Equities

18 March 2012 │ 30 pages

India Budget

Tame, at a Tough Time

- Equities
- Economics

- **Playing too safe** —This budget takes few chances: Economically, Politically and sentiment-wise. It could well be the most measured approach, but with no meaningful longer-term structural reform, only modest attempts at fiscal reform and few handouts to businesses, this budget is unlikely to change the underlying economic momentum/mood. That could be a little negative for the market – given its 15%+ move in 2012 – partly anticipating an economic and Government policy-making revival.
- **Budget Maths: more realistic but not entirely** — The Budget targets a fiscal deficit of 5.1% (against market hopes of sub 5%). The maths is more reasonable than last year, but we expect slippage of about 40bps due to fuel subsidies and growth risks. The bond market for now is clearly not impressed or believing, with yields rising in reaction.
- **Reforms and Tax increases are both small** — The Government has signaled some reform; subsidies (2% of GDP), incentives for retail equity investors, corporate debt market opened for foreigners; and softly reiterated old promises - FDI in Retail/Aviation, implementation of DTC and GST. It has also expectedly raised Excise and Service taxes (from 10% to 12%) and tightened the screws on loopholes and evasion. All of this is in the right direction, but these are cautious and small steps, and none of them are likely to meaningfully alter either the longer-term landscape or the near-term prospects.
- **Investment over Consumption this time**— The budget's thrust is on investment; Infrastructure, utilities, Power and Coal imports – all of which benefit from breaks (also Cement). It is consumption which sees higher taxes that could face some risks (Autos), while Energy stocks will likely see the biggest earnings downgrades. We expect overall market earnings to fall marginally by 1-2% if growth largely holds.
- **Steadying the Ship, but stoking the rally?** — No. This budget seeks to tread the middle ground on fiscal consolidation and sustaining growth. It could well be the most appropriate course of action, but this is not what would drive markets over the near term.

Aditya Narain, CFA
+91-22-6631-9879
aditya.narain@citi.com

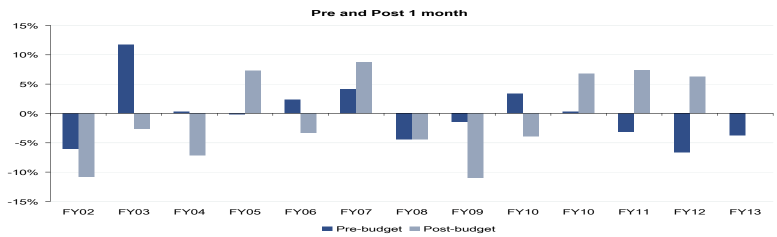
Rohini Malkani
+91-22-6631-9876
rohini.malkani@citi.com

Anushka Shah
+91-22-6631-9878
anushka.shah@citi.com

Jitender Tokas,CFA
jitender.tokas@citi.com

India Research Team

Figure 1. Market Performance Around the Budget



Source: Bloomberg, CIRA

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Contents

Tame, at a Tough Time

Middle Ground

Muddled expectations…but high hopes…..which have probably been belied

We do not believe the market really knew what it wanted (apart from it being a good budget) – so it is somewhat hard to judge it against expectations. But what we believe the market was generally looking for in the backdrop of its fairly strong and ahead-of-peers YTD rally – was something that would justify an improved outlook; near or long term. It had already got some tailwind on the monetary side – falling inflation, reduced reserve ratios, and the RBI's talk of a reversing interest rate cycle. The budget was when the improvement in the fiscal side of the story was hoped for; and hence the general but non-specific expectations.

A little bit of consolidation, reform and hope….that's called the middle ground

The Government has chosen the middle ground. A little bit of fiscal consolidation (Excise and Service taxes are up), a little bit of reform (offshore debt funding, capping subsidies) and a little bit of hope (economy is picking up – higher tax rates should not impact growth). It could well be the most appropriate way to go given both economic and political risks. But it eschews some of the tougher reforms that are now fundamentally needed to address increasing structural issues that the economy is facing. These reforms could be critical to boost confidence and expectations in the corporate sector. It has also largely stayed away from near-term concessions or incentives for the economy or the market, which could at least light up expectations over the near term.

Safe and possibly appropriate way to play it…but that's not what markets like

Is it the appropriate route? Possibly, but we do see it banking on hope and expectations that the economy will start recovering soon rather than doing much to drive it. This will also keep in check the risks of meaningful further fiscal deterioration or imbalances, but in the backdrop of an equity market that has been amongst the strongest performers globally YTD, it is likely to disappoint. We would highlight that the last three budgets of this Government have seen the market close 5%+ after one month of the budget, and we believe this is unlikely to be the case this year.

Investment cycle over the consumption one…this time

The budget does seek to support the investment cycle and easing some of the strain in the infrastructure, Energy and Power sectors through funding and tax concessions. These are the sectors that benefit from this budget, while it is the consumption sectors that will face the brunt of the higher excise tax levels. We see a fairly modest overall earnings impact of the budget on the market - about negative 1 – 2%; with the Energy sector taking the largest hit.

Marginally negative impact for market earnings……and we detail our economics, sector and stocks implications

We present our Economist Rohini Malkani's detailed analysis of the budget, and our sector and stock takeaways, across the market below.

Staying the Course and Keeping Fingers Crossed

Rohini Malkani
+91-22-6631-9876
rohini.malkani@citi.com

Anushka Shah
+91-22-6631-9878
anushka.shah@citi.com

- **FY13 Budget: Playing Safe, Economically and Politically** — Set against a weak political backdrop, the FY13 budget posted no major surprises. While this was always going to be a difficult budget, given fiscal and political constraints, the FM chose to play safe. In this context, the thrust areas in this budget are: (1) Growth – Maintaining it through some investment and funding incentives, rather than accelerating it. (2) Fiscal – Attempts to widen the tax base and cap the subsidy bill to 2% of GDP. (3) Governance – Gradual recourse to more usage of UID-Aaadhar. However, there is not enough of the aggression on the bigger picture reform than the market was hoping for; given that it would be the last opportunity ahead of the 2014 general elections.

- **Budget Arithmetic – More Realistic, But Not Entirely** — While the >100bps slippage in the FY12 deficit to 5.9% v/s estimates of 4.6% was no surprise, key is that numbers (i) do not fully account for fuel subsidy; (ii) includes disputed telecom-related capital gains. The FY13 numbers are more credible, but not entirely and we expect a slippage of ~40bps to 5.5%. The arithmetic is based on nominal growth of 14% (GDP of 7.6% and inflation of 6.5%), revenues +22.7% and expenditure +13.1%. While growth assumptions are realistic, we could see slippage on revenues and expenditures.

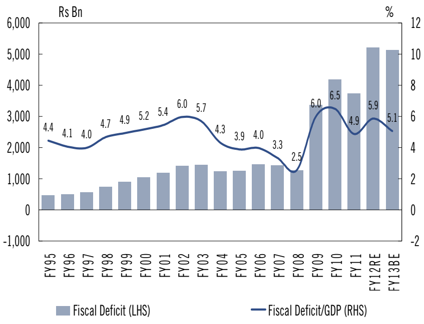
  – **Revenues: Targets dependent on Growth Sustaining and Markets holding up** — The budget has estimated a 19.5% increase in gross tax collections (*excise 29.1%, customs 22%, services 30.5%, corporate 13.9%, and income 13.9%).* Taking into account the increase in excise and services tax rates from 10% to 12%, coupled with widening the service tax net, these are achievable provided growth holds up. Key to meeting estimates would be (1) 32% growth in non-tax revenues to Rs1646bn (of this telecom revenues are estimated at Rs400bn); and (2) The Rs300bn divestment target, which is dependent on market conditions *(See pg 3).*

  – **Expenditures: Capping the Subsidy Bill is Positive, but who bears the cost?** — The budget has estimated a 13.5% rise in expenditures led by a 22.1% rise in plan expenditure and an 8.7% rise in non-plan expenditure. However, key to note is that similar to last year, the budget has once again factored a 12.2% contraction in the subsidy bill. Looking at the details *(see pg 4-5),* while the numbers for food and fertiliser seem realistic, estimates for fuel are conservative. A caveat to this could be the budget proposal to restrict subsidies to 2% of GDP in FY13 wherein it has said it would fully provide for food subsidies while the others would be funded to the extent that they can be borne by the economy without any adverse implications.

- **Bottom Line** — The FY13 fiscal deficit of Rs 5136bn or 5.1% of GDP while slightly higher than market expectations could overshoot targets by ~40bps to 5.5% of GDP. Today's non-eventful budget, read in conjunction with yesterday's rather hawkish monetary policy, has resulted in yields edging slightly higher.

Budget Snapshot and Key Focus Areas

Figure 2. Trends in the Centre's Fiscal Deficit (Rs Bn, % GDP)



Source: Ministry of Finance

FY12 Deficit: Slippage in line with expectations – The fiscal deficit for FY12 was finally pegged at Rs5136bn or 5.9% of GDP v/s budget expectations of Rs 4128bn (4.6% of GDP). However, this was no surprise given that during FY12, expenditures have been trending higher while revenues were running below budget estimates. Moreover, key to note is that the numbers (i) do not fully account for the fuel subsidy and (ii) include disputed telecom-related capital gains

FY13 numbers are more credible than the previous year, but not entirely – The fiscal arithmetic is based on nominal GDP growth of 14% (real GDP of 7.6% and inflation of 6.5%), total revenues rising 22.7% and expenditure rising 13.1%. While the growth assumptions are realistic, we could see some slippage on both revenues as well as expenditures.

