Budget Preview 2010-11 – 'Tightening Purse Strings'

Fiscal prudence is expected to be the primary agenda of Budget 2010-11. This is certainly not the year for industry-specific freebies or any galloping gross budgetary support. Instead, the Finance Minister will aim at bringing down fiscal deficit, largely through stimulus withdrawals, disinvestments and 3G auctions, among others. Inflation control measures (mainly food inflation) will also be a focus area.

We expect significant positive measures for the rural economy, in line with the government's agenda of inclusive growth, infrastructure development and educational reform. Announcement on disinvestment and GST roadmap will be tracked closely. The budget is unlikely to cause any negative impact for equities. However, it may fall short of the triggers to boost the markets. The expected excise hike could act as a near-term depressant for certain sectors.

Excise duty hike – On the hit list

Corrective measures to repair India's balance sheet seem imminent. The fiscal position stands stressed with a 16-year high deficit of 6.8% of GDP (not accounting for off-balance sheet items and state deficits). With CSO advance estimates hinting at a GDP growth of 7.2% for 2009-10, the government is bound to withdraw some of the stimulus doled out previously.

A hike of 2% in excise duty seems likely (ex*cise duty was reduced from 14% to 10% in December 2008 and to 8% in February 2009*). The government will justify this move citing the healthy upswing in automobiles and consumer durables in recent months. Though a 2% increase should not hurt industry fortunes, anything above it may affect some. The excise duty hike will not only help the cause of declining indirect tax receipts, but also attune the excise duty - service tax integration, ahead of the Goods & Services Tax (GST) introduction.

Disinvestment, GST roadmap; revenue focus

The government is likely to provide a roadmap for its disinvestment plan and GST implementation in the budget. The government will aim at a sizeable inflow of Rs250bn from disinvestment proceeds (actual conversions will depend on stock market conditions). Given the certain delay in timely roll-out, the government is now expected to target GST implementation before the end of 2010.

Other revenue-boosting measures may include certain additions to the service tax net. There is also a possibility of a roll-back in service tax rate. We do not foresee any tinkering in corporate tax rates though. We expect the government to target Rs300-350bn from 3G auctions. The Draft Direct Tax Code may win a mention, but being under consultation, the major amendments stated in the draft will get the go ahead only in the year to follow.

Moderate GBS hike by 12-14%

Industry expectations of large allocation increases are unlikely to be met. While media reports highlight the Planning Commission recommendation of an 18% Gross Budgetary Support (GBS) hike, the actual rise could be in the range of 12-14%, given the need for expenditure control. The fiscal deficit for FY10 would be ~7% and we expect the budget to target 5.5% of GDP next year.

Infrastructure development: In full steam

Infrastructure development momentum will continue with flagship programmes like Bharat Nirman and JNNURM set to witness significant rise in allocations. The potential reform areas include transparency in PPP project bids, land issues and the green signal to long-term bank finance for infrastructure. Other moves include positive steps for affordable housing, a rise in NHAI budgetary support besides national project status for certain state irrigation projects.

Rural reform: High on agenda

The UPA agenda of inclusive growth will translate into key steps for rural development. The estimated 0.2% decline in farm output for 2009-10 make this initiative even more critical. While allocations to the flagship programmes will continue, the NREGA may not win large allocations as the government would probably give priority to curb leakages and inefficient resources.

Measures to curb spiraling food inflation

Inflation control will be an important issue. The government will most likely attempt easing of pressures, food inflation in particular. One or more of regulatory actions like imposition of stock limits, futures contract delisting, movement restrictions and de-hoarding drives could be used. Measures to address supply side issues like augmentation through imports may also be taken.

Pro-Education norms: Noteworthy rise

We expect a substantial rise in both primary as well as secondary education allocations. The new fundamental Right to Education between 6 to 14 years of age would be the focal point of reform. The Sarva Siksha Abhiyan is also likely to get a boost.

Other targets: A mixed bag

- The budget could also address the need for primary healthcare and public health in semi-urban and rural areas. Attempts towards reducing the ultimate cost to patients may be made.
- The SEBI demand for doing away with tax benefits to corporates investing in mutual funds, if implemented, would increase the corporate tax outgo, closing the arbitrage. This would be a major negative for the mutual fund industry. This isn't an expectation from our end but cannot be ruled out.
- No significant measures seem likely for Exports and Information Technology. The government would prefer to wait and watch on how the global economy fares in the coming time.
- The defence space is likely to witness increased spending this year.
- The matter related to Fuel price hike is expected to be taken up after the budget.

Following are key sector-wise expectations and their likelihood of happening

Automobiles

Key expectations	Probability	Impact
Partial roll back of excise duty cut announced in Dec-08 and Feb-09	High	Negative for all auto manufacturers
Removal of differential excise duty between large and small cars	Low	Positive for M&M and Tata Motors
Extension of accelerated depreciation for CVs	Low	Positive for Tata Motors and Ashok Leyland
Withdraw specific excise duty element of Rs 15,000 on PC (other than small cars)	Low	Positive for passenger car manufacturers (other than small car)
Partial Roll back of excise duty cut on auto components announced as a part of stimulus package	High	Negative for auto manufacturers as auto component manufacturers would completely pass through the hikes
Partial roll back of excise duty cut announced in December 2008 and February 2009	Medium	Positive for tyre manufacturers

