Emkay

Your success is our success

PRE-BUDGET EXPECTATIONS 2008-09


Expectations: Pre-budget 2008-09

- Balancing act on growth v/s social commitments to continue

- Since this budget is the last full budget (next budget most likely to be vote-on-account budget) of UPA, the FM may be tilted towards social commitments

- The tug of war between inflation and growth related measures will also continue

- We expect higher allocations to education, unemployment, healthcare to support the social commitments

- Infrastructure will again turn out to be the key thrust area and we expect further measures to be announced to boost investment in this area

- Budget allocation to agriculture related items may get intensified as agriculture is a weak component to the GDP. An increase in agri supply also eases out inflation

Expectations (cont.)

- Fiscal deficit could be projected at sub 3% level
- Govt's commitment towards achieving the 9% GDP rate will continue
- Further cut in certain custom duties in commodity sectors like metals, petrochem and chemicals is expected as this will ease out the supply side constraints on one hand and reduce the pressure on inflation on the other
- A cut in direct tax rates expected as the first 10 months' direct tax collections have been 40% above the target
- We expect a likely cut in corporate tax rate to 30%. This is despite the fact that we expect a populist budget
- The individual threshold limit might get revised upwards or alternatively there might be an investment based incentive scheme introduced to channelise savings for investment purposes

Expectations (cont.)

We have tried to give sectorwise wishlists. However, we feel that all may not get carried out. Hence, we have also mentioned what we think could possibly be a part of the budget amendments

Views on the capital market vis-à-vis budget

We believe that the Indian capital market has seen tremendous volatility in the last one month based on global cues, and there has not been any significant position built up on the expectation of budget. Hence, we believe that capital market would take this budget as a normal event unless there are some significant surprises (negative or positive) in the budget

Economy Scorecard

Rs bn	M9FY 07	M9FY08	%yoy chg	FY2007 RE	FY2008 BE	%yoy chg	M9FY07 as % of FY07	M9FY08 as % of FY08
RECEIPTS								
Revenue Receipt	2,809	3,556	26.6	4,233	4,864	14.9	66.4	73.1
Capital Receipt	80	410	416.0	60	432	621.8	133.0	95.1
Total Receipt	**2,883**	**3,967**	**37.3**	**4,293**	**5,296**	**23.4**	**67.3**	**74.9**
EXPENDITURE								
Non- Plan Expenditure (Exc Int)	2,722	3,371	23.8	4,089	4,754	16.3	66.6	70.9
Plan Expenditure	1,115	1,372	23.0	1,727	2,051	18.7	64.6	66.9
Total Expenditure	**3,837**	**4,743**	**23.6**	**5,816**	**6,805**	**17.0**	**66.0**	**69.7**
Revenue	3,477	3,949	13.6	5,068	5,579	10.1	68.6	70.8
Capital	360	794	120.4	749	1,226	63.8	48.1	64.7
Fiscal Surplus/(Deficit)	(949)	(776)	(18.2)	(1,523)	(1,509)	(0.9)	62.3	51.4
As % of GDP				(3.7)	(3.2)			
Revenue Surplus/(Deficit)	(668)	(392)	(41.3)	(834)	(715)	(14.3)	80	54.9
As % of GDP				(2.0)	(1.5)			
Primary Surplus/(Deficit)	(22)	342	-	(61)	80	-	36.2	424.8
As % of GDP				(0.1)	0.2			

Source: Controller General of Accounts

Sectoral Expectations

Automobiles

Components	Wish List	Our Expectations
2 & 3 Wheelers	Excise duty to be reduced from 16% to 8% Ensuring availability of finance and cheaper rate of interest	Excise Duty on 2 & 3 wheelers to be cut to 12%
Passenger Vehicles	Excise duty to be reduced to 16%. Current rates: Small cars– 16% Others – 24%	Excise duty to drop by 4% on both models. Small cars– 12% Others – 20%
Small car	Small car to be defined in relation to its length only, instead of length and engine	Classification of small cars to be made based on its length
Commercial Vehicles (Bus)	Excise duty to be reduced from 24% to 16%	Not expecting a reduction
Auto components	Removal of inverted duty structure on some components. Eg currently custom duty on natural rubber is twice that of import of tires	Simplified structure to ensure parity between the raw material imports and finished goods imports

Automobiles

Components	Wish List	Our Expectations
Auto components	Reduction in excise rates in view of rising FTAs with other nations	Benefits might not be limited only to auto and auto compo sector
Auto and Auto components	Maintain the current peak import duty and increase in import duties on specific products, where there is a threat from imports	Maintain the current peak import duty and increase in import duties on specific products
Auto and Auto components	Extension of weighted avg deduction upto 150% till 2012	Benefits might not be limited only to auto and auto compo sector

While the sector is going through a consolidation phase, we are positive on the sector. Based on the expected growth of GDP we believe it can record double digit CAGR growth over the next 5 years.

