Run-up to Union Budget 2011: Low on expectations

- Amid rising concerns over the government's fiscal position and the sustained inflation pressures, the Union Budget for 2011-12 is likely to throw some light on the government's plans to address the core issues. However, given that elections are due in five states (of which four are ruled by the United Progressive Alliance), the focus may shift to spending in social sector schemes like the National Rural Employment Guarantee Act (NREGA), food security and right to education.
- From the perspective of investors, the key thing to watch would be the government's guidance on fiscal consolidation and the means to fill in the fiscal deficit despite the absence of one-time income like the income from the auction of third generation (3G) spectrum and the rising cost of energy (ie crude oil). Other pending issues relating to tax reforms, curtailment of subsidies etc are likely to be touched but the Street does not expect any path-breaking announcement or initiatives to deal with these issues in this budget. Given the low expectations the risk of negative surprises from the budget is limited.
- In terms of key changes on the taxation front, there could be a further rollback of the fiscal stimulus given during the 2008 crisis in the form of excise duty cut from 14% to 8% for certain segments. It was partially rolled back to 10% and could be revised up again in this coming budget. There is also a possibility of an increase in the service tax rate to 16% to shore up the revenues and make up for the expected reduction in custom duty on crude oil and petroleum products.

Social spending to gain prominence over other matters

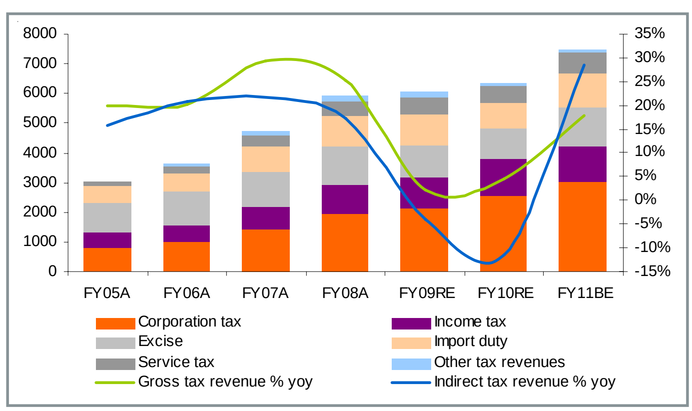
In view of the discontent in the masses due to spiralling inflation and election in five states, the budget spending may be inclined towards social sectors. Programmes like NREGA, right to education and food security bill would entail increased allocations. We believe there could be significant allocation for implementing the right to education and the proposed Food Security Act while more clarity will emerge on the coverage and implementation of these schemes. Going by the National Advisory Council's recommendations on providing guaranteed foodgrain supply, the food subsidy bill is expected to increase substantially from the existing Rs56,700 crore to around Rs1 lakh crore.

In addition, the government may take some necessary measures to maintain growth in the agriculture segment in order to ensure economic growth in FY2011. As observed by the Reserve Bank of India (RBI), the inflation rate has gained structural character; thus the focus on the agriculture segment would also take care of the food inflation. Further, the government is likely to announce measures to improve the credit facilities at reasonable rates, irrigation facilities and logistics to increase the productivity.

Fiscal deficit to be guided mostly by expenditure side

Unlike in FY2011, the government has lesser flexibility to raise resources in FY2012 as one-time revenue sources such as 3G and broadband auctions would not be available. Secondly, the expenditure in FY2012 is likely to be higher than that in FY2011 due to the increased outlay for the government's programmes and its rising subsidy burden driven by higher oil prices. The budgetary allocation for schemes like food security is likely to double while there could be a significant rise in expenses on NREGA schemes. The oil prices are unlikely to retract significantly and hence would add to the subsidy bill, thereby keeping the expenditure high.

Fiscal and revenue deficits



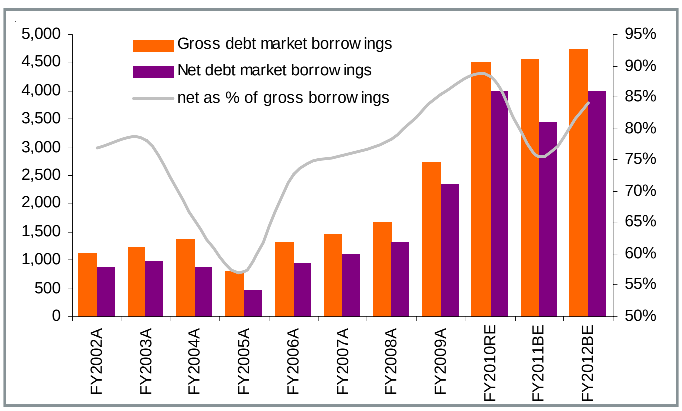
For Private Circulation only

Though the tax revenues have been on the rise, the gap between the government's revenues and expenditure would increase mainly led by higher spending. With rising crude oil prices and high inflation the government is unlikely to do away with subsidies which will weaken its fiscal position. However, the government can go selective and reframe the subsidy structure to streamline its expenses. We, therefore, believe the expenditure is the key to fiscal consolidation and would continue to threaten an increase in the fiscal deficit.

