

26 February 2010

India Budget FY11

Fiscal consolidation, slow stimulus exit

- Start of long-term fiscal consolidation.** The FY11 Central government fiscal deficit target of 5.5% – a marked improvement from 6.8% in FY10 – is realistic, we think. In fact, by FY13 we expect revenue account to be nearly balanced. Even in FY11, tax and non-tax revenue collections could surprise on the upside, leading to better-than-budgeted fiscal consolidation and lower market borrowing.
- Slow stimulus exit will support growth.** The modest roll-back of stimulus measures is positive for deepening and broad-basing a nascent growth recovery. Only a 2ppt excise duty hike was in line with expectations. No roll back in services tax cut came as a positive surprise.
- Inflationary impact significant.** The combined impact of excise and customs rate hikes including the hike in diesel and petrol (to pass on the tax hike) would add to inflation. We now expect inflation to peak at 11% by Mar '10 from 9.6% (earlier estimate). A 50bps hike in policy rates in Apr-10 monetary policy now appears certain.
- Disposable incomes – give and take?** Relief in personal taxes through wider slabs and continued rural spending will increase consumer disposable incomes. However, oil price hikes coupled with a rise in other prices due to excise increase might eat up a sizable part of that.
- Negligible earnings impact.** Status quo on our sector selections. The net impact of budget measures on Nifty earnings is -1% for FY11. Our key sector overweights continue to be IT Services, Auto and Industrials; key underweights are Financials, Energy and Materials.

Sensex: 16429

Nifty: 4922

Sujan Hajra

 +9122 6626 6720
 sujanhajra@rathi.com

India Research Team

 +9122 6626 6666
 institutionalresearch@rathi.com

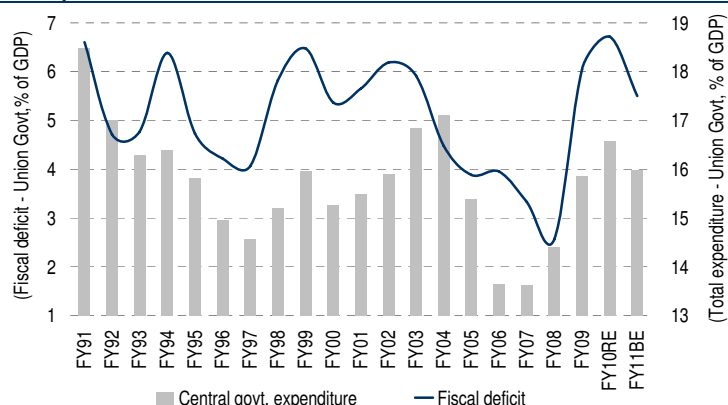
Key budget numbers

	FY10 (RE)	FY11 (BE)
Budget size (Rs bn)	10,215	11,087
Gross tax-GDP ratio (%)	10.3	10.8
Receipt growth (%)	23.5	7.9
Expenditure growth (%)	15.6	8.5
Net govt. borrowing (Rs bn)	3,984	3,450
Fiscal deficit-GDP ratio (%)	6.7	5.5

RE- Revised, BE-Budget estimates

Source: Anand Rathi Research

India – Steps toward fiscal consolidation



Source: Company, Anand Rathi Research

Sector impact

Positive	Banks, Construction
Negative	Cement, Consumer, Oil & Gas, Property, Telecom, Utilities
Neutral	Auto, Cap Goods, IT Services, Metals

Source: Anand Rathi Research

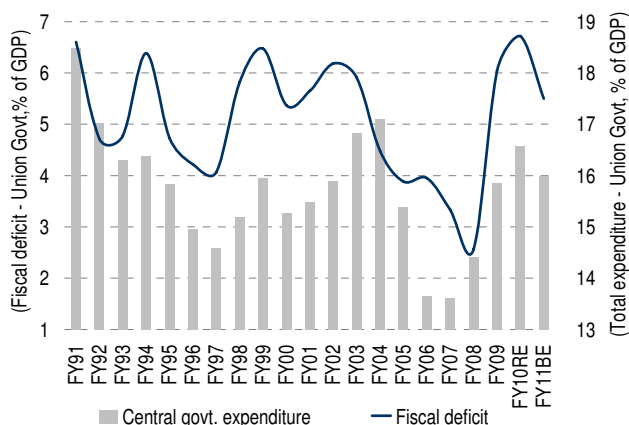
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Fiscal consolidation, slow stimulus exit

The FY11 Central fiscal deficit target of 5.5% – a marked improvement from 6.8% in FY10 – is realistic, and we think this is a start of a long-term fiscal consolidation over the next three years. The modest roll-back of stimulus measures is positive for deepening and broad-basing a nascent growth recovery. We think budget measures could increase WPI inflation to 11% by Mar '10. A 50bps hike in policy rates now appears certain in the Apr '10 monetary policy. Net impact of budget measures on Nifty earnings is negligible.

Significant fiscal consolidation. Including the fertilizer and fuel subsidies, the Centre’s fiscal deficit is estimated to be 5.5% of GDP in FY11 (see Fig 3). This is a marked improvement over the 7.8% deficit in FY09 and 6.8% in FY10 (both included fertilizer and fuel subsidies). The Finance Minister expects the deficit to fall to 4.8% in FY12 and 4.1% in FY13. Successful implementation of the direct tax code and goods and services tax (GST) in the FY12 budget could result in an even more marked change in the deficit. By FY13, we expect the primary balance (current receipts net of non-interest current expenditure) to turn positive and revenue account (current receipts net of current expenditure) balanced.

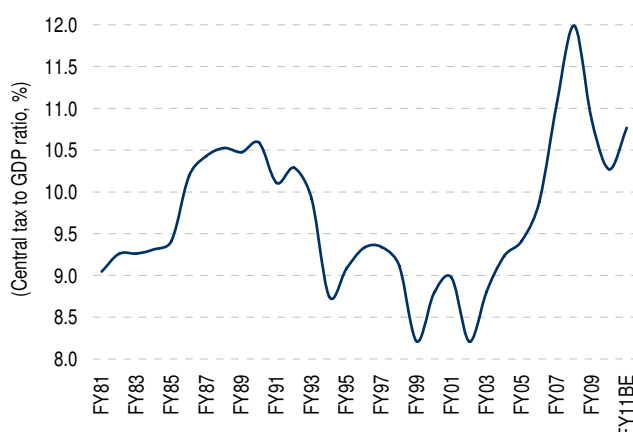
Fig 1 – Fiscal scenario



Source : GOI, Anand Rathi Research

Slow stimulus exit to help growth. The Budget partially rolled back the earlier cut in excise duty, with the median rate raised to 10% from 8%. Incidentally, the median rate was cut in phases from 16% in FY08 to 8% by Feb'09. This modest roll back was in line with our expectations. Contrary to our expectation of a roll back in the services tax rate, the government held the rate at 10%. However, more sectors are being brought under the services tax net.

