Macquarie Research
Equities

INDIA

# India budget review

7 July 2009

### Sectoral impact of budget

| Positive | Neutral |
|---|---|
| Infrastructure | Auto |
| FMCG | Banks |
| Pipe producers | Pharma |
| | Property |
| | Retail |
| | Textile |
| | Oil & Gas |

Source: Macquarie Research, July 2009

### Stock impact

| Stock | Ticker | Budget impact |
|---|---|---|
| BHEL | BHEL | Positive |
| IDFC | IDFC | Positive |
| ITC | ITC | Positive |
| IVRCL | IVRCL | Positive |
| Reliance Industries | RIL | Negative |

Source: Macquarie Research, July 2009

### Top picks

| Company | Ticker | Rec. | Price (Rs) | TP (Rs) | Upside |
|---|---|---|---|---|---|
| Axis Bank | AXSB | OP | 794 | 903 | 14% |
| BHEL | BHEL | OP | 2,101 | 2,312 | 10% |
| Sterlite | STLT | OP | 589 | 862 | 46% |
| Tata Steel | TATA | OP | 397 | 584 | 47% |
| Unitech | UT | OP | 76 | 95 | 25% |

Price as of 6 July 2009

Source: Macquarie Research, July 2009

### Least preferred

| Company | Ticker | Rec. | Price (Rs) | TP (Rs) | Upside |
|---|---|---|---|---|---|
| GMR Infra | GMR | UP | 133 | 104 | -22% |
| Idea | Idea | UP | 69 | 45 | -35% |
| Zee Entert. | Zee | UP | 171 | 90 | -47% |

Price as of 6 July 2009

Source: Macquarie Research, July 2009


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## Victim of unrealistic expectations

### Event

- The Indian markets sold off aggressively (the BSE Sensex was down 6%) following the announcement of India's FY3/10E budget – we think unrealistic expectations were the issue rather than any particular provisions in the budget.

### Impact

- **Headline fiscal deficit** forecast at a worse-than-expected 6.8% of GDP compared to expectation of 6.0−6.5%. Relative to the target of 5.5% of GDP announced in the interim budget in February, the deficit worsening is mainly due to the loss in revenue from the changes in personal income tax (loss of 0.4% of GDP), what we believe to be an impractical (and, in our view, unbelievable for a government that has indicated its preference for disinvestment) assumption of a loss of 0.02% of GDP for disinvestment, and no reversal in any of the cuts in excise duty and service tax. We believe there is a strong possibility that the fiscal deficit is better than the official forecast.
- **Infrastructure is the biggest beneficiary.** The highlights of the budget were:
  - ⇒ **Infrastructure** received a big push, with budgetary allocations up, across the board – roads and urban infrastructure are key beneficiaries. Moreover, tax breaks on R&D was extended to equipment manufacturers.
  - ⇒ **Higher MAT** (minimum alternate tax) will squeeze earnings for a number of companies – the largest loser is Reliance Industries.
  - ⇒ **Benign taxation.** Personal income taxes were cut by around 2−3% for all slabs – this, along with the abolition of the fringe benefit tax, will act as a minor stimulus to consumption. The FBT abolition is also positive for large service sector employers (IT, banks, insurance) who were struggling with the nitty-gritty of complying with that tax.
  - ⇒ **Cigarettes untouched.** Excise duty on cigarettes was unchanged, which was a positive surprise for us. ITC is the key beneficiary.
- **The reform story stays in place.** The lack of any specific reform measures seems to have raised doubts on the government resolve: We think the market is looking for the wrong announcements in the wrong forum. The budget has limited itself (as it has for some years now) to issues pertaining to government finances – issues like fuel price reform and FDI liberalisation will be pursued on other forums. Even after this announcement, there are significant positives from a policy perspective: The benign taxation referred to above, as well as a specific timeline (45 days) for a new tax code.

### Outlook

- We believe the markets have overreacted, and we maintain our positive stance on the market. We raise our April 2010 Sensex target to 18,000 from 15,000, largely capturing a 20% upgrade to our FY3/11 Sensex earnings since 8 May 2009, when we set our Sensex target. The target PER multiple remains at 15.6x, the average from 2004 onwards.
- Our top picks are Axis Bank, BHEL, Tata Steel, Unitech and Sterlite (which replaces Reliance Industries). Our least preferred are GMR Infra, Idea Cellular and Zee Entertainment.

## Fig 1 Sector valuation

| | Market cap (US$bn) | PER (x) | | Diluted EPS growth (%) | |
|---|---|---|---|---|---|
| Sector | | **2010E** | **2011E** | **2010E** | **2011E** |
| Pharma | 6.9 | 29.7 | 21.5 | 29.5 | 38.2 |
| Auto | 12.8 | 15.9 | 14.4 | 24.5 | 10.6 |
| Engineering & Construction | 64.0 | 21.3 | 17.1 | 41.9 | 24.1 |
| Oil & Gas | 157.0 | 13.0 | 10.0 | 37.3 | 30.7 |
| IT | 50.2 | 11.2 | 10.0 | 16.2 | 12.2 |
| Cement | 12.4 | 9.8 | 11.3 | 4.1 | -12.9 |
| Metals & Mining | 43.4 | 14.6 | 8.8 | -36.5 | 65.2 |
| Telecom & Media* | 36.8 | 14.4 | 12.5 | 14.0 | 15.1 |
| Real Estate | 8.2 | 8.6 | 8.2 | 1.1 | 5.4 |
| Consumer | 33.6 | 24.5 | 20.4 | 19.9 | 20.1 |
| Banks | 101.9 | 13.6 | 11.8 | 5.3 | 15.3 |
| Total Coverage | 561.2 | 14.3 | 11.5 | 12.1 | 23.6 |
| Sensex | 461.0 | 14.6 | 12.2 | 11.3 | 19.2 |