Banking & Fin Services

Components	Wish List	Our Expectations
Deposits	Give deposits raised for infrastructure lending S/88 status	We expect the deposits to be given
Tax	Allow infrastructure related financing to get tax exemption u/s10(23G)	We are not expecting any exemptions
Tax	Allow tax exemption for deposits for maturity 3-5 years, currently only 5 years deposits allowed the exemption	We are not expecting any exemptions

Capital Goods

Components	Wish List	Our Expectations
Power Equipment	Reducing CVD on imports of power equipment and other inputs from 16% to 8% and reduction of custom duty from 10% to 5%	CVD to be reduced from 16% to 8% Custom Duty reduced from 10% to 5%
Custom Duty	Complete exemption of custom duty in select cases- (1) transmission equipment attached to UMPP project (2) power equipment for UMPP project	Custom Duty to be completely exempted
Dividend Distribution Tax	Relief of DDT on distribution of profits	Infra SPV will be relieved of dividend distribution tax on distribution of profits
Cold Chains	Cold chains to attract infrastructure status to boost investment in cold chains	Not expected to attract infrastructure status

Capital Goods

Components	Wish List	Our Expectations
UMPP	ECB norms will be relaxed for UMPP projects	Likely to happen
Power	Lending to power sector to come under priority sector	Not to be included in priority sector
Power Equipment	To reduce excise duty on power equipment and other inputs from 16% to 8%	Lower duty will translate into lower set-up costs and subsequently lower tariffs
Others	Expect lower budgetary support to railways, urban infrastructure and power. Diversion of funds to priority areas like health, education and rural development	Unlikely

Capital Goods and Infrastructure (CGI) has been a major beneficiary of the current investment-led economic growth in India. The sector has grown at rate of 25% in sales and 80% in net profit, since the current uptrend in economic cycle in 2003. We believe that, enabling environment and accommodative policies will be aimed in the current budget to support the ongoing growth phase.

Cement

Components	Wish List	Our Expectations
Excise Duty	Abatement of 35%-55% on Excise Duty	Proposal to be passed only if benefit is passed on to final consumer.
Vat	To be reduced from 12.5% to 4%	Not expecting a reduction

The industry has been growing at a CAGR of 9-10% for last 3-4 years. Given the robust demand outlook on housing and massive on creation of infrastructure, the cement demand is expected to remain buoyant and grow at a CAGR of 10% over next two to three years.

Construction

Components	Wish List	Our Expectations
Tax	• Benefit under Section 80 IA to be restored • Extension of Section 80 IA for another ten years beyond 2009	We expect the budget will clear he Government's stand on the issue and give a detailed guidelines as to what activities are covered under the Section
Infrastructure Spending	Increase in allocation for varios infrastructure programme like NHDP, Bharat Nirmaan etc. by 30%+	Being the last budget before election, we expect increasing thrust on areas like urban infrastructure, rural roads, irrigation and power

Policy initiatives expectations:

➢More initiatives are expected to be announced regarding the utilization of forex reserves for infrastructure projects.

➢Investment in debt offerings by infrastructure companies should be brought under benefits for deduction under section 80C

➢Measures to encourage FDI in infrastructure projects

Fertiliser & Chemicals

Components	Wish List	Our Expectations
Policies Front	Positive change in policies to incentivise the efficient players Linking the fertiliser subsidies with import parity prices Ensure availability of gas Increase the budgetary provision of fertiliser subsidies and clear the previous dues	We expect positive changes in policies – - to benefit efficient players, - to attract new investment - to reduce the mounting subsidy bills
Duty Structure	Chemicals: Peak custom duty should remain unchanged Which at present is - Caprolactum 12.5%, Methanol 7.5%, Soda Ash 7.5%, Fertiliser : Custom duty to be removed from presently – Urea 5.0%, Di-ammonium Phosphate 5.0%	Chemicals: Peak custom duty to be reduced by 2.5%, viz. Caprolactum 10.0%, Methanol 5% Soda Ash 5.0% Fertiliser – Custom duty should be removed.

Demand for all the fertilizers (Urea, Phosphate and Potash) have grown significantly in last 2 years supported by good monsoon. As a result of growing imports and sharp rise in production cost, government expenditure on fertiliser subsidies is expected to go up to Rs 480 bn from Rs 240 bn in previous year. To reduce the subsidy burden and increase the domestic supplies fertiliser ministry is expected to come with new fertiliser policies.