Borrowings to remain at higher levels

The government may announce higher borrowings in the budget to take care of the increase in its spending. In FY2011 its borrowing target (net) was reduced to Rs3.5 trillion due to the higher than expected collections from the 3G and broadband auctions. However, in FY2012 the net government borrowings are likely to be Rs4 trillion, which may keep the bond yields at higher levels and add to the liquidity pressures in the economy.

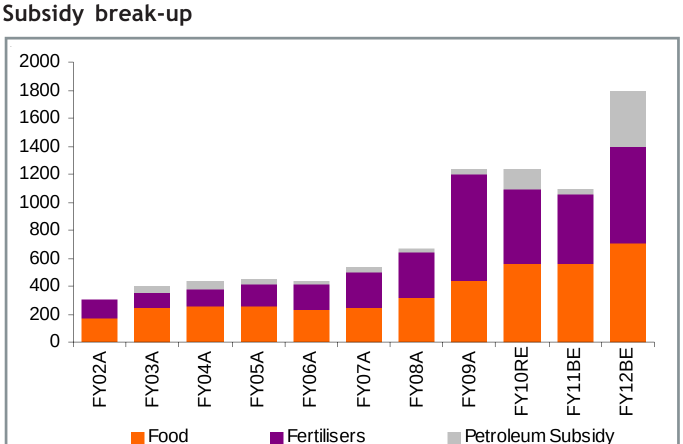
Government borrowings



Clarity on divestment policy

With limited scope to ramp up revenues in order to fund the fiscal deficit, the government would be dependent on the proceeds from divestments. Therefore, the government is expected to announce an aggressive disinvestment target as a few large public sector undertakings (PSUs) are likely to hit the market in FY2012. The budget may throw some light on the list of companies in which the government's stake is likely to be divested.

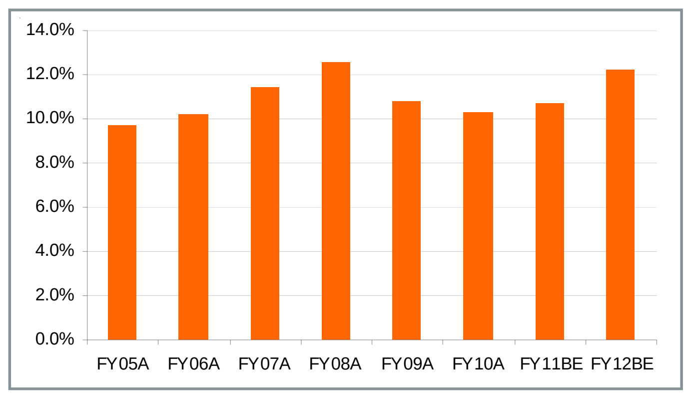
Subsidy break-up



Clarity on tax reforms

In the previous budget the government had touched upon the subject of tax reforms and given guidance on the implementation of the Goods and Services Tax (GST) and the Direct Tax Code (DTC). The government would be keen on moving ahead on tax issues like the GST and the DTC to increase the traction in the tax revenues as it seems the only way to achieve the fiscal targets. Although we do not expect any major announcement on the tax front, yet the budget could throw up some roadmap for the implementation of the GST and the DTC. The implementation of the GST is the key to increase the tax revenues and any step in that direction will increase the revenue visibility.

Tax revenues as % of GDP



Broadly, we do not expect any increase in the tax rates but some measures could be announced to expand the tax base.

Widening of the service tax net

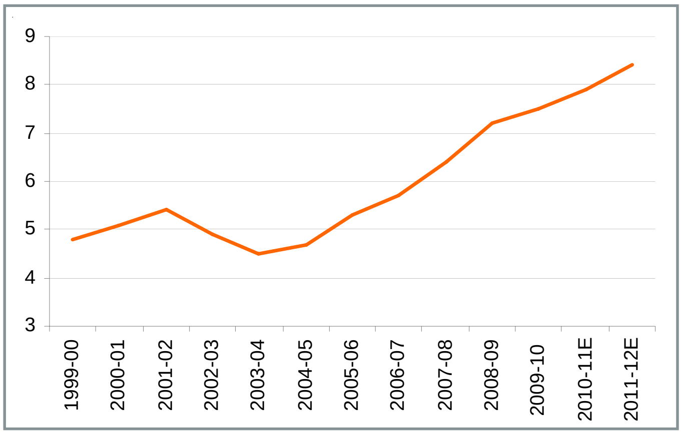
As per the service tax framework, more than hundred services come within its purview. This number is expected to increase in the coming budget through either the addition of new services or the expansion of the scope of the existing services. Certain welfare services such as health and education services coupled with legal services, postal services etc could be brought under the ambit of the service tax.

The Minimum Alternative Tax (MAT)—though there is expectation of an increase in the MAT rate from 18% currently to about 20%, we expect the rate to remain unchanged. This is due to the fact that the Software Technology Park of India (STPI) benefit is likely get over from FY2012 while the DTC will come into force in the same year.