Note: Sector data based on Macquarie India's coverage universe. All prices are in local currency, as of 6 July 2009.
* Excluding Dish TV which has negative PAT
** Sensex data (ex-market cap) is based on a combination of estimates from Macquarie (for rated stocks) and Bloomberg (for non-rated stocks)

Source: Macquarie Research, July 2009

## Economic view − Positives clouded by a wider fiscal deficit

The budget is pro-growth and appears to be designed to ensure the improving momentum on economic growth even if it is at the expense of delayed fiscal consolidation. Importantly, the government has taken some steps towards fiscal reforms that are positive but these seem to have been ignored. Indeed, the recent hike in local petrol and diesel prices indicates to us that it would be wrong to conclude that the government does not want to move forward with tough decisions. Moreover, the details of the budget do not suggest that the government is not serious about reforms, in our view.

The initial reading of the budget suggests that the local equity market has over-reacted owing to unrealistic expectations and ignoring the positive moves in the budget. For example, an announcement related to increasing the FDI limit in the insurance sector was unlikely to be in the budget, as this has already been announced; the key is to pass it in Parliament. Further, as we have maintained, overall approach toward reforms by the current government will occur in baby steps rather than a big bang, and several relevant issues will be dealt with outside the purview of annual budgets.

Also, the overall budget deficit outcome would have been a lot more positive if the government had not undertaken the changes on personal income tax (loss of 0.4% of GDP relative to the interim budget) and had actually announced a slightly better assumption on disinvestment. The combined effect of these two could have boosted revenues by 0.9% of GDP.

**Fig 2 India federal budget, 2009−10**

| | FY08 Actual | FY09 BE | FY09 RE | FY10 BE Feb 09 | FY10 BE Jul 09 |
|---|---|---|---|---|---|
| % of GDP, FY end Mar | | | | | |
| Total receipts (incl. non debt capital receipts) | 12.4 | 11.6 | 10.8 | 10.3 | 10.6 |
| Revenue receipts | 11.5 | 11.4 | 10.6 | 10.1 | 10.5 |
| Tax (net) | 9.3 | 9.6 | 8.8 | 8.3 | 8.1 |
| Gross | 12.6 | 13.0 | 11.8 | 11.1 | 10.9 |
| Less states' share | 3.2 | 3.4 | 3.0 | 2.8 | 2.8 |
| Nontax | 2.2 | 1.8 | 1.8 | 1.9 | 2.4 |
| Non debt capital receipts | 0.9 | 0.3 | 0.2 | 0.2 | 0.1 |
| Recovery of loans | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 |
| Other receipts | 0.8 | 0.2 | 0.0 | 0.0 | 0.0 |
| Total expenditure | 15.1 | 14.2 | 16.9 | 15.8 | 17.4 |
| Interest payments | 3.6 | 3.6 | 3.6 | 3.7 | 3.9 |
| Defence | 1.9 | 2.0 | 2.2 | 2.4 | 2.4 |
| Direct subsidies | 1.5 | 1.3 | 2.4 | 1.7 | 1.9 |
| Revenue expenditure | 12.6 | 12.4 | 15.1 | 14.1 | 15.3 |
| Capital expenditure | 2.5 | 1.7 | 1.8 | 1.7 | 2.1 |
| Revenue (operating) balance | -1.1 | -1.0 | -4.5 | -4.0 | -4.8 |
| Primary balance | 0.9 | 1.1 | -2.5 | -1.8 | -3.0 |
| Fiscal balance | -2.7 | -2.5 | -6.1 | -5.5 | -6.8 |

Source: Macquarie Research, July 2009

### Key focus on boosting domestic demand

As expected, the budget is high on social-sector programs, including infrastructure and rural/urban development, agriculture, and the allocation for the Employment Guarantee Act has also increased, but the budget is disappointingly low on disinvestment. In the budget, disinvestment has been pegged at a mere Rs11.2bn in the current fiscal year, despite the rhetoric for a bigger number. We believe it is quite possible that the FM is being conservative so as to deliver a positive surprise, but we'll have to wait to track that as the year progresses.

Separately, the sunset clause for IT has been extended for another year, and the excise duty on petrol-driven trucks has been cut to 8.0% from 20.0%. While the minimum alternative tax (MAT) has been raised to 15% from 10%, the carry-forward exemption period has been increased to ten years from seven years.

There are two key issues that we focus on: (1) the pace of fiscal consolidation; and (2) the reform agenda.

**(1) Fiscal consolidation:** The key negative is undoubtedly the wider fiscal deficit of 6.8% of GDP for FY3/10 compared to 6.2% of GDP in the last fiscal year. However, we believe it is worth bearing in mind that this is not a tax-and-spend budget. The increase in the budget deficit is due to higher spending that has not been offset by reversing the general excise and custom duties that were cut to deal with the economic downturn.