Fig 2 – Tax to GDP ratio



Source : GOI, Anand Rathi Research

Inflationary impact significant. The government has increased customs duty on crude and petroleum products and increased the specific excise duty on petrol and diesel by Re1 each. These steps have increased diesel and petrol prices by Rs2.55/litre and Rs2.71/litre, respectively. This would directly push the WPI (wholesale price index) inflation by 30 basis points (bps). The indirect impact would also be roughly of the same magnitude. Decontrolled petroleum prices are also likely to rise due to the hike in customs duty on these products. In addition, part of the 2ppt hike in excise duty would also be passed on. Overall, the budgetary measures are likely to lead to a 150bps increase in WPI inflation. Given this, we revise our earlier inflation estimate of 9.6% by Mar '10 to 11%. We expect WPI inflation to soften to 6% by Nov '10. The hardening of inflation is likely to lead to a 50bps hike in repo and reverse-repo rates in the Apr '10 Monetary Policy.

Focus on consumption. As in FY10, the FY11 Budget focuses on stimulating private consumption. The cut in personal income tax, a modest excise duty roll back and no change in the services tax rates testifies to this. Despite the 43% jump in non-plan capital expenditure, the amount is only 14% of non-plan revenue expenditure. Therefore, the FY11 recovery story seems to be woven mainly around continued expansion in private consumption. Likely higher inflation and rise in excise, however, could eat away a sizable part of the increase in disposable income from the tax cuts.

Negligible earnings impact. The tax structure has been changed in the FY11 budget. The main changes: surcharge lowered from 10% to 7.5%, MAT raised from 15% to 18% and excise duty hiked by 2ppt. In our view, the net impact of these changes is negligible as the EPS of Nifty50 companies will decline by only 1% in FY11. Thus, earnings growth expectation for FY11 would be 23.5% (as against 24.7% before the budget). Our analysts believe that most of the excise duty changes would be passed on to consumers and the change is not significant enough to have any adverse impact on demand by itself. Thus, the impact of the excise duty increase would be neutral to earnings growth. Lowering the surcharge would have a marginal positive impact on earnings. On the other hand, the increase in MAT would be marginally negative for earnings. The net impact of both on earnings growth of Nifty50 companies is negligible. Our key sector overweights are IT Services, Auto and Industrials; sector underweights are Financials, Energy and Materials.

Fig 3 – India's fiscal situation

	(Rs billion)				(Growth, %)	
	FY09	FY10BE	FY10RE	FY11BE	FY10RE	FY11BE
Total receipt	8,314	10,208	10,271	11,087	23.5	7.9
Revenue receipt	5,403	6,145	5,773	6,822	6.9	18.2
Total tax receipt	6,053	6,411	6,331	7,467	4.6	17.9
Share of state, UT in Central taxes	1,620	1,669	1,680	2,126	3.7	26.5
Tax receipt for Centre	4,433	4,742	4,651	5,341	4.9	14.8
Personal income tax	1,060	1,129	1,250	1,206	17.9	-3.5
Corporate income tax	2,134	2,567	2,551	3,013	19.5	18.1
Customs duty	999	980	845	1,150	-15.4	36.1
Excise duty	1,086	1,065	1,020	1,320	-6.1	29.4
Services tax	609	650	580	680	-4.8	17.2
Other tax	164	20	86	98	-47.9	14.0
Non-tax receipt	969	1,403	1,122	1,481	15.7	32.0
Interest	207	192	192	193	-7.3	0.2
Dividend and profit	386	498	520	513	34.6	-1.3
Other non-tax	376	714	410	776	9.0	89.2
Capital receipt	2,911	4,063	4,498	4,265	54.5	-5.2
Net market borrowings	2,336	3,980	3,984	3,450	70.5	-13.4
Disinvestment of PSUs	6	11	260	400	4,486.2	54.1
Receipts from small savings etc.	(13)	133	133	133		0.0
Recovery of loans	61	42	43	51	-30.7	20.6
Other capital receipt	521	(102)	80	231	-84.7	190.9
Total expenditure	8,840	10,208	10,215	11,087	15.6	8.5
Non-plan expenditure	6,087	6,957	7,064	7,357	16.0	4.1
Revenue expenditure	5,590	6,188	6,419	6,436	14.8	0.3
Interest payments	1,922	2,255	2,195	2,487	14.2	13.3
Defence	733	869	884	873	20.6	-1.2
Explicit subsidies	1,297	1,113	1,310	1,162	1.0	-11.3
Others	1,638	1,952	2,030	1,914	23.9	-5.7
Capital expenditure	497	769	644	921	29.6	42.9
Loans and advances	15	10	12	10	-22.7	-13.6
Defence	409	548	478	600	16.9	25.5
Others	73	210	154	311	112.3	101.1
Plan expenditure	2,752	3,251	3,152	3,731	14.5	18.4
Revenue expenditure	2,348	2,784	2,644	3,151	12.6	19.2
Central plan	1,665	2,003	1,878	2,309	12.8	22.9
States plan	683	781	766	842	12.2	10.0
Capital expenditure	405	468	508	580	25.5	14.2
Central plan	317	396	413	497	30.5	20.3
States plan	88	72	94	82	7.2	-12.6
Gross fiscal deficit	3,370	4,010	4,140	3,814	22.9	-7.9
Revenue deficit	2,535	2,827	3,291	2,765	29.8	-16.0
Primary deficit	1,448	1,755	1,945	1,327	34.4	-31.8
Gross fiscal deficit (% of GDP)	6.0	6.5	6.7	5.5		
Revenue deficit (% of GDP)	4.5	4.6	5.3	4.0		
Primary deficit (% of GDP)	2.6	2.8	3.2	1.9		

BE: Budget estimate, RE: Revised estimate.

Source: Government of India.

Budget numbers

Absence of one-offs keeps spending contained. There is considerable skepticism about the budget estimate of an 8.5% jump in overall expenditure and within that a 0.3% rise in non-plan revenue expenditure. We, however, feel that it is a reflection of large one-off expenditure in FY10. Such spending included (i) payment of back salaries and other dues to Central public servants, (ii) drought relief payments, (iii) payment of the last installment of the farmers' loan waiver to the banks and (iv) stimulus related spending.

