



Growth will follow Fiscal Prudence

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Contours of Budget: Our View

With the fiscal deficit for 2009-10 pegged at 6.8% and inflationary expectations scaling back there seems to be a consensus that the government may pull back from the stimulus in a calibrated way. It seems the forthcoming Union Budget will mark the beginning of the exit. This being given the main question that needs to be answered is: **Whether the government's focus on fiscal prudence via rolling back the stimulus will hurt the economic recovery?**

We feel the government, in Budget 2010-11, will be able to manage both i.e. medium-term fiscal prudence and long-term growth agenda. Though we do not expect any big bang policy moves; some definite monitorables for the Budget 2010-11 would be the focus of the government on infrastructure and social sector spending to keep the engine of consumption rolling, government borrowings (taking into account private sector crowding does not take place and inflationary expectations), roadmap on reforms like GST rollout and oil sector deregulation.

Key points to watch out for:

- Rolling back the fiscal stimulus will happen but in a calibrated fashion. We expect that there may be a 200 bps roll back in excise duty, which will strengthen the indirect tax revenue for the Centre in 2010-11
- With recovery in the economy happening at a better-than-anticipated rate we expect the government to budget higher corporate and income tax revenues. We expect tax revenues to go up by 16.7% in 2010-11
- The buoyancy in tax revenues will provide room to the government to allocate towards expenditure, which will not pressurise deficit
- Though it may not be budgeted like FY10BE, we expect disinvestments to happen in FY11 to the tune of Rs 30,000 crore. Coupled with this we also expect the government to complete 3G auction in FY11, which will add about Rs 35000 crore to the government kitty
- On the spending side, though there may not be enough room for the government, social sector spending and infrastructure spending will continue to get higher allocation. We believe these will keep the consumption cycle rolling
- The government may budget in higher subsidies on account of food subsidy (high food inflation) and petroleum subsidy (higher oil prices and clouds over oil sector deregulation).
- On the borrowing front, we expect it to be at levels of FY10E. However, this time around any higher figure w.r.t FY10 may spook bond yields on account of crowding out the private sector. Also, inflation management of the government would be a key monitorable this fiscal. We expect the net Centre's borrowing to be just below the Rs 4,00,000 crore mark
- Also, there may be some announcement related to the roadmap of certain key reforms like the rollout of GST, direct tax code and oil sector deregulation
- We expect the government to budget a gross fiscal deficit of 5.6% for 2010-11BE

All in all, we believe Budget 2010-11 will definitely focus on fiscal consolidation. However, it will also manage to anchor in long-term growth expectations. We believe both growth and fiscal prudence will go hand in hand in Budget 2010-11.

We expect tax revenues to go up by 16.7% in 2010-11

We expect disinvestments to happen in FY11 to the tune of Rs 30,000 crore

Subsidies might be higher on account of food inflation and rising petroleum prices.

Government borrowing likely to be in and around Rs 4,00,000 crore and expect the gross fiscal deficit to be at 5.6% for 2010-11BE



What's happened so far?

Exhibit 1: Fiscal performance so far...

Particulars	FY08	FY09 RE	FY10 BE	April -Dec 2009-10	April -Dec 2008-09	% change
Total receipt	739900	871000	1020838	707540	597216	18.5 0.0
Revenue receipt	541900	562200	609600	389271	375937	3.5
Tax Receipt for the Centre	439500	466000	474218	307591	309927	-0.8
Direct tax revenue				247783	214861	15.3
Corporation tax				168299	144034	16.8
Income tax				79484	70827	12.2
Indirect Tax Revenue				168311	211934	-20.6
Customs				58611	82741	-29.2
Excise Duty				63045	77108	-18.2
Service tax				37056	39416	-6.0
Other indirect taxes				9599	12669	-24.2
Less: Share of states in the revenues				108503	116868	-7.2
Non tax revenue receipt	102400	96200	140279	81680	66010	23.7 0.0
Capital receipt	198000	308800	406341	318269	221279	43.8 0.0
Total Expenditure	712700	901000	1020838	707540	597216	18.5 0.0
Non plan expenditure	507700	618000	695689	497381	426419	16.6
Plan expenditure	205100	283000	325149	210159	170797	23.0
Gross Fiscal deficit	126900	326500	400996	309980	218262	42.0
Revenue deficit	52600	241300	282735	251254	173830	44.5
Primary deficit	-44100	133800	175485	179975	94527	90.4
Gross Fiscal deficit (% of GDP)	2.7	6.2	6.8			