Capex growth and supply augmentation

Notwithstanding the strong growth in the economy, concerns have been growing such as inflation, a steep rise in interest rates etc, which could threaten the demand for both investment and consumption. To address that there may be increased allocation for infrastructure development and social spending, benefitting the construction and consumer sectors. The government may come up with a suitable, legitimate model for promoting public-private joint ventures and boosting foreign direct investment (FDI) in the domains of infrastructure development and insurance.

Infrastructure spending as % of GDP



Governments accounts (Rs billion)

Particulars	FY10	FY11BE	FY11RE
Revenue receipt	**5773**	**6822**	**7904**
Tax (net)	4651	5341	5723
Non tax	1122	1481	2181
Capital receipts	**303**	**451**	**451**
Recovery of loans	43	51	51
Others	260	400	400
Total receipt	**6076**	**7273**	**8355**
Non-plan expenditure	**7064**	**7361**	**8161**
Non-plan rev expenditure	4037	3949	3949
Revenue	6419	6436	7236
Interest	2195	2487	2487
Additional subsidy	187	0	800
Capital	644	925	925
Plan expenditure	**3152**	**3731**	**3731**
Revenue	2644	3151	3151
Capital	508	580	580
Total expenditure	**10216**	**11092**	**11892**
Revenue	9064	9587	10387
Capital	1152	1505	1505
Fiscal surplus/(deficit)	(4,140)	(3,819)	(3,537)
as a % of nominal GDP	*-6.7*	*-5.5*	*-5.1*

Sectoral wish-list/expectations

Automobile

Sector outlook: Globally the automobile sector forms about 10% of a country's gross domestic product (GDP). During recession, all major economies of the world gave a boost to their automobile sector to meet their GDP growth objectives. Recently, macro headwinds such as rising interest rates and surging commodity and fuel prices have created a challenging growth environment for the domestic automobile sector. We do not expect any major roll-back of excise duty or curtailment of the incentives given to the automobile sector earlier.

Expected budget impact: **Negative**

Sector outlook: **Neutral**

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Excise duty	10% (on small cars, two-wheelers, commercial vehicles).	Retain the current excise duty structure.	Neutral	For industry as a whole.
Excise duty on utility vehicles (UVs)	22%+ Rs15,000.	Increase duty by 2% or additional duty by Rs5,000.	Negative	For UV manufacturers such as Mahindra and Mahindra (M&M), Tata Motors.
Excise duty on small diesel cars	10%	May recommend differential excise duty based on the Parikh Committee's recommendation.	Negative	For Tata Motors.
Rationalisation of customs duty on imported vehicles	110%	Bring down customs duty on imported vehicles.	Positive	For Bajaj Auto, Tata Motors and importers of luxury vehicles.
Lower excise duty on petrol/diesel	24%	Bring down excise duty selectively on diesel to limit impact of inflation.	Positive	To benefit Tata Motors, M&M.
Incentives for green cars	0% excise.	Likely to be extended.	Positive	M&M, Reva.
Correction in the inverted duty structure for imported rubber and rubber products	20% duty on import of natural rubber and 7% on finished rubber products.	Equate duty on import of natural rubber with that on import of finished rubber products (tyres).	Positive	Tyre manufacturers like Apollo Tyres, Ceat.
To retain research and development (R&D) benefits	200% weighted reduction.	Retain R&D benefits.	Positive	To benefit Hero Honda Motors, neutral for other automobile companies.
Increased allocation to NREGA	Rs41,000 crore.	Increase allocation.	Positive	To indirectly benefit M&M.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	EPS (Rs) FY12E	PE (x) FY11E	PE (x) FY12E	Reco
Bajaj Auto	1,318	1,545	90.5	103.0	14.6	12.8	Buy
M&M	650	756	47.8	52.4	13.6	12.4	Buy

Banking

Sector outlook: We maintain our neutral stance on the sector due to liquidity issues, margin pressures and provision expenses that would negatively affect the profits of banks. Though the non-performing asset (NPA) position is likely to stablise, the public sector banks (PSBs) will have to provide for pension liabilities while the private banks will face pressure from the rising employee cost. However, since bank stocks have corrected significantly, the comfort has increased on the valuation front. Our top picks from the sector are Axis Bank, Yes Bank, Bank of Baroda and Punjab National Bank (PNB).

Expected budget impact:
Neutral

Sector outlook:
Selectively Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Long-term infrastructure bonds with tax breaks	As of now, banks can raise five-year deposits, which are eligible for tax deduction under section 80C of the Income Tax Act.	Permission to float long-term infrastructure bonds with tax breaks like those offered by non-banking finance companies (NBFCs; IDFC, REC etc).	Positive	Unlike the NBFCs (IDFC, REC, IIFCL), if the banks are allowed to issue tax-free infrastructure bonds, it would help them to raise long-term resources for infrastructure financing.
Take-out financing	IIFCL has suggested that it will take out the loan after six years of financial closure and will take the loan on its books only if it is a standard asset.	Banks want loans to be taken out of their books at a mutually agreed period even if the same have turned into NPAs.	Positive	This would increase banks' participation in infrastructure projects and improve the asset-liability mismatches.
Government borrowings	The government is likely to borrow about Rs4.5 trillion in FY2011, though it will be cushioned by the collections from the 3G auctions and the proceeds from divestments.	The government's expenditure should be within limits as its spending may further aggravate the liquidity problem.	Negative	The net borrowings are likely to be higher, in view of the election in five states, lower repayments and unavailability of one-time revenues (like the 3G collections).