In fact, the government has *actually* removed the 10% surcharge on personal income tax and also increased the standard deduction for individuals. The combination of moves on direct taxes suggests that the government is perhaps more concerned about the growth outlook, especially in light of the recent poor news flow on monsoon season rainfall. The combination of the spending boost and the favourable impact of higher disposable income on consumption offers a potential insurance downside risk to growth.

The change in the personal income tax collection in the current budget relative to the interim budget in February is around 0.4% of GDP. The government could have avoided the positive changes on individual direct taxes, and thus reported a smaller fiscal deficit. If growth surprises on the upside as the year progresses, some of the indirect tax cuts could be reversed before the end of the current fiscal year, thereby offering some upside to the current gross tax projection of a mere 2.1% over the revised estimate for FY3/09.

**Don't lose sight of fiscal arithmetic**

Including the off-budget subsidy last year, the federal government fiscal deficit in the last fiscal year was 8.0% of GDP (cash deficit was 6.2% of GDP). In the current fiscal year, the government has only indicated a special bond issuance of 0.2% of GDP for oil marketing companies (nothing on fertiliser), suggesting that the federal government's fiscal deficit (including off-budget spending) of 7.0% of GDP is lower than last year's outcome.

Even if we work on the assumption that the government will have to issue more on off-budget (say, around 0.5% of GDP), the fiscal deficit outcome (including off-budget spending) of 7.5% of GDP will still be lower than last year's deficit of 8.0% of GDP.

The government's borrowing will be clearly much higher than market expectations and will likely make the bond market nervous. Gross borrowing is expected at Rs4.51tr, up 24.7% compared to the forecast in the interim budget in February. Net borrowing (ie, gross minus repayments) is now pegged at Rs3.97tr, up 29%. The Reserve Bank of India (RBI) will likely have no choice but to continue to be a key buyer of government securities in order to ensure that long-term rates do not rise sufficiently, thereby acting as a disincentive to the banks from cutting interest rates.

**(2) Fiscal reforms:** The reaction of the equity market appears to suggest that there are no reformist measures in the budget. We believe this is incorrect. The finance minister has indicated the need for fiscal consolidation, but also felt the need for continued fiscal boost for the time being, especially when private investment is weak and there are lingering risks to the resilience of rural consumption if the monsoon rainfall disappoints and hits rural demand.

The removal of the irritant fringe benefit tax (FBT) and commodity transaction tax (CTT) are positive steps as the government has been resisting killing these taxes. Further, the goal of announcing a new direct tax code within the next 45 days has been ignored by investors. This could potentially be a meaningful positive, as the whole tax structure will then be reformed to check widespread exemptions and to facilitate a move towards lower tax rates.

Also, the finance minister has indicated reforming the fertilizer subsidy, which cost the government around 0.4% of GDP in off-budget spending in the last fiscal year (nothing has been budgeted for this year). The government intends to move towards a nutrient-based subsidy regime instead of the current product-pricing regime. Admittedly, the key will be the actual implementation.

The disappointing assumption of Rs11.2bn on disinvestment (same as that of the interim budget) should not be taken as a change of heart on disinvestment, in our view. Perhaps the finance minister is being too cautious given the still unsettled details around disinvestment game plan but not on intent. The assumption is so low that we believe there can only be a positive surprise on the actual outcome.

### Bottom line: Boost growth, delayed fiscal consolidation

The jump in spending should further cushion the economy by boosting domestic demand but this comes via delayed fiscal consolidation. Admittedly, the budget appears short on concrete measures for fiscal consolidation, but the main push toward that consolidation will likely come after the recommendations of the current Finance Commission (headed by tax expert Vijay Kelkar) are announced in October.

Although the government has reiterated its desire for fiscal consolidation, we believe it would be irresponsible for the government to announce a road map or targets now only to revise them a few months later once the recommendations of the Finance Commission become available later this year. Separately, early comments from S&P hint that an immediate downgrade to India's sovereign credit rating appears to be of low probability.

## Impact of budget on India Infra

**BHEL to gain from R&D benefit being extended to entire range of manufactured products**

- **Tax deduction on R&D to be 150% weighted:** The government has allowed a weighted deduction of 150% of R&D spend for all manufactured products rather than the earlier permitted list of drugs, pharma, electronic equipment, computers, telecommunications, and chemicals.
- **BHEL to benefit:** BHEL would spend close to Rs9bn on R&D in FY10; actual spend in FY09 was Rs6.5bn. The enhanced R&D deduction norm would add Rs1.5bn to net profit in FY10, which is Rs3.1/share.

**Expected power spending to increase by 46% in FY10**

The government has estimated that total spend on the power sector in FY10 would be around Rs531bn against the actual spend of Rs36.3bn, YoY growth of 46%. The number includes spending by all central utilities. BHEL's revenue growth would directly depend on capex by power utilities. In terms of sanctity of the guided numbers, actual FY09 spend is only 10% below the budgeted numbers.

**Infra financing − Large focus on delivery mechanism**

Infrastructure financing was focused on the budget. IIFCL (India Infrastructure Finance Company ltd), which would re-finance banks for loans extended to the infrastructure sector, would have more flexibility to extend debt to the projects.

The concept of "take out financing" would be introduced, with IIFCL providing take out financing in the infra sector. In short, take out financing would allow banks to extend debt to the infra sector with the clause that IIFCL would be take over the debt in 3−5 years' time. This would allow banks to lend to the infra sector without being too concerned about the asset-liability mismatch.

We would await actual measures on these fronts to assess the effectiveness of the financing programs. The entire infra space would likely benefit if these steps actually have an impact.