Source: Budget Documents, ICICIdirect.com Research

Exhibit 2: Few hits and misses for the government YTD

Hits 	Misses 
Increased outlay on infrastructure spending	Increase in revised estimate for fiscal deficit to 6.8% for 2009-10
Increased focus on social spending, for instance a 144% hike in allocation to NREGS and 45% hike in allocation to Bharat Nirman	Rs 1120 crore estimated as receipts from disinvestment, which is way below market expectations
Elimination of FBT and CTT	Increase in MAT from 10% to 15%
Increase in slabs on the personal income tax	

Source: ICICIdirect.com Research

Revenue receipt for the government has shown a moderate growth of 3.5% YoY for 9MFY10. This moderation was mainly due to the fall in indirect tax revenues as a result of stimulus declared by the government in FY10

Growth in direct tax revenue is far better than the indirect revenue segment. Even after the modifications in individual income tax slabs last year income tax rose 12.2% YoY (9MFY10). Also, with a better-than-anticipated recovery in the economy and pick-up in domestic consumption, corporate tax collections have grown by 17% YoY

Indirect tax revenue receipts for 9MFY10 have declined by 21% mainly led by a decline of 29.2% YoY and 18% YoY in customs duty and excise duty, respectively. Customs duty was down mainly due to the fall in value of imports whereas excise was down owing to the reduction in rates being a part of government announced stimulus

Non-tax revenues may not be comparable as the government has accounted for 3G in 2009-10 Budget estimates. We believe these will not be coming this fiscal. Otherwise, other sources of non-tax revenues are well on track to meet the budgeted estimates

Capital receipts have grown by 44% YoY mainly due to higher receipts from disinvestments and government borrowings

How will finances look this year?

Exhibit 3: P&L account of the government

Particulars	FY09	FY10 BE	FY10 RE	FY11 BE
Total receipt	900,953	1,020,838	1,030,670	1,147,412
Revenue receipt	562,173	614,497	581,844	725,967
Net Tax Receipt for the Centre	465,970	474,218	469,967	564,014
Tax revenue	627,949	641,079	636,828	763,496
Direct Tax Revenue	344,600	369,575	379,045	442,161
Corporation tax	222,000	256,725	251,871	299,726
Income tax	122,600	112,850	127,174	142,435
Indirect Tax Revenue	283,349	271,504	257,783	321,335
Customs	108,000	98,000	84,611	94,764
Excise Duty	108,359	106,477	99,071	132,507
Service tax	65,000	65,000	60,878	78,532
Other indirect taxes	1,990	2,027	13,224	15,531
Less: Share of states in the revenues	161,979	166,861	166,861	199,482
Non tax revenue receipt	96,203	140,279	111,877	161,953
Capital receipt	338,780	406,341	448,826	421,445
Borrowings	326,512	397,957	414,640	386,344
Others	12,268	8,384	34,186	35,102
Total Expenditure	900,953	1,020,838	1,030,670	1,147,412
Non plan expenditure	617,996	695,689	698,599	763,736
Plan expenditure	282,957	325,149	332,071	383,676
Gross Fiscal deficit	326,512	397,957	414,640	386,344
Revenue deficit	241,300	282,735		
Primary deficit	133,800	175,485		
Gross Fiscal deficit (% of GDP)		6.8%	6.9%	5.6%
GDP	5,321,753	5,881,459	6,013,581	6,915,618
Expected Nominal GDP Growth		10.5%	13.0%	15.0%

Source: Budget documents, ICICIdirect.com Research

Note: 2009-10RE and 2010-011BE are estimates of ICICIdirect.com Research

For 2009-10BE we expect direct tax collections to post better numbers on the back of better economic recovery. For 2010-11, we expect this segment to grow by 16% YoY

The overall fall in tax revenue for FY10 will be mainly due to the stimulus impact, which has led to a decline in indirect tax revenue in FY10. We expect the government to roll back the duty cuts in a phased manner in FY11. This will help improve indirect tax collections. We expect the same to grow by 24% YoY

We have stripped off the 3G auction from non-tax revenues in 2009-10E and included a figure of Rs 35000 crore in 2010-11BE. We also expect the income from dividend to improve, going forward

We expect big bang disinvestments to get going in FY11 and have built in Rs 30,000 crore of proceeds for the same. Also, we expect the gross market borrowings to increase marginally