Possible upside to tax revenue. The change in GDP composition from government expenditure in FY10 to private consumption and investment is likely to improve tax collection in FY11. In particular, we expect considerable upside from direct taxes – both personal and corporate.

Modest non-tax revenue target. The 32% jump in non-tax revenue in the FY11 budget reflects accrual of 3G spectrum auction money in FY11 in place of FY10. There could be considerable upside from dividend and profit transfer to the government from public sector units, especially the RBI.

Both fiscal deficit and market borrowing likely to be lower. In line with the above, we expect the fiscal deficit number to be better than the budget number. In addition, we estimate considerable mobilization under the small savings schemes which would further reduce the market borrowing requirement.

Sectors

Autos



Amit Kasat

+9122 6626 6615
amitkasat@rathi.com

Rohan Korde

+9122 6626 6733
rohankorde@rathi.com

The 2% excise duty hike will be negative for the sector, but the wider personal income tax slabs and other positives should partly mitigate its impact. We expect two-wheeler and small-car demand to benefit from tax structure change. Continued infra focus positive for CVs.

Fig 4 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Companies
2% increase in excise duty	Negative	Maruti Suzuki and other car companies
Expanded tax slabs for personal income tax	Positive	Bajaj Auto, Hero Honda, Maruti Suzuki, Tata Motors, M&M
Infrastructure focus	Positive	Tata Motors, Ashok Leyland
Rural infrastructure development	Positive	M&M
Increase in MAT	Negative	Tata Motors

Source: Gol, Anand Rathi Research

Budget announcements

- Rate reduction in CENVAT partially rolled back from 8% to 10% (from 20% to 22% on UVs and bigger cars). Central excise duty on petrol and diesel enhanced by Re1 per litre each.
- Continuing focus on infrastructure and 13% increase in allocation to road transport.
- Provision of Rs661bn for rural development and focus on rural infrastructure projects under Bharat Nirman.
- Widening income-tax slabs for individuals (10% tax rate on income of Rs0.16m to Rs0.5m and 20% on Rs0.5m to Rs0.8m).
- Increase in MAT rate applicable on companies (from 15% to 18% of book profits), while lowering surcharge on domestic companies (from 10% to 7.5%).
- Weighted deduction on in-house R&D increased – from 150% to 200%.
- Road transportation of cereals and pulses to be exempted from service tax.

Impact on the sector

The only significant negative for the auto sector is from the increase in CENVAT rate. However, as the quantum is at the lower end of the expected band, the impact is slightly dampened. Similarly, the increase in MAT rate would raise taxation for Tata Motors. Most other proposals are positive for the auto and auto-component sectors. The expansion in tax slabs would increase disposable income and hence is a positive for two-wheeler and small-car demand. The continuing infrastructure focus is a positive for CVs.

Impact on companies

Auto companies are expected to pass on the impact of the excise duty hike to customers. For example, Maruti Suzuki has already announced a price hike of Rs3,000 to Rs13,000 across models. Other manufacturers are expected to follow suit. While this increases the cost of acquiring a car, the quantum of increase is unlikely to deter prospective buyers.

The decrease in surcharge on tax is a positive for all companies, though the

increase in MAT rate is likely to hit Tata Motors.

The continuing focus on infrastructure development, road transport and rural infrastructure would be positive for CVs (Tata Motors, Ashok Leyland) and tractor companies (M&M, Escorts).

From a demand perspective, the widening of income-tax slabs for individuals would be a positive for the sector. For an individual earning between Rs0.5m and Rs0.8m, the increase in disposable income would be Rs20,000 (equal to nearly eight EMIs for a commuter motorcycle). For an individual earning over Rs0.8m, it would be Rs50,000 (equivalent to nearly five EMIs for a lower-end compact car).

Banks/Financial Services



Clyton Fernandes
+9122 6626 6744
clytonfernandes@rathi.com

Kaitav Shah
+9122 6626 6735
kaitavshah@rathi.com

There are many positives for financials in the budget – a lower fiscal deficit (good for government bond yields), minimal interest subventions, re-cap of government banks, “farm loan relief scheme” extension, fresh bank licenses to NBFCs and private players.

Fig 5 – Impact on the sector and on stocks

Budget announcements	Impact on sector	Impact on companies
Fiscal deficit – 5.5% of GDP	Positive for bond yields	All banks
Re-capitalization of government banks	Positive	SBI, IDBI, Central Bank, UCO Bank, Dena Bank, Vijaya Bank, Bank of Maharashtra
Banking licenses to private players and NBFCs provided they fulfill RBI criteria	Positive	NBFCs
Interest subventions to continue – agriculture, pre-shipment credit, poor households and low-cost housing	Neutral	All banks
Additional tax deduction up to Rs20,000 for investments in long-term infra bonds for individual taxpayers	Positive	PFC, IDFC, REC
The “agriculture debt waiver and debt relief scheme” has been extended by six months to 30 Jun '10	Positive	All banks, especially PNB, BoB and OBC

Source: Anand Rathi Research

Budget announcements

- Fiscal deficit announced at 5.5% of GDP
- Ownership of banks and insurance companies to remain as is
- Budgetary support of Rs165bn for re-capitalization of government-owned banks, to ensure each bank has minimum Tier-1 capital adequacy of 8%
- The RBI is considering issuing additional banking licenses to private players and NBFCs provided they fulfill RBI criteria
- A host of interest subsidies were announced:
 1. Interest subvention of 2% to be paid as incentive to farmers who repay short-term crop loans on time
 2. Extension of interest subvention of 2% on pre-shipment credit for employment-oriented export sectors
 3. Interest subsidy of 1% to poor households to be provided on loans up to Rs0.1m from banks
- Target for agricultural credit set at Rs3,750bn
- The “agriculture-debt waiver and debt-relief scheme” has been extended by six months, to 30 Jun '10
- Infrastructure financing:
 1. IIFCL to disburse Rs250bn under the takeout financing scheme in consultation with banks to facilitate incremental lending to the infrastructure sector over the next three years;
 2. IIFCL to refinance in FY11 commercial bank loans of Rs60bn for infrastructure projects
- Additional deduction of up to Rs20,000 from taxable income for investment in long-term infrastructure bonds over and above the Rs100,000 limit for individual taxpayers.

- The Government of India, RBI and NABARD would each contribute Rs1bn to a “Financial Inclusion Fund” to increase penetration of financial services
- Re-capitalization of regional rural banks would strengthen their capital adequacy and support additional credit to the rural sector.

Impact on the sector

Fiscal deficit. The decrease in the fiscal deficit (as percent of GDP) augurs well for government bond yields, which are expected to be stable now. Banks are likely to make reduced marked-to-market provisions on their investment books and/or on trading losses on G-Secs.