Top picks

Company	CMP (Rs)	Price target (Rs)	BV (Rs) FY11E	BV (Rs) FY12E	BV (Rs) FY13E	PE (x) FY11E	PE (x) FY12E	PE (x) FY13E	Reco
Axis Bank	1,296	1,590	462	546	647	2.8	2.4	2.0	Buy
Yes Bank	277	415	110	154	183	2.5	1.8	1.5	Buy
Bank of Baroda	908	998	449	556	688	2.0	1.6	1.3	Buy
PNB	1,101	1,472	625	766	921	1.8	1.4	1.2	Buy

Capital goods and engineering

Sector outlook: In view of the robust investment expected in the Indian infrastructure sector, particularly the power sector, the demand outlook for the capital goods sector remains bright. However, various infrastructural bottlenecks, political scams and organisational inertia have slowed down the pace of awarding of orders in recent times. Nonetheless, most of the companies have revenue visibility for more than two years in terms of their book-bill ratio. We also remain positive on the sector for its attractive valuations. However, concerns on Chinese competition would persist unless the government intervenes by withdrawing import incentives. Our top picks from the sector are Larsen and Toubro (L&T), Bharat Heavy Electricals Ltd (BHEL), Thermax and V-Guard Industries.

Expected budget impact:

Positive

Sector outlook:

Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Withdrawal of import duty exemption on power equipmentfor mega power projects	Import duty exempt under mega policy.	Mixed as boiler-turbine-generator (BTG) players are lobbying for the withdrawal while the private utilities are lobbying for retaining the clause.	Positive	Beneficial for BHEL, L&T, Thermax and BGR Energy Systems if implemented. However, the government would concentrate on fast completion of power projects, hence the withdrawal of the exemption looks unlikely.
Increase in excise duty	10%	Could be increased to 12%.	Negative	For all companies as it would further pressurise the margins.
Fund allocationfor the Accelerated Power Development and Reform Programme (APDRP) and Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY)	-	Emphasis on power transmission and distribution(T&D) sector should continue.	Positive	For T&D companies like ABB, Crompton Greaves, Areva, KEC International and Diamond Power Infrastructure.
Fund allocation and incentives for the renewable energy sector	-	More incentives to boost the renewable energy sector.	Positive	For renewable energy players like Suzlon, Shriram EPC and Moser Baer.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	EPS (Rs) FY12E	EPS (Rs) FY13E	PE (x) FY11E	PE (x) FY12E	PE (x) FY13E	Reco
L&T	1,661	1,955	73.8	91.0	108.0	22.5	18.3	15.4	Buy
BHEL	2,130	2,781	116.9	139.0	158.9	18.2	15.3	13.4	Buy
Thermax	641	909	32.4	42.0	48.9	19.8	15.3	13.1	Buy
V-Guard Ind	156	237	12.6	18.2	26.9	12.4	8.6	5.8	Buy

Cement

Sector outlook: Given the poor execution of infrastructure projects, the overall volume growth of the cement industry is unlikely to meet the guidance of 9% (anticipated by the large cement players) for FY2011 and will be in the range of 7-8%. However, the supply discipline followed by the manufacturers so far has resulted in a strong cement realisation in H2FY2011, particularly in the southern region. Going ahead, we believe a pick-up in the cement offtake could break the supply discipline and bring the prices under pressure. In addition, the key concerns remain an oversupply of cement due to capacity addition and cost pressure in terms of higher coal prices and increased freight cost because of an increase in fuel prices and the lead distance. Hence, we maintain our negative stance on the sector.

Expected budget impact:

Neutral

Sector outlook:

Negative

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Excise duty on cement	The excise duty on packaged cement is Rs290 per tonne where the maximum retail price (MRP) of cement is less than Rs190 per 50kg bag. On the other hand, where the MRP is greater than Rs190, the excise duty is 10%.	A) The industry expects abatement of the excise duty as it is charged on the MRP which implies double taxation. B) The industry expects a uniform excise duty slab.	Neutral	We believe it is unlikely to be implemented. Hence neutral for the sector as a whole.
VAT	Value-added tax (VAT) on cement and clinker is charged at 12.5%.	Industry expects it should come down to 4% to bring in line with other construction materials like steel.	Neutral	If implemented positive for the sector as it will bring down price of the cement. However, we believe it is unlikely to be implemented. Hence neutral for the sector as a whole.
Import duty on coal/pet coke/ gypsum	Import duty on coal/pet coke/ gypsum is 5%.	Industry expects it should come down to 0%.	Positive	Positive for companies that import coal such as UltraTech Cement, Binani Cement, Shree Cement, Ambuja Cement and JK Cement will be the key beneficiaries.

Education

Sector outlook: The government is focused on improving the literacy rate and the quality of education in the country. The spending on education is expected to rise 12-fold per household between 1995 and 2025 due to an increase in the income levels of the Indian middle class. However, the sector is un-organised with regional content and a large number of regional players are dependent on government spending. The quality of education in the rural areas remains poor. Though private players are entering the sector, the sector would still remain dependent on government spending. Any delay in government programmes to boost education and red-tapism could delay the growth of the sector.

