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Union Budget FY2011

A Tight Rope Walk – Accumulate At Dips

Ambit Capital Pvt. Ltd

Murali Krishnan
Head of Research
Tel.: +91-22-3043 3299
muralikrishnan@ambitcapital.com

Research Team
Tel.: +91-22-3043 3000

Union Budget 2010-11

That the Union Budget 2011 is not populist is a relief. The trade off is between growth and inflation with huge optimism on growth assumptions. Domestic demand will be the growth driver with consumption as the central theme.

No big reform except for new banking licenses to the Private Sector and NBFCs that was positive to create more financial intermediation in the country. A thrust on Infrastructure and PSU banks appears good for lending to that sector, the Kirit Parekh committee escapes mention; petrol/ diesel hike not good for inflation and customs duty hike, steep. The only positive — corporate surcharge, cut from 10.0% to 7.5%; personal tax slabs enhanced, keeping the rate unchanged, leaving more money in the hands of individual tax payers.

Road map for general sales tax (GST) implementation more affirmative through: 1) excise duty and service tax at the same level as today at 10.0%; 2) special advisory group constituted for IT infrastructure for GST implementation; and 3) an Endeavour to implement GST by April 1, 2011. Plenty of challenges but the targets appear good.

Direct Tax Code by 2011 is an affirmative action.

Partial rollback of fiscal concessions is much along expected lines.

Fiscal deficit: The government is in the fiscal consolidation mode. Budget expenditure has been moderated to a large extent. Receipts clearly depend on GDP growth. Expectations that direct and indirect taxes will grow are optimistic, given customs slid 15% last year in collections; this time the budget is predicting 35% growth. Likewise for excise collections that were a negative 6% to a growth of 30%. Fiscal deficit is expected to move from 6.9% to 5.5% — a steep task; and there is a qualitative shift from non-plan to planned expenditure. Lower borrowings will exert less incremental pressure on 10-year bond yields in the near-term. Divestments of Rs400bn can be fairly achieved.

Focus on stocks driven by earnings: We have a Sensex trading band of 14900-19000 and expect markets to trade in this range. There could be short-term volatility as markets have priced in the current growth numbers and multiples are not cheap. Our Sensex EPS for FY10E is Rs.805 and for FY11E, Rs1,013 implying a P/E band of 14.7x-18.8x FY11E EPS. The index currently trades at 16.2x FY11EPS.

Our recommendation: Our high-conviction sectors are Consumer Staples and Durables, Healthcare, Automobiles, Media, Infrastructure/Construction, Metals, Power and Capital Goods. Our preference is lower for Cement, Real Estate and Telecom. We are Neutral on Financials and Oil and Gas from a valuation perspective.

Risks to our call: In our view the predominant risk is inflation (rising global commodity prices, increase in fuel prices through the budget proposals and partial rollback of fiscal sops); hardening of interest rates as RBI exits its policy on soft rates as monetary tightening has begun. Others are: global economic recovery, consequential flows into Emerging markets and India; higher disinvestment targets; new paper supply and a reversal in dollar carry trade.

Direct Taxes

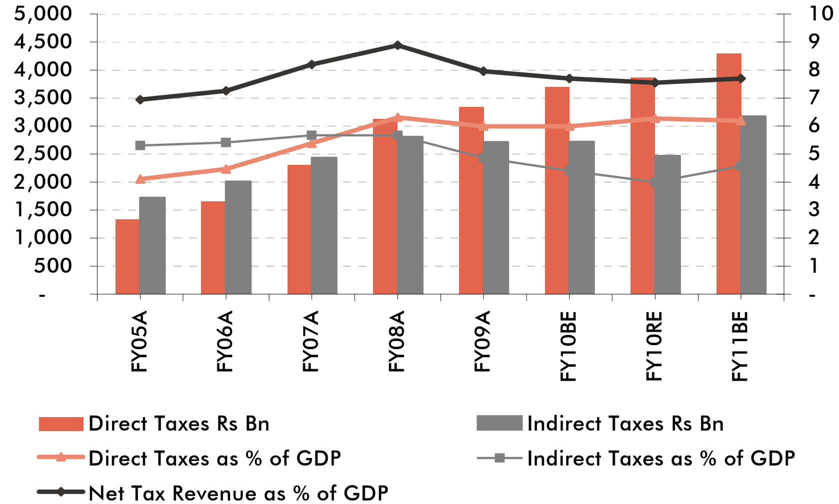
- Minimum Alternate Tax (MAT)
  - Rate of taxation increased from 15% to 18%
- Corporate Tax
  - Surcharge on domestic companies reduced from 10% to 7.5%
- Income Tax
  - Personal income tax slabs further widened
  - Allowance of investment in long-term infrastructure bonds to the extent of Rs20,000 as additional deduction over and above the existing limit of Rs100,000 on tax savings
- Weighted deduction on expenditure incurred on in-house R&D enhanced from 150% to 200%
  - Deduction for payments made to research associations, colleges increased from 125% to 175%
- Direct Taxes Code (DTC) likely to take effect from 1 April 2011
- Net impact: Revenue loss to the tune of Rs260bn