Capital infusion. Banks would be given capital to grow the business – positive for those that are constrained for capital.

Banking licenses. The RBI’s aim to grant new banking licenses is positive for NBFCs as they would obtain access to deposits, substantially reducing their cost of funds.

Interest subsidies and interest subventions announced are minimal, and not likely to have a major impact.

Agricultural credit. The target for agricultural credit is high, which is in sync with the government’s focus on this sector. In case of a poor monsoon in FY11, banks’ exposure to relatively riskier assets could increase, leading to likely higher credit losses.

Infrastructure spends. The takeout financing scheme for infrastructure financing is expected to reduce banks’ asset-liability mismatch. Business growth driven by the infrastructure sector is likely to be the largest earnings driver for banks.

Investment in infrastructure bonds. Deduction of Rs20,000 from taxable income for investments in notified infrastructure bonds is a positive for infrastructure financing companies, in raising long-term funds

Impact on companies

Decrease in the fiscal deficit is a positive for banks, especially government banks with longer duration portfolios and higher marked-to-market exposures, as yields are expected to decline / remain stable.

Capital infusion in government-owned banks is positive for State Bank of India, IDBI, Central Bank, UCO Bank, Dena Bank, Vijaya Bank and Bank of Maharashtra.

The RBI’s potential issuance of fresh bank licenses is positive for IFCI, IDFC, Reliance Capital, LIC Housing Finance and IndiaBulls Financials.

Extension of the “Agriculture Debt Waiver and Debt Relief” scheme by six months is positive for all government-owned banks, particularly Punjab National Bank and Bank of Baroda. (They have already provided for such loans and could see some NPA provisioning writeback.)

IIFCL’s takeout financing scheme and refinancing schemes are positive for all banks with high exposure to the infrastructure sector, particularly IDBI, Central Bank, ICICI Bank, and SBI.

Deduction of Rs20,000 from taxable income towards notified infra-sector bonds is positive for PFC, REC and IDFC.

Capital Goods and Engineering



Satish Kumar
+91 22 6626 6770
satishkumar1@rathi.com

Nishit Master
+91 22 6626 6738
nishitmaster@rathi.com

Madhurendra M
+91 22 6626 6729
madhurendramanderwal@rathi.com

The additional deduction under Sec 80C of the IT Act for investment in infrastructure bonds along with greater allocation to the sector would boost development. Increase in defense spend positive for Defense equip. manufacturers.

Fig 6 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Impact on companies
Rs600bn capital Defense expenditure for FY11	Positive for Defense equipment manufacturers	Positive for Bharat Electronics, BEML, Tata Power, L&T, etc
Increase in MAT rate – to 18%	Marginally negative for infrastructure companies	Negative for GMR Infra, GVK Power, Lanco Infra, Reliance Infra
Additional deduction under Sec80C of the Income Tax Act of Rs20,000 for investment in long-term infrastructure bonds	Positive for infrastructure as a result of more funds available to finance infrastructure projects	All infrastructure companies

Source: Gol, Anand Rathi Research

Budget announcements

- Capital expenditure on Defense budgeted for FY11 at Rs600bn, 9.4% higher than FY10 budgeted expenditure and 25.5% higher than revised expenditure for FY10
- The MAT rate has been increased from 15% to 18%
- Additional deduction has been allowed of Rs20,000 under Sec 80C of the Income-Tax Act for investment in long-term infrastructure bonds
- Plan allocation for infrastructure has been increased to Rs1.7trn, which accounts for over 46% of the total Plan allocations
- Thrust on renewable energy sources through the Jawaharlal Nehru Solar mission aiming at solar capacity of 20 GW by 2022.
- Concessional customs duty of 5% and exemption of Central excise duty on capital goods used to set up photovoltaic solar thermal power generating units. Project import status to ‘monorail projects for urban transport’ would now attract a concessional basic duty of 5%.

Impact on the sector

- Higher capital Defense expenditure to benefit domestic Defense equipment companies.
- Increase in MAT rate (effective increase of 2.94%) is marginally negative for companies undertaking long-gestation projects. However, this would lead to lower short-term cash flows and MAT credit entitlements could be claimed against taxes to be paid in later years.
- Encouragement provided to save by allowing additional deduction under Sec 80C of the IT act could lead to more available for the ever-increasing funds required in the infrastructure sector. Positive.
- Project import status for Monorail projects to help lower costs and raise profitability.

Impact on companies

- BEL, BEML, Tata Power, L&T to benefit from Defense expenditure.
- Lower short-term cash flows of GMR Infra, GVK Power, Reliance Infra, Lanco Infra as a result of higher MAT payments.
- Concessional duty on monorail projects to benefit Larsen & Toubro, which is building the Mumbai monorail.

Cement



Jaspreet Singh Arora

+9122 6626 6727

jaspreet@rathi.com

Manish Valecha

+9122 6626 6552

manishvalecha@rathi.com

The impact of the Budget on the cement sector would be negative. The increase in excise duty (2%), increase in diesel prices and increase in cess on coal (by Rs50 per ton) would be negative for the sector. However, the greater allocation to infrastructure would be positive for the sector, due to increased demand.

Fig 7 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Impact on companies
Increase in excise duty, by 2%, Increase in diesel prices, by Rs2.55/lt, Increase in cess on coal, by Rs50/ton	Negative	All cement companies
Increased allocation for infra projects	Positive	All cement companies

Source: Gol, Anand Rathi Research

Budget announcements

- Increase in excise duty on cement (from 8% to 10%) and on clinker (from Rs300/ton to Rs375)
- The hike in diesel prices (by Rs2.55/litre) due to the increase in excise duty and customs duty on oil products
- Levy in cess on coal – by Rs50 per ton
- Allocation stepped up for infrastructure programs such as NHDP, Bharat Nirman and JNNURM.

Impact on the sector

The impact of the increase in excise duty (by Rs80-100 per ton), the hike in diesel prices (~Rs32/ton) and the levy of cess on coal (Rs5/ton) would be negative for the sector. Companies would have to raise prices (by Rs6-7 a bag) to nullify the impact of these changes. This is likely, we believe, considering the good demand-supply scenario and the ongoing peak construction season.

The greater allocation to infrastructure schemes such as the Indira Awas Yojana (Rs100bn), NHDP (Rs199bn) and Bharat Nirman (Rs480bn) would boost demand for cement.

