Union Budget FY11 Expectations

A tightrope walk

Pathik Gandotra / Sameer Bhise
Tel: +91 22 6622 2525 / 2574
Email: pathik@idfcsski.com / sameer@idfcsski.com

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FY10 – a report card

What they delivered

- ✓ Disinvestments have seen strong traction
- ✓ Higher public spending on infrastructure to prime growth
- ✓ Ambitious road projects seeing pickup in '*on-ground*' action
- ✓ Social spending continued though NREGS
- ✓ Clearance of Right to Education bill
- ✓ Draft Direct Tax Code presented by the Finance Ministry
- ✓ Initiation of the UID project

What they didn't

- ✓ Implementation of GST delayed
- ✓ Auction of 3G telecom licenses
- ✓ Reforms in Insurance FDI still awaited
- ✓ Setting up an 'Independent Evaluation Office' for flagship schemes catalysed by Planning Commission
- ✓ Strengthening of Right to Information Act
- ✓ No further steps on Women's Reservation Bill

Challenges faced during the year

- ✓ Monsoon shortfall led to skyrocketing food inflation (upto ~20%yoy)
- ✓ Low credit growth despite higher government spending remained a concern throughout the year; FY11 government borrowing could be an uphill task
- ✓ H1N1 flu exposed the lack of health infrastructure in the country
- ✓ Slip-up on diplomatic issues such as Sharm-al-Sheikh, climate change

FY11 budget – likely themes

Fiscal consolidation to gain focus; expect partial withdrawal of stimulus

Inflation management to be on government's top priority

Continued emphasis on public spending (esp. rural infra) to prime growth;

expect higher allocations for social programs

Formalization of PPP process on roads and other infrastructure;

Reforms for other sectors expected to be mixed bag

FY11 government borrowing – unlikely to decline materially and thus, remains a key monitorable

Time for stimulus withdrawal?

With growth back on track…

(% yoy growth)	FY10E*
Agriculture, Forestry & Fishing	(0.2)
Industry	8.2
Services	8.7
GDP at factor cost	**7.2**

**CSO estimates; Source: CSO*

…RBI has already acted on stimulus withdrawal…

Measure/ Facility	Potential release of liquidity (Rs bn)	Extent of liquidity withdrawn
CRR Reduction	1,600	360
Unwinding/Buyback/De-sequestering of MSS securities	1,555	
Open Market Operations (purchases)	801	
Term Repo Facility	600	600
Increase in Export Credit Refinance	266	266
Special Refinance Facility for SCBs (Non-RRBs)	385	385
Refinance Facility for SIDBI/NHB/EXIM Bank	160	
Liquidity Facility for NBFCs through SPV *	250	250
Total (1 to 8)	5,617	1861
Add: Statutory Liquidity Ratio (SLR) Reduction	400	400

Source: RBI, IDFC-SSKI Research

~40% of stimulus already withdrawn!!

…expect government to follow suit

	(Rs bn)
Reduction in excise duty and CENVAT	404
Sixth Pay Commission dues	400
Increase in Gross Budgetary Support	400
Increased allocation to NREGS	250
Agricultural Debt waiver & Debt Relief	157
Non-plan grants to states	100
Other measures	149
Total	1,860
(% of FY10 GDP)	3.2%

Source: RBI, IDFC-SSKI Research

Source: Budget documents, IDFC-SSKI Research

- ✓ We expect hike in excise duties (by 200bp) as well as service tax (to FY08 levels) as the government begins withdrawal from stimulus
- ✓ As fiscal consolidation takes centre-stage, we see slower growth in public expenditure (relative to FY10)
- ✓ We expect food (& other) subsidies to rise as govt. moves to check inflation

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Reforms and divestments – a mixed bag

Reforms - a lot more needed

- ✓ GST rollout remains under cloud
- ✓ Significant clarity needed on Direct Tax Code
- ✓ Need a strong political will for implementation of clear fuel pricing policy
- ✓ Increase in FDI in insurance & retail
- ✓ PFRDA and SBI (Amendment) and LIC (Amendment) bills still are pending