Expected budget impact:
Positive

Sector outlook:
Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Allocation for education sector	Planned outlay towards general education was increased by 16% to Rs42,036 crore in budget for 2010-11.	Increase allocation.	Positive	Increased allocation would give impetus to education reforms. This would mean higher information and communication technology (ICT) spend and adoption of technology for education. Positive for Educomp Solutions, Everonn Education and NIIT.

Hotel

Sector outlook: The Indian hotel industry has recently witnessed a strong improvement in business fundamentals after the lull in FY2010. With a strong growth in foreign tourist arrivals and buoyancy in domestic tourism, we expect the growth momentum in the occupancies and average room rate to sustain in the coming quarters. The industry is seeking Infrastructure status for quick completion of the ongoing projects and loans at lower rates for its future capital expenditure (capex). We expect Indian Hotels Company to be the key beneficiary of the current improved business environment.

Expected budget impact:
Neutral

Sector outlook:
Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Section 80IA	-	Extend 80IA benefits to hotel industry.	Positive	All new hotel projects will be able to avail of the benefit of deduction of 100% with respect to profits and gains for a period of ten years.
Luxury tax	Luxury tax rates are different for different locations: Mumbai - 10%; Delhi - 12.5%; Bangalore - 12%; and Chennai - 12.5%.	The industry wants a drastic reduction in the luxury tax and a uniform rate of 5-6% at all-India level.	Positive	Positive for all the hotels (especially for the premium brands like Taj, Hiltons, Oberoi's, The Leela and Orchids).

Top picks

Company	CMP	Price		EPS (Rs)			PE (x)		Reco
	(Rs)	target (Rs)	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	
Indian Hotels	82	106	0.9	3.2	4.9	91.1	25.6	16.7	Hold

FMCG

Sector outlook: The Indian fast moving consumer goods (FMCG) sector with a market size of Rs130,000 crore is the fourth largest sector in the Indian economy. The sector has grown at a CAGR of 11% over the last decade and is expected to sustain the strong growth on the back of strong domestic consumption in the long run. However, the high food inflation and the surging input cost are likely to affect its growth in the near term. Hence, we expect the government to provide some support to the sector in the upcoming budget. We maintain ITC as our top pick from the sector in view of the strong visibility of its long-term earnings. We like Godrej Consumer Products Ltd (GCPL) in the mid-cap FMCG space.

Expected budget impact:
Neutral

Sector outlook:
Selectively Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
In general				
Increase in MAT rate	MAT rate at 18%.	Increase MAT rate to 20%.	Negative	This will affect the companies like Hindustan Unilever Ltd (HUL), GCPL and Dabur India.
Increase in excise duty	Excise duty stood at 10%.	No change.	Neutral	Most FMCG companies have low single-digit excise pay-out, as their facilities are located in excise-free zones. However, HUL will be the most affected, as a higher proportion of its sales is coming from the excisable facilities.
Dividend distribution tax	Currently 15% (1.66% - surcharge + education cess).	Reduce to 10%.	Positive	All FMCG companies (including HUL, ITC, GCPL, GSK Consumers, Colgate-Palmolive and Britannia Industries) are good dividend payers.
Focus on rural development	Allocation under various schemes such as NREGA at Rs40,100 crore and others.	Increase in development and allocation for various programmes to enhance rural income.	Positive	Positive for all FMCG companies as 30-50% of their consolidated revenues come from rural India.
Segment/ Category-wise				
Excise duty on cigarette	Specific excise duty (varying with the type and the length of cigarette).	Expected to increase by 6-8%.	Neutral for ITC, negative for other companies.	If the excise duty on cigarette increases by 6-8%, it will be neutral for ITC, as it can be easily passed on to the consumers through price increases. However, if the excise duty is increased by more than 8% it may affect the profitability of ITC's cigarette business.

Contd...

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Segment/ Category-wise				
Excise duty on packaged water	8% at present.	Full exemption.	Positive	Packaged mineral water is recognised as the common man's product and hence the demand for full exemption from excise duty. If the demand is met it will be positive for Tata Global Beverages Ltd (TGBL), Bisleri and Coca Cola.
Excise duty on sugar confectionery	10% currently.	Reduce to 4%.	Positive	If the excise duty is reduced, it will be positive for ITC, Perfetti India etc.
Excise duty on condensed milk	10% currently.	Reduce to 4-8%.	Positive	If the excise duty is reduced, it will be positive for Nestle India and Amul.
Excise duty on biscuits	4% currently.	Full exemption.	Positive	The Indian Biscuit Manufacturers' Association has recommended the complete abolition of the excise duty on biscuits as the same is consumed by the common man and is also distributed as a relief material during natural calamities. If the demand is met, it will be positive for ITC, Britannia Industries, Parle-Agro and the other small players.
Excise duty sanitary napkins	10% currently.	Full exemption.	Positive	The Feminine and Infant Hygiene Association of India has sought the waiver of the 10% excise duty on sanitary napkins as the duty makes the product expensive. If the duty is removed, it will be positive for Procter & Gamble, Johnson & Johnson etc.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	FY12E	FY13E	PE (x) FY11E	FY12E	FY13E	Reco
ITC*	157	207	6.5	7.7	9.0	24.1	20.3	17.4	Buy
GCPL	361	443	13.6	17.2	20.7	26.6	21.0	17.5	Buy

