Exclusive Union Budget 2013 Impact Report

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Preface

Whether justified or not, Union Budgets have always generated excitement in India. This time around though, the excitement was more than usual and for two reasons. First, it was to be presented by a man with a reputation for big bang budgets. And secondly, it was to be the last budget before the next general elections. And thus people were keen to know how populist it could possibly be? Especially against the backdrop of stubbornly high inflation and bloated Government finances.

The verdict is out and Mr P Chidambaram has chosen to play very safe we believe. There certainly isn't any big bang announcements and only minor tweaking here and there. The good news though is that the **FM has also managed to keep the populist in him under strict check.** In other words, there will be no more fiscal profligacy and fiscal consolidation will be doggedly pursued.

However, committing to fiscal prudence is one thing. And sticking to the target entirely another. Thus, questions have been raised about how exactly the FM and his team would manage to bring down the deficit to below 5% in the next fiscal? A valid question indeed we believe. **For while the expenditure has been raised substantially, very little has been done by way of increasing revenues.** The optimists in the markets though are willing to give the minister a chance. They contend that whatever incentives have been given by him will help in pushing economic growth further and thus, help him meet his fiscal targets.

Warm regards,
Team Equitymaster

Key sector impact of the Budget

Autos

- The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) will be continued in the 12th Plan. The Budget has provided Rs 148.7 bn for JNNURM. Out of this, a significant portion will be used to support the purchase of up to 10,000 buses especially by the hill States. This is a positive for companies such as Tata Motors and Ashok Leyland which are leading players in the bus space and especially in an environment where volumes of MHCVs have been declining.

- **The government's stress on the road sector will also augur well for the auto sector from a long term perspective**. The Government has decided to constitute a regulatory authority for the road sector. Bottlenecks that have been stalling road projects will be addressed and 3,000 kms of road projects in Gujarat, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh will be awarded in the first six months of FY14.

- The Budget proposes to increase the excise duty on SUVs from 27% to 30%. However, the increase will not apply to SUVs registered as taxis. This is a negative for players such as Mahindra & Mahindra (M&M), Tata Motors and Maruti Suzuki, which are strong players in the overall UV space. It must be noted that at a time when most segments in the auto industry were under pressure, utility vehicles (UVs) including SUVs grew at a very healthy pace in the current fiscal.

Banking

- The target for agricultural credit which is a major driver of agricultural production is expected to increase to Rs 7 trillion in FY14 from Rs 5.75 trillion in FY13. The interest subvention scheme for short-term crop loans is to be continued and a farmer repaying the loan on time will be able to get credit at 4% p.a.

- Before the end of FY13, the Finance Ministry shall provide Rs 125.2 bn as an additional capital infusion for 13 PSU banks. This is set to increase to Rs 140 bn in FY14. The government is committed that these banks will meet Basel III norms as and when they come to force in a phased manner. However, **PSU banks have been seeing major asset quality stresses and have written off a number of non-performing assets (NPAs), thus eroding capital. Taxpayer money is thus being used to fund the NPAs of these banks** especially accounts like Kingfisher Airlines. We believe that this constant recapitalization of PSU banks may just be a case of throwing good money after bad.

- The Finance Minister also proposed to set up India's first Women's Bank which will be a public sector bank. Rs 10 bn will be granted by the government as initial capital and necessary approvals, including the banking licence is expected to be set in place by October, 2013. While we appreciate the FMs efforts on gender issues, we don't believe that such a bank has anything new to offer in India's crowded banking space. In consultation with RBI, the finance minister proposes to provide Rs 60 bn to the Rural Housing Fund in 2013-14. The Rural Housing Fund set up through the National Housing Bank is used to refinance lending institutions, including Regional Rural Banks, that extend loans for rural housing.
- A fund for urban housing is proposed to be set up in order to mitigate the shortage of houses in urban areas. The finance ministry proposes to ask National Housing Bank to set up the Urban Housing Fund and, in consultation with RBI, and proposes to provide Rs 20 bn to the Fund in 2013-14.
- Banks will be permitted to act as insurance brokers so that the entire network of bank branches will be utilized to increase insurance penetration, which is relatively low in India. Banking correspondents will also be allowed to sell micro-insurance products.