**Allocations increased for most of government infra projects**

- **National Highway development program** − 23% increase to Rs160bn. IVRC, NJCC to benefit
- **Urban infra (JNNURM)** − 87% increase to Rs129bn. PEC, HCC, to benefit
- **T&D reform program (APDRP-II)** − 160% increase to Rs21bn. ICSA (AURFI IN) to be key beneficiary
- **Accelerated irrigation program** − 75% increase. IVRCL key beneficiary

**Negative is no clarity on extension of 80IA benefits.**

Currently, all infra developers get a 10 year tax holiday. This tax holiday is expiring in 2010. It was expected that the government would provide clarification.

## Fig 3 Sectoral impact of budget

| Event | Vs Expectation | Impact | Companies Affected | | | |
|---|---|---|---|---|---|---|
| | | | Positively | | Negatively | |
| | | | Bloomberg Code | Impact on Earnings | Bloomberg Code | Impact on Earnings |
| **Auto** | | | | | | |
| Additional excise duty applicable to large cars/utility vehicles of engine capacity 2000cc and above has been reduced from Rs20,000 per vehicle to Rs15,000 per vehicle | Marginally positive | While the reduction in excise duty is not very significant, this should help to a small extent in improving the affordability of larger vehicles. While the industry had demanded the removal of additional duty and reduction in gap in basic excise duty with respect to small cars, we believed that there was a low probability of this happening. | TTMT IN, MM IN | | | |
| Weighted deduction of 150% for R&D expenditure continued | Neutral | The deduction should help companies with relatively large R&D spend to lower taxes and thus improve profitability | TTMT IN, MSIL IN, AL IN | | | |
| Increase in JNNURM allocation by 87% to ~Rs129bn | Neutral | The government had provided assistance to state transport units for purchase of ~15,000 buses under the JNNURM scheme as a part of the fiscal stimulus package. The deadline for this has also been extended to Dec 2009 from the previous June 2009. While it is not clear how much of the new allocation will be used for improving public transport, an increase in allocation under the JNNURM for the same will help improve bus sales for the commercial vehicle manufacturers. | TTMT IN, AL IN | | | |
| Interest subvention scheme for short term crop loans up to Rs3 lakh per farmer at the interest rate of 7% per annum to be continued and increase in credit flow of over 13% for the agriculture sector | Neutral | Tractor demand could improve due to better availability of finance at lower rates | MM IN | | | |
| Excise duty on petrol driven trucks has been reduced from 20% to 8%. Excise duty on chassis of such trucks has been reduced from '20% + Rs10,000' to '8% + Rs10,000' | Positive | This measure is not likely to have any impact as fleet operators prefer diesel and CNG trucks over petrol driven trucks | | | | |
| **Banks** | | | | | | |
| No change in income tax limits on housing loans | Expected | Neutral for HDFC | | | | |
| Push to infrastructure schemes | Expected | Positive | AXSB, IDFC | | | |
| Higher fiscal deficit to push up bond yields | Unexpected | Negative | | | State owned banks | |
| **Basic Materials** | | | | | | |
| Imposition of service tax on railway freight | Negative | This is not likely to have any impact as this is Modvatable against excise duty payments | | | | |
| No increase in excise duty | Positive | In order to improve the fiscal situation it was expected that the Government may look at increasing tax collections by hiking excise duty for Steel and | Positive for all cement and steel stocks | | | |

## Fig 3 Sectoral impact of budget

| Event | Vs Expectation | Impact | Companies Affected: Positively – Bloomberg Code | Positively – Impact on Earnings | Negatively – Bloomberg Code | Negatively – Impact on Earnings |
|---|---|---|---|---|---|---|
| | | Cement. No change in excise duty for steel and cement should benefit these companies positively | | | | |
| Increase in MAT from 10% to 15% | Negative | New power projects which enjoy benefits under Sec 80 (IA) are liable for taxes at MAT rates. Increase in MAT rates will negatively impact these companies | | | JSP IN, STLT IN | ~2-3% |
| No increase in export duty for Iron Ore | Positive | No increase in export duty of iron ore or imposition of any special duty will ensure that iron ore exports from India remain competitive | SESA IN | | | |
| 4% increase in excise duty on Viscose Staple Fibre | Negative | No impact, will be passed on as it is Modvatable. | | | | |
| **Consumer discretionary** | | | | | | |
| Increase in import duty of gold offset by decrease in excise duty of branded jewellery | Unexpected | Cost of input would increase but that would be offset by decrease in excise duty on finished product. Impact likely to be limited as not all jewellery sold by jewellery retailers is classified as branded due to the absence of printed logo/ brand names on jewellery | Branded jewellery players | 1−2% | | |
| **FMCG** | | | | | | |
| No direct moves | | | | | | |
| Focus on growth in agriculture sector, farm loan interest subsidies, increased allocation under rural employment guarantee scheme and minor cut in direct tax rates | In line with expectations | Indirect benefits for income levels − primarily in rural areas | ITC,MRCO | Positive bias over a long-term time frame | | |
| No hike in cigarette excise duty | Contrary to expectations of a tax hike | A lack of tax hikes would ensure that the recent price hikes would flow straight down to the bottom line | ITC | 6−7% | | |
| Fringe benefit tax withdrawn | Broadly in line with expectations | Sales promotion would now be exempt from fringe benefit tax | ITC, MRCO | 0.5−1.0% | | |
| MAT increased from 10% to 15% | Unexpected | The cash component of taxes paid would go up. Accounting taxes would not change materially | MRCO | Less than 1% | | |
| **Infrastructure** | | | | | | |
| IIFCL (India Infrastructure Finance Company Ltd), which would re-finance banks for loans extended to the infrastructure sector, would get more flexibility to extend debt to the projects. IIFCL would take over debt in 3−5 years time. | positive | This would allow banks to lend to infra sector without being too concerned on asset-liability mismatch. | Entire infra space | | | |
| 23% increase in National Highway Development Programme (NHDP) | positive | Investment in roads sector would get further boost | IVRC IN, NJCC IN | | | |
| 87% increase in Urban Infra (JNNURM) | positive | Primarily water and urban transport sub-sectors to benefit | PEC IN, HCC IN | | | |
| 160% increase in T&D reform programme (APDRP-II) | positive | Initial impact only on first phase of APDRP-II which entails controlling T&D losses | AURFI IN | | | |
| 75% increase in accelerated irrigation programme budget | positive | Irrigation projects to get a boost | IVRC IN | | | |
| Government has allowed weighted deduction of 150% of R&D spend for all manufactured products rather than earlier permitted list of drugs, pharma, | positive | BHEL would spend close to Rs9bn on R&D in FY10; actual spend in FY09 was Rs6.5bn. The enhanced R&D deduction norm, would add Rs1.5bn to net profit | BHEL IN | | | |