Impact on companies

The increase in excise duty, in diesel prices and the cess on coal would be negative for all cement companies in the long term. Increased allocation to the various infrastructure schemes would be positive from the demand perspective. Greater allocation for schemes such as the Indira Awas Yojana would specifically benefit mid-cap cement companies such as Orient Paper, Birla Corp and Kesoram Industries due to increased demand from rural housing.

Fig 8 – Change in excise duty structure on cement

Particulars	Present Rate	Proposed Rate
Bagged Cement (MRP<Rs190/bag)	Rs230/ton	Rs290/ton
Bagged Cement (MRP>Rs190/bag)	8% of MRP	10% of MRP
Bulk Cement	8% of MRP or Rs230/ton, whichever is higher	10% of MRP or Rs290/ton, whichever is higher
Clinker	Rs300/ton	Rs375/ton

Source: Budget Document

Construction



Jaspreet Singh Arora

+9122 6626 6727
jaspreet@rathi.com

Manish Valecha

+9122 6626 6552
manishvalecha@rathi.com

The increased government outlay on various infrastructure schemes is positive for the construction sector. The thrust given to financing projects is also positive for all construction companies.

Fig 9 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Impact on companies
Rs1.7trn allocation for infrastructure development	Positive	All construction companies
JNNURM allocation at Rs116bn (same as last year)	Positive	All construction companies
NHDP allocation hiked to Rs199bn (from Rs175bn)	Positive	NCC, Era, IVRCL, HCC
Bharat Nirman allocation hiked to Rs480bn (from Rs453bn)	Positive	IVRCL, NCC, HCC
AIBP allocation hiked to Rs115bn (from Rs97bn)	Positive	IVRCL, NCC, HCC
Power allocation upped to Rs51.3bn (from Rs22.3bn)	Positive	JPA, NCC, Era

Source: Gol, Anand Rathi Research

Budget announcements

- Allocation of Rs1.7trn for infrastructure development
- JNNURM allocation maintains previous year's level of Rs119bn
- Enhanced allocation to national highway expenditure, to Rs199bn (from Rs175bn in FY10)
- Enhanced allocation to Bharat Nirman (rural infra with focus on roads, irrigation, drinking water, telephony, housing and electrification), to Rs480bn (from Rs453bn in FY10)
- Increased allocation for Accelerated Irrigation Benefit Programme (AIBP), to Rs115bn (from Rs97bn in FY10)
- Rs100bn allocated for the Indira Awas Yojana (rural housing scheme)
- IIFCL to provide long-term financial assistance to infrastructure projects, to the tune of Rs200bn for FY11 (Rs90bn in FY10). It has also been authorized to refinance bank lending to infrastructure projects of over Rs60bn in FY11 (from Rs30bn in FY10)
- Allowance of an additional tax deductible Rs20,000 for investment in long-term infrastructure bonds
- Increased allocation for the power sector, to Rs51.3bn (from Rs22.3bn in FY10).

Impact on the sector

The increase in government outlay for infrastructure projects is positive for the construction sector. The thrust given to financing projects is also positive.

Impact on companies

Companies focusing on the verticals of roads, housing, power and urban infra would largely benefit. Some of the companies to gain from the increased allocation on infrastructure are Nagarjuna Constructions, Era Infra and IVRCL.

Consumer Goods



Shirish Pardeshi

+9122 6626 6730
shirishpardeshi@rathi.com

Aniruddha Joshi

+9122 6626 6732
aniruddhajoshi1@rathi.com

The Budget was a rude shock for ITC, with an 11-18% increase in excise on cigarettes. The last time the sector saw such a quantum jump in excise in FY02, volumes collapsed 8%! We estimate a 15-20% downside to ITC's FY11 profit forecasts. We also see other negatives for the consumer sector from the Budget – 200bps increase in excise negative for HUL and GSK Consumer; higher MAT rate to impact Dabur, GCP and Emami; and higher oil product prices would increase raw material costs for all companies.

Fig 10 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Companies
Increase in MAT rate, by 300bp	Negative	Dabur, Emami, GCP
Increase in excise duty, by 200bp	Negative	HUL, GSK-CH, Colgate
Increase in customs duty on Crude oil, by 500bp	Negative	HUL, Marico, Dabur, Emami
Increase in allocation to NREGA	Positive	All companies
Higher excise duty on cigarettes	Negative	ITC*
Higher customs duty on crude derivatives	Negative	All companies
No change in excise duty on biscuits	Positive	Britannia
10% excise on sanitary napkins & baby diapers	Negative	Procter & Gamble

Source: Gol, Anand Rathi Research *Rating and earnings under review (Current rating Buy)

Budget announcements

- MAT to be raised 300bps – from 15% to 18%.
- Excise duty on most consumer products to be increased 200bps – from 8% to 10%.
- Excise duty on biscuits left unchanged at 4%.
- Excise on cigarettes to be increased by around 11%-18%.
- There is a new 5% import duty on crude oil and products.

Fig 11 – Hike in excise duty on cigarettes

Cigarette lengths	Current*	Proposed*	Increase (%)	Normal Description
Non-Filter				
Less than 60mm	819	669	(18.3)	Micro – Non-filter
More than 60mm but not more than 70mm	1,323	1,473	11.3	Regular – Non-filer
Filter				
Less than 60mm	819	669	(18.3)	Micro
More than 60mm but not more than 70mm	819	969	18.3	Regular
More than 70mm but not more than 75mm	1,323	1,473	11.3	Mini King
More than 75mm but not more than 85mm	1,759	1,959	11.4	King

Source: Gol, Anand Rathi Research. * per 1,000 cigarettes

Impact on sector

The consumer sector would clearly be impacted. To pass on the additional excise, consumer companies would need to raise prices. Cigarette companies would be under pressure to hike prices – by almost 12%-15% – to pass on the additional excise and VAT. Companies paying tax as per MAT would face higher tax outgo, of ~300bps.

Fig 12 – Excise hike and volume growth in cigarettes for ITC

Details	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08*	FY09	FY10e
Excise hike (%)	4.2	7.7	17.3	5.5	1.0	(0.4)	3.6	4.0	5.0	8.1	0.0
Volume growth (%)	(2.4)	0.5	(8.4)	4.2	3.1	7.1	8.4	7.1	(0.7)	(2.9)	8.0
Price hike (%)	8.8	10.1	14.0	4.9	2.2	1.2	4.5	5.8	8.5	12.6	6.0

Source: Company, Anand Rathi Research * VAT increase 12.5%

Impact on companies

ITC would be impacted and may have a problem increasing prices at the cost of volume. The past trend (FY02) indicates that steep price increases has resulted in volume decline. Earnings of Dabur, GCP and Emami would be impacted by 3%-5%. Higher crude oil prices would result in higher prices of HDPE (packaging material), LAB and liquid paraffin. This would hit HUL, Dabur, Marico and Emami. Britannia would not be faced with any major pressure to raise prices.