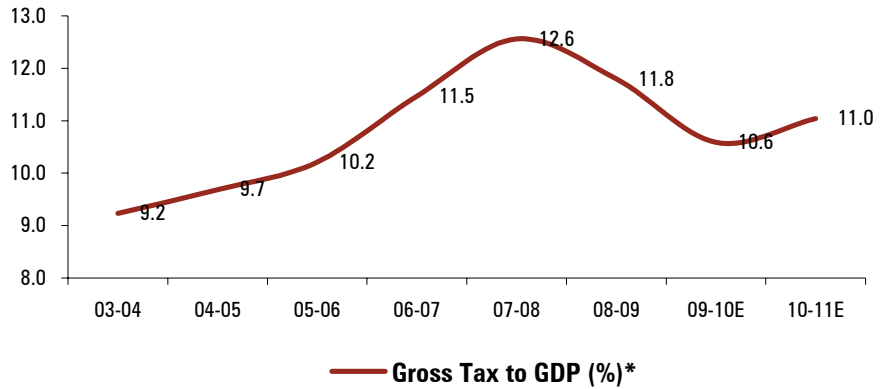
We expect the non-Plan expenditure to be more than estimates on account of higher defence and subsidy allocation

We expect the gross fiscal deficit to be at 6.9% and 5.6% in FY10 and FY11, respectively

Trends in fiscal performance...

With the improvement in the economy we expect earnings and consumption to pick up in FY11E. Therefore, we have built in higher tax revenues. Also, the likely roll back of some indirect taxes will help the tax to GDP ratio to claw back to 11% in FY11BE from 10.6% in FY10

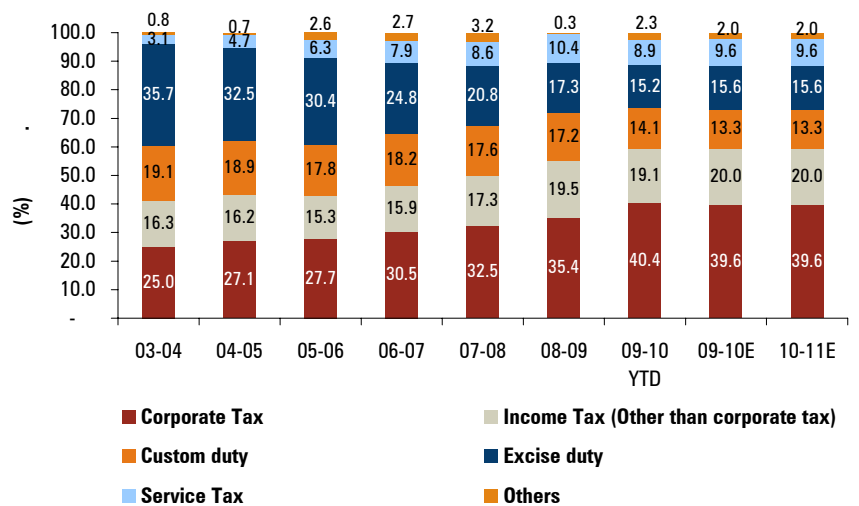
Exhibit 4: Tax to GDP ratio to improve, going forward



Source: Budget documents, ICICIdirect.com Research

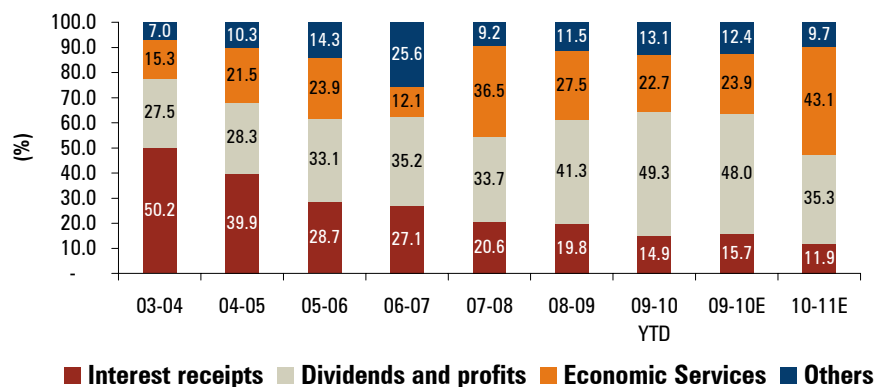
Till date direct tax revenue collections have grown while indirect tax revenues fell on the back of stimulus announced. On a full year basis, there may be some shortfall in the total revenue receipts owing to a decline in indirect tax revenues and postponement of 3G auction