Ferrous Metal

Components	Wish List	Our Expectations
Export Tax	Increase in Export Tax on Iron Ore. Current: Ferrous(<62%) – Rs50/t Ferrous(>62%) – Rs300/t	Increase in iron ore export tax to 8-10% on ad valorem basis
Excise Duty	Duty on steel products to reduce from 16% to 8%	Excise Duty to be reduced to 8%
Royalty Structure	Change in royalty structure on iron ore from fixed sum/t basis to ad valorem basis. Current royalty varies from Rs11-27/t	Change in the structure to come about. Likely to be in the range of 4-5% of the market price
Custom Duty	Reduction in custom duty on coke from 5% to 2%	Not expecting any reduction

Indian steel industry is witnessing an annual growth of around 10%. In FY07, average steel prices increased by 20-30% as compared to FY06. Spot iron ore prices have doubled in past one year and contract Iron ore prices are expected to increase by 50-70% in CY08. Some measures may be taken in the budget to check the iron ore exports and also excise duty on various steel products may be reduced.

FMCG

Components	Wish List	Our Expectations
Central excise on packaging material	To be reduced from 16% to 8%	Excise duty on packaging material will reduce to 8%
Vat rate on Cigarettes	To be reduced from 12.5% to 4%	Not expecting a reduction
Vat on Biscuits	To be reduced from 12.5% to 4% Only food product to be charged over 4%	Not expecting a reduction
Duties on vegetable oil, palm oil and crude derivatives	Reduction of effective duties from 18-19% to 15-16%	Effective duties reduced to 15-16% to soften input cost pressure
Customer Service Tax	To be reduced from 3% to 2%	Reduction in CST expected as withdrawal target of CST 2010-11 approaching
Excise duty on Soaps and Detergents	To be reduced from 16% to 8%	Not expecting a reduction

In the 9MFY2008, FMCG sector has grown at 12-15% rate. But, the industry is experiencing steep inflationary pressure leading to jump in product prices. Unless measures are taken in current budget to soften price pressures it will be difficult to stimulate and sustain demand.

IT – Software

Components	Wish List	Our Expectations
Tax	Extension of existing tax benefits under Section 10A and Section 10B	We believe that the government could consider extending the existing tax benefits for STPI's under Section 10 A and Section 10 B for a period of 3 years for smaller scale units which could help the medium size IT cos
Tax	Reduction in Dividend Distribution Tax (DDT) from 15% to 12.5%	We believe that the DDT will be reduced to 12.5% and this could encourage Indian IT companies to pay a higher dividend

Paper

Components	Wish List	Our Expectations
Duty Structure	Not to reduce the customs duty from current 10% Excise duty to be reduced from 12.8% to 10%	Custom Duty to reduce to 7.5% No changes expected in the Excise Duty

At present the paper industry size is at 8.2 million tonnes (including 1.6 million mt of Newsprint). Printing and writing paper industry which includes branded copier, industrial paper and specialty paper is expected to grow at a CAGR of 7.3% 6.6 mn mt to 9.4 mn mt by FY2011. Some varities of the paper like copier paper is expected to grow at a CAGR of 19% driven by increased corporate activities.

Pharma

Components	Wish List	Our Expectations
R&D	Weighted deduction on R&D (Section 80 IB) to be extended to 2012	Can be extended for another 5 years until 2012
R&D	Tax Incentives to be extended to Govt. recognized CRO centers	Expect to widen R&D definition to cover expenses on clinical trials and patent filings
R&D	Extend tax Benefit to standalone R&D entity	We don't expect any extended benefits
Income Tax	Exemption for 100% deductions in profits for EOU u/s 10B for income tax should be extended beyond FY09	We do not expect any exemptions
Excise Duty	To be reduced from 16% to 8%	Excise Duty to be cut to 8%
Fringe Benefit Tax	FBT on non employees needs to be reviewed	FBT to be removed
Currency appreciation	Special Incentives to protect export driven industry against rising rupees	Special incentives to be introduced
Others	Increase allocation on Healthcare infrastructure, HIV eradication, etc	Allocation to be increased

The Pharmaceutical Industry has been expanding at a CAGR of 13% over 2002-2007 and continuously beating the economy in terms of growth. India's growing importance in the global pharma industry because of rising opportunities in CRAMS space bound to ensure a CAGR of at least 16% over 2007-11. We expect that companies, which are well diversified in formulations, custom research and new drug discovery and development, will benefit most from the budget proposal.