<u>FY13 Budget Arithmetic</u>:

Revenues rising by 22.7%, led by tax revenues up 20.1%.

Expenditures rising by 13.1%

Fiscal Deficit of 5.1% of GDP vs. 5.9% in FY12

We expect a slippage of ~40bps to 5.5%

Figure 3. Budget Snapshot (Rs Bn)

Rs bn	FY12RE	FY13BE	Growth rate
a. Revenue receipts	7,670	9,357	22.0
Tax revenues	6,423	7711	20.1
Non-tax	1,247	1646	32.0
b. Non-debt cap receipts	**298**	**417**	40.0
Recoveries of loans	143	116.5	-18.3
Divestments	155	300	93.6
c. Total receipts (a+b)	**7,967**	**9,773**	22.7
h Plan expenditure on rev & cap a/c	4,266	5210.25	22.1
i. Non-plan expenditure on rev & cap a/c	8,921	9699	8.7
j. Total expenditure (d+f) =(h+i)	**13,187**	**14,909**	13.1
j. Fiscal Balance (c-j)	**-5220**	**-5136**	-1.6
% to GDP	-5.9	-5.1	-13.7
Revenue Balance (a-d)	-3950	-3504	-11.3
% to GDP	-4.4	-3.4	-22.2
Primary Balance (j-1)	-2464	-1938	-21.3
% to GDP	-2.8	-1.9	-31.0
GDP assumption	**89,122**	**101,599**	**14.0**

Source: Budget Documents

Five-pronged budget focus

Figure 4. Key Focus Areas – Budget FY13

Focus Area	Key Measures
Investment Environment	- Bringing forward implementation of the Advance Pricing Agreement to improve tax certainty - Introducing a 'Rajiv Gandhi Equity Savings Scheme', allowing for tax deduction to new retail investors in equities - Allowing QFIs to access Indian Corporate Bond Markets - Proposing to move a host of financial sector reforms in the Budget Session of Parliament, including the PFRDA Bill, Banking Laws Amendment Bill
Agriculture	- Increased allocation for the Rashtriya Krishi Vikas Yojana (RKVY) - affordable agri credit through an additional interest rate subvention of 3% for prompt paying farmers (in addition to 7% provided in FY13) - Setting up a National Mission on Food Processing
Infrastructure	- ECBs permitted to part finance rupee debt of power projects, capex on roads/highways, low cost affordable housing
Inclusive Growth	Creating a PDS using the Aadhar platform. Computerization of PDS to become operational by Dec-12 Enhanced allocation for rural drinking water/sanitation, rural infra development, education, health and National Rural Livelihood Mission
Governance	Laying in the house a 'White Paper on Black Money' and proposing steps to curb unaccounted flows

Source: Budget Documents, Citi Investment Research and Analysis

Revenues – Targets dependent on Growth Sustaining and Markets holding up

The budget assumes: (1) gross tax collections rising by 19.5% YoY to 10.6% of GDP; and (2) Non-Tax Revenues rising by 32% YoY.

Figure 4. Non-Tax Revenues (Rs Bn)

Rs Bn	FY11	FY12RE	FY13BE
Fiscal Services	1	1	1
Interest Receipts	197	201	192
Dividends and Profits	480	501	502
Other General Services	95	104	111
Social Services	8	26	14
Econ Services (incl 3G)	1,367	368	786
TOTAL	**2,186**	**1,247**	**1,646**

Source: Budget Documents

Figure 5. Trends in Revenues (Rs Bn)

Rs Bn	FY07	FY08	FY09	FY10	FY11	FY12RE	FY13BE
Corporation tax	**1,443**	**1,929**	**2,134**	**2,447**	**2,987**	**3,277**	**3,732**
% YoY	42.5	33.7	10.6	14.7	22.1	9.7	13.9
% GDP	3.4	3.9	3.8	3.8	3.9	3.7	3.7
% to total taxes	30.5	32.5	35.3	39.2	37.7	36.3	34.6
Income tax	**751**	**1,026**	**1,060**	**1,224**	**1,391**	**1,667**	**1,899**
% YoY	34.1	36.7	3.3	15.4	13.6	19.9	13.9
% GDP	1.7	2.1	1.9	1.9	1.8	1.9	1.9
% to total taxes	15.9	17.3	17.5	19.6	17.5	18.5	17.6
Excise duty	**1,176**	**1,234**	**1,086**	**1,030**	**1,377**	**1,501**	**1,937**
% YoY	5.7	4.9	-12.0	-5.2	33.7	9.0	29.1
% GDP	2.7	2.5	1.9	1.6	1.8	1.7	1.9
% to total taxes	24.8	20.8	17.9	16.5	17.4	16.6	18.0
Customs collections	**863**	**1,041**	**999**	**833**	**1,358**	**1,530**	**1,867**
% YoY	32.7	20.6	-4.1	-16.6	63.0	12.7	22.0
% GDP	2.0	2.1	1.8	1.3	1.8	1.7	1.8
% to total taxes	18.2	17.6	16.5	13.3	17.1	17.0	17.3
Service tax	**376**	**513**	**609**	**584**	**710**	**950**	**1240**
% YoY	63.1	36.4	18.8	-4.1	21.6	33.8	30.5
% GDP	0.9	1.0	1.1	0.9	0.9	1.1	1.2
% to total taxes	7.9	8.6	10.1	9.4	9.0	10.5	11.5
Gross Tax Collections	**4,735**	**5,931**	**6,053**	**6,245**	**7,931**	**9,017**	**10,776**
% YoY	29.3	25.3	2.0	3.2	27.0	13.7	19.5
% to GDP	11.0	11.9	10.8	9.7	10.3	10.1	10.6
Net Tax Collections	**3,512**	**4,395**	**4,433**	**4,565**	**5,699**	**6,423**	**7,711**
% YoY	29.9	25.2	0.9	3.0	24.8	12.7	20.1
% to GDP	8.2	8.8	7.9	7.1	7.4	7.2	7.6

Source: Budget Documents

The budget has estimated 20.1% in net tax collections (excise 29.1%, customs 22%, services 30.5%, corporate 13.9%, and income 13.9%).

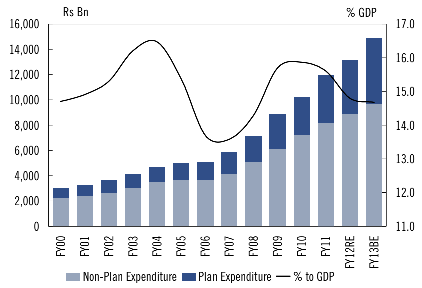
- **Direct Taxes** – ***Estimated to result in a net revenue loss of Rs45bn***
  - In a move towards implementing the DTC, **income tax** exemptions were enhanced from Rs1.8mn to Rs2mn
  - **Withholding taxes** on interest payments of ECBs for 'stressed infra sectors' including power, airlines, roads, ports reduced from 20% to 5% for three years
  - In a bid to reduce transaction costs in the capital market, the **Securities Transaction Tax** was reduced from 0.125% to 0.1%
  - Several steps to deter use of **unaccounted money,** including compulsory reporting requirements, allowance to re-open assessments up to 16 years
- **Indirect Taxes** – ***Estimated to result in net revenue gain of R459bn***
  - **Service Taxes**: In a move towards GST and to widen the tax base, a negative list was introduced, where all but 17 services would be taxed at a higher rate of 12% (from 10% earlier). Items under the negative list include services by the govt/local authorities, and agri.
  - **Excise duties**: Raised from 10% to 12%.
  - **Customs duties**: Reduced for agri, thermal power producers, LNG, coal mining, railway equipment, textiles inputs, while duties on cigarettes and tobacco were raised

Service tax measures would raise revenues to the tune of Rs187bn . See Spotlight on Services – Role in Economy and Taxation for details on service taxes.

Expenditures – Capping the Subsidy Bill is Positive, but Who Bears the Cost?

The budget allows room for total expenditure to rise 13.1% in FY13 from 10.1% growth in FY12. This factors in a 22.1% rise in plan expenditure and an 8.7% increase in non-plan spending.

Figure 6: Trends in Plan and Non-Plan Expenditure (Rs Bn, % GDP)



Source: Budget Documents

The budget has once again factored a 12.2% contraction in the subsidy bill with estimates for fuel being on the conservative side

A caveat could be the budget proposal to restrict subsidies to 2% of GDP in FY13 where-in food subsidies would be fully provided but others would be funded to the extent that they can be borne by the economy without adverse implications

Figure 7. Trends in Expenditures (Rs Bn)