Engineering

- In order to improve the availability of power in the Leh-Kargil region, a transmission system from Srinagar to Leh is expected to be constructed at the cost of Rs 18.4 bn. This will improve connectivity in the northern region.

FMCG, Foods & Tobacco

- The specific excise duty on cigarettes has been increased by about 18% with similar increases proposed on cigars and cigarillos. While market leader ITC may be able to pass on the higher burden, companies like Godfrey Phillips and VST Industries reeling under falling off take may be have to take a hit on margins.
- The much-anticipated **Goods and Services Tax (GST) which was expected to provide a level playing field to the FMCG industry and boost its output has been delayed yet again** for want of Constitutional Amendment and draft bill on GST. The Finance Minister has taken the first step by setting aside a sum of Rs 90 bn towards the first installment of the balance of Central Sales Tax (CST) compensation.

Infrastructure & Real Estate

- 3,000 kms of road projects in Gujarat, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh will be awarded in the first six months of 2013-14.
- The FM proposed to constitute a regulatory authority to address the many concerns faced by the road construction sector.
- Measures taken to increase investment in infrastructure, including encouragement of infrastructure debt funds, credit enhancements to infra companies, doubling the limit of issuing tax infra free bonds to Rs 50,000 crores, amongst others.
- TDS of 1% when there is transfer of immovable property for a consideration exceeding Rs 50 lacs.
- Additional deduction of interest to the tune of Rs 1 lac for a first time home buyer who is taking a loan up to Rs 25 lacs. This will give a fillip to the brick, cement and steel sectors and provide employment to construction laborers.

Metals and Mining Sector

- India is facing a coal shortage problem for some time now. The Finance Minister has acknowledged this in his budget speech. Coal imports during the period April-December, 2012 have crossed 100 million tonnes (mt). It is estimated that imports will rise to 185 mt in 2016-17. If the coal requirements of the existing power plants and the power plants that will come into operation by March 31, 2015 are taken into account, there is no alternative except to import coal and adopt a policy of blending and pooled pricing. The Finance Minister has said that one of the ways to increase domestic coal production was to devise a PPP policy framework, with Coal India as one of the partners.

- The government has also introduced a 4% excise duty on silver manufactured from smelting zinc or lead, to bring the rate on par with the excise duty applicable to silver obtained from copper ores and concentrates. This could be negative for players like Hindustan Zinc. But will not have much impact on the overall mining sector.

Oil & Gas sector

- Proposal to move from profit sharing to revenue sharing for oil and gas blocks/contracts. Under the current system, the oil firms first recover their costs from sales of oil and gas and then share profits with the Government. Such practice promotes cost inflation or 'front lining' of the costs to delay the distribution of profits by oil firms to the Government. This has led to delays in decision-making on exploration and development investments of the Contractor.

  With the proposed move, the Government will start getting its share (in line with the level of oil and gas output and the price at which these would be sold) with the onset of production in the field irrespective of the cost recovery. It will also ensure immediate gains for the Government in case of a hydrocarbon price surge or significant field discoveries. Most importantly, the move will lead to greater synergy between the Government and oil companies, minimise government intervention and complications in accounting and promote Government's objective of promoting rapid exploration and development in the oil and gas sector.

- Review of Natural Gas Pricing - **The ridiculously low domestic gas prices have disincentivised further exploration and investment in domestic gas assets**. If gas prices are hiked, it will promote further investment in gas sector and will be positive for gas producing (such as Oil and Natural Gas Corporation Ltd) and distribution companies. That said, an increase in gas prices will adversely impact the financial prospects of end users, especially power and fertilizer sector that have been thriving on subsidized gas so far. The Government is likely to face stiff opposition against this proposal and barely a year before elections, execution risk is high.

- Policy on exploration of shale gas on the anvil - The move is positive as it will reduce dependence on oil and gas imports. At the same time, even if timely action is taken, the gestation period for such projects will be huge and benefits will take a long time to flow in.