* Any significant increase in the excise duty on cigarettes would cause the stock to underperform temporarily, thereby providing an investment opportunity

Information Technology

Sector outlook: The information technology (IT) sector has outperformed the broader market over the last few months on the back of a strong revival in the sector's fundamentals, especially on the demand side. For the upcoming Union Budget FY2011-12, we remain optimistic about the extension of the STPI benefits for another year till the time the DTC comes into force. However, in the event of non-extension of the STPI benefits, we do not expect much impact on investor sentiments as the Street has already factored in a higher tax rate for FY2012. We remain positive on the IT sector with a longer-term perspective. Our top picks from the sector are Infosys Technologies, HCL Technologies, Polaris Software and NIIT Technologies.

Expected budget impact:

Neutral

Sector outlook:

Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Tax exemptions under sections 10A and 10B (STPI)	Under section 10A/10B software exports are exempt from tax till FY2011.	Continue the STPI scheme and tax incentive under section 10A/10B for next five years.	Neutral	In the event of non-extension of the tax benefits under STPI, the effective tax rates would increase by 700-800 basis points to 25-28% in FY2012. However, this is already known and factored in. But any possible extension (for the mid-cap companies) could be a positive surprise.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs)			PE (x)			Reco
			FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	
Infosys	3,105	3,817	121.0	153.7	190.8	25.7	20.2	16.3	Buy
HCL Tech	483	622	24.3	32.2	41.5	19.9	15.0	11.6	Buy
Polaris Soft	185	234	20.0	22.2	28.7	9.3	8.4	6.5	Buy
NIIT Tech	195	285	30.0	28.7	35.6	6.5	6.8	5.5	Buy

Infrastructure

Sector outlook: Given the heavy investment required in the infrastructure space, we believe the government's thrust on infrastructure spending will continue. Even in the last budget the government had increased fund allocation across sectors. However, due to various scams, political issues and high inflation the government's focus had shifted from infrastructure spending over the past few months. Thus, the project award activity and the execution of projects have been very slow recently, resulting in lower infrastructure spending. However, going ahead, we believe the project awarding activity should pick up once again after the budget. Moreover, since the stocks have corrected significantly, the comfort has increased on the valuation front. Our top picks from the sector are IL&FS Transportation Networks (India) Ltd (ITNL), IRB Infrastructure Developers (IRB Infra) and Pratibha Industries.

Expected budget impact:

Positive

Sector outlook:

Neutral

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Infrastructure spending by the government	Rs1.7 lakh crore providedfor infrastructure development in 2010-11.	Higher allocation should continue.	Positive	Given the heavy investment required in the sector, higher allocation should continue. Enhanced funding will be positive for all the infrastructure companies.
Infrastructure financing	Infra bonds and take-out financing introduced last year.	A number of measures required to ease out infrastructure financing.	Positive	The infrastructure space faces heavy funding constraints. Introduction of a few measures will help speed up the infrastructure spending and the execution of projects, thereby easing the burden of the infrastructure developers.
MAT rate	18% currently.	Increase to 20%.	Negative	An increase in the MAT rate will be negative for the infrastructure developers like IRB Infra, ITNL, IVRCL Assets, Gammon Infrastructure Projects, GMR Infrastructure, GVK Power & Infrastructure and Mundra Port & Special Economic Zone.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	EPS (Rs) FY12E	EPS (Rs) FY13E	PE (x) FY11E	PE (x) FY12E	PE (x) FY13E	Reco
ITNL	221	395	20.1	27.9	29.4	11.0	7.9	7.5	Buy
IRB Infra	174	285	14.4	18.6	20.4	12.1	9.4	8.5	Buy
Pratibha Ind	57	71	6.9	8.8	12.2	8.3	6.5	4.7	Buy

Media

Sector outlook: According to the FICCI KPMG 2010 report, the Indian media & entertainment industry is expected to grow at a compounded annual growth rate (CAGR) of 13% over 2009-14 to reach Rs109,100 crore. This along with the structural changes in the industry, eg digitisation, and the improving spending trend of the urban and rural Indians augurs well for the growth of the sector in the coming years. Our top pick from the sector is Eros International Media.