IT Services



Tarun Sisodia

+9122 6626 6777
tarunsisodia@rathi.com

Naushil Shah

+9122 6626 6708
naushilshah@rathi.com

Atul Thakkar

+9122 6626 6724
atulthakkar@rathi.com

The increase in MAT rates (from 15% to 18%) is a short-term negative for the sector. Higher expenditure on education, e-governance and defense is positive, though.

Fig 13 – Impact of the Budget on sector and stocks

Budget announcements	Impact on sector	Companies
Increase in MAT – from 15% to 18%	Negative	Most outsourcing companies (with units in software technology parks) and mid-caps not yet ready for SEZ
Greater spend on primary education	Positive	Educomp, Everonn, NIIT, Aptech, Core Projects
Increase in spending on e-governance and defense	Positive	Infotech Enterprises, Rolta India, Vakrangee Software
Increase in UIDAI spend	Positive	Bartronics, TCS

Source: Govt, Anand Rathi Research

Budget announcements

- Minimum Alternative Tax (MAT) increased – from 15% to 18%.
- Greater spend on primary education.
- Increase in capital expenditure for the defense sector.
- Increase in UIDAI expenditure.

Impact on the sector

MAT increase. The increase in MAT would affect most IT companies, more so mid-cap companies. (Almost all large caps have most of their units in SEZs, where MAT is not applicable.) Nevertheless, MAT now paid would be off-set once the tenure of the STPI clause has run its course. Hence, an increase in MAT would be negative in the short run, but neutral in the longer run.

Greater spending on primary education. Government spend on primary education has increased from Rs268bn to Rs310bn, up 15.7% yoy. This is in line with the “The Right to Education Bill, 2009”. This seeks to provide every child of six to fourteen years the right to free and compulsory education in a neighborhood school until completion of elementary education. Hence, this is positive for the companies providing IT-related services to the education sector.

In addition, states would have access to Rs36.8bn for elementary education under the Thirteenth Finance Commission grants for 2010-11.

Increase in capital expenditure for the defense sector. Capital expenditure on defense has been budgeted at Rs600bn (9% higher than in the previous budget) and 25% higher than the revised estimate for FY10. This is positive for companies providing technology to the defense sector.

Increase in UIDAI spend. The Central government is committed to having a central database and has allocated Rs19bn to implement the Unique Identification Authority of India (UIDAI) scheme.

Impact on companies

MAT. Negative for most of the outsourcing companies with units in software technology parks and for mid-caps, which are not yet ready for SEZs.

Fig 14 – Tax-rate increase in FY11 due to increase in MAT – negative for FY11

Companies (%)	FY11 tax rate (pre)	FY11 tax rate (post)	Change
Infosys	22.0	22.0	-
TCS	20.0	20.8	0.8
Wipro	17.0	17.5	0.5
HCL Tech	20.0	21.2	1.2
Tech Mahindra	17.0	18.4	1.4
Mphasis	16.3	17.6	1.3
Rolta India	17.3	18.7	1.4
Infotech Enterprises	28.0	28.2	0.2
Polaris Software	18.0	19.5	1.5
Allied Digital	20.0	21.0	1.0

Source: Anand Rathi Research

Greater spend on primary education. Positive for the companies providing IT-related services to the education sector – Educomp, Everonn, NIIT, Aptech, Core Projects.

Increase in capital expenditure for the defense sector. Positive impact on companies providing technology to the government sector – Rolta India, Infotech Enterprises.

Metals



Amit Kasat

+9122 6626 6615
amitkasat@rathi.com

Rahul Menon

+9122 6626 6717
rahulmenon@rathi.com

The greater allocation to infrastructure would be demand positive in the long term. Hike in excise duty to 10% (from 8%) would be neutral to negative depending on the ability of steel companies to pass on the hike to consumers, without hurting demand. MAT increase of 300bps would be mainly negative for JSP.

Fig 15 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Companies
Partial rollback of excise duty	Neutral to partially negative	-ve for SAIL, Tata Steel, JSW Steel
Increase in MAT	Negative	-ve for JSP
Cess of Rs50/ton on thermal coal	Negative	-ve for Nalco, Hindalco, Sterlite
Competitive bidding for coal blocks	Positive	+ve for all metals companies
Increase in customs duty on silver	Positive	+ve for HZ

Source: Gol, Anand Rathi Research

Budget announcements

The overall allocation of Rs1,730bn to infrastructure would be positive for domestic steel demand. The impact of the hike in excise duty (from 8% to 10%) would range from neutral to partially negative depending on the ability of steel companies to pass on the increase to consumers. The increase in MAT (to 18%) would marginally impact the profitability of Jindal Power (a subsidiary of Jindal Steel & Power) and Sterlite Energy. The levy of a Rs50/ton cess on Indian coal would increase power costs for metals companies accessing linkage coal.

Impact on the sector

Overall, the impact of the above announcements would be marginally negative for metals companies. From a demand point of view, increased infrastructure spending, interest subvention to the housing sector and increase in personal-tax exemption limits would be positive for steel demand. However, the partial rollback of excise duty may impact revenues of steel companies if they are unable to pass on the increase to consumers. The cess of Rs50/ton on Indian coal would increase costs for captive power plants with access to linkage coal. The government's plan to introduce competitive bidding for captive coal blocks would speed up allocation and development of coal mines.

Impact on companies

Steel companies like SAIL, Tata Steel and JSW Steel may see some erosion in revenues if they are unable to pass on the excise duty hikes to end-consumers. The MAT increase would impact Jindal Power's profitability. However, there would be some relief in terms of reduced surcharge (from 10% to 7.5%). A cess of Rs50/ton on Indian coal would increase fuel costs for companies such as Nalco, Hindalco and Sterlite, whose operations are power-intensive. The increase in customs duty on silver (from Rs1,000/kg to Rs1,500) would be marginally positive for Hindustan Zinc.

Fig 16 – EPS impact of increase in MAT

Company	Old estimates		Revised estimates		Change (%)	
	FY11e	FY12e	FY11e	FY12e	FY11e	FY12e
JSP	54.3	78.4	53.2	76.8	-2.0	-2.0
Sterlite	69.4	96.3	69.1	95.3	-0.5	-1.0

Source: Anand Rathi Research

Oil & Gas



Vishwas Katela
+9122 6626 6760
vishwaskatela@rathi.com

Budget proposals are negative for the oil & gas sector overall. MAT hike would be negative for RIL and Cairn India. Cairn, however, would benefit marginally from higher crude price realization on increased customs duty. Refiners stand to lose on lower duty protection, on account of higher customs duties. Upstream players ONGC and OIL would benefit by 3-4% on higher crude realization.