**Fig 3 Sectoral impact of budget**

| Event | Vs Expectation | Impact | Companies Affected | | | |
|---|---|---|---|---|---|---|
| | | | Positively | | Negatively | |
| | | | Bloomberg Code | Impact on Earnings | Bloomberg Code | Impact on Earnings |
| electronic equipment, computers, telecommunications, and chemicals. | | in FY10 which is Rs3.1/share | | | | |
| **IT,Telecom& Media** | | | | | | |
| MAT rate increase from 10% to 15% | Negative | MAT rate increase to 16.99% from 15.33% (effective), which is NEGATIVE for Telecom and IT services companies, who currently pay MAT | | | TCS IN, HCLT IN, IDEA IN, SPCM IN, MTNL IN | No impact on EPS but negative impact on cash flows due to higher tax rate payable on book profits |
| 5% customs duty introduced on set top boxes | Negative | 5% customs duty introduced on set top boxes, which is negative for digital broadcast platforms, DTH, Digital Cable and IP TV | | | DITV IN, WWIL IN | Marginal impact on EPS given that STB subsidy is a large cost item, and the higher cost of STB will likely not be passed onto customers |
| Fringe benefit tax (FBT) has been abolished | Marginal positive | FBT on ESOPs was being already passed through to employees. This is positive for only Tech Mahindra's and Hexaware's top-management, which has large number of outstanding ESOPs. Otherwise, little impact on earnings for other key companies in the sector | | | | |
| Extension of STPI sunset clause by another year | Neutral | Upgrade in FY3/11E EPS across the IT services sector. Mid-caps (6−8% upgrade) benefit more than top-tier names (3−5%). This was expected and hence is not a positive surprise | TCS IN, HCLT IN | 3−8% depending on the size of the company (smaller companies benefit more) | | |
| Increase in Standard Deduction to lead to higher income of Rs1,000 per annum | Positive | Broader personal tax rate cuts and a higher standard deduction will put more money in the hands of consumers. This, along with the broader thrust on agriculture will likely lead to higher disposable income in the hands of consumers, which may push up wireless ARPU by 1−1.5% | BHARTI IN, IDEA IN | ~1% | | |
| **Oil & Gas** | | | | | | |
| Setting-up of national gas pipeline grid/highway | positive | Both gas upstream and pipeline transmission companies shall benefit from enhanced connectivity and hence greater demand | GAIL IN, GUJS IN, RIL IN, ONGC IN | | | |
| Central support for Assam Gas cracker | positive | Uncertainty towards viability of this project may be lifted | GAIL IN | | | |
| Plan to consider a sustainable system for pricing petroleum products will be taken-up separately | negative | This re-affirms government's oil sector reforms, but pre-budget stocks such as ONGC & GAIL had run-up | | | ONGC IN, GAIL IN, BPCL IN, | |

