The increase in current tax rate has negative implications for cash flow of the consolidated entity. However, impact on reported earnings will be minimal, as the company will create a deferred tax asset on MAT paid.

Tax sops on laying oil & gas pipeline will benefit pipe and API-grade steel producers

- All capital expenditure incurred in connection with laying cross-country oil & gas pipeline will be fully allowable as tax deduction. This can accelerate implementation of gas grid, which would benefit pipe producers such as Welspun and API-grade steel producers JSW Steel.

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Pharma & Healthcare – Neutral

Positive: Private healthcare providers (Apollo, Fortis)

Negative: MAT-paying pharma companies (Cipla)

Higher MAT rate

- Rise in MAT rate to impact pharma companies that enjoy exemptions due to several schemes and hence pay MAT.
- Amongst stocks in our coverage, Cipla is currently subject to MAT.

Lower duty on select drugs

- Customs duty reduced from 10% to 5%.
- Totally exempt from excise duty and countervailing duty.
- List of drugs includes:
    - influenza vaccine
    - nine specified life-saving drugs used for treatment of breast cancer, hepatitis-B, rheumatic arthritis, etc.
    - bulk drugs used for the manufacture of such drugs.

Private healthcare for BPL (below poverty line) families

- Under Rashtriya Swasthya Bima Yojana (RSBY), operationalised last year. Allocation of Rs3.5bn—up 40% YoY.
- More than 4.6 million BPL families have been issued biometric smart cards; scheme to be extended to all BPL families
- Freedom of choice in healthcare services from an extensive list of hospitals including private hospitals,
- Potential beneficiaries: private healthcare providers such as Apollo, Fortis, Max

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Power – Neutral

Positive: Power ancillary companies

Negative: Merchant power plants, some Central Power sector utilities

MAT: increased to 15% from 10%

- **Negative:** for power plants availing 80IA benefit and selling power through short-term PPAs (JSPL)
- **Neutral:** for competitively won projects, as bidding conditions usually allow changes in tax rate as a pass-through (Reliance Power, Tata Power, Lanco, Sterlite Energy)
- **Neutral:** State / private utilities under regulated post-tax RoE regime unaffected (Rel Infra, Tata Power, CESC)
- **Negative:** Utilities under pre-tax RoE (mostly central owned), as the tax differential between MAT and company tax lowered (NTPC)

80IA benefits: Sunset clause extended for both new plants/transmission lines and reconstructed/ revived genco plants to FY11

- **Positive:** for all utilities and in particular for NTPC which revives old stations acquired from state utilities

Customs' duty on permanent magnet (PM) lowered from 7.5% to 5%

- **Positive:** for WTG producers using PM technology
- **Key beneficiary:** No listed company in this space; Suzlon Energy does not use this technology

APDRP scheme allocation increased to Rs20.8bn (up 160% from FY09BE)

- **Positive:** for companies engaged in T&D loss reduction/ IT services to utilities.
- **Key beneficiaries:** ICSA, KLG Systel.

Rajiv Gandhi Grameen Vidyutikaran Yojana allocation increased to Rs70bn (up 27% from FY09BE)

- **Positive:** for T&D equipment suppliers.
- **Key beneficiaries:** KEC, Jyoti, Kalpataru, EMCO, Apar, Bharat Bijlee, Voltamp.

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Negative for MAT payers like Puravankara, HDIL, Unitech and Sobha

Increase in MAT will increase cash tax outgo - Negative

- Residential players deriving benefits under Section 80IB will be adversely affected by the increase in MAT.
- The increase in current tax rate has negative implications for cash flow. However, impact on reported earnings will be minimal, as the company will create a deferred tax asset on MAT paid.

Expectation of increase in tax-deductible interest limit on home loans unfulfilled

- While the cut in income tax surcharge and the increase in exemption limit by Rs10,000 will improve disposable income, the increase in tax-deductible home loan interest limit failed to come through.
- As a result, renting a house continues to receive significantly favourable tax treatment compared to owning it.

Shorter extension of STPI sunset clause vis-à-vis expectation positive for SEZ developers

- Developers with new IT parks were looking for 3-4 year extension of STPI sunset clause. However, the extension provided till Mar 2011 is inadequate to create demand for such properties.
- IT/ITES players will continue to seek space in SEZs aiding developers with large SEZ footprint like DLF.

Disallow allotment of more than one unit in an affordable housing project to a family

- Post April 2010, no related persons can be allotted more than one unit in a housing project where the developer seeks to avail 80IB benefits.
- This restriction could result in fewer developers availing 80IB benefits under this route.

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Telecom – Neutral

Higher rural disposable income will lead to increase in spending by subscribers

- Allocation for National Rural Employment Guarantee Scheme increased by 44% over FY09 actual spend; this would directly lead to an increase in spending by subscribers.

MAT hike from 10% to 15% to have marginal impact on earnings – from slightly higher net interest expense

- Effective reported tax rate will not change materially, based on the specific circle-wise combination of higher current tax and MAT credit .
- Bharti's current tax rate had approached the MAT rate, and cash tax outgo should rise sharply, which may increase interest expense by Rs0.7bn; ~0.7% impact on EPS due to higher interest cost. On the other hand, greater quantum of MAT credit will likely keep the overall tax rate from rising sharply, and hence EPS impact should be limited to the higher interest cost. Negligible impact for RCOM, Idea etc.

Increase in estimate for 3G auctions proceeds to Rs350bn—ambitious, to say the least

- From the previous estimate of Rs200bn in the interim budget for FY10, the estimate of proceeds from 3G auctions is increased to Rs350bn. This increase accounts for almost the entire increase in non-tax revenue estimates.
- However, at Rs350bn for 5-6 slots on the average, it would amount to Rs60bn-70bn for a pan-India licence for a slot (~1.7-2x the reserve price), and looks steep, especially since international players are still constrained by the 74% FDI limit.
- This also signals that if the Govt has done its numbers carefully, then perhaps more than just the 3G spectrum may be auctioned (recently submitted Spectrum Committee Report advocates auction of 2G spectrum also).

Re-introduction of CVD exemption on mobile phones for one year a modest positive – countered by imposition of customs duty on set-top boxes

- Exemption of special CVD of 4% on mobile phone parts to be reintroduced for 1 year.
- Impact expected to be modest, as the effective price reduction will be ~2-3%, and will not materially alter subscriber spending. Besides, in Maharashtra, the increase in VAT from 4% to 12% from this month will have a bigger impact.
- Set-top boxes cost to increase because of imposition of 5% custom duty – negative for Bharti and RCOM

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Other Budget measures

Commodities Transaction Tax (CTT)

- CTT that was earlier levied on commodity futures contracts has been abolished.
  - Positive for Financial Technologies (promoter company of MCX).

Textiles: export-oriented companies should continue to derive support from lower funding costs

- Hike in allocation towards Market Development Assistance Scheme by 148% YoY to Rs1.2bn.
- Extended period for which interest subvention of 2% (on pre-shipment credit) will be available from 30 Sep 2009 to 31 Mar 2010.

Disclaimer

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.
Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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