Fig 17 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Impact on companies
Customs duty hike on crude and petro-products, by 5%	Negative / Positive	Negative for refiners, Positive for Cairn India
Excise duty hike of Rs1/litre on petrol and diesel	Neutral	No impact as the same would be passed on in form of price hikes
Excise duty increase (from 8% to 10%) on petrochemical products	Neutral	No impact as the higher duties would be passed on
MAT increased to 18% (from 15% earlier)	Negative	RIL, Cairn India
Surcharge on corporate tax revised to 7.5% (from 10% earlier)	Marginally positive	All

Source: Gol, Anand Rathi Research

Budget announcements

- Customs duty on crude hiked to 5% (from nil earlier); duty on petrol and diesel hiked to 7.5% (from 2.5% earlier) and on other refined products to 10% (from 5% earlier)
- Excise duty hiked by Rs1/litre on petrol and diesel each
- Excise duty increase (from 8% to 10%) on petrochemicals
- MAT increased to 18% (from 15% earlier)
- Surcharge on corporate tax revised to 7.5% (from 10% earlier)

Impact on the sector

Overall, the impact of the above proposals is negative for the sector.

Despite a 5% across-the-board hike in customs duty on crude and most petroleum products, the duty protection available to refiners would be reduced. This is so because refiners would lose on LPG and kerosene (and fuel losses): on these, they would not get the benefit of duty protection due to nil customs duty on them. Thus, the proposal would be largely negative. Upstream players would benefit from higher realization on crude.

With the government announcing an increase in petrol and diesel prices (by Rs2.71 and Rs.2.55 per litre, respectively), the impact of the increase in customs and excise duty on petrol and diesel would be neutral.

The proposal to increase MAT is negative for Reliance Industries and Cairn India, as their net tax outgo could rise. The impact on Cairn would be to a great extent countered by the higher realization on crude, on account of customs duty coming back on crude.

Impact on companies

We see a net negative impact of 6-7% on RIL on account of lower duty protection on refinery and a higher MAT. The impact on Cairn India on higher crude realization but a higher MAT outgo would be about 2-3%. The impact of lower duty protection on refining margins of OMCs, at US\$70/bbl of crude prices, would be about US\$0.4-0.5/bbl and would imply a negative impact of 6-9% on earnings. ONGC and OIL would benefit by 3-4% from higher realization on crude (higher custom duty).

Property



Samar Sarda

+9122 6626 6726

samarsarda@rathi.com

The new service tax in Budget FY11 on under-construction projects would be negative for the property sector. It can have a 5-7% earnings impact on property developers as the tax is applicable on the selling price. If developers try to pass on the tax to buyers, it could impact the nascent demand recovery in the sector.

Fig 18 – Impact of the Budget on the sector and companies

Budget announcements	Impact on sector	Impact on companies
Service tax on un-completed construction complexes	Negative – increase in service tax burden on developers	All developers not paying such tax
Extension to Mar '11, of interest subvention on housing loans up to Rs1m	Positive for houses up to Rs2m	Puravankara (Provident Housing), Unitech (Unihomes), DLF & Brigade Enterprises (proposed launch of value homes)
Allocation of Rs12.7bn to the Rajiv Gandhi Awas Yojana	Positive	HDIL, DB Realty, Akruti City

Source: Gol, Anand Rathi Research

Budget announcements

- “Construction of a complex intended for sale, wholly or partly, by the builder or any person assigned by the builder before, during or after construction (except for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorized by the builder before the grant of the completion certificate under any law for the time being under force) shall be deemed to be a service provided by the builder to the buyer”.
- Interest subvention for housing loans up to Rs1m extended by a year, to Mar '11.
- Further allocation of Rs12.7bn for the Rajiv Gandhi Awas Yojana, (RGAY) a 700% increase from last year's allotment.

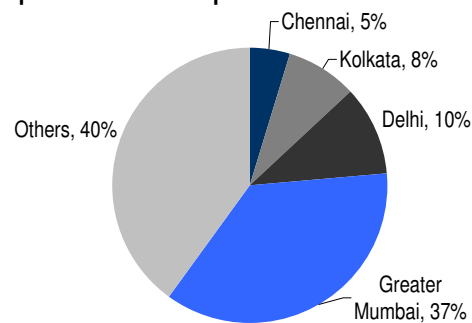
Impact on the sector

- Developers who were not paying this service tax previously would be impacted. Depending on the composition scheme, the tax could be passed on to buyers, either resulting in higher prices of under-construction properties or cuts in developers' margins. Higher prices could impact volume, especially in metros such as Mumbai, Delhi and Pune.
- The extended interest subvention scheme is positive for purchasers looking for property under Rs2m.
- The increased allotment for housing for the urban poor under the Rajiv Gandhi Awas Yojana would lead to quicker clearance of slum rehabilitation schemes in densely populated metropolises such as Mumbai, Delhi, Kolkata, etc.

Impact on companies

- All companies not paying service tax on properties being sold and under construction would be hit. From our discussion with developers, most Bangalore-based property developers were paying such tax. Developers from the NCR, Mumbai and Pune regions were not. Although further clarity is sought, all major companies except a few from Bangalore would be hit.
- Puravankara (under Provident Housing) and Unitech (under Unihomes) have launched homes, most falling under Rs2m. The new volumes from the extension of the interest subvention scheme could benefit DLF and Brigade (intending to launch such low-ticket-size homes).
- More than 15% of the Indian population lives in slums¹. Sixty percent of these slums are in the top four metros. The increased allotment to RGAY, depending on state government utilization plans, would provide the needed impetus to developers with expertise in such projects. HDIL, DB Realty, Ackruti City and Unitech could be key beneficiaries of such projects.

Fig 19 – Slum population in million-plus cities¹



Source: GOI, Anand Rathi Research

¹ 2001 census

Telecoms



Sanjay Chawla

+9122 6626 6608
sanjaychawla@rathi.com

Yogesh Kirve

+9122 6626 6731
yogeshkirve@rathi.com

While the direct impact of FY11 Union Budget on the telecoms sector is largely neutral in our view, the indirect impact through a diesel-price hike (by 7% or Rs2.6/litre) is negative. We estimate a 25 to 30-bp impact on the EBITDA margin of listed majors (Bharti, RCom and Idea). Among key Budget measures: (1) increase in the MAT rate is incrementally negative for medium-term EPS, but its value impact is offset by a modest reduction in the corporate tax rate; (2) higher disposable income due to reduction in the personal tax rate may not spur short-term telecom usage, given excess competition; and (3) the Rs350bn receipts budgeted from 3G/BWA spectrum auctions in FY11 may turn out optimistic, unless more spectrum blocks are auctioned.