Power

Components	Wish List	Our Expectations
Customs duty on fuels	Fuel Oils like furnace oil, LSHS from : 10% to 5% Non-coking coke & petroleum coke from: 5% to 2% Naptha & liquefied propane from: 5% to 2% Metallurgical coke with ash content <12%	Likely Unlikely Likely Likely
Income Tax	Sec 80-IA to be extended from FY11 to FY17	Extension of sec 80-IA (of Income Tax Act) from FY11 to FY17
Captive coal mining	To get infrastructure status and enjoy extended benefits	Likely to get the status and enjoy benefits on par with mega power projects
Power Plants	Sec 80-IA of Income Tax Act to cover plants less than 1,000MW	Plants less than 1,000MW not to be covered under Sec 80-IA

Of the 78,577MW power generation predicted in the 11th five year plan 68% has already been ordered. The 12th five year plan is looking for a capacity addition of 82,000MW. These numbers ensure robust growth in the industry and huger potentials for further upsides.

Pipe

Components	Wish List	Our Expectations
Water and Sanitation Projects	Planned outlay in water and sanitation projects to be raised further	Planned outlays are expected to hike further
Oil & Gas	More focus on investment in oil & gas exploration and production related activities	We expect more focus to be given in these areas
Excise Duty	Excise duty on HR coils to be reduced from 16% to 8% Excise duty exemption on water pipes to be extended to oil and gas pipes also	Not expecting any reduction. Exemption extended to oil and gas pipes also

As per various industry estimates, about USD 100 bn of the line pipe demand from both domestic as well as exports market is expected in the next five to seven years. Over 20,000 kms of oil & gas pipelines has already been announced by public and private oil & gas companies. We expect the industry outlook to remain positive on account of continuous investment made by public and private players in oil & gas E&P and transportation, water & sanitation projects, etc.

Real Estate

Components	Wish List	Our Expectations
Tax	100% Tax deduction enjoyed in development of residential units to be continued Sec 80IB also includes tax deduction from the slum rehabilitation projects Tax benefits on the interest and principal component for home loans to continue	Companies to continue getting the 100% tax deduction We expect continuation of the deduction for slum rehabilitation to continue We expect this tax benefit to continue

Telecom

Components	Wish List	Our Expectations
Duty	Reduction and simplification of duties to a single levy structure	Reduction in the levy structure

The telecommunication industry continues to remain strong and is subjected to grow with over 7million additional subscribers every month. Any reduction in the levy structure would be positive for the industry as the benefits would be passed on to the subscribers which would lead to an acceleration in subscriber/volume growth due to increased affordability.

The Team

Institutional Equities Team			
Anish Damania	Business Head	anish.damania@emkayshare.com	91-22-66121203
Research Team			
Ajay Parmar	Head Research	ajay.parmar@emkayshare.com	91-22-66121258
Ajit Motwani	Cement & Capital Goods	ajit.motwani@emkayshare.com	91-22-66121255
Amit Adesara	Logistics, Engines,Real Estate	amit.adesara@emkayshare.com	91-22-66121241
Chirag Shah	Auto, Auto Ancillaries	chirag.shah@emkayshare.com	91-22-66121252
Kashyap Jhaveri	Banks	kashyap.jhaveri@emkayshare.com	91-22-66121249
Manik Taneja	IT	manik.taneja@emkayshare.com	91-22-66121253
Manoj Garg	Pharma	manoj.garg@emkayshare.com	91-22-66121257
Mehul Mukati	Power & Power Equipment	mehul.mukati@emkayshare.com	91-22-66121250
Naveen Jain	Construction, Real Estate	naveen.jain@emkayshare.com	91-22-66121289
Pritesh Chheda, CFA	FMCG, Engineering, Mid -	pritesh.chheda@emkayshare.com	91-22-66121273
Rohan Gupta	Paper, Fertilisers, Real Estate	rohan.gupta@emkayshare.com	91-22-66121248
Sumit Modi	Telecom	sumit.modi@emkayshare.com	91-22-66121288
Vishal Chandak	Metals	vishal.chandak@emkayshare.com	91-22-66121251
Chirag Dhaifule	Research Associate	chirag.dhaifule@emkayshare.com	91-22-66121238
Chirag Khasgiwala	Research Associate	chirag.khasgiwala@emkayshare.com	91-22-66121254
Pradeep Agrawal	Research Associate	pradeep.agrawal@emkayshare.com	91-22-66121340
Prerna Jhavar	Research Associate	prerna.jhavar@emkayshare.com	91-22-66121337
Vani Chandna	Research Associate	vani.chandna@emkayshare.com	91-22-66121272
Meenal Bhagwat	Database Analyst	meenal.bhagwat@emkayshare.com	91-22-66121322