Indirect Taxes

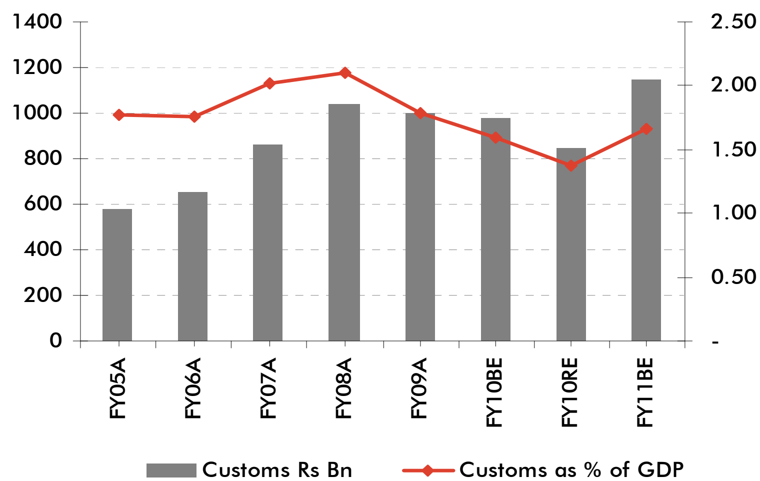
- Central excise duties
  - All non-petroleum products to be charged at 10% ad valorem (as against 8% originally)
  - Basic duty of 5% on crude petroleum; 7.5% on diesel and petrol and 10% on other refined products
  - Central excise duty on petrol and diesel enhanced by Re1/litre each
  - Specific duties on portland cement and cement clinker increased proportionately
  - Ad valorem component of excise duty on large cars, MUVs and SUVs increased from 20% to 22%
- Central excise duties - exemptions
  - Machinery and equipment needed for initial set-up of photovoltaic and solar thermal power generating units
  - Inputs used in the production of rotor blades for wind energy generators
- Customs duties - concessional rates
  - Machinery and equipment needed for initial set-up of photovoltaic and solar thermal power generating units
  - Project import status to monorail projects for urban transport
- Introduction of GST likely to be simultaneous with DTC with effect from 1 April 2010
- Net impact: Revenue gain to the tune of Rs435bn

Tax Receipts - Greater Thrust On Indirect Taxes

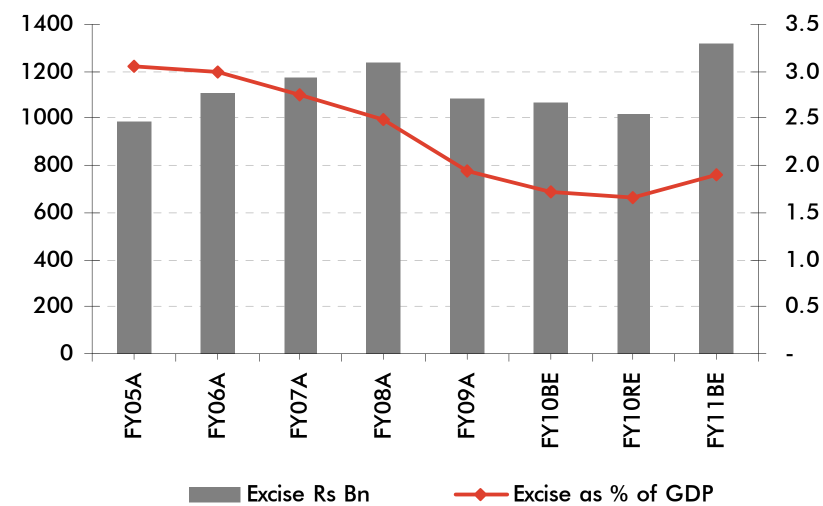
Increasing share of Indirect taxes in Tax receipts



Customs – FY11BE ~36% higher than FY10RE



Excise duties – FY11BE 30% higher than FY10RE



Source for all the above charts :RBI, Budget Document, Ambit Capital Research

Road To Fiscal Consolidation - Fanning Inflation

Expenditure

- 8% growth in overall budgeted expenditure over FY10RE
  - Quantum of increase restricted to Rs872bn
  - Nearly two-thirds of the increase is towards Plan Expenditure

- Arresting the growth in Non-Plan expenditure
  - Marginal 4% increase in FY11BE over FY10RE at Rs7,361bn
  - Non-Plan expenditure as a % of total expenditure is likely to dip from 69% to 66%
  - However, interest payments and subsidies continue to be a considerable drain