Fig 20 – Impact of FY11 Budget announcements on the telecoms sector

Budget announcements	Impact on sector	Impact on companies
Increase in diesel price	Negative	EBITDA margin impact of 25-30bps for major wireless operators
Increase in MAT rate to 18% (from 15%); Neutral Cut in corporate tax rate (surcharge)	Neutral	Negative EPS impact for Bharti, but <u>value neutral</u> for Bharti, RCOM and Idea
Reduction in personal income tax rates	LT positive	LT positive for all telcos
No change in service tax rate	Neutral	Neutral for all telcos
CVD exemption on imported mobile phone components extended till Mar '11; exemption also extended to mobile accessories	Positive	No direct impact on telcos; however, potentially lower handset prices to aid mobile penetration growth

Source: Anand Rathi Research

Budget announcements

- Service tax rate kept unchanged at 10% vs. an expected 200-bp hike
- Minimum Alternative Tax (MAT) rate increased to 18% (from 15%); the 'effective' MAT rate (including surcharge and education cess) would rise to 19.93% (from 17%)
- Corporate income tax reduced to 7.5% (from 10%); this brings down the 'effective' corporate tax rate to 33.22% (from 33.99%)
- Reduction in personal income tax rates through changes in income slabs—this would boost the disposable income of people earning above Rs300,000 p.a. – by Rs21,000 to Rs51,000
- Exemption from Countervailing Duty (CVD) on components used in the manufacture of mobile phones in India to be extended till Mar '11 (by one year). Separately, the exemption would now be available to import mobile accessories as well
- Hike in fuel taxes, leading to a hike in retail diesel prices – by Rs2.6/litre (7%)
- The budget factors in revenues from 'other communication services' (largely license and spectrum fees) of Rs148bn (excluding spectrum auction proceeds) in FY11. This is 7% higher than Rs138bn (budget estimate) in FY10 and works out to 8.3% of estimated FY11 industry revenues (vs. 8.4% in FY10).

Impact on the sector

Higher MAT rate is slightly negative for EPS and cash flows in the medium term, as telecoms companies are mostly paying tax at the MAT rate.

However, the value impact of higher MAT would be offset by the lower corporate tax rate (lower surcharge), which boosts long-term cash flows.

Separately, lower personal income taxes would boost disposable income, but may not spur short-term mobile usage/spending, given the keen competition. Nonetheless, in the long term, higher disposable income should boost consumer spending on telecoms (especially on VAS/3G).

Status-quo on service tax rate is neutral, although this was widely anticipated to be raised by 200bps

Increase in diesel prices, by Rs2.6 per litre (+7%), would hurt the wireless EBITDA margins of telcos—we estimate margin erosion of 10-12bps for every Rs1/litre increase in the price of diesel (used to run cell sites, wherever and whenever grid electricity is unavailable).

Impact on companies

Higher MAT rate impacts our FY11 and FY12 EPS estimates for Bharti by ~3.5%. Impact on the reported earnings of RCom/Idea is negligible, as both companies are adjusting MAT credits in their P&L from accumulated tax losses. While the increase in MAT rate would result in higher cash outflow on taxes, these companies are anyway expected to come out of the 'MAT phase' over the next few years. As such, the impact on value (DCF) is immaterial.

We estimate EBITDA margins of leading players (Bharti, RCom and Idea), to be impacted by 25-30bps, due to the increase in diesel prices. The estimated impact on FY11 EPS is 1.2%, 2.5% and 7.3% for Bharti, RCom and Idea, respectively.

Utilities



Satish Kumar

+91 22 6626 6770
Satishkumar1@rathi.com

Madhurendra M

+91 22 6626 6729
madhurendramanderwal@rathi.com

The cess on coal and hike in MAT rate would be negative for utilities. The additional deduction under Sec 80C of the IT Act for investment in infrastructure bonds and greater allocation to the infrastructure sector would boost infrastructure development.

Fig 21 – Impact of the Budget on the sector and stocks

Budget announcements	Impact on sector	Impact on companies
Increase in MAT rate to 18%	Negative for power utilities and infrastructure	Marginally negative for JSW Energy, Adani Power, PowerGrid, GMR Infra, GVK Power, Lanco Infra, Reliance Infra
Cess of Rs50/ton on coal to create a Clean Energy fund	Negative for utilities with mercantile sales where fuel costs are not passed on	Negative for Adani Power, JSW Energy, though small impact
Excise duty of 16% on sale of electricity from SEZ to domestic-tariff areas or non-processing areas of SEZ	Negative for utilities located in SEZs with off-take arrangements outside SEZs	Negative for Adani Power

Source: Gol, Anand Rathi Research

Budget announcements

- Plan allocation for infrastructure has been increased to Rs1.7trn, accounting for over 46% of Plan allocations
- MAT rate has been increased to 18% (from 15%)
- Proposal to set up a coal regulatory authority to ensure economic coal pricing and transparency in the allocation of captive coal blocks
- Thrust to renewable energy sources through the Jawaharlal Nehru Solar Mission targeting solar capacity of 20 GW by 2022
- Concessional customs duty of 5% and exemption of Central excise duty on capital goods used to set up photovoltaic and solar thermal power generating units.
- Additional deduction has been allowed, of Rs20,000, under Sec 80C of the Income-Tax Act for investment in long-term infrastructure bonds.

Impact on the sector

- Increase in MAT rate (effective increase of 2.94%) is slightly negative for companies undertaking long gestation projects. This would only result, however, in lower short-term cash flows, and MAT credit entitlements could be claimed against taxes to be paid in later years
- Encouragement provided to save, by allowing additional deduction under Sec 80C of the IT Act, could lead to additional funds for the ever-increasing funding requirements in infrastructure. Positive.
- Coal cess of Rs50 per ton on coal produced in India and on imported coal to create a Clean Energy Fund is negative for utilities whose off-take arrangements do not have the provision to pass on fuel costs.

Impact on companies

- Lower short-term cash flows of GMR Infra, GVK Power, Reliance Infra, Lanco Infra, JSW Energy, Adani Power on higher MAT payouts.
- Coal cess could be negative for companies like JSW Energy and Adani Power, though the impact would be small.

Appendix 1

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