Divestments - strong intent

	Amount raised by government (Rs bn)
OIL	22
NHPC	20
NTPC	83
Total	**125**

Source: Company

- ✓ Government has shown strong action on the divestments front
- ✓ In FY10, government could realized ~Rs200bn from divestment proceeds (including lined up issues for NMDC, SJVNL,REC)
- ✓ FY11 divestment proceeds could also top ~Rs200bn

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Fiscal position – need for consolidation

Public finances* - a balancing act

(Rs bn)	2009-10BE	2010-11E	% yoy growth
Net tax revenues	4,742	5,736	21.0
Non-tax revenues	1,403	1,410	0.5
Non-debt capital receipts	53	59	11.3
Total receipts	**6,198**	**7,204**	**16.2**
Non-plan expenditure	6,957	7,930	14.0
Plan expenditure	3,251	3,253	0.1
Total expenditure	**10,208**	**11,183**	**9.6**
Fiscal Deficit	**4,010**	**3,979**	**(0.8)**
(% of GDP)	***6.5***	***5.7***	***NA***

**excluding realizations from 3G spectrum license sale & divestments*
Source: Budget documents, IDFC-SSKI Research

- ✓ While tax revenues are expected to pick up in FY11, we expect expenditure to remain at elevated levels
- ✓ We expect the government to utilize the buoyancy in tax revenues to allocate higher spends for social programmes
- ✓ Fiscal deficit would remain almost the same (absolute terms) at ~Rs4tn

- ✓ FY11 could witness a substantial rise in off-budget subsidies due to higher oil prices
- ✓ We expect overall subsidy bill to inch up to ~Rs1.29tn (~15% yoy increase) for FY11 led by rise in food subsidies

The subsidies bill

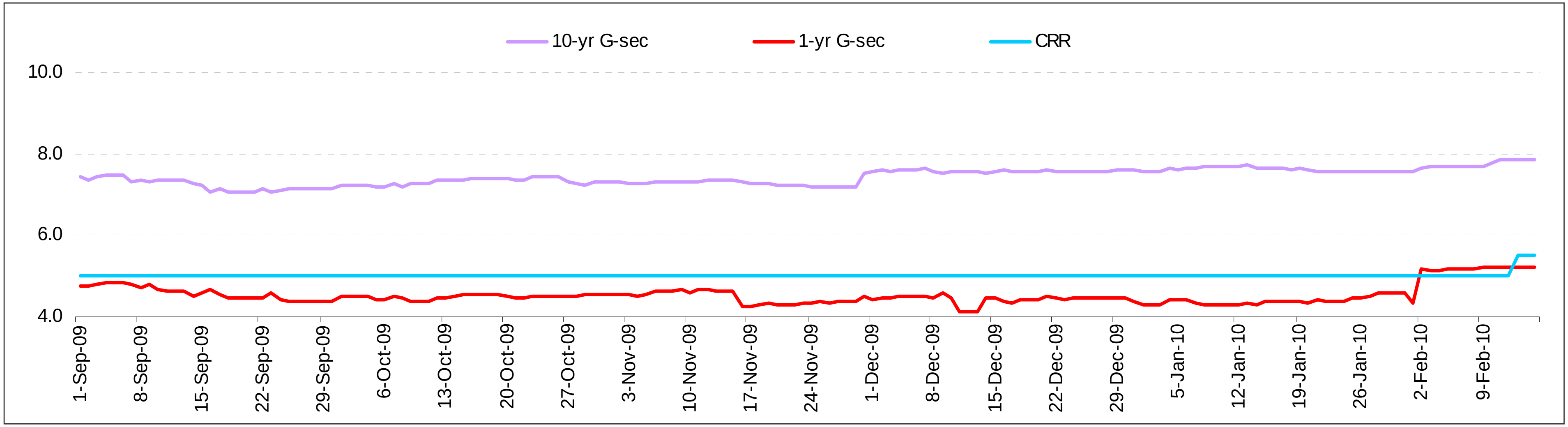
(Rs bn)	FY09RE	FY10BE
Food	436	525
Fertilizers	758	500
Petroleum	29	31
Interest Subsidies	41	26
Others	28	31
Total	**1,292**	**1,113**

Source: Budget documents, IDFC-SSKI Research

Expect fiscal deficit to remain at elevated levels; lower FY11 borrowing could be a key positive