Receipts

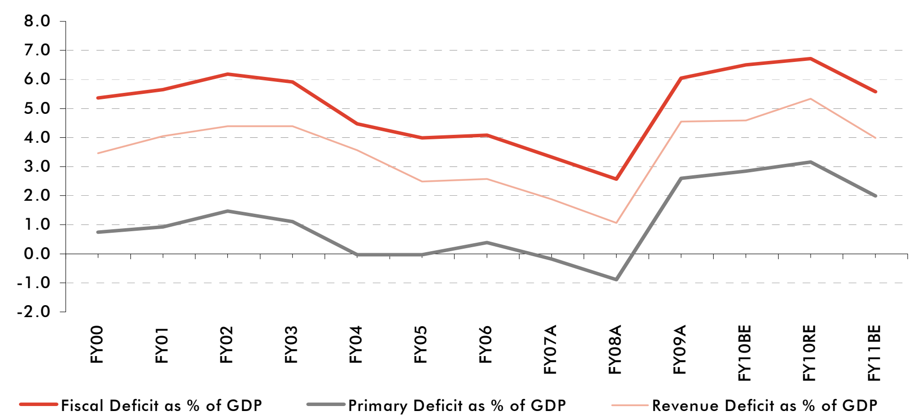
- Easy on direct taxes - raising resources through the indirect taxes route
  - Targeting a 29% hike in excise duties - concomitant with a 36% growth in customs duties
  - Likely to pose inflationary concerns across sectors
  - Ambitious plan to raise Rs400bn through divestment proceeds

- Lower than anticipated fiscal deficit at Rs3,814bn

Deficit as % of GDP

	FY07A	FY08A	FY09A	FY10BE	FY10RE	FY11BE
Fiscal Deficit	3.3	2.6	6.0	6.5	6.7	5.6
Revenue Deficit	1.9	1.1	4.5	4.6	5.3	4.0
Primary Deficit	-0.2	-0.9	2.6	2.8	3.2	2.0

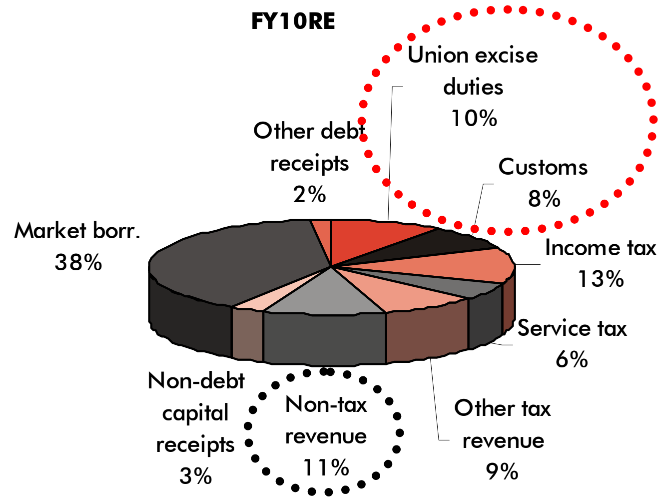
Reducing Deficit as % of GDP

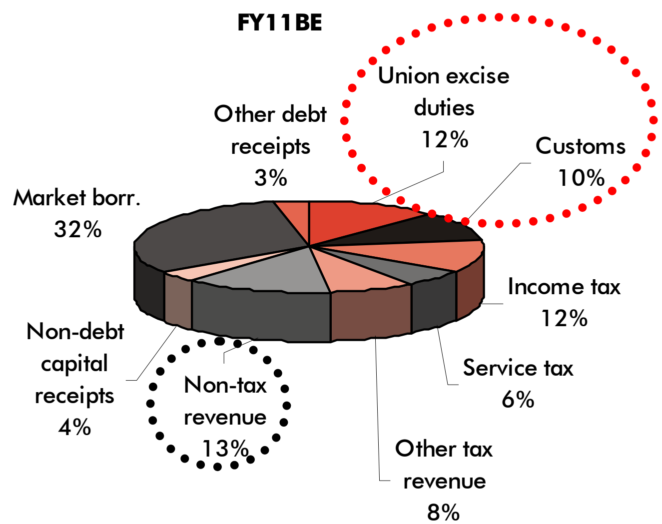


Source for all the above table & chart :RBI, Budget Document, Ambit Capital Research