## Fig 3 Sectoral impact of budget

| Event | Vs Expectation | Impact | Companies Affected | | | |
|---|---|---|---|---|---|---|
| | | | Positively | | Negatively | |
| | | | Bloomberg Code | Impact on Earnings | Bloomberg Code | Impact on Earnings |
| | | 8−10% on expectations of this materialising in the budget | | | IOCL IN, HPCL IN | |
| All pipeline infrastructure capex shall be tax-free | positive | Enhances viability by reducing capital cost of oil & gas pipeline transmission infrastructure. | GAIL IN, GUJS IN, BPCL IN | | | |
| Increase in Minimum Alternate Tax (MAT) from 10% to 15% | negative | ~5% reduction in RIL's earnings as tax rate is typically at MAT. Cairn's earnings would be hurt in the first couple of years of Rajasthan oil production start-up | | | RIL IN, CAIR IN | |
| Mineral oil definition amended to include gas for 7-year tax holiday exemption for blocks to be awarded under NELP VIII | positive | This will enhance bidding interest in NELP VIII. It is still unclear whether this will apply to earlier NELPs also. | RIL IN, ONGC IN, CAIR IN | | | |
| 4% excise duty re-imposed on cotton | positive | Price difference between substitute fibre, polyester would narrow enhancing demand of polyesters | RIL IN | | | |
| **Pharma** | | | | | | |
| No mention of raising weighted deduction benefit of 150% on R&D expenditure. | Industry has been raising voice for extending the deduction for another 5 years (ie, up to March 2017) and also increasing it to 200%. It would have been a positive but since not much hope was build around it we would consider it a non-event | Neutral | Na | na | na | na |
| Excise duty left unchanged at 4% for drugs and pharmaceutical products falling under Chapter 30 | Widely expected − status quo maintained | Neutral | na | na | na | na |
| **Pipe Producers** | | | | | | |
| Setting-up of national gas pipeline grid/highway | positive | Major boost for welded pipe demand | WGS IN, JSAW IN, PSLL IN | | | |
| All pipeline infrastructure capex shall be tax-free | positive | Enhances viability by reducing capital cost of pipeline transmission infrastructure, expect new pipeline projects to be implemented | WGS IN, JSAW IN, PSLL IN | | | |
| Accelerated Irrigation Benefit Programme (AIBP): Outlay increased by 75% | positive | This will spur demand for pipes for irrigation linked infrastructure | JSAW IN, PSLL IN, WGS IN | | | |
| Mineral oil definition amended to include gas for 7-year tax holiday exemption for blocks to be awarded under NELP VIII | positive | This will increase investments in India's exploratory blocks. Positive for Seamless pipe producers. | MHS IN, JSAW IN | | | |

## Fig 3 Sectoral impact of budget

| Event | Vs Expectation | Impact | Companies Affected | | | |
|---|---|---|---|---|---|---|
| | | | Positively | | Negatively | |
| | | | Bloomberg Code | Impact on Earnings | Bloomberg Code | Impact on Earnings |
| **Property** | | | | | | |
| No direct moves | | | | | | |
| Focus on urban development (eg, allocation under Urban Renewal Mission increased) | In line with expectations | Indirect benefits for development of infrastructure in urban areas, which help property demand | DLFU IN, UT IN, AKCL IN, IBREL IN, MLIFE IN, APIL IN | Positive bias over a long-term time frame | | |
| Retail | | | | | | |
| No impact | | | | | | |
| Lowering of promoter holding in phased manner (to 75%) | This move was proposed last year and has now been announced | Impact on all companies with promoter holding over 75%. Impact likely to be minimal as it is will be done in a phased manner | | | AKCL (87%), DLFU (79%) | |
| **Textiles** | | | | | | |
| Interest subvention for textiles sector extended to 2010 | Broadly in line with expectations | The export oriented textiles sector is the second largest generator of employment in India. The sector is facing serious pressures due to weak demand in the US and Europe and a volatile currency. Hence the concessions were expected to continue | ARVND | Positive 2-3% | | |