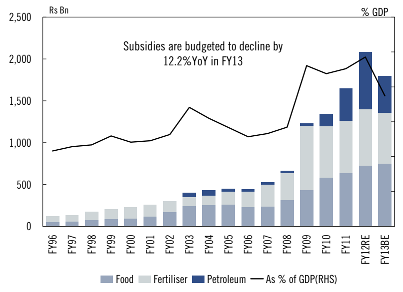
Rs bn, year end March	FY07	FY08	FY09	FY10	FY11	FY12RE	FY13BE
1. Revenue Expenditure	**5,146**	**5,945**	**7,938**	**9,118**	**10,407**	**11,619**	**12,861**
%YoY	17.1	15.5	33.5	14.9	14.1	11.6	10.7
% GDP	12.0	11.9	14.1	14.1	13.6	13.0	12.7
a. Of which: Non Plan Rev Exp	**3,722**	**4,209**	**5,590**	**6,579**	**7,265**	**8,157**	**8,656**
Interest	**1,503**	**1,710**	**1,922**	**2,131**	**2,340**	**2,756**	**3,198**
%YoY	13.3	13.8	12.4	10.9	9.8	17.8	16.0
% GDP	3.5	3.4	3.4	3.3	3.0	3.1	3.1
Subsidies	**571**	**709**	**1,297**	**1,414**	**1,734**	**2,163**	**1,900**
%YoY	20.2	24.2	82.9	9.0	22.7	24.7	-12.2
% GDP	1.3	1.4	2.3	2.2	2.3	2.4	1.9
Food	240	313	438	584	638	728	750
Fertilizer	262	325	766	613	623	672	610
Petroleum	27	28	29	150	384	685	436
Others (incl grants)	42	43	65	67	89	78	105
Defense	**517**	**543**	**733**	**907**	**921**	**1,048**	**1,138**
Pensions	**221**	**243**	**329**	**561**	**574**	**562**	**632**
Grants to States	357	358	382	459	498	553	642
Admin and social services	**553**	**647**	**927**	**1,107**	**1,198**	**1,075**	**1,146**
b. Plan Revenue Expenditure	**1,424**	**1,736**	**2,348**	**2,539**	**3,142**	**3,462**	**4,205**
2. Capital expenditure	**688**	**1,182**	**902**	**1,127**	**1,566**	**1,568**	**2,048**
%YoY	3.6	71.9	-23.7	25.0	39.0	0.1	30.6
% GDP	1.6	2.4	1.6	1.7	2.0	1.8	2.0
c. Defence	338	375	410	511	621	661	796
d. Loans	75	493	87	121	298	102	247
of which repaid to NSSF	0	0	0	0	0	0	0
e. Plan Capital expenditure	**274**	**315**	**405**	**495**	**648**	**804**	**1,005**
3. Plan expenditure on rev & cap	**1,699**	**2,051**	**2,752**	**3,034**	**3,790**	**4,266**	**5,210**
%YoY	20.8	20.7	34.2	10.2	24.9	12.6	22.1
% GDP	4.0	4.1	4.9	4.7	4.9	4.8	5.1
4. Non Plan ex on rev & cap	**4,135**	**5,077**	**6,087**	**7,211**	**8,183**	**8,921**	**9,699**
%YoY	13.3	22.8	19.9	18.5	13.5	9.0	8.7
% GDP	9.6	10.2	10.8	11.2	10.7	10.0	9.5
TOTAL EXPENDITURE(1+2 =3+4)	**5,834**	**7,127**	**8,840**	**10,245**	**11,973**	**13,187**	**14,909**
% YoY	15.4	22.2	24.0	15.9	16.9	10.1	13.1
% GDP	13.6	14.3	15.7	15.9	15.6	14.8	14.7
Memo:							
Defense	**855**	**917**	**1,143**	**1,418**	**1,541**	**1,709**	**1,934**
%YoY	6.2	7.3	24.6	24.1	8.7	10.9	13.1
% GDP	2.0	1.8	2.0	2.2	2.0	1.9	1.9
Defense Revenue Expenditure	517	543	733	907	921	1,048	1,138
Defense Capital Expenditure	338	375	410	511	621	661	796

Source: Budget Documents

Subsidies – Fuel Assumptions Appear Optimistic, Again

Within plan spending, outlays for energy, general economic services, industry/ materials have seen a significant rise. On the non-plan expenditure front, a key worry remains **subsidies**, which are projected to see a 12.2% contraction in order to meet the non-plan spending targets. We think these assumptions are optimistic, primarily due to slippage on fuel subsidies. Unless painful price increases are implemented (which are likely to be difficult given political compulsions); these targets may be difficult to meet.

Figure 8. Trends and Components of Subsidies (Rs Bn, % GDP)



Source Budget Documents

Fuel Subsidies

The budget factors in oil subsidies at just Rs436bn. However, key to note, that this incorporates deferred oil subsides from FY12, to the tune of Rs 250bn. Going forward for FY13, assuming crude averages ~US$125/bbl this year, our oil & gas analyst, Saurabh Handa, expects gross under-recoveries[1] for the oil marketing companies to touch an all-time high of Rs1.62tn in FY13.

While the de-regulation of petrol subsidies last year has helped, oil companies are making major losses on diesel and cooking fuels.

Current Losses: Diesel Rs13/ltr; LPG Rs326/cylinder; Kerosene Rs28.5/ltr

Sensitivities:

Every US1/bbl change in oil prices = Rs30bn

Every Rs1 depreciation = Rs80bn

This assumes that the government implements some price hikes (i.e. prices of diesel would be raised by ~Rs5/l, LPG by ~Rs70/cyl, and kerosene by ~Rs2/l). While there is little clarity on the subsidy-sharing formula, assuming the government shares~ 45% of the total, the subsidy bill could rise to Rs731bn in FY13.

Bottom Line: Taking into account the FY12 deferred oil subsides, the Rs436bn outlay projected for FY13 is conservative. A caveat to this could be the budget proposal to restrict subsidies to 2% of GDP in FY13 where-in it has said it would fully provide for food subsidies while the others would be funded to the extent that they can be borne by the economy without any adverse implications.

Figure 9. Subsidy sharing mechanism (Rs bn)

	FY11	FY12E	FY13E	FY14E
Gross under-recoveries	**782**	**1,420**	**1,624**	**1,266**
Less: upstream sharing	303	639	812	633
% of total	*39%*	*45%*	*50%*	*50%*
Less: oil bonds/cash from gov't	**410**	**767**	**731**	**570**
% of total	*52%*	*50%*	*45%*	*45%*
Net under (over)-recoveries	**69**	**14**	**81**	**63**
Oil Price Assumptions	**86.6**	**110**	**125**	**120**

Source: Company Reports, Citi Investment Research and Analysis Estimates

[1] **Fuel subsidies** are provided for the difference between retail prices and global crude prices. At present, the government administers prices of diesel, LPG and kerosene. While petrol prices were de-regulated last year, only periodic adjustments are made in practice. Gross under-recoveries on oil indicate total losses made by oil companies. As per a subsidy-sharing agreement, the govt compensates for ~50% of these losses, with the balance shared by upstream and downstream oil companies.

Public Finances in Pictures

Figure 10. Trends in the Centre Fiscal Deficit (% GDP)

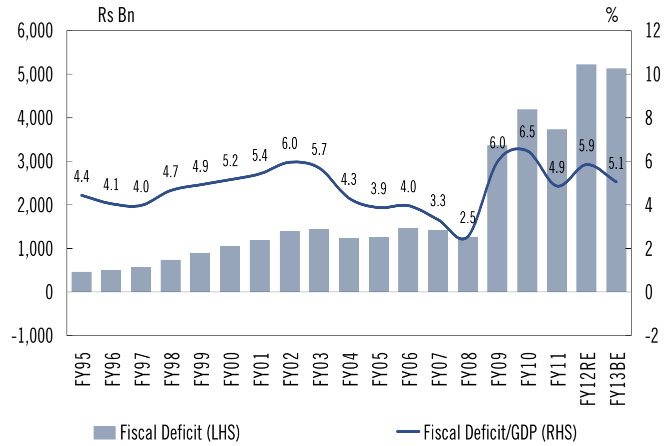


Figure 11. Trends in Tax Revenues (% GDP)

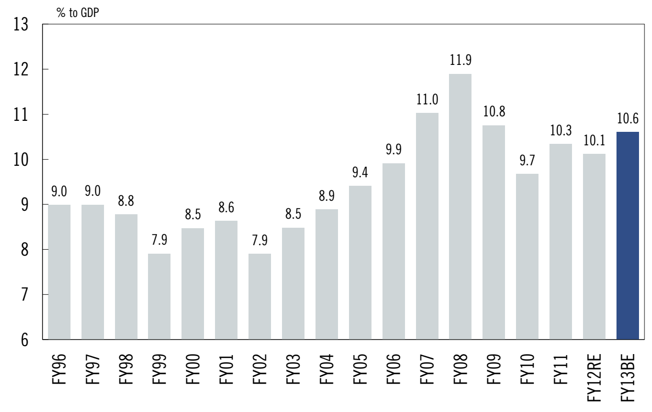


Figure 12. Trends in Expenditure (Rs Bn, %YoY)

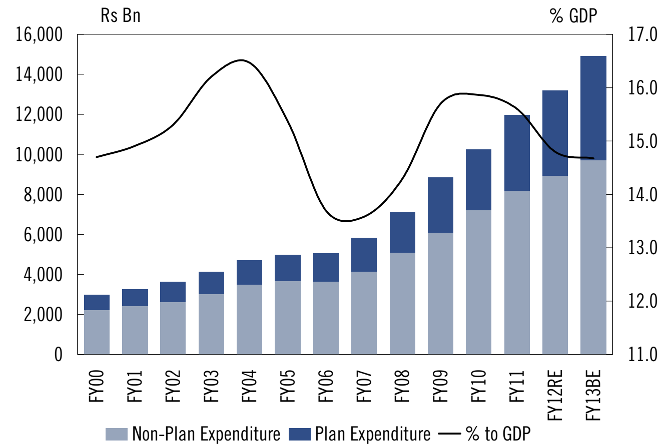


Figure 13. Trends in Subsidies (Rs Bn, %)