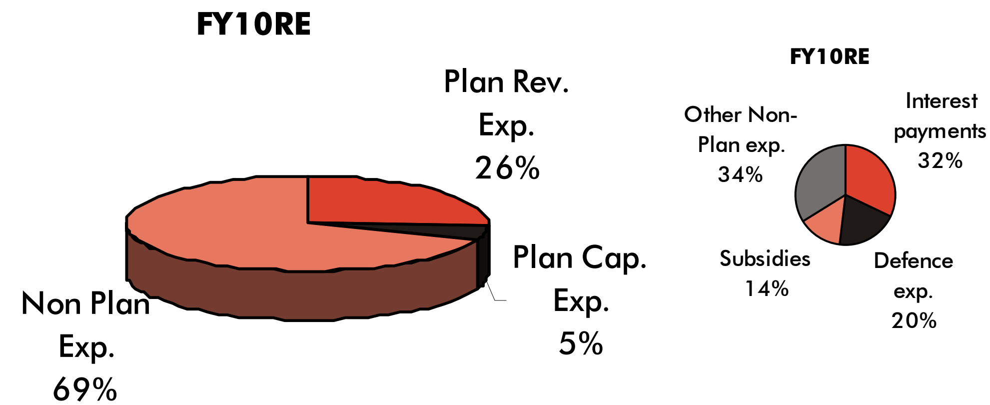
Budget 2011 – The Pie

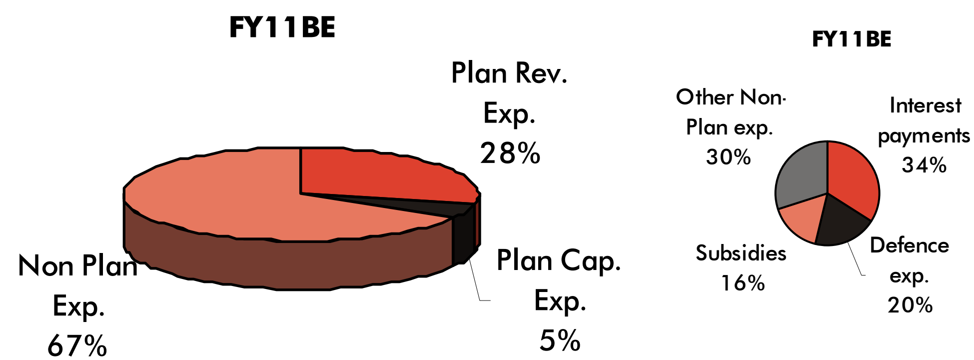
Where the money comes from





Where the money goes to





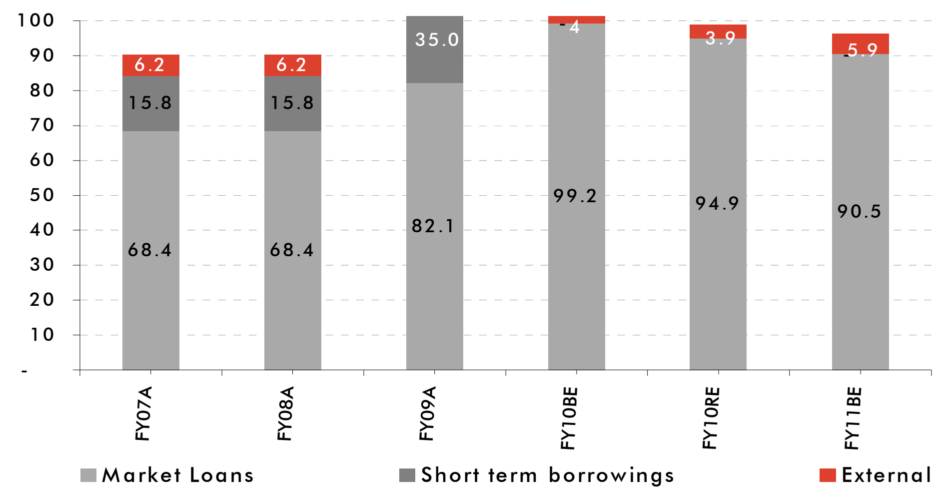
Source for all the above charts :RBI, Budget Document, Ambit Capital Research

Lower Market Borrowings – Less Pressure On 10-yr Yields In Near Term

- Total debt receipts budgeted to be lower than FY10E levels
- Lower proportion of deficit to be financed through market borrowings
  - Less likelihood of crowding out of private investment
  - Less pressure on benchmark yields on an immediate-term basis

Pattern of Deficit Financing

	FY09A	FY10BE	FY10RE	FY11BE
Market Loans	82.1	99.2	94.9	90.5
Short term borrowings	35.0	-	(0.9)	-
External assistance (Net)	3.9	4.0	3.9	5.9
Securities issued against Small Savings	(0.5)	3.3	3.2	3.5
State Provident Funds (Net)	2.8	1.2	2.0	1.8
Other Receipts (Net)	(23.4)	(7.8)	(3.1)	(1.7)
Debt Receipts %	100	100	100	100
Total Debt Receipts Rs Bn	2,844	4,010	4,196	3,814



Source for all the above table & chart: RBI, Budget Document, Ambit Capital Research