Expect markets to remain nervous

Rising concerns on inflation and monetary tightening



Source: Bloomberg

Global cues and shape of global recovery

- ✓ Lack of clarity policy stimulus & shape of global recovery could be dampeners
- ✓ Negative newsflow regarding sovereign defaults in EU would keep upside capped in the near-term
- ✓ Further strengthening of the USD (against EM currencies and Euro) would lead to reversal of flows (especially through ETFs)

Earnings momentum to remain strong;
Maintain our long-term view (12-month Sensex target of 20,000)

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Winners and Losers

Sector	Impact	Comments
Agri/Agri-related	√	With Food Security being the priority and agri inflation the priority, expect increase in allocation towards agriculture, irrigation and agri infrastructure.
Engineering/Capital Goods	√	Thrust on schemes such as APDRP and RGGVY to continue and engineering companies to be key beneficiaries
Financials	√	Expect capitalization of PSU Banks to be passed during the budget. Hike in insurance FDI limit could be a key positive
Infrastructure	√	Focus on infrastructure spending to continue which will continue to drive order flows for construction companies and asset ownership opportunities for infrastructure developers.
Oil & Gas	√	Clarification on Section 80 IB deduction on Gas exploration for Pre NELP and NELP I-VII blocks
Real Estate	√	Affordable housing could be the theme for the budget
Automobiles	X	Excise duty on small cars, 2Ws and CVs likely to be hiked by 4%
Cement	X	Excise duty concessions announced in the stimulus packages to be removed
FMCG	X	Roll back of stimulus – excise duty increase from 8% to 10% to be marginally negative
Telecom	X	Increase of MAT rate from current 16.5% could see lower reported earnings while hike in customs duty to impact future capex plans of telcos

Budget expectations

Agri-related

Measure expected	Likely impact	Key stocks affected
With Food Security being the priority and agri inflation the priority, expect increase in allocation towards agriculture, irrigation and agri infrastructure. Increase in MIS coverage target from 1m to 1.3m	**Positive:** Higher allocation for MIS projects	Jain Irrigation

Automobiles

Measure expected	Likely impact	Key stocks affected
Excise duty on small cars, 2Ws and CVs likely to be hiked by 4%	Excise duty hike likely to be passed on to the end consumer. Negative for cars, 2Ws and CVs	Maruti, Tata Motors, Ashok Leyland, Hero Honda, Bajaj Auto, TVS Motors,
Excise duty on large cars likely to remain unchanged	Neutral for the UV space	Neutral for M&M

Budget expectations

Cement

Measure expected	Likely impact	Key stocks affected
Excise duty concessions announced in the stimulus packages to be removed	Expect cement companies to pass on a hike in excise duty to consumers; cement prices might be raised, but no impact seen on net realizations to companies	ACC, Ambuja, Grasim and Ultratech
Tax incentives on housing to continue	Will support residential real estate demand and hence, demand for cement	
Infrastructure focus to continue	Will be positive for cement from the demand perspective	

Construction

Measure expected	Likely impact	Key stocks affected
Focus on infrastructure spending to continue	Will continue to drive order flows for construction companies and asset ownership opportunities for infrastructure developers	
Easing of norms for infrastructure financing		
Tax rates unlikely to be changed; 80IA benefits for developers to continue	Profitability of infrastructure projects to be maintained	

Budget expectations

Consumer goods

Measure expected	Likely impact	Key stocks affected
Roll back of stimulus – excise duty increase from 8% to 10%	**Neutral:** Impact to be very marginal on margins as most of the FMCG companies have effective tax rate of <3% **Negative:** HUL to be negatively impacted with higher sales from non excise free units – effective tax rate for HUL is highest	HUL
5% increase in excise duty on cigarettes	**Neutral:** Excise rate increase of 5% would mean 2.5-3% increase in effective excise. Excise rate increase more than 5% may have negative impact on cigarettes volume	ITC
Roll back of stimulus – increase in service tax from 10% to 12%	**Negative:** Increase in advertising cost, which is currently at 13-14% of the revenues	HUL, Dabur, GCPL, Marico, Nestle, Colgate