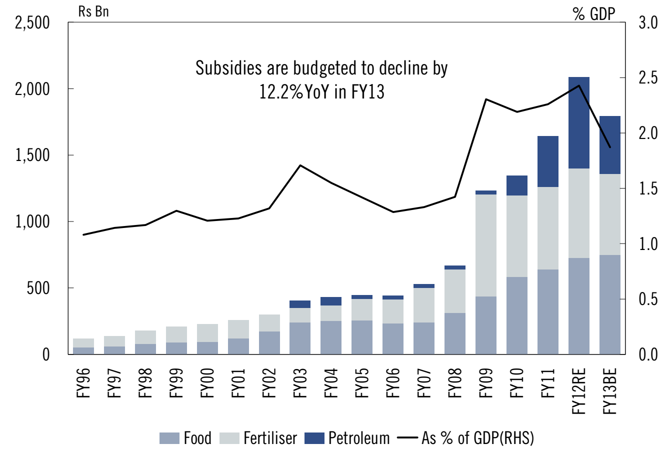


Figure 14. Trends in Divestments – Actual vs. Budgeted (Rs Bn)

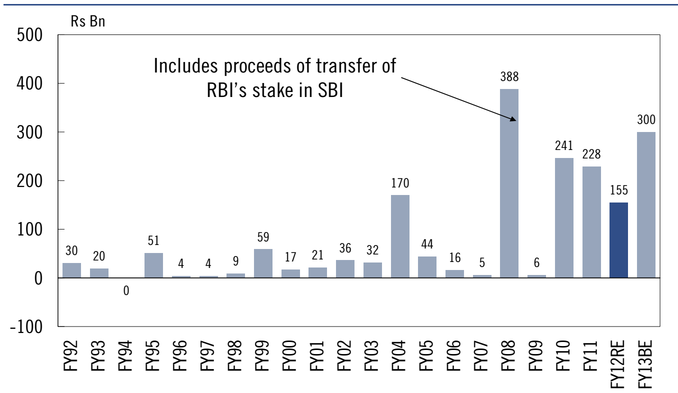
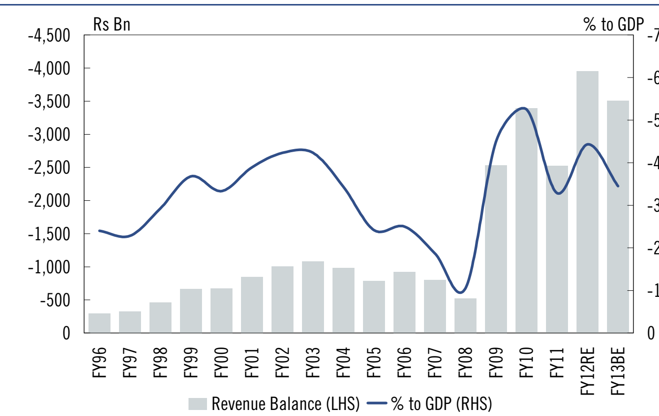


Figure 15. Trends in the Revenue Deficit (Rs Bn, % GDP)



Source for all charts: Budget Documents

Snapshot of Government Finances

Figure 16. India – Snapshot of Central Government Finances (Rs Bn, %)

	FY07	FY08	FY09	FY10	FY11	FY12RE	FY13BE	BUDGET FY13– KEY HIGHLIGHTS
a. Gross Tax Revenue	**4,735**	**5,931**	**6,053**	**6,245**	**7,931**	**9,017**	**10,776**	
% to GDP	11.0	11.9	10.8	9.7	10.3	10.1	10.6	**Revenues**
% YoY	29.3	25.3	2.0	3.2	27.0	13.7	19.5	Key Assumptions: Income Tax +13.9%,
Corporation tax	1,443	1,929	2,134	2,447	2,987	3,277	3,732	Customs +22%, Excise +29.1%,
Income tax	751	1,026	1,060	1,224	1,391	1,667	1,899	Corporate +13.9%, Service +30.5%
Excise duty	1,176	1,234	1,086	1,030	1,377	1,501	1,937	
Import duty	863	1,041	999	833	1,358	1,530	1,867	Increase in service taxes from 10% to
Service tax	376	513	609	584	710	950	1,240	12%, negative list introduced
b. (-) Devolvement to States & UTs	**126**	**187**	**164**	**127**	**108**	**92**	**101**	Excise duties also raised from 10% to
c. Net tax revenues (a-b)	1,223	1,536	1,620	1,680	2,232	2,594	3,065	12%
d. Non tax revenues	3,512	4,395	4,433	4,565	5,699	6,423	7,711	
e. Net revenue receipts (c+d)	**832**	**1,023**	**969**	**1,163**	**2,186**	**1,247**	**1,646**	
f. Non-debt capital receipts	**64**	**439**	**67**	**332**	**353**	**298**	**417**	Divestment targets appear more realistic
Recovery of loans	59	51	61	86	124	143	117	
Divestments/Other	5	388	6	246	228	155	300	
g. TOTAL REVENUES (e+f)	**4,408**	**5,858**	**5,470**	**6,060**	**8,237**	**7,967**	**9,773**	
%YoY	22.7	32.9	-6.6	10.8	35.9	-3.3	22.7	
h. Revenue expenditure	**5,146**	**5,945**	**7,938**	**9,118**	**10,407**	**11,619**	**12,861**	**Expenditures**
Interest (1)	1,503	1,710	1,922	2,131	2,340	2,756	3,198	
Defense	517	543	733	907	921	1,048	1,138	
Subsidies	571	709	1,297	1,414	1,734	2,163	1,900	Fuel subsidies appear understated
Pensions	221	243	329	561	574	562	632	
Grants to States	357	358	382	459	498	553	642	
Admin and social services	553	647	927	1,107	1,198	1,075	1,146	
Plan expenditure	1,424	1,736	2,348	2,539	3,142	3,462	4,205	
i. Capital expenditure	**688**	**1,182**	**902**	**1,127**	**1,566**	**1,568**	**2,048**	
Defense	338	375	410	511	621	661	796	
Loans	75	493	87	121	298	102	247	
Plan expenditure	274	315	405	495	648	804	1,005	
j. Plan expenditure	**1,699**	**2,051**	**2,752**	**3,034**	**3,790**	**4,266**	**5,210**	Plan exp budgeted to rise 22.1%YoY
k Non Plan expenditure	**4,135**	**5,077**	**6,087**	**7,211**	**8,183**	**8,921**	**9,699**	Non-plan exp slated to rise 8.7%
l. TOTAL EXPENDITURE (h+i): (j+k)	**5,834**	**7,127**	**8,840**	**10,245**	**11,973**	**13,187**	**14,909**	
% YoY	15.4	22.2	24.0	15.9	16.9	10.1	13.1	
Deficit trends								
m. Fiscal Balance (g-l)	**-1,426**	**-1,270**	**-3,370**	**-4,185**	**-3,736**	**-5,220**	**-5,136**	**Fisc Deficit for FY13 budgeted at 5.1%**
% to GDP	-3.3	-2.5	-6.0	-6.5	-4.9	-5.9	-5.1	**from 5.9% in FY12RE**
n. Revenue Balance (e-h)	**-802**	**-526**	**-2,535**	**-3,390**	**-2,523**	**-3,950**	**-3,504**	We expect a slippage of ~40bps to 5.5%
% to GDP	-1.9	-1.1	-4.5	-5.2	-3.3	-4.4	-3.4	
o. Primary Deficit (m-1)	**77**	**441**	**-1,448**	**-2,054**	**-1,396**	**-2,464**	**-1,938**	
% to GDP	0.2	0.9	-2.6	-3.2	-1.8	-2.8	-1.9	
Financing the deficit								
Market borrowings (Net)	1,104	1,318	2,336	3,984	3,254	4,364	4,790	Market Borrowings are up 9.8%YoY
PPF & special deposits	52	39	80	161	125	100	120	
Small savings	0	-113	-13	133	112	-103	12	
Net external assistance	85	93	110	110	236	103	101	
Others	140	204	418	-189	-56	1,000	112	
Cash Surplus	45	-271	438	-14	64	-245	0	
Total financing								
Memo items (% to GDP)								
Centre	-3.3	-2.5	-6.0	-6.5	-4.9	-5.9	-5.1	
State	-1.8	-1.5	-2.4	-3.3	-2.5	-2.5	-2.5	
Combined	**-5.4**	**-4.1**	**-8.4**	**-9.6**	**-8.3**	**-8.0**	**-7.7**	
Off Balance Sheet Items	-0.9	-0.6	-1.7	-0.2	1.0			
Total Deficit	**-6.3**	**-4.7**	**-10.1**	**-9.8**	**-7.3**	**-8.0**	**-7.7**	
Combined liabilities	79.3	76.1	76.1	75.0	71.3	70.0	69.0	

*Includes proceeds of transfer of RBI's stake in SBI. RE: Revised Estimates; **BE: Budgeted Estimates, based on the government's nominal GDP forecast of Rs101599bn or 14%YoY.** Source: Budget Documents, CIRA

Statistical Snapshot

Figure 17. India – Macroeconomic Summary, FY00-13E (%)