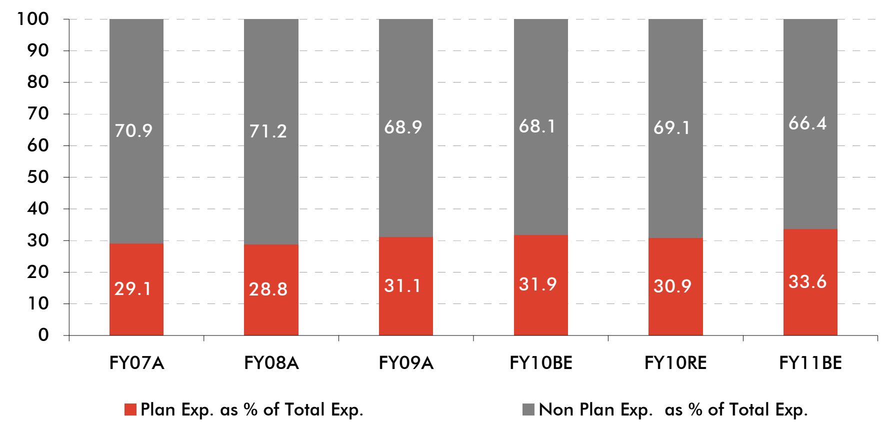
Migrating Toward A Higher Plan Expenditure Regime

- Increasingly higher emphasis on Plan Expenditure
  - Plan Expenditure as a % of total expenditure to grow from ~30% to ~34% by FY11
  - Plan Expenditure as % of GDP inches up from 5.1% to 5.4%
- Focused on investment in physical infrastructure
  - Thrust on Capital Expenditure within Plan Expenditure

Expenditure as % of GDP

	FY07A	FY08A	FY09A	FY10BE	FY10RE	FY11BE
Plan Exp. as % of Total Exp.	29.1	28.8	31.1	31.9	30.9	33.6
Non Plan Exp. as % of Total Exp.	70.9	71.2	68.9	68.1	69.1	66.4

Breakup of total expenditure



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Receipts - A Snapshot

RECEIPTS (RsBn)	FY09A	FY10BE	FY10RE	FY11BE	YoY %	% of GDP FY10RE	% of GDP FY11BE
1. Tax Revenue							
Gross Tax Revenue	**6,053**	**6,411**	**6,331**	**7,467**	**17.9**	**10.3**	**10.8**
Corporation tax	2,134	2,567	2,551	3,013	18.1	4.1	4.3
Income tax	1,206	1,129	1,314	1,281	(2.6)	2.1	1.8
Other taxes and Duties	4	4	5	6	18.0	0.0	0.0
Customs	999	980	845	1,150	36.1	1.4	1.7
Union Excise Duties	1,086	1,065	1,020	1,320	29.4	1.7	1.9
Service Tax	609	650	580	680	17.2	0.9	1.0
Taxes of the Union Territories	15	16	16	17	2.5	0.0	0.0
Less- NCCD transferred to the National Calamity Contingency Fund	18	25	32	36	12.7	0.1	0.1
Less States' Share	1,602	1,644	1,648	2,090	26.8	2.7	3.0
Net Tax Revenue	**4,433**	**4,742**	**4,651**	**5,341**	**14.8**	**7.5**	**7.7**
2. Non -Tax Revenue							
Interest Receipts	207	192	192	193	0.2	0.3	0.3
Dividend and Profits	386	498	520	513	(1.3)	0.8	0.7
Other Non-Tax Revenue	368	706	399	766	91.9	0.6	1.1
Receipts of Union Territories	8	8	11	9	(13.8)	0.0	0.0
Total Non-Tax Revenue	969	1,403	1,122	1,481	32.0	1.8	2.1
Total Revenue Receipts	5,403	6,145	5,773	6,822	18.2	9.4	9.8
3. CAPITAL RECEIPTS*							
A. Non-debt Receipts							
Recoveries of Loans & Advances@	61	42	43	51	20.6	0.1	0.1
Miscellaneous Capital receipts	6	11	260	400	54.1	0.4	0.6
Total 3A	**67**	**53**	**302**	**451**	**49.4**	**0.5**	**0.7**
B. Debt Receipts							
Market Loans	2,336	3,980	3,984	3,450	(13.4)	6.5	5.0
Short term borrowings	996	-	(39)	-	(100.0)	(0.1)	-
External assistance (Net)	110	160	165	225	35.9	0.3	0.3
Securities issued against Small Savings	(13)	133	133	133	-	0.2	0.2
State Provident Funds (Net)	80	50	85	70	(17.6)	0.1	0.1
Other Receipts (Net)	(666)	(313)	(132)	(63)	(52.0)	(0.2)	(0.1)
Total 3B	**2,844**	**4,010**	**4,196**	**3,814**	**(9.1)**	**6.8**	**5.5**
Total Capital Receipts (A+B)	**2,911**	**4,063**	**4,498**	**4,265**	**(5.2)**	**7.3**	**6.2**
4. DRAW-DOWN OF CASH BALANCE	**526**	**-**	**(56)**	**-**	**(100.0)**	**(0.1)**	**-**
Total Receipts (1+2+3+4)	**8,840**	**10,208**	**10,215**	**11,088**	**8.5**	**16.6**	**16.0**
Financing of Fiscal Deficit (3B+4)	**3,370**	**4,010**	**4,140**	**3,814**	**(7.9)**	**6.7**	**5.5**
Receipts under MSS (Net)	**(818)**	**(388)**	**(860)**	**473**	**(154.9)**	**(1.4)**	**0.7**
@ excludes recoveries of short-term loans and advances from States and loans to Government servants, etc.	17	15	19	15	(21.1)	0.0	0.0
* The receipts are net of repayments.	-	-	-	-			