Financials

Measure expected	Likely impact	Key stocks affected
Expect government to pass budget proposal for capitalization of PSU Banks (out of the proceeds of a ~USD$2bn loan from World Bank)	Positive for the PSU Banks that have significantly low Tier-I CRAR	Dena Bank, Syndicate Bank, OBC
Hike in FDI limits in insurance companies	Positive for companies with insurance subsidiaries enabling them to unlock value	All insurance holding companies

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Budget expectations

IT Services

Measure expected	Likely impact	Key stocks affected
Status quo on STPI sunset clause in FY11 to be maintained	Neutral for Indian IT Services companies	All IT Services stocks

Metals

Measure expected	Likely impact	Key stocks affected
Hike in export duty on iron ore lumps from 10%	Negative	Sesa Goa
Hike in export duty on iron ore fines from 5%	Negative	Sesa Goa
Hike in Ad valorem duty royalty in iron ore which is currently at 10%	Negative	Sesa Goa & NMDC
Increase in exise duties from current 8%	Negative	All steel companies across our universe

Budget expectations

Oil & gas, petrochemicals

Measure expected	Likely impact	Key stocks affected
Clarification on Section 80 IB deduction on Gas exploration for Pre NELP and NELP I-VII blocks	Upstream players who are engaged in exploration and or development of natural gas assets will see their significant up tick in project return	ONGC, RIL
Clarity on authorization and powers of PNGRB with respect to authorization of CGD licenses and newer pipelines	Players in the downstream segment of the gas segment	GAIL, GSPL, GGCL

Power equipment

Measure expected	Likely impact	Key stocks affected
Thrust on schemes such as APDRP and RGGVY to continue	Will support demand for power T&D equipment	Crompton, Emco, ABB
Roll back of excise duty concessions announced in the stimulus packages	Producers expected to pass on increased costs to users	BHEL, Crompton, ABB, Emco, Kalpataru, Jyoti, KEC

Power utilities

Measure expected	Likely impact	Key stocks affected
No changes in tax rates expected	Status quo	

Budget expectations

Real estate

Measure expected	Likely impact	Key stocks affected
Continuation of section 80IB of the Income Tax Act (providing tax relief to builders for construction of units less than 1000sq.ft built up area in metros)	- Developers would get tax reliefs and thereby would be encouraged to construct more middle class and affordable homes - Support Govt in reducing shortage of housing units (expected to be ~22.4msf as per the 10th plan estimate)	DLF, Unitech
Increase in exemption limit under Section 24 (Interest on home loan) to increase from present Rs0.15m to at least Rs0.2m	- Increased exemptions for interest payments to improve affordability of home buyers - Residential real estate likely to see demand momentum continuing	DLF, Unitech
- Tax Deduction at Source (TDS) on housing rental income to be brought down from 16.83% to 10% for individual homeowners - Flat slab of 15% to be considered on rental income for NRIs - Standard deduction of 30% towards maintenance to be increased to 40% for local residents and 50% for NRIs	-Demand and supply situation to improve as more and more incentives given and passed on to both licensor and licensee -NRI investments to increase (as lot of NRIs lock up their apartments for fear of higher taxation and an upfront TDS of more than 30%)	DLF, Unitech
Township development to be given priority by providing infrastructure status to Integrated Townships (exemption allowed under Section 80IA)	-Development momentum for townships would accelerate	DLF, Unitech

Budget expectations

Telecom

Measure expected	Likely impact	Key stocks affected
3G auctions update (Economic survey)	Clarity on the timeline and governments expectations from the auction process – better visibility	Bharti, Idea, RCOM, MTNL, TTLS, GTL Infrastructures
Increase of MAT rate from current 16.5%	Negatively impacts the reported earnings of all telecom service providers	Bharti, Idea, RCOM, MTNL, TTLS
Increase of customs duty on telecom equipments	Impacts the future capital expenditure plans	Bharti, Idea, RCOM, MTNL, TTLS
Utilisation of USO fund for expanding telecom network in rural areas	Enhances profitability of rural operations	Bharti, Idea, RCOM
Increased focus on social schemes like NREGAs, etc	Increase in rural demand for mobile services	Bharti, Idea, RCOM
Inclusion of tower companies into Sec 80 IA	Improves profitability of tower companies and thereby increases chances of value unlocking by telecom service providers	Bharti, Idea, RCOM