- 5 million metric tonnes per annum (MMTPA) terminal in Dabhol to be fully operational in 2013-14

Pharma

- The 15% investment allowance on investment in plant and machinery above Rs 100 cr can benefit Pharma companies making such investments.

Power

- Proposed to extend the eligible date of power projects to avail benefit under section 80-IA till next year. This would be a positive for power generators.

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Telecom, Media and Information Technology

- The Finance Minister has proposed to increase the excise duty on high end mobile phones from 1% to 6%. For this purpose, the higher end mobile phones are those that cost more than Rs 2,000. This would have a major impact on the penetration levels in the country. As such the incremental penetration is more from the rural side. This segment typically goes for mobile phones in the lower cost categories which are untouched by this increased duty.
- Import duty on set top boxes has been hiked from 5% to 10% which will make imported set top boxes costlier thereby impacting the cost structure of DTH companies.
- The Budget has required that all post offices are required to move to core banking solutions. It has allocated Rs 5.3 bn towards this endeavor. This would attract IT companies having the requisite domain knowledge and product offering to serve the need.

Textile sector

- Continuing the Technology Upgradation Fund Scheme (TUFS) for the textile sector during the 12th Plan will mean subsidized interest rates for capital investments in the sector. The investment target for the plan period is Rs 1.5 trillion. The major focus would be on modernisation of the power-loom sector. We think this will have a meaningful impact only on the smaller players in the sector.
- Apparel and garment manufactures, which includes some of the major players in Indian textile sector, could benefit from the grant of up to Rs 100 m each for setting up Apparel Parks to house apparel manufacturing units.

What to expect?

The Finance Minister has decided to tap the 'super rich' category in the country to collect more taxes. This category, classified as those with taxable income above Rs 10 m, would be contributing more this year in order to fund the necessary expenditures. However, the relief for them is that the surcharge of 10% would be valid for only a year.

The interesting aspect in the Union Budget was the increase in overall expenditure. Despite the need to curb the growing fiscal deficit, the Finance Minister has increased the overall expenditure to Rs 16.65 trillion in 2013-2014 (higher by 11.7% YoY). A large part of this expenditure would continue to be made towards populist measures like increasing allocation to the NREGS scheme, PMGSY scheme for rural development, increasing allocation for minorities and scheduled castes, etc. **But given that this is the last Budget before the elections, a populist approach was expected.**

There were a lot of benefits announced for the women including a bank set up for them. There was also an allocation of funds towards improving safety for women. Such measures we feel would have limited use unless there is a reform in laws as well. **While gender bias and equality is a concern in the country, but it requires reforms in laws and not just allocation of funds.** Hopefully the government will enact these laws and ensure that the funds are utilized for the purpose for which they are intended.

The Budget was largely silent on measures to attract foreign direct investments (FDI) and increase exports so as to curtail deficits. The measures to boost investments in capital markets too were non committal. As expected the Budget has increased the scope of the Rajiv Gandhi Savings Scheme. It has also cut down the securities transaction tax in all of the categories. This would provide a boost to the capital markets. However, we do not think the measures will incentivize investors enough to invest in equities.

Overall the Budget was a lackluster one. All eyes were on the Finance Minister in the hope that Budget measures would look at reducing the fiscal deficit. Though he has pegged the fiscal deficit at 4.8% of GDP this year, he has also increased the expenditures. **These expenditures would be funded by additional surcharges on the 'super rich' category**. But having left the tax slabs unchanged, there would not be much increase from the tax revenues from the larger taxpaying community. There was also a lack of announcements on other major avenues through which the government plans to raise revenues this year.

While the fiscal deficit targets do look ambitious, they don't seem impossible to achieve as per us. A little help from rain gods and the global economy and we should be there we believe. As far as stock markets are concerned, we've never believed that budgets have the ability to alter the long term story of an economy. More so a budget as neutral as this one. **Hence one would be better off not focusing on it too much. Attention should instead be paid to the fundamentals of the company and the valuations** that it is trading at.

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