Year to 31 March	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
National Income Indicators*														
Nominal GDP (Rs bn)	20,279	21,840	23,676	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,574	76,741	89,122	102,044
Nominal GDP (US$ bn)	467	478	493	528	623.5	720.5	833.7	950.2	1240.6	1223.9	1362.3	1683.7	1,853	2,072
Per Capita GDP (US$)	467	469	474	500	582	662	754	847	1,090	1,061	1,163	1,416	1,535	1,692
Real GDP growth (%)	6.0	4.4	5.8	3.8	8.5	7.6	9.5	9.6	9.3	6.7	8.4	8.4	6.9	7.0
Agriculture growth (%)	0.5	-0.2	6.3	-7.2	10.0	1.6	5.1	4.2	5.8	0.1	1.0	7.0	2.5	3.0
Industry growth (%)	4.6	6.4	2.7	7.1	7.4	9.4	9.7	12.2	9.7	4.4	8.4	7.2	3.9	5.0
Services growth (%)	9.5	5.7	7.2	7.5	8.5	9.4	10.9	10.1	10.3	10.0	10.5	9.3	9.4	9.0
By Demand * (%YoY)														
Consumption	7.2	3.0	5.3	2.3	5.4	2.3	8.6	7.9	9.3	7.6	8.1	8.1	6.0	6.3
Pvt Consm	6.1	3.4	6.0	2.9	5.9	2.1	8.5	8.7	9.2	7.1	7.0	8.1	6.5	6.5
Public Consm	13.2	0.9	2.3	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	14.3	7.8	3.9	5.0
Gross Fixed Capital Formn	11.2	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	3.5	6.8	7.5	5.6	6.5
Cons; Invst, Savings ** (%GDP)														
Consumption	79.4	78.5	78.9	77.2	75.0	70.3	69.3	68.3	67.4	68.8	69.4	68.4	67.9	67.0
Capital Formation	25.3	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.1	35.8	35.4	36.0
Gross Domestic Savings	24.2	23.2	22.9	25.7	29.1	32.4	33.4	34.6	36.8	32.0	33.8	32.3	33.0	33.5
Real Indicators (%YoY)														
Cement despatches (domestic)	15.2	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	4.8	8.0	9.0
Commercial vehicle sales	22.0	-11.9	-4.5	28.0	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	14.1	15.0
Car sales	45.3	-5.3	3.2	7.8	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.3	-4.0	7.5
Two-wheelers	9.4	0.7	15.3	17.0	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	15.0	11.0
Diesel consumption	5.6	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	6.0	6.0
Mobile Tele density	0.2	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.9	67.9	74.9	81.6
Monetary Indicators (% YoY)														
Money supply	14.6	16.8	14.1	14.7	16.8	12.0	21.4	21.3	21.1	19.3	16.7	16.0	17.0	17.0
Inflation – WPI (Avg)	3.3	7.1	3.6	3.4	5.5	6.5	4.4	6.5	4.8	8.0	3.6	8.6	9.0	7.0
CPI (Avg)	3.4	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	13.0	9.5	9.0	7.0
Bank credit growth	18.2	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.7	21.4	18.0	18.0
Deposit growth	13.9	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	18.0	17.0	15.8	17.0	17.0
Fiscal Indicators (% GDP)														
Centre's fiscal deficit)	-5.2	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.9	-5.9	-5.1
State fiscal deficit	-4.5	-4.0	-4.1	-3.9	-4.2	-3.3	-2.4	-1.8	-1.5	-2.4	-3.3	-2.5	-2.5	-2.5
Combined deficit (Centre+State)	-9.0	-9.1	-9.5	-9.1	-8.1	-7.2	-6.5	-5.4	-4.1	-8.4	-9.6	-8.3	-8.0	-7.7
Off Balance Sheet Items	-	-	-	-	-	-	-0.5	-0.9	-0.6	-1.7	-0.2	NA	NA	NA
Combined liabilities (dom+ext)	73.8	77.1	82.0	85.5	85.4	85.2	83.0	79.3	76.1	76.1	75.0	71.1	70.0	69.0
External Sector (% YoY)														
Exports (US$bn)	37.5	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	250.5	288.0	331.2
% YoY	9.5	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	37.3	15.0	15.0
Imports (US$bn)	55.4	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	381.1	457.3	521.3
%YoY	16.5	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	20.0	14.0
Trade deficit (US$bn)	-17.8	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-130.6	-169.2	-190.0
Invisibles (US$bn)	13.7	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	84.6	105.0	116.5
Current Account Deficit (US$bn)	-4.1	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-45.9	-64.2	-73.6
% to GDP	-0.9	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.7	-3.5	-3.6
Capital Account (US$bn)	9.5	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	62.0	62.1	72.6
% GDP	2.0	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.7	3.4	3.5
Forex Assets (excl gold) (US$bn)	35.1	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	271.6	270.6
Months of imports	7.6	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	7.1	6.2
External Debt (US$bn)	98.3	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	261.0	306.4	326.6	341.6
Short Term Debt	3.9	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	71.5	81.5
Exchange Rate														
US$/INR - annual avg	43.4	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	49.3
% depreciation	2.8	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	2.4
US$/INR - year end	43.6	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	50.7	44.9	44.6	50.3	50.0
% depreciation	2.8	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.3	-8.0	26.4	-11.4	-0.7	12.8	-0.6

*Using spliced data, FY12 GDP data are Advanced Estimates by the CSO ** At current prices. Source: CSO, RBI, Ministry of Finance and CIRA Estimates

Sector Views

Autos

Jamshed Dadabhoy
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Arvind Sharma
+91-22-6631-9852
arvind1.sharma@citi.com

Expected Pain, Unexpected Relief

- **Excise duty raised, as expected- immediate reaction from OEMs** — Predictably, excise duty on passenger vehicles was raised by 200bps (22% to 24% for large cars and 10% to 12% on small cars). In addition, for cars with engine size> 1,500cc, the excise duty was increased to an ad valorem rate of 27% from 22%+Rs 15,000 specific duty. On chassis, the excise rate has been changed to an ad valorem rate of 22% and 25% from the earlier rate of 10% / 22% plus Rs 10,000/unit. Per press reports (source: Economic Times/NDTV.com), OEMs have already announced price hikes- **1)** M&M (UV- Rs6-30k and tractor - Rs 5-6k; **2)** Tata Motors and Maruti have announced price hikes in order to pass on excise duty increases to customers.
- **No diesel vehicle tax** — Contrary to expectations, the govt didn't introduce a specific duty on diesel cars. This is a positive for OEMs with diesel portfolios - M&M, Tata Motors and also Maruti wherein diesel cars are ~40% of profits (per our estimates).
- **Customs duty increase on imported cars** — Customs duty on Completely Built Units (CBUs) of passenger cars (price> US$40,000 and engine capacity>3000cc for petrol and 2500cc for diesel) was increased from 60% to 75%
- **Tax slabs widened- disposable incomes expected to rise** — Tax slabs were widened further (exemption limit raised by Rs 20,000 to Rs 200,000 from Rs 180,000). Also, an extra deduction up to Rs 10,000 was introduced for interest from Savings Bank accounts. This should positively affect disposable income, particularly more evident for low income customers (relevant for 2 Wheelers).
- **Impetus to rural sector** — Continuing with past trends, the govt announced a slew of fiscal incentives to the rural sector. This bodes well for auto OEMs with a high rural exposure, viz. M&M, Maruti and Hero MotoCorp. Some of the incentives are: **1)** Extension of capitalization and refinancing of RRBs, **2)** Increase of outlay for Rashtriya Krishi Vikas Yojana , **3)** Increase of outlay for the Deptt of Agriculture and Cooperation, **4)** Target for agri credit raised with subventions of 3% for prompt credit repayment and on post-harvest loans against negotiable warehouse receipts.

Figure 5. Budget impact on auto sector

Change	Impact	Business Implications	Stock Impact
Excise duty hikes by 200bps	Negative	OEMs have already raised prices. In the backdrop of adverse macro, demand decline is imminent	Negative
No additional tax/excise on diesel vehicles	Positive	Diesel vehicle demand will continue to remain high vis-à-vis petrol variants	M&M, Maruti, TTMT benefit. Maruti could consider further investment in diesel engines
Broadening of tax slabs	Slightly positive	Increase in discretionary income for mainly lower and middle income segments. Should be restricted to urban areas and is positive for 2Ws	Slightly positive for M&M, Hero MotoCorp, Bajaj Auto, Maruti
Impetus to rural sector.	Positive	Rural demand for autos (mainly 2Ws, small cars, tractors) should increase with rising income levels. Should benefit more to OEMs with wider rural network (eg HMCL to benefit more than BJAUT	Rural demand for autos (mainly 2Ws, small cars) should increase. Should benefit OEMs with wider rural netwrok (eg HMCL to benefit more than BJAUT)

Source: Citi Investment Research and Analysis

Oil & Gas

Cess Hike –ve for Upstream; No Subsidy Developments

Saurabh Handa
+91-22-6631-9858
saurabh.handa@citi.com

Abhishek Sahoo
abhishek.sahoo@citi.com

- **Additional cess on crude; -ve for ONGC, Cairn, OIL —** Cess on crude produced domestically has been raised sharply to Rs4,500/T from Rs2,500/T earlier, with indexation being cited as the rationale (was last revised in 2006-07). This could negatively impact upstream players (ONGC, Cairn, and OIL). Assuming the new rate applies to the entire domestic crude sales volumes of the companies, the impact on our FY13E earnings is ~8% for Cairn (similar impact on NAV), ~9% for ONGC, and ~15% for OIL.

- **FY13 fuel subsidies under-provided for** — Fuel subsidies for FY12 under-recoveries have been budgeted at ~Rs450bn, which equals the 9M compensation announced by the gov't for the oil marketing companies. Therefore, similar to last year, the 4Q gov't share has seemingly not been considered in this year's budget and will likely slip into the (revised) FY13 budget. The gov't has so far provided ~Rs400bn for fuel subsidies in FY13 – if, like last year, this pertains entirely to 4Q, it implies: (i) the upstream share for FY12 under-recoveries could be limited to just ~39-40% (vs. our expectation of 45%), and (ii) the entire gov't share for FY13 (we forecast gross under-recoveries of ~Rs1.62tr, gov't share of ~Rs730bn) has not been provided for (a negative for the govt's fiscal deficit targets).