Source: RBI, Budget Document, Ambit Capital Research

Expenditure - A Snapshot

EXPENDITURE (RsBn)	FY09A	FY10BE	FY10RE	FY11BE	YoY %	% of GDP FY10RE	% of GDP FY11BE
Non-Plan Expenditure							
Revenue Expenditure	5,968	6,188	6,865	7,004	2.0	11.1	10.1
Interest Payments	1,922	2,255	2,195	2,487	13.3	3.6	3.6
Defence	1,142	869	1,363	1,473	8.1	2.2	2.1
Subsidies	1,297	1,113	1,310	1,162	(11.3)	2.1	1.7
Grants to State and U.T. Governments	382	486	466	460	(1.3)	0.8	0.7
Grants to Foreign Governments	14	16	16	17	7.6	0.0	0.0
Pensions	329	350	422	428	1.4	0.7	0.6
Police	199	254	246	222	(9.9)	0.4	0.3
Others	682	846	847	755	(10.9)	1.4	1.1
Capital Expenditure	119	769	199	352	77.4	0.3	0.5
Total Non-Plan expenditure	**6,087**	**6,957**	**7,064**	**7,357**	**4.1**	**11.5**	**10.6**
PLAN EXPENDITURE							
Revenue Expenditure	2,348	2,784	2,644	3,151	19.2	4.3	4.5
Capital Expenditure	405	468	508	580	14.2	0.8	0.8
Total Plan expenditure	**2,752**	**3,251**	**3,152**	**3,731**	**18.4**	**5.1**	**5.4**
TOTAL EXPENDITURE	**8,840**	**10,208**	**10,215**	**11,088**	**8.5**	**16.6**	**16.0**

Source: RBI, Budget Document, Ambit Capital Research

Union Budget – Sectoral Impact

Automobiles

Sector	Standard excise duty rate increase	Increase in ad-valorem (excise duty) levy on Large cars and SUVs.	Macro factors	Increase in excise duty on petrol and diesel	Weighted deduction on in-house R&D
Key budget proposals	Increase to 10% from 8%	Increase to 22% from 20%	Increase in personal income by ~Rs50,000 per head. Rural schemes such as NREGA allocation increased by 30%	Excise duty increased by Re1. Retail prices of diesel and petrol increased by Rs2.67/litre and Rs2.58/litre resp.	Increased to 200% from 150%
Sector impact	Positive. Marginal rollback, in line with expectation	Negative	Positive. Demand push via higher disposable income	Negative. Low probability of equivalent increase in freight rates.	Positive
Stock impact	Two-wheelers, CVs and passenger car manufacturers.	M&M and Tata Motors	Two-wheeler and small car manufacturers	Tata Motors and Ashok Leyland	Tata Motors and Ashok Leyland
Impact on earnings	Neutral. Expected to be passed on.	Negative	Positive	Negative	Positive

BFSI

Key budget proposals	Sector impact	Beneficiaries	Impact on earnings
Rs165bn to be used towards recapitalisation of PSU banks to a minimum Tier-I of 8%	Positive	Dena Bank, Oriental Bank of Commerce, Andhra Bank, Syndicate Bank, IDBI Bank, Union Bank and Bank of Baroda	Positive impact on earnings - quantum of impact to vary upon actual capital infusion in each bank
Considering issue of additional banking licences to private sector participants and NBFCs	Positive	IFCI, IDFC, Reliance Capital, M&M Financial Services, SREI Infrastructure	Positive - reduces cost of mobilising resources by enabling access to low-cost funds, especially current and savings deposits