Expected budget impact:
Neutral

Sector outlook:
Neutral

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Customs duty on set-top boxes and other equipment	Customs duty on set-top boxes is 5%.	The abolition of the customs duty or a moratorium of three years on the customs duty on set-top boxes is commensurate with the digitisation target of the Telecom Regulatory Authority of India.	Positive	DTH and cable operators are suffering losses due to a high customer acquisition cost. The FICCI-KPMG 2010 report expects the number of digital homes to increase from 21.3 million in 2009 to 84.5 million in 2014. Any reduction or moratorium would reduce the costs and improve the profitability of the operators.
FDI in cable, DTH and FM radio	Currently FDI limit in DTH and cable is 49% and that on FM radio is 20%.	Increase FDI limit on DTH and cable to 74% and that on FM radio to 49%.	Positive	The DTH and cable industries are capital intensive and increased FDI would reduce the funding burden of the sector.
Entertainment tax	Entertainment tax levied by various states at different rates of 40-50%.	Include entertainment tax in GST.	Positive	The standardisation of the entertainment tax would lead to improved profitability for the producers, distributors and the multiplex industry.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	EPS (Rs) FY12E	EPS (Rs) FY13E	PE (x) FY11E	PE (x) FY12E	PE (x) FY13E	Reco
Eros Intl	160	247	13.4	16.5	20.7	11.9	9.7	7.7	Buy

Oil & Gas

Sector outlook: The Indian oil & gas space has witnessed significant reforms in the form of petrol price de-regulation. However, the recent spike in crude oil prices and the mounting inflation pressure have resulted in uncertainty regarding the timing of diesel price de-regulation. The burden of the rising fuel under-recoveries would remain an overhang on the oil marketing companies (OMCs) and upstream companies (Oil and Natural Gas Corporation [ONGC], Oil India Ltd [OIL] and GAIL India). Reliance Industries Ltd (RIL) would benefit from improving refining margins but the declining gas production from the Krishna-Godavari D-6 block is a concern. Our top pick from the sector is GAIL India due to its strong earnings growth visibility.

Expected budget impact:

Neutral

Sector outlook:

Neutral

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Section 80IB for seven-year tax holiday on natural gas production for NELP I-VII blocks	Section 80IB deduction on gas exploration available only on NELP VIII block	Clarification on Section 80IB deduction on gas exploration for NELP I-VII blocks	Positive	In case of non-extension of tax exemption on natural gas production for NELP I-VII blocks, the E&P companies would have to pay full tax rate. However, the Street has already assumed tax holiday for RIL.
Cut in import duties	5%	Nil	Positive	To reduce the cost of raw materials for the refining companies and thus their gross refining margins.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs)			PE (x)			Reco
			FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	
GAIL	457	585	26.3	30.9	35.9	17.4	14.8	12.7	Buy

Power

Sector outlook: During the April-January FY2011 period, India generated about 669 billion units of power and its energy deficit remained in the range of 8%. Against a target of 21,441MW India has added fresh capacity of about 10,210MW in the year till date, taking its total capacity to 170,228MW. This deficit is attributed to several challenges at the execution level and the government could address the same to boost the company's power generation capacity. The delay from the leading power equipment suppliers is likely to be resolved soon as new players are rolling up their sleeves and would continue to get some kind of support from the government. On the other hand, the shortage of coal in India is another issue at present. To add to that, the deteriorating financial health of the distributing companies (discoms) remains a concern. We remain mildly positive on the sector in view of these opportunities and challenges.

Expected budget impact:
Neutral

Sector outlook:
Negative

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Extension of benefits of 80IA to power projects till2015	Fiscal benefits available under section 80IA to power projects till March 31, 2010 at present.	Extension of fiscal benefits under section 80IA to power projects from March 2010 to 2015.	Positive	The extension of the time limit to 2015 will be helpful for the Ultra-Mega Power Projects coming up in the next year.
Improvement in the financial health of the distribution side of power sector	NA	Reforms: Steps to improve the financial health of the state electricity boards (SEBs) with higher subsidy and allocation.	Positive	Despite demand, some of the SEBs have backed off from buying power due to their current weak financial position. Hence, this could bring more power to consumers and improve the supply chain of power in the country.
Incentives and higher plan allocation for renewable sources of energy	5% concession of customs duty on solar power equipment and excise duty benefits on rotor blade of wind generators.	Improvement in plan allocation for the renewable energy segment and the continuation of the existing excise and customs duty concessions.	Positive	As the country is moving towards significant coal-based power generation capacity, India will face environmental challenges. Hence, the government needs to promote renewable energy especially when power generation economics highly favours coal.

Pharma

Sector outlook: The growth trajectory in the key markets of Indian pharma remains robust. Hence, we maintain our positive view on the sector. Exports still hold significant promise as Indian pharma has a low market share of 10% in the USA and a 5% share in the emerging markets. The large first-to-file (FTF) opportunities and strong abbreviated new drug application (ANDA) pipeline make us believe that the US opportunity remains attractive. With product-specific opportunities and scaling up in niche segments, the Indian pharmaceutical (pharma) companies appear to be better prepared to address the growth opportunities. The price/earnings (P/E) expansion over the past two years has been backed by strong fundamentals. We expect the sector's current multiple of 20x FY2012E P/E to sustain with a positive stance on the pharma sector. Our top picks from the sector are Lupin, Glenmark Pharmacueticals and JB Chemicals.