Banking

Key expectations	Probability	Impact
Extension of prepayment period for 'agricultural debt waiver and debt relief scheme'	High	Positive for PSU Banks
Proposal for recapitalization of PSU Banks with low CAR	Medium	Positive for small PSU Banks
Increase in FDI limit for the insurance sector from current 24% to 49%	Low	Positive for banks having insurance ventures

Cement

Key expectations	Probability	Impact
Partial roll back of excise duty cut announced in Dec-08 and Feb-09	High	Negative for entire sector as players may find it difficult to pass on the hike
Replacing current excise duty structure with uniform excise rate at 8%of MRP	Low	Negative for East based manufacturers
Re-imposition of custom duty on imports	Low	Positive for all cement manufacturers
VAT on cement and clinker be brought down to 4%	Low	Positive for all cement manufacturers

Construction

Key expectations	Probability	Impact
Increase infrastructure spending	High	Positive for all construction companies as their order books will grow
Increase focus on JNNURM, Accelerated Irrigation benefit program	High	Positive for urban infrastructure development and water management companies
Clarity on takeout financing for IIFCL funding	Medium	Positive for infrastructure development companies looking to fund their projects
Allow contractor and sub-contractors to reap benefits of Sec 80-IA	Low	Positive for both contractors and sub-contractors

FMCG

Key expectations	Probability	Impact
Continued spending for development of rural sector	High	Positive for all FMCG companies
Partial roll back of excise duty cut announced in Dec-08 and Feb-09	High	Negative for FMCG companies especially HUL
Increase in excise duty on cigarettes	High	Negative for cigarette companies
3 years accelerated depreciation of 200% on R & D for new units in Food Processing and Packaging	Low	Positive for all Food Processing companies

Hotels

Key expectations	Probability	Impact
Infrastructure status (u/s 80IA) for the industry at par with that accorded to airports, railways etc	Medium	All new hotel projects would get 100% tax exemption on profits for 10 years; positive for all players

Information Technology

Key expectations	Probability	Impact
Extension of tax holiday for STP units and EOUs by at least three years to 2013-14	Medium	Positive for all; medium and small sized software companies to benefit more than large companies
Rollback of MAT for STP units & EOUs	Low	Positive for all; medium and small sized software companies to benefit more than large companies
Flexibility to SEZ units for deciding any 5 consecutive years within the first 10 years of operation for 100% tax exemption	Low	Positive for all software companies
Deduction to be allowed u/s 10AA on transfer of existing 10A/10B non-SEZ units to SEZ area	Low	Positive for all software companies
Clarification given in the Finance Act 2009 with regard to calculation of tax exemption for SEZs to be made effective retrospectively from January 2006	Medium	Positive for large software companies due to their material SEZ presence
Clarity on applicability of VAT and/or service tax on packaged software and customized software	Medium	Positive for product companies
Deemed exports made by EOUs and supplies made to an EOU to be allowed as deduction under u/s 10B	Low	Positive for all software companies
Signifcant increase in allocation for Education	High	Positive for education companies

Metals & Mining

Key expectations	Probability	Impact
Partial roll back of excise duty cut announced in Dec-08 and Feb-09	High	Companies will not be able to pass on the complete rise in cost, marginally negative for steel manufacturing companies
Removal of 5% customs duty on steel products	Low	Negative for steel manufacturing companies due to lower parity prices
Increase in export duty on iron ore by 5%	Low	Negative for Sesa Goa, positive for companies which lack iron ore integration

Oil & Gas

Key expectations	Probability	Impact
De-regulation of petrol and diesel pricing	Low	Lower subsidy burden; positive for OMCs, ONGC, OIL and GAIL
Calrification on 80-IB benefit for gas exploration	High	RIL, ONGC, OIL to gain if tax holiday extended to gas
Increase in custom duties on petroleum products	Low	Higher subsidy burden; negative for OMCs, ONGC, OIL and GAIL
Declared goods status to natural gas	Medium	Uniform sales tax rate leading to improved competitiveness of CNG vs other fuels
Increase in cess and royalty on crude oil production from Pre-NELP blocks	Medium	ONGC and OIL to witness lower margins
Reduction in custom duties on Naphta	Medium	Positive for RIL

Telecom

Key expectations	Probability	Impact
Estimate of 3G revenues/indicative timeframe for completion of 3G auction	High	-
Uniform license fee regime	Low	Would eliminate concerns regarding arbitrage due to differential license rates across telecom services; beneficial to all the operators if implemented
Extension of 100% tax exemption on profits u/s 80IA from current 5 years to 10 years	Low	Positive for all the companies

Utilities

Key expectations	Probability	Impact
Increase allocation to rural electrification schemes	High	Positive for T&D players like KEC, Jyoti Structures, Kalpataru Power, Bharat Bijlee, EMCO, Voltamp, ABB, Areva T&D
Impose import duty on power plant equipments	Medium	Expect 5-7.5% duty to be levied Positive for domestic equipment manufacturers like BHEL, L&T, Siemens Negative for generating companies using imported equipments
Increase spending on hydro projects and allocation of atleast 1 UMPP during the year	High	Positive for all equipment suppliers
Extension of Sec 80-IA benefits	High	Positive for power generators and transmission players like NTPC, Tata Power, CESC, Reliance Power and PGCIL
Higher allocation to renewable energy	High	Positive for equipment suppliers of wind turbine - Suzlon and solar modules - Websol

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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