Source: Macquarie Research, July 2009

## Fig 4 Coverage universe

| Company Name | Recommendation | Bloomberg | TP (Rs) | Price (Rs) | Upside/ downside | Analyst |
|---|---|---|---|---|---|---|
| Aban Offshore | Underperform | ABAN IN | 315 | 809 | -61% | Jal Irani |
| ABB India | Underperform | ABB IN | 402 | 745 | -46% | Inderjeetsingh Bhatia |
| Associated Cements | Neutral | ACC IN | 652 | 724 | -10% | Rakesh Arora |
| Ambuja Cements | Outperform | ACEM IN | 96 | 87 | 10% | Rakesh Arora |
| Akruti City | Underperform | AKCL IN | 364 | 482 | -24% | Unmesh Sharma |
| Ashok Leyland | Underperform | AL IN | 12 | 29 | -59% | Abhishek Singhal |
| Ansal Properties & Infrastructure | Underperform | APIL IN | 38 | 54 | -29% | Unmesh Sharma |
| Arvind Mills | Underperform | ARVND IN | 12 | 26 | -54% | Unmesh Sharma |
| ICSA | Outperform | AURFI IN | 260 | 163 | 59% | Inderjeetsingh Bhatia |
| Axis Bank | Outperform | AXSB IN | 903 | 794 | 14% | Seshadri Sen |
| Bharti Airtel | Outperform | BHARTI IN | 975 | 783 | 25% | Shubham Majumder |
| Bharat Heavy Electricals | Outperform | BHEL IN | 2,312 | 2,101 | 10% | Inderjeetsingh Bhatia |
| Bajaj Auto | Underperform | BJAUT IN | 800 | 961 | -17% | Abhishek Singhal |
| Bank of Baroda | Outperform | BOB IN | 515 | 406 | 27% | Seshadri Sen |
| Bank of India | Outperform | BOI IN | 405 | 327 | 24% | Seshadri Sen |
| Bharat Petroleum | Outperform | BPCL IN | 523 | 445 | 18% | Jal Irani |
| Cairn India | Underperform | CAIR IN | 175 | 219 | -20% | Jal Irani |
| Cipla | Underperform | CIPLA IN | 200 | 258 | -22% | Abhishek Singhal |
| Crompton Greaves India | Outperform | CRG IN | 310 | 286 | 8% | Inderjeetsingh Bhatia |
| DLF | Neutral | DLFU IN | 322 | 310 | 4% | Unmesh Sharma |
| GAIL India | Outperform | GAIL IN | 382 | 315 | 21% | Jal Irani |
| Glaxosmithkline Pharmaceuticals | Outperform | GLXO IN | 1,760 | 1,268 | 39% | Abhishek Singhal |
| GMR Infrastructure | Underperform | GMRI IN | 104 | 133 | -22% | Inderjeetsingh Bhatia |
| Gujarat NRE Coke | Outperform | GNC IN | 87 | 40 | 116% | Rakesh Arora |
| Grasim Industries | Outperform | GRASIM IN | 2,599 | 2,298 | 13% | Rakesh Arora |
| HCL Technologies | Underperform | HCLT IN | 93 | 187 | -50% | Shubham Majumder |
| HDFC Ltd | Outperform | HDFC IN | 2,731 | 2,356 | 16% | Seshadri Sen |
| HDFC Bank | Neutral | HDFCB IN | 1,500 | 1,424 | 5% | Seshadri Sen |
| Hero Honda | Underperform | HH IN | 650 | 1,359 | -52% | Abhishek Singhal |
| Hindalco Industries | Underperform | HNDL IN | 45 | 78 | -42% | Rakesh Arora |
| Hindustan Petroleum | Outperform | HPCL IN | 417 | 318 | 31% | Jal Irani |
| Hindustan Zinc | Outperform | HZ IN | 781 | 563 | 39% | Rakesh Arora |
| Indiabulls Real Estate | Outperform | IBREL IN | 246 | 203 | 21% | Unmesh Sharma |
| ICICI Bank | Underperform | ICICIBC IN | 436 | 680 | -36% | Seshadri Sen |
| IDBI | Underperform | IDBI IN | 39 | 101 | -62% | Seshadri Sen |
| Idea Cellular | Underperform | IDEA IN | 45 | 69 | -35% | Shubham Majumder |
| Infrastructure Development Finance Company | Outperform | IDFC IN | 141 | 134 | 5% | Seshadri Sen |
| Indian Oil | Outperform | IOCL IN | 685 | 539 | 27% | Jal Irani |
| ITC | Outperform | ITC IN | 225 | 198 | 14% | Unmesh Sharma |
| IVRCL | Outperform | IVRC IN | 369 | 330 | 12% | Inderjeetsingh Bhatia |
| Jindal Steel and Power | Outperform | JSP IN | 2,823 | 2,498 | 13% | Rakesh Arora |
| JSW Steel | Outperform | JSTL IN | 826 | 575 | 44% | Rakesh Arora |
| Mahindra Lifespace Developers Ltd | Underperform | MLIFE IN | 209 | 262 | -20% | Unmesh Sharma |
| Marico | Outperform | MRCO IN | 85 | 72 | 18% | Unmesh Sharma |
| Mundra Port & Special Economic Zone | Outperform | MSEZ IN | 617 | 540 | 14% | Inderjeetsingh Bhatia |
| Maruti Suzuki India | Underperform | MSIL IN | 680 | 1,038 | -34% | Abhishek Singhal |
| MTNL | Underperform | MTNL IN | 51 | 96 | -47% | Shubham Majumder |
| National Aluminium Company | Underperform | NACL IN | 120 | 285 | -58% | Rakesh Arora |
| Nagarjuna Construction | Underperform | NJCC IN | 121 | 130 | -7% | Inderjeetsingh Bhatia |
| ONGC | Underperform | ONGC IN | 756 | 1,070 | -29% | Jal Irani |
| Patel Engineering Company | Neutral | PEC IN | 445 | 431 | 3% | Inderjeetsingh Bhatia |
| Petronet LNG | Underperform | PLNG IN | 35 | 66 | -47% | Jal Irani |
| Punjab National Bank | Underperform | PNB IN | 362 | 641 | -44% | Seshadri Sen |
| Power Finance Corp | Neutral | POWF IN | 200 | 195 | 3% | Seshadri Sen |
| Punj Lloyd | Underperform | PUNJ IN | 142 | 199 | -29% | Inderjeetsingh Bhatia |
| Ranbaxy Laboratories | Underperform | RBXY IN | 140 | 262 | -46% | Abhishek Singhal |
| Reliance Industries | Outperform | RIL IN | 2,405 | 1,893 | 27% | Jal Irani |
| Rolta India | Outperform | RLTA IN | 435 | 117 | 271% | Shubham Majumder |
| Reliance Petroleum | Underperform | RPET IN | 73 | 119 | -39% | Jal Irani |
| Steel Authority of India | Underperform | SAIL IN | 120 | 151 | -21% | Rakesh Arora |
| State Bank of India | Underperform | SBIN IN | 900 | 1,654 | -46% | Seshadri Sen |
| Shopper's Stop | Underperform | SHOP IN | 65 | 147 | -56% | Unmesh Sharma |
| Siemens India | Underperform | SIEM IN | 161 | 458 | -65% | Inderjeetsingh Bhatia |
| Syndicate Bank | Underperform | SNDB IN | 41 | 69 | -40% | Seshadri Sen |
| Sterlite Industries | Outperform | STLT IN | 862 | 589 | 46% | Rakesh Arora |
| Sun Pharmaceuticals | Outperform | SUNP IN | 1,410 | 1,127 | 25% | Abhishek Singhal |
| Tata Steel | Outperform | TATA IN | 584 | 397 | 47% | Rakesh Arora |
| Tata Communications | Underperform | TCOM IN | 315 | 468 | -33% | Shubham Majumder |
| Tata Consultancy Services | Outperform | TCS IN | 675 | 381 | 77% | Shubham Majumder |
| Tata Motors | Underperform | TTMT IN | 120 | 283 | -58% | Abhishek Singhal |
| Unitech Limited | Outperform | UT IN | 95 | 76 | 25% | Unmesh Sharma |
| Vijaya Bank | Underperform | VJYBK IN | 21 | 42 | -50% | Seshadri Sen |
| Zee Entertainment | Underperform | Z IN | 90 | 171 | -47% | Shubham Majumder |
| Zee News | Outperform | ZEEN IN | 42 | 39 | 8% | Shubham Majumder |