Consumer - 1

	Excise duty/ Service Tax changes	Customs duty changes	Corporate Tax changes	Personal Tax changes
Key budget proposals	▪ Standard excise duty increase from 8% to 10% ▪ Change in slab for excise duty on cigarettes, 11%-18% increase ▪ Central excise duty increase on petrol and diesel. Rs2.67/litre for petrol; Rs2.58/litre for diesel ▪ Reduction in central excise on corrugated boxes and cartons to 4% from 8% ▪ Increase of excise duty on gold, platinum and silver ▪ Transportation by road of cereals and pulses to be exempt from service tax	Marginal reduction of customs duty on Rhodium and Gold	▪ MAT increased to 18% from 15% ▪ Reduction of surcharge to 7.5% from 10% for domestic companies ▪ Benefit of investment linked deduction extended to new hotels of two-star category and above.	▪ Change in income tax slabs, saving of maximum Rs50,000. Beneficial to 60% tax payers ▪ Additional tax saving deduction of Rs20,000
Sector impact	Negative	Positive	Positive	Positive
Beneficial to	Marginally in specific segments	Titan, Gitanjali Gems	All except Dabur, GCPL	All
Detrimental to	All particularly for ITC and Titan	None	See above	None
Impact on earnings	Negative particularly for ITC* (3-4%)	Marginal	▪ Dabur, GCPL 3-4% Negative, ▪ For other c.1% Positive	No direct impact

** VAT increase in state of Gujarat*

Consumer - 2

	Banking	Agriculture growth	Rural stimulus
Key budget proposals	Government to re-capitalise Regional Rural Banks to support increased lending to the rural economy.	▪ Address issue of opening up of retail trade in agriculture produce ▪ To address deficit in the storage capacity; FCI to hire godowns from private parties for a guaranteed period of 7 years ▪ ECBs to be available for cold storage for agricultural and allied produce	▪ 25% of total plan outlay allocation for development of rural infrastructure ▪ Allocation under NREGS increased by 29% to Rs401bn (US$8.6bn)
Sector impact	Positive	Positive	Positive
Beneficial to	All	All	All particularly ITC, HUL, Dabur, Godrej Consumer
Detrimental to	None	None	None
Impact on earnings	No direct impact	No direct impact	No direct impact

Cement

Key budget proposals	Impact
Increase of excise duty to 10% from 8% of retail	Total negative impact of approximately Rs7.3/bag
2. Increase in the price of diesel and petrol by Re1/litre	Negative impact implying Rs5/bag assuming a sale rate of Rs250/bag
3 Increase in coal price by Rs150/tonne depending on the grade	Negative impact implying Re0.8/bag assuming a sale price of bag of Rs250/
	Negative impact implying Rs1.5/bag

Healthcare

	Weighted Deduction on R&D	MAT	Excise duty	Basic duty and CVD on importation of Equipments	Inclusion of more families as part of Rashtriya Swasthya Bima Yojana (RSBY)	Plan allocation for the Ministry of Health and Family Welfare
Key budget proposals	Increased from 150% to 200% for own research	Increased to 18% from 15%	Increase in excise duty from the earlier 8% to 10% on raw material (APIs and intermediates)	Uniform, concessional basic duty of 5 %, CVD of 4 % with full exemption from special additional duty on all medical equipment	Extend RSBY benefits to all such Mahatma Gandhi NREGA beneficiaries who have worked for more than 15 days during the preceding financial year	Increased from Rs195.3bn to Rs223bn for the financial year 2010-11
Sector impact	Positive	Negative	Negative	Positive	Positive	Positive
Stock impact	Sun, Dr. Reddys, Ranbaxy, Glenmark, Lupin, Biocon	Cipla, Sun Pharma, Cadila Pharma, Torrent Pharma	GSK, Pfizer	Apollo Hospitals, Fortis	All Pharmaceutical companies	All Pharmaceutical companies
Impact on earnings	Positive	Negative	Marginal	Positive	None	None

Infrastructure/Construction

	Increased outlay	Exemption limit	MAT Increase
Key budget proposals	Allocation for road transport up from Rs175.2bn to Rs198.9bn	Deduction of additional amount of Rs20,000 over and above current Rs1,00,000 for tax savings	MAT rate increased to 18% from 15%
Sector impact	Positive	Positive	Marginally Negative
	All construction companies operating in road transport segment viz L&T, IVRCL, Nagarjuna, HCC, Punj Lloyd, Gammon , Patel, KNR Constructions etc	With about 20mn households in Rs2-5lakh income bracket, this can create a Rs400bn long term financing mechanism. In the absence of debt market for long term financing this is a huge positive for Infra sector	Negative impact for pure play BOT asset owners viz. GMR ,GVK, Gammon Infra vis a vis a mix of BOT & cash contractors viz. L&T, IVRCL, Nagarjuna, HCC, Gammon, Punj Lloyd, Patel etc
Impact on earnings	Positive	Positive	~2.5% impact on valuation