- **Customs duty removed on LNG for power generation** — The import of LNG used for generating power has been reduced from 5% to nil. Since the exemption is limited to LNG used for power, it may be not have a very meaningful impact on LNG usage, and consequently, on the gas value chain, as the use of LNG in the sector is minimal.

- **Direct cash subsidies** — The gov't has reiterated its intention of ultimately moving towards a direct cash subsidy mechanism. This would mean market determined prices of fuels such as LPG and kerosene, with targeted transfers of subsidies into the bank accounts of intended beneficiaries. This scheme will be implemented with the help of the UID-Aadhar project. To this end, pilot projects on direct subsidies for LPG and kerosene have already been launched by OMCs, which will be expanded to 50 districts within the next six months before nation-wide implementation. While there is no clarity on the timelines of eventual implementation, this could be a long-term positive for the gov't-owned oil companies since it will lead to an overall reduction in under-recoveries.

- **Other measures —** These include: (1) Increase in excise duty rates from 10% to 12% – impact on petchem prices, though producers (such as RIL, GAIL) should be able to pass on the increase; (2) increase in service tax rate from 10% to 12% – impact on pipeline tariffs, though gas transporters (such as GAIL, GSPL) should be able to pass on the increase, (3) announcement of Viability Gap Funding support to oil & gas/LNG storage facilities and oil & gas pipelines for PPP projects.

Figure 1. India Oil & Gas - Budget 2012-13 impact

Change	Pre-budget	Post-budget	Stock impact
Increased cess on domestic crude production	Rs2,500/T	Rs4,500/T	Negative for Cairn, ONGC, and OIL. Cairn's earnings (and NAV) could be impacted by ~8%, while ONGC and OIL's earnings are likely to be impacted more (~9% and ~15% respectively) because their earnings are already understated due to subsidies.
Subsidies	FY12 budgeted subsidy of Rs650bn includes Rs200bn spillover from 4QFY11 + Rs450bn for 9MFY12, i.e., 4QFY12 subsidy has once again not been provided for in the FY12 budget (similar to last year)	FY13 budgeted subsidy of Rs400bn could be largely towards 4QFY12 compensation, i.e., there has been little or no provision made for FY13 subsidies, which will impact the govt's fiscal targets	If the FY13 budgeted subsidy of Rs400bn is entirely for 4QFY12 compensation, this is a near-term +ve for gov't-owned upstream firms (ONGC, OIL), since it would limit their FY12 contribution to ~39-40% (vs. our expectation of 45%). However, insufficient budgeted gov't compensation for FY13 raises uncertainty for next year.
Zero customs duty on LNG imports for power	5% customs duty for all LNG	Nil customs on LNG imported for power production; no change in customs duty on LNG for all other consumers	Only a marginal +ve for the gas value chain (PLNG, GAIL, GSPL), as minimal amount of LNG currently goes into power generation
Increase in excise duty	10%	12%	Impact on petchem prices, though producers such as RIL, GAIL should be able to pass on the increase
Increase in service tax rate	10%	12%	Impact on pipeline tariffs, though transporters such as GAIL, GSPL should be able to pass on the increase
VGF for Oil & Gas/LNG storage, pipelines	No gov't support	Viability gap funding for support to PPP in oil & gas/LNG storage facilities, oil & gas pipelines	Positive for longer term development of the gas value chain in the country
Move towards direct cash subsidies	Proposed by Kirit Parikh committee	Pilot projects to be expanded to 50 districts in 6 months; ultimate move towards direct transfer of subsidies on kerosene and LPG	Positive for gov't-owned oil companies in the long-term, though timelines on eventual implementation remain uncertain

Source: Citi Investment Research and Analysis

Infrastructure, Electric Utilities, Cap goods

Marginally Positive

Venkatesh Balasubramaniam
+91-22-6631-9864
venkatesh.balasubramaniam@citi.com

Deepal Delivala
+91-22-6631-9857
deepal.delivala@citi.com

Atul Tiwari, CFA
+91-22-6631-9866
atul.tiwari@citi.com

- **No big ticket announcements** — While the budget did not make any big ticket announcements as far as the infrastructure sector is concerned, it tried to address sector-specific issues (power) and also introduced measures to channel more funding into the infrastructure sector.

- **Measures to facilitate funding, a positive** — 1) tax free bonds of Rs600bn to be allowed for funding infrastructure sector (increased from Rs300bn earlier), 2) the rate of withholding tax on interest payments on ECBs is proposed to be reduced from 20% to 5% for three years for certain infrastructure sectors (power; airlines; roads and bridges; ports and shipyards; affordable housing; fertilizer; and dams), 3) Irrigation, oil and gas storage facilities, oil and gas pipelines to be also made eligible to avail of Viability Gap Funding under PPP mode.

- **Power Sector: positive** —1) Full exemption from basic customs duty and a concessional CVD of 1% (from 5% earlier) to Steam coal for a period of two years till March 31, 2014, which would benefit IPP's dependant on imported coal, 2) Full exemption from basic duty on Natural Gas and Liquified Natural Gas; and Uranium concentrate, Sintered Uranium Dioxide in natural and pellet form. 3) Extension of the sunset date by one year for power sector undertakings - so that they can be set up on or before March 31, 2013 for claiming 100 per cent deduction of profits for 10 years, 4) Additional depreciation of 20 % in the initial year is proposed to be extended to new assets acquired by power generation companies, 5) Allow External Commercial Borrowings (ECB) to part finance Rupee debt of existing power projects.

- **Road Sector: marginally Positive** — 1) Set a target of awarding 8,800kms of road projects under NHDP in FY13 (7,300kms expected to be awarded in FY12), 2) allocation of the Road Transport and Highways Ministry enhanced by 14%, 3) allow ECB for capex on the O&M of toll systems for roads and highways so long as they are a part of the original project, 4) Full exemption from import duty on specified equipment imported for road construction by contractors of Ministry of Road Transport and Highways, NHAI and State Governments is being extended to contracts awarded by Metropolitan Development Authorities.

- **Irrigation Sector** — 1) Structural changes in Accelerated Irrigation Benefit Programme (AIBP) to maximise flow of benefit from investments in irrigation projects, 2) Allocation for AIBP in 2012-13 to be increased by 13%, 3) Irrigation and Water Resource Finance Company being operationalised to mobilise large resources to fund irrigation projects.

Telecom

Realistic Expectations

Gaurav Malhotra, CFA
+91-22-6631-9885
gaurav.a.malhotra@citi.com

Jitender Tokas, CFA
jitender.tokas@citi.com

- **Revenue estimates reasonable** — The Govt's revenue expectations from the telecom sector at Rs 582bn assume revenue growth at 10% and Rs400bn from spectrum auction. The proceeds look reasonable in context to the quantum of spectrum available and likely to be bid for.

  - **2G auctions**: TRAI has disclosed 10-40MHz is available for GSM and ~3-10 for CDMA. We expect both Sistema (CDMA) and Uninor (GSM) to bid in circles where they have commercial operations while GSM incumbents may selectively bid where they are facing capacity crunch. Overall, we expect bidding for ~3 blocks (pan-India) of 2G spectrum.

  - **700MHz auction**: 2 blocks of 20MHz spectrum in the 700MHz band are likely to be auctioned based on spectrum availability. The 700MHz band is superior (coverage & propagation) to the 2300Mhz band which was sold for Rs128bn (one block) in 2010. We believe interest in this band could be as high.

- **Higher service tax could dampen usage** — The rise service tax rate from 10% to 12% is likely to be passed on to subscribers. Our on-ground research shows that low ARPU subs tend to budget a fixed amount for mobile phone spend. Therefore higher service tax could somewhat subdue usage.

- **Proposed tax change retrograde; sentiment negative** —The Govt. is seeking to enhance the scope of 'source rule of taxation' to ensure that India has the right to tax any offshore transaction where the underlying assets are in India, irrespective of the domicile of involved entities or the corporate structure used to route the funds. Additionally, the Govt. contends that the party (resident or non-resident) making payment to a resident or non-resident for any income taxable in India is required to deduct tax at source. This clarificatory amendment will be effective retrospectively from 1962 and is patently aimed to address the well-known dispute over an offshore transaction in the telecom space, where the Supreme Court had ruled against the Govt.

Banks

Neutral

Aditya Narain, CFA
+91-22-6631-9879
aditya.narain@citi.com

Manish Chowdhary, CFA
+91-22-6631-9853
manish.chowdhary@citi.com

Pooja Kapur
pooja.kapur@citi.com

- **A quiet budget** — The Union Budget was a relatively quiet one for the banking sector. There were no major announcements (structural or otherwise) and only a few tweaks. Slightly more actionable though on the financial services segments. Overall, an expectedly neutral budget.
- **Banks: Mild positive on savings deposits** — Key measures were: a) allowing savings deposit interest (up to Rs10,000) to be income deductible (i.e. – no tax on this) and b) continued recapitalization of PSU banks (Rs159bn additional capital infusion). We believe this is likely to support creation of savings deposits, especially in the current high rate environment and should be a positive medium term.
- **Life Insurance: Higher tax incidence a negative** — Life insurance is likely to see higher tax incidence from: a) MAT umbrella extended to insurance companies – will raise effective tax to 18.5% (from ~14%); and b) Revised service tax guidelines – 3% tax on FYP (for investment-linked policies), 1.5% for subsequent years. This is likely to be a slight negative for the industry as it could impact growth (higher service tax) and earnings near term.
- **Capital markets: Positive moves, though details awaited** — There was more potential positive news for capital markets and players: a) Introduction of new tax deductible equity investment scheme (up to Rs50,000 annually); and b) Slight reduction in Securities Transaction Tax (on delivered shares). While details are still awaited on the former, it should encourage retail equity participation longer term and could be positive for asset management and financial service providers.