Expected budget impact:

Positive

Sector outlook:

Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Spending on healthcare sector	Expenditure allocation towards healthcare sector stands at Rs22,300 crore.	Increase in thrust on healthcare sector.	Positive	An increased focus on the sector would lead increased investment in the sector
R&D	200% weighted deduction on R&D; 175% weighted deduction for outsourced work.	Extend the benefit for R&D expenses in outsourced studies, such as clinical trials and specific lab studies, including those incurred overseas to 200%.	Positive	This will incentivise investment in R&D and encourage new drug development. Positive for Biocon, SPARC, Piramal Life Sciences.
Excise duty	Formulations have an excise duty of 4% while that on active pharmaceutical ingredients (APIs) is 10%.	Excise duty structure to be made at par, ie excise duty on APIs should be reduced from 10% to 4%.	Positive	With no disparity in the duty structure, there would be no price hikes and this would benefit the end user.
Income tax	Under section 10B, 100% export-oriented units (EOUs) are exempt from paying tax on their profits till FY2011.	Extension of tax exemption beyond FY2011, possibly for the next three years.	Positive	The exemption beyond FY2011 will provide some relief to companies like Dishman Pharma, Divis Labs, Cipla and Torrent Pharma, which have EOUs.
Infrastructure status for healthcare industry	The hospitals that start functioning in specified tier-II and tier-III cities before March 31, 2013 are currently allowed a tax holiday on profits earned by them in the initial five years.	Grant of Infrastructure status for the healthcare industry in view of the burgeoning demand and the rising cost of healthcare. Also, the extension of grant of related tax holidays and exemptions.	Positive	Beneficial for companies like Apollo Hospitals, Fortis Healthcare, Max Healthcare and Wockhardt Hospitals, as it will not only enable them to spur an increase in investment in the hospital space but also facilitate new entities into the industry.

Top picks

Company	CMP (Rs)	Price target (Rs)	EPS (Rs) FY11E	EPS (Rs) FY12E	EPS (Rs) FY13E	PE (x) FY11E	PE (x) FY12E	PE (x) FY13E	Reco
Lupin	425	520	19.1	23.1	27.2	22.3	18.4	15.6	Buy
Glenmark	293	371	17.6	19.5	24.1	16.6	15.0	12.2	Buy
JB Chemicals	112	174	15.3	18.3	22.2	7.3	6.1	5.1	Buy

Retail

Sector outlook: The Indian modern retail segment is at a nascent stage with penetration of less than 6%, in an overall retail industry size of $350 billion. A favorable demographic profile and an increasing purchasing power coupled with a changing mindset towards an organized retail format augurs well for the modern retail players. Along with a strong revenue momentum, the players' efforts towards front end as well as back end cost rationalisation and optimisation will start bearing fruits in time to come. We remain positive on Indian retail as a structural domestic play

Expected budget impact:

Positive

Sector outlook:

Positive

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
FDI	Foreign investment is allowed in single brand retail up to 51% while 100% investment is allowed in the wholesale cash and carry sector	Allowing FDI in multi brand retail	Positive	Various government departments including the agriculture ministry are in support for opening up of the retail sector, any positive traction on the same in the budget would prove positive for the industry players.
Service tax	Rentals fall under the preview of services and thus attract service tax	Exemption of rentals from service tax	Positive	-

Top picks

Company	CMP	Price		EPS (Rs)			PE (x)		Reco
	(Rs)	target (Rs)	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	
KKCL	536	615	33.3	42.4	47.2	16.1	12.6	11.4	Buy
Provogue	43	95	2.8	3.7	4.5	15.3	11.6	9.5	Buy

Telecom

Sector outlook: The telecom (wireless) industry has grown by leaps and bounds. Currently with ~ 750 million subscribers, it still stands at an all India penetration level of ~60%, and rural penetration of as low as ~30%, thus providing ample growth opportunity. Of late the sector had witnessed high competition, impacting players' earnings profile. With the completion of the 3G auction process and stabilizing competition we believe the domestic environment remains strong. But high level of regulatory uncertainty (recommendations/ proposals relating to one time excess spectrum charge, high payments towards license renewal fee) coupled with spectrum shortage still plague the industry, and hence we remain cautious on the sector.

Expected budget impact:
Neutral

Sector outlook:
Cautious

Key budget expectations

Issue	Current status	Proposal/Likely changes	Impact	Comments
Tax holiday benefits in case of mergers/ amalgamations	Currently available in the form of tax benefits u/s 80 IA.	Continue the tax holiday benefits or alternatively bring in provisions to prevent misuse	Positive	In order to encourage consolidation in the highly competitive telecom industry, tax benefits provided u/s 80 IA would improve the financial viability of the merger
Tax treatment of 3G spectrum payment	Currently no guidelines available, players have capitalized the same	Amendments in the Income tax law ,to provide depreciation claim on upfront 3G spectrum fee	Positive	Would provide clarity and minimize litigation
Tax holiday benefits u/s 80IA to new players (providing services after 2005)	Currently available	Extension of the benefits	Positive	In order to give a boost to the telecom sector due to the long gestation period

Top picks

Company	CMP	Price		EPS (Rs)			PE (x)		Reco
	(Rs)	target (Rs)	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	
Bharti Airtel	328	335	16.6	24.2	28.4	19.8	13.6	11.6	Hold

The author doesn't hold any investment in any of the companies mentioned in the article.