IT Services

	MAT Increase	Outlay for e-governance	Outlay for Sarva Shiksha Abhiyan (SSA)
Key budget proposals	To 18% from 15%	Increased to Rs10.5bn from Rs9bn	Increased to Rs150bn from Rs131bn.
Sector impact	Marginally negative	Positive	Positive
Impact on companies	Unlikely to impact P&L; cash flows would be marginally impacted	TCS, Wipro, Infosys, CMC, HCL Tech, HCL Infosystems	Educomp, NIIT, Everonn
Impact on earnings	No impact	Positive	Positive

Metals

	Infrastructure	Excise Duty Hike	Clean Energy Cess
Key budget proposals	Increased allocation for infrastructure projects	Excise duty hike from 8% to 10%	Clean energy cess of Rs100/t levied on coal.
Sector impact	The budget's infrastructure focus while positive is already reflected in the market's expectations for sales volume growth. Hence, no impact on an incremental basis.	Companies will try to pass on the higher excise duties to consumers. Given the positive domestic demand outlook for metals, we believe they will be able to pass them on to a large extent.	The higher coal costs (estimated at ~5%) will increase power and fuel costs for metal companies.
Impact on earnings	Minimal impact on an incremental basis.	We expect relatively low impact of excise duties on net revenue or earnings, as companies are likely to pass on the hike to consumers.	Low. Power and fuel costs to increase by about 3%. About 1% impact on net profits for steel companies.

Oil & Gas

Key budget proposals	Upstream	Refining & Petchem	Marketing
MAT rate changed from 15% to 18%	Negative for MAT paying companies	Negative for MAT paying companies	Negative for MAT paying companies
Central excise duty on MS and HSD increased by Re1/ltr, unchanged for other refined products	No Impact	An increase in excise duty would be pass through for Refiners.	Price hike on petrol by 2.67/ltr and diesel by Rs2.58/ltr negates the negative impact of duty hike. Under-recoveries to remain unchanged
Customs duty on crude oil restored to 5%	Marginally Positive	Negative for Refiners, as the crude cost increases concomitantly	Negative for OMCs, as the crude procurement cost increases
Customs duty on MS and HSD increased from 2.5% to 7.5% and for other refined products, from 5% to 10%	No Impact	▪ A positive for Refiners as it counterbalances the increase in customs duties for crude oil ▪ Marginally positive for Petrochemical – increase in feedstock cost negated by higher pricing power	Negative for OMCs as they are net importers of refined products.
Net Impact	The increase in customs duty for crude coupled with MAT increase makes the impact Neutral for upstream MAT paying entities.	The overall impact on Refiners is Neutral whereas it is marginally positive for Petrochemical players	The combined impact of changes on OMCs is net negative, as far as their earnings are concerned. However there is a marginal change in the under-recovery for FY11E.
Beneficiaries	ONGC, OIL	GAIL	-
Losers	RIL	RIL	IOC, BPCL, HPCL

Telecom

	MAT Increase	3G spectrum auction	Exemption from Special Additional Duty
Key budget proposals	Rate increased from 15% to 18%	Govt has accounted for Rs360bn revenue from the auction	To bring down the cost of mobile phones
Sector impact	Marginally negative		Marginally positive impact, would increase demand for mobile phones
Stock Impact	Unlikely to impact P&L as most of telecom operators avail MAT credit facility, negative impact on cash flow		Spice Mobiles
Impact on earnings	No EPS impact		Positive

Real Estate

Key budget proposals	Impact
Implementation of service tax on presale of residential property. Sale of residential property after completion certificate carries no charge	Very negative for the entire sector since residential sales is primarily pre-sales. Residential sales comprise between 65% to 100% of the stocks under coverage.
Implementation of service tax on rental of office or retail space will attract service tax	Negative for stocks such as DLF and marginal for other stocks
Change in Sec 80(IB)- Projects which have approval of Sec 80(IB) will be able to complete the project for up to 5 years instead of earlier 4 years	Neutral for stock since no change in the projects which have approval of Sec 80 (IB)
Extension of time for subvention of interest rates for housing below Rs2mn	Marginal positive impact on Purvankara, Unitech
Service tax on the lease of land	No impact

Power Utilities

	Clean Energy Cess	MAT Increase
Key budget proposals	Clean Energy cess (levy) on all coal and lignite production in India at Rs100/tonne	MAT rate increased to 18% from 15%
Sector impact	Neutral to Negative	Neutral to Negative
	All power utilities; except those with captive coal mining within same entity and using imported coal / lignite No impact on projects recovering tariffs on regulated basis	No impact on projects recovering tariffs on a regulated basis However projects awarded on tariff-based bidding and merchant power plants would need to absorb the incremental tax
Impact on earnings	~5% impact on profits, for merchant power plants	~3% impact on profits

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Ambit Capital Pvt Ltd.
Ambit House, 3rd Floor,
449, Senapati Bapat Marg, Lower Parel, Mumbai 400 013, India.
Phone : +91-22-3043 3000, Fax : +91-22-3043 3100

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