Figure 6. Union Budget FY12-13: Key Measures and Their Impact

Measures Taken	Impact	Business Implication	Stocks Impacted
Rs159bn capital infusion into PSU Banks	Positive	Supports healthy equity levels, credit growth	PSU Banks
Deduction of Rs10,000 on interest from savings deposits	Positive	Impetus for savings accounts growth	All banks
Service tax on life insurance premiums - 3% of FYP and 1.5% subsequently	Neutral	Marginal increase in service tax incidence	HDFC, Kotak, ICICI, Reliance Capital
Insurance companies to come under MAT	Negative	Will raise effective tax rate to 18.5% from ~14% earlier	HDFC, Kotak, ICICI, Reliance Capital
Retail equity investments up to Rs50,000 allowed 50% tax deduction	Positive	Supports equity investments and capital market segments, though details awaited	Edel, Motilal, Rcap
Reduction in STT (on delivered shares) to 0.1% from 0.125%	Neutral	Reduces transaction costs on equity	Edel, Motilal, Rcap

Source: Citi Investment Research and Analysis

Metals and Mining

Marginally Positive

Pradeep Mahtani
+91-22-6631-9882
pradeep.mahtani@citi.com

Raashi Chopra, CFA
+91-22-6631-9862
raashi.chopra@citi.com

- **Key measures** — The FY13 budget has largely been in line with expectations for the metals and mining industry. Key highlights: 1) **Excise duty hike** from 10% to 12%; 2) **Customs duty exemption/reduction** on thermal coal, coal mining projects, machinery imported for iron ore pellet/beneficiation plants, machinery/instruments for surveying and prospecting; 3) **Higher customs duty** on non-alloy flat-rolled steel, gold.

- **Lower cost of imported coal; coal mining projects** — Customs duty on thermal coal has been withdrawn (5% earlier) and CVD reduced from 5% to 1%. The revised rates are applicable till 31 Mar14. These measures are welcome given supply has been lagging demand. Key beneficiaries would be aluminium companies (mainly Nalco) and Hindustan Zinc (~50% coal imported; likely PAT impact ~1%). Coal India is unlikely to be impacted as domestic prices are already at a significant to discount to global prices. Customs duty exemption on coal mining projects should benefit Coal India.

- **Higher import duty on flat steel; gold** — Customs duty on flat steel products has been hiked from 5% to 7.5%. This measure makes imports more expensive and would result in higher landed cost of imported coal. However, steel companies are not considering a price hike immediately. If flat product prices are hiked, companies benefiting would be JSW Steel (flat products are ~76% of volumes), Tata Steel India (~65%), SAIL (~50%) and JSPL (~30% of steel volumes). Higher customs duty on gold (from 5% to 10% for non-standard gold) would benefit Hindalco marginally as gold is a by-product of its copper business.

- **Focus on iron ore value addition; mining** — Customs duty on plant and machinery for iron ore pellet/beneficiation plants has been reduced from 7.5% to 2.5%. Import duty on machinery and instruments for surveying/prospecting has been cut from 10% or 7.5% to 2.5%.

Cement

Lower Coal Duty Helps Marginally; Excise Change Neutral

Pradeep Mahtani
+91-22-6631-9882
pradeep.mahtani@citi.com

Raashi Chopra, CFA
+91-22-6631-9862
raashi.chopra@citi.com

- **Key measures** — (1) Changes in excise duty calculation methodology; 2) Thermal coal has become fully exempt from customs duty (earlier 5%).

- **Excise duty calculation methodology revised** — There is a small net impact on cement excise duty payable which is around +/- Rs1 per 50 kg bag or +/- Rs20 per tonne. The new excise duty for packaged cement (on non-mini cement producers) is calculated as 12% ad valoreum (on retail price) + Rs120/tonne. The ad valoreum value is after taking 30% abatement on the retail price. This compares to the earlier excise duty formula: (1) For cement sold at less than Rs190/50kg bag: 10% ad valorem on ex-factory price + Rs4/bag; (2) For cement sold at more than Rs190/bag: 10% ad valorem + Rs8/bag. For bulk cement excise duty has been revised from 10% ad valorem on ex-factory price to 12% ad valoreum on the retail price (after 30% rebate). For example, cement sold at Rs300/bag (ex factory price ~Rs240) would have earlier attracted an excise duty of Rs32/bag (@10% of Rs240+Rs8). Under the new proposal cement will now attract an excise duty of Rs31/bag (@12% of Rs210+Rs6). In this example there is a gain of ~Rs1/bag to the cement company but it could also be a loss of ~Rs1/bag; negligible either way.

- **Lower cost of imported coal** — Customs duty on thermal coal has been withdrawn (5% earlier) and CVD reduced from 5% to 1%. The revised rates are applicable till 31 Mar14. This measure should have a small positive impact on cement companies as some of them depend on imported coal. The gainers would be Ambuja Cements (imports ~30% of coal usage), UltraTech (33%) and India Cements (55-60%; not under coverage). The impact on PAT of cement companies we cover is likely to be 1-2%. ACC imports only 10% of its requirements, and so the impact is smaller. It plans to raise imports to 15-20% over the next couple of years.

Figure 7. Key Measures and Their Impact

Excise duty change	Pre-budget	Post-budget	Stock Impact
Cement sold at <Rs190/bag	10% ad-valorem + Rs4/bag (Rs80/t)	12% ad-valorem + Rs6/bag (Rs120/t)	Marginal
Cement sold at >Rs190/bag	10% ad-valorem + Rs8/bag (Rs160/t)	12% ad-valorem + Rs6/bag (Rs120/t)	
Non-packaged cement	10% ad valorem	12% ad valorem	

Source: Ministry of Finance (Union Budget), Citi Investment Research and Analysis

IT Services, Education & Media

Neutral

Surendra Goyal, CFA
+91-22-6631-9870
surendra.goyal@citi.com

Rishi V Iyer
+91-22-6631-9871
rishi.iyer@citi.com

Aditya Mathur
+91-22-6631-9841
aditya.mathur@citi.com

- **MAT on units operating in SEZs** — Industry body Nasscom had recommended that MAT on SEZ income may be withdrawn, at least in respect of SEZs which have already been notified. We were not expecting any change and so no changes in the budget are in line with expectations.

- **MAT rate** — Industry body had recommended that MAT rate be brought down to 1/3rd of corporate tax rate i.e. 10%. Our expectation was that this is unlikely to happen and no change is in line with our expectations.

- **Other issues** — Nasscom had requested on clarity on witholding tax, denial of tax deductions for onsite services and support for SMEs (as SMEs cannot set up in SEZ due to restrictive conditions in the act). There is no clarity on these issues in the Union budget.

- **Service tax increase** — the increase in service tax from 10% to 12% impacts only the domestic business, which is a single digit percentage of business for most of our coverage companies and it may be passed through.

- **Clause on royalty payments** — there is a provision on "Royalty" being subject to tax withholding wef 1977. It seems that the right to use any "software" will also be termed as "Royalty". Impact of the same for the industry is not yet clear. Infosys is already deducting tax at source from all the payments being made towards "Software" and hence will not see any substantial impact due to this.

Education

- **No big surprises** — (a) Provided Rs 255b for Sarva Shiksha Abhiyan - ~22% yoy (b) 6000 schools to be set up as part of 12th plan - 2500 on public partner partnership (c) setting up of credit guarantee fund to ensure better credit flow of credit to deserving students.

- **Service tax change unlikely to have material impact**—Pre-school and school education, recognized education at higher levels and approved vocational education are in the negative list for service tax purposes (hence exempt) and hence this should not a material impact on education sector.

Media

- **Higher service tax affects satellite operators** — The increase in service tax from 10% to 12% will have an impact on DTH operators like Dish TV.

Consumer & Retail

Cigarettes: MRP Based Taxation Signals Regime Shift

Jamshed Dadabhoy
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Aditya Mathur
+91-22-6631-9841
aditya.mathur@citi.com

- **~15% cigarette excise hike for ITC….** — The government increased basic excise duty on cigarettes (>65mm length) by charging a 10% ad valorem duty (levied on 50% of MRP) to the existing specific rates. For ITC's portfolio, this works out ~15% increase in excise – is in line with investor expectations. Management may need to raise prices by 7-8% to neutralize the impact.
- **….but has broader implications** — While the overall increase in excise for FY13 was largely in line, the linkage of excise payable to cigarette MRP could have longer-term implications as this may impact pricing flexibility that the cigarette majors have enjoyed in the past. Companies were able enhance margins by higher pricing, but may now need to pass through some gains to the government.
- **Some other duty changes** — a) Central excise duty has been increased to 12% (from 10%) for consumer products. We note that for players like Asian Paints, this offsets the reduction in import duty on $Ti0_2$ (~7.5% from 10% earlier); b) Excise duty on a number of FMCG products has been increased as the government tweaks duty on non-petroleum products with lower rate (increased to 2% from of 1%); c) Players like Marico are impacted by the 200bps improvement in service tax in the Kaya business.
- **Mixed for retailers** — a) Basic customs duty / CVD on standard gold bars is raised by 2% to 4%. This is after the January 2012 change, wherein customs duty was changed to 2% ad valorem vs. specific duty of Rs300/ 10gm. Thus, overall price of gold is higher by ~3% YTD - while it may not impact volumes meaningfully, directionally it attempts to temper gold purchases – a negative for players like Titan, in the backdrop of moderating discretionary consumption & higher discounts. However, from a competitive stance, the govt attempts to bring unbranded jewellery within the excise ambit – liable to also pay 1% excise (but only 30% of the invoice value). b) Pantaloon and other retailers may have a small benefit with the change in excise on branded garments – excise duty increased to 12% from 10%, but the abatement component has changed to 70% from 55%, implying ~90-100bps lower outgo.