Exhibit 5: Contribution of segments to total tax revenue



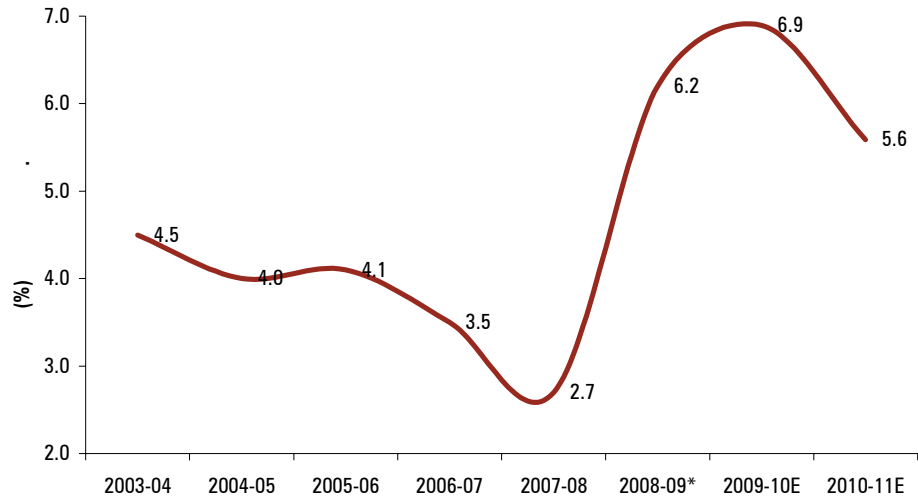
Source: Budget documents, ICICIdirect.com Research

Exhibit 6: Contribution of segments to total non-tax revenue



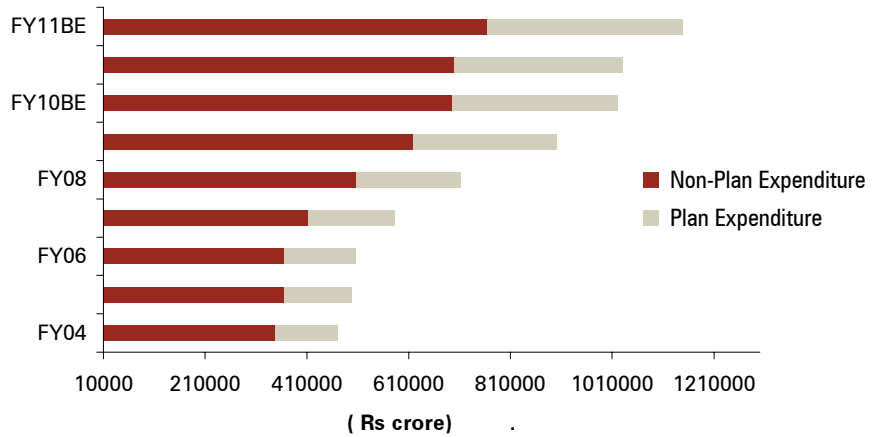
Source: Budget documents, ICICIdirect.com Research

Exhibit 7: Trend in gross fiscal deficit as % of GDP



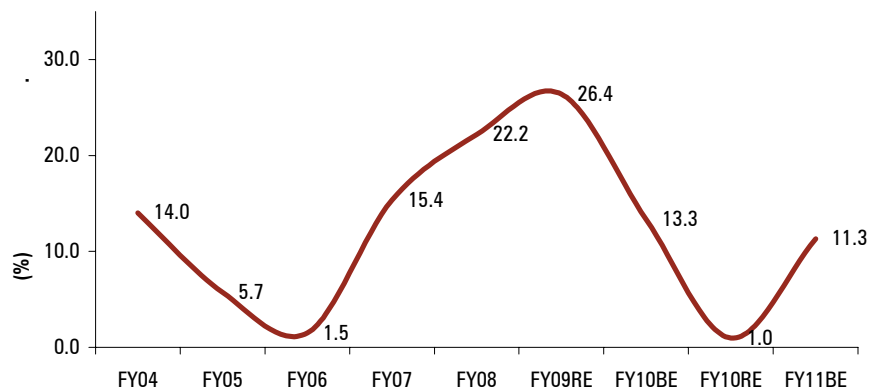
Source: Budget documents, ICICIdirect.com Research