Source: Macquarie Research, July 2009

### Fig 5 Non-rated stocks mentioned in the note

| Stock | Ticker | Price (Rs) |
|---|---|---|
| Gujarat State Petronet | GUJS | 50 |
| Hindustan Construction Ltd | HCC | 103 |
| Jindal Saw | JSAW | 378 |
| Maharashtra Seamless | MHS | 255 |
| Mahindra & Mahindra | MM | 712 |
| PSL Limited | PSLL | 115 |
| Sesa Goa | SESA | 180 |
| Spice Communications | SPCM | 63 |
| Welspun Gujarat | WGS | 185 |

Source: Bloomberg, July 2009

## Important disclosures:

### Recommendation definitions

**Macquarie - Australia/New Zealand**
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

**Macquarie – Asia/Europe**
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

**Macquarie First South - South Africa**
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

**Macquarie - Canada**
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

**Macquarie - USA**
Outperform (Buy) – return >5% in excess of benchmark return (Russell 3000)
Neutral (Hold) – return within 5% of benchmark return (Russell 3000)
Underperform (Sell)– return >5% below benchmark return (Russell 3000)

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

### Volatility index definition*

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ/Canada stocks only

### Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa*
**ROA** = adjusted ebit / average total assets
**ROA Banks/Insurance** = adjusted net profit /average total assets
**ROE** = adjusted net profit / average shareholders funds
**Gross cashflow** = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

### Recommendation proportions – For quarter ending 30 June 2009

| | AU/NZ | Asia | RSA | USA | CA | EUR |
|---|---|---|---|---|---|---|
| Outperform | 40.38% | 48.53% | 40.00% | 44.02% | 57.42% | 40.20% |
| Neutral | 39.25% | 17.08% | 45.00% | 37.45% | 32.90% | 39.21% |
| Underperform | 20.38% | 34.40% | 15.00% | 18.53% | 9.68% | 20.59% |

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# Macquarie Research
# Equities

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| Alex Pomento (Philippines) | (632) 857 0899 |
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| Daniel Chang (Taiwan) | (8862) 2734 7516 |
| Alastair Macdonald (Thailand) | (662) 694 7741 |

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## Sales

### Regional Heads of Sales

| | |
|---|---|
| Giles Heyring (ASEAN) | (65) 6231 2888 |
| Peter Slater (Boston) | (1 617) 598 2502 |
| Thomas Renz (Geneva) | (41) 22 818 7712 |
| Ajay Bhatia (India) | (9122) 6653 3200 |
| Andrew Mouat (India) | (9122) 6653 3200 |
| Verdi Budiman (Indonesia) | (6221) 2598 8310 |
| Jason Lee (Malaysia) | (603) 2059 8888 |
| Gino C Rojas (Philippines) | (632) 857 0761 |
| Greg Norton-Kidd (New York) | (1 212) 231 2527 |
| Luke Sullivan (New York) | (1 212) 231 2507 |
| Scot Mackie (New York) | (1 212) 231 2848 |
| Sheila Schroeder (San Francisco) | (1 415) 835 1235 |
| John Sim (Singapore) | (65) 6231 2888 |

### Regional Heads of Sales cont'd

| | |
|---|---|
| Angus Kent (Thailand) | (662) 694 7601 |
| Michael Newman (Tokyo) | (813) 3512 7920 |
| Charles Nelson (UK/Europe) | (44) 20 3037 4832 |
| Rob Fabbro (UK/Europe) | (44) 20 3037 4865 |
| Nick Ainsworth (Generalist) | (852) 3922 2010 |

### Sales Trading

| | |
|---|---|
| Adam Zaki (Asia) | (852) 3922 2002 |
| Mike Keen (Europe) | (44) 20 3037 4905 |
| Mona Lee (Hong Kong) | (852) 3922 2085 |
| Brendan Rake (India) | (9122) 6653 3204 |
| Stanley Dunda (Indonesia) | (6221) 515 1555 |
| Mario Argyrides (Korea) | (822) 3705 8610 |

### Sales Trading cont'd

| | |
|---|---|
| Edward Robinson (London) | (44) 20 3037 4902 |
| Thomas Chin (Malaysia) | (603) 2059 8888 |
| Robert Risman (New York) | (1 212) 231 2555 |
| Matthew Ryan (Singapore) | (65) 6231 2888 |
| Isaac Huang (Taiwan) | (8862) 2734 7582 |
| Jon Omori (Tokyo) | (813) 3512 7838 |

### Alternative Strategies

| | |
|---|---|
| Convertibles - Roland Sharman | (852) 3922 2095 |
| Depository Receipts - Robert Ansell | (852)3922 2094 |
| Derivatives - Wayne Edelist | (852) 3922 2134 |
| Futures - Tim Smith | (852) 3922 2113 |
| Structured Products - Andrew Terlich | (852) 3922 2013 |