Figure 8. Consumer: Budget Implications

Change	Expectations	Business Implication	Stock Impact
Additional 10% ad valorem duty on 50% of MRP in cigarette	10-15% increase	In line, but linkage to MRP may limit pricing flexibility	Neutral for ITC, Godfrey Phillips, VST
Change in excise duty on branded apparel		~90-100bps benefit to branded players	Small positive for Pantaloon and other retailers
Basic customs duty / CVD is increased on standard gold bars by to 4%		Impacts jewellery majors	Negative for Titan

Source: Citi Investment Research and Analysis

Indian Pharma & Healthcare

Hospitals +ve, Pharma Largely Neutral – A Few Hits on Tax

Prashant Nair, CFA
+91-22-6631-9855
prashant.nair@citi.com

Anshuman Gupta
+91-22-6631-9873
anshuman.gupta@citi.com

- **Hospitals Benefit Again** — Hospitals benefit significantly from the budget, with further sweetening of tax provisions. On the other hand, as expected, the budget is unlikely to affect the pharma sector from a business or valuation perspective. Other than some tinkering with excise rates (likely to be passed on) and extension of 200% weighted deduction for R&D (expected, maintains status quo), the sector is untouched. A few companies would be affected by the move to extend MAT beyond corporates - this appears priced in post the immediate stock movements.
- **Investment linked deduction for hospitals sweetened further** — The investment linked tax deduction for hospitals with over 100 beds (allowed to offset capex, excl land, goodwill & financial instruments against pre-tax profit) would now be allowed on a weighted basis of 150%. Apollo & Fortis stand to benefit a lot, given is aggressive expansion plans & high effective tax rates. Though P&L would not be affected, tax will shift to the deferred tax line, leading to lower cash outflow - positive, given the high capital intensity in the biz. Apollo, with an effective tax rate of 32%, would be the main beneficiary.
- **MAT Loophole Plugged: Some Companies Affected** — The extension of Minimum Alternate Tax (MAT) beyond corporates to include all persons claiming profit-linked deductions would lead to higher effective tax rates for a few companies. This would bring 'Partnership' firms under the gamut of MAT. Some pharma companies conduct manufacturing operations through 'Partnerships' in locations offering tax shields in order to stay out of the MAT net - no longer possible. Cadila is one of the companies to be affected, with its manufacturing plant in Sikkim being structured as a partnership.
- **Excise duty on APIs hiked to 12% (+200%), formulations to 6% (+100bps)** — We expect most companies to pass on the increase. Larger players, with strong brands, would be better placed to do so.
- **Weighted deduction (200%) on in-house R&D extended for another 5 years** — This maintains status quo and is on expected lines. No incremental impact, in our view.

Figure 9. Impact on Pharmaceuticals and Healthcare Sectors

Change	Impact	Business Implication	Stock Impact
Investment linked deduction for hospitals up to 150% from the current 100%	Positive	Higher deferred tax and hence lower cash outflow; greater thrust to capex	Positive for Apollo, Fortis
Extension of MAT beyond corporates	Negative for a few companies	Some cos manufacture through partnership firms, thereby keeping a part of profits outside the MAT loop. This loophole has been plugged	Negative for Cadila
Excise duty on APIs up to 12% from 10%	Negative to Neutral	Expect formulation players to pass on the hike to customers	No major impact
Weighted deduction (200%) on in-house R&D extended for another 5 years	Positive (on expected lines)	Will reward companies that spend on R&D - more material in a higher effective tax rate environment	No incremental impact

Source: Citi Investment Research and Analysis

Real Estate

Focus on Affordable Housing

Surendra Goyal, CFA
+91-22-6631-9870
surendra.goyal@citi.com

Rishi V Iyer
+91-22-6631-9871
rishi.iyer@citi.com

- **Budget proposes to —** (a) Allow ECB for low cost affordable housing projects (b) Set up Credit Guarantee Trust Fund to ensure better flow of institutional credit for housing loans (c) Extend the scheme of interest subvention of 1% on housing loan up to Rs 1.5m (where the cost of the house does not exceed Rs2.5m) for another year (d) Interest linked deduction on capex in affordable housing to be provided at enhanced rate of 150% against 100% now.

- **Rate of withholding tax on interest payment on ECBs —** The rate of withholding tax on interest payments on ECBs is proposed to be reduced from 20% to 5% for three years for the affordable housing sector.

- **Service tax increases to result in price/rent escalation —** Assuming that the service tax increases are passed through, this could result in a small increase in prices/rents.

- **Impact on the sector** — Government's focus on affordable housing continues to be high. Our coverage companies have very limited exposure to affordable housing and hence impact is unlikely to be much.

Figure 10. Stocks mentioned in the note

RIC	Company	Rating	Current Market Price
ABUJ.BO	Ambuja Cements	3	168.1
APLH.BO	Apollo Hospitals	1	608.3
ASPN.BO	Asian Paints	3	3210.4
BAJA.BO	Bajaj Auto	3	1721.9
CADI.BO	Cadila Healthcare	2	712.0
CAIL.BO	Cairn India	1	345.6
COAL.BO	Coal India	1	342.3
EDEL.BO	Edelweiss Capital	3	29.5
FOHE.BO	Fortis Healthcare	1	107.1
GAIL.BO	GAIL	2	367.1
GDFR.BO	Godfrey Phillips India Lmited	NR	3090.3
GSPT.BO	Gujarat State Petronet	1	77.4
HALC.BO	Hindalco Industries	1	140.4
HDFC.BO	Housing Development Finance Corp.	NR	665.2
HROM.BO	Hero MotoCorp	3	1955.1
HZNC.BO	Hindustan Zinc	3	129.6
ICBK.BO	ICICI Bank	1	917.0
ICMN.BO	India Cements Ltd	NR	103.1
INFY.BO	Infosys Ltd	2	2866.1
ITC.BO	ITC	1	216.1
JNSP.BO	Jindal Steel and Power	1	575.3
JSTL.BO	JSW Steel	1	747.7
KTKM.BO	Kotak Mahindra Bank	2	539.9
MAHM.BO	Mahindra & Mahindra	2	677.0
MOFS.BO	Motilal Oswal Financial Services	3	119.7
MRTI.BO	Maruti Suzuki India	1	1373.7
NALU.BO	National Aluminium	3	57.0
OILI.BO	Oil India	2	1211.9
ONGC.BO	Oil & Natural Gas	1	273.3
PART.BO	Pantaloon	3	155.7
PLNG.BO	Petronet LNG	2	162.3
RELI.BO	Reliance Industries	1	772.0
RLCP.BO	Reliance Capital	1	400.0
TAMO.BO	Tata Motors	1	286.7
TISC.BO	Tata Steel	2	454.4
TITN.BO	Titan Industries	3	232.5
ULTC.BO	UltraTech Cement	3	1480.4
VSTI.BO	VST Industries Ltd	NR	1375.6

Source: Citi Investment Research and Analysis

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Reliance Capital (RLCP.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Manish Chowdhary, CFA

	Date	Rating	Target Price	Closing Price
1	18-Jun-09	3M	*821.00	884.50
2	5-Sep-10	3M	*788.00	783.00
3	13-Jul-11	3M	*555.00	590.45

	Date	Rating	Target Price	Closing Price
4	26-Sep-11	*1M	*500.00	389.35
5	5-Oct-11	1M	*455.00	315.85
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	*1	455.00	321.25

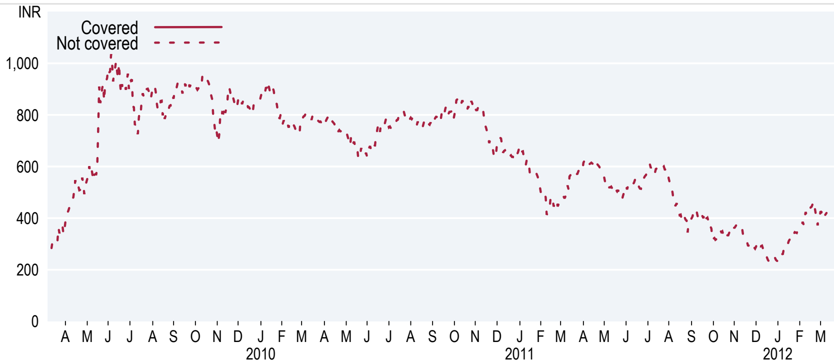
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Reliance Capital (RLCP.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

A member of the household of Aditya Narain, CFA, Analyst, holds a long position in the securities of Reliance Capital.

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Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Ambuja Cements, Apollo Hospitals, Asian Paints, Bajaj Auto, Cadila Healthcare, Cairn India, Coal India, Edelweiss Capital, GAIL, Gujarat State Petronet, Hindalco Industries, Housing Development Finance Corp., Hero MotoCorp, Hindustan Zinc, ICICI Bank, Infosys Ltd, ITC, Jindal Steel and Power, JSW Steel, Kotak Mahindra Bank, Mahindra & Mahindra, Motilal Oswal Financial Services, Maruti Suzuki India, National Aluminium, Oil India, Oil & Natural Gas, Pantaloon, Petronet LNG, Reliance Industries, Reliance Capital, Tata Motors, Tata Steel, Titan Industries, UltraTech Cement in the past 12 months.

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