Exhibit 8: Plan and non-plan expenditure



Source: Budget documents, ICICIdirect.com Research

Exhibit 9: Growth in total government expenditure



Source: Budget documents, ICICIdirect.com Research

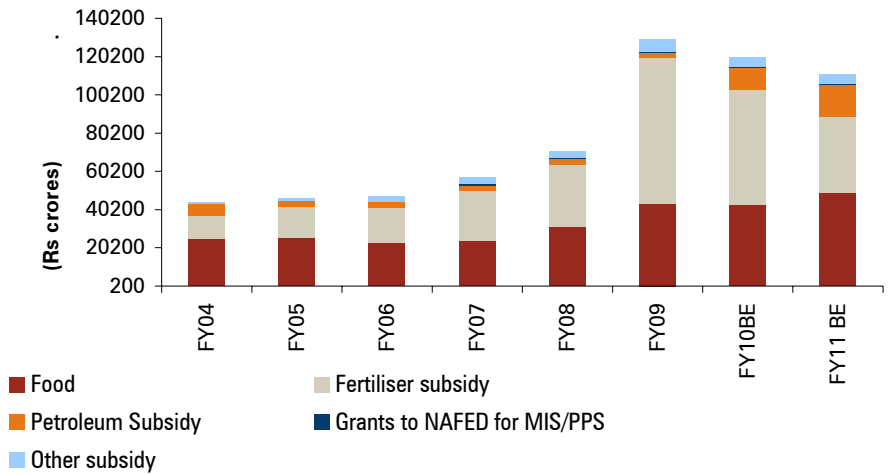
The gross fiscal deficit for 2010-11 would be at 5.6%. This would be mainly contained by higher revenues and non-debt capital receipts

We believe that non-plan expenditure will be higher than 10% mainly due to a rise in food subsidy and defence expenditure.

We have estimated a 20% rise in defence expenditure for 2010-11BE

We do not expect the expenditure to rise substantially though it will remain at elevated levels. We estimate that total expenditure will grow by 11.3% in FY11BE

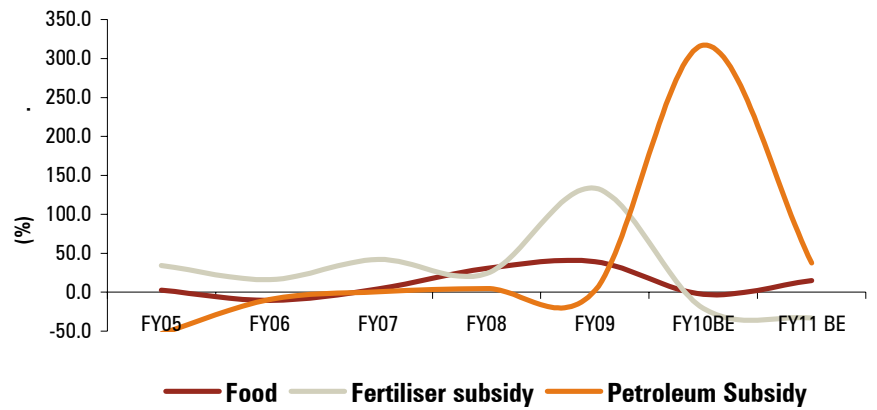
Exhibit 10: Trends in subsidy



Source: Budget documents, ICICIdirect.com Research

The government may budget in higher subsidies on account of food subsidy (high food inflation) and petroleum subsidy (higher oil prices and clouds over oil sector deregulation)

Exhibit 11: Growth rate in major government subsidies



Source: Budget documents, ICICIdirect.com Research

Buoyant tax revenues in FY11 will enable the government to make higher allocations to social sector schemes and help maintain its aim of inclusive growth

Exhibit 12: Movement in government flagship programmes

Gov't Flagship programmes	FY07	FY08	FY09	FY10	CAGR(%)
NRHM	6207	9947	12050	14127	32
BN	18696	24603	31280	45356	34
NREGS	11300	12000	16000	39100	51
JNNURM	4595	5482	6866	12887	41
ICDS	4087	5293	6300	-	-
APDRP	7121	11000	20000	35000	70

Source: Budget documents, ICICIdirect.com Research

Roadmap for key reforms

Goods and services tax (GST)

The introduction of the dual goods and services tax (GST) is expected to remove the present problem of tax cascading by moving to a common tax base and by subsuming various central and state taxes and levies into the central goods and the services tax (CGST) and state goods and services tax.

One of the key challenges related to the GST is with regard to supply chains. At present, the supply chains are impacted by several forces, some intrinsic to the organisation, some market specific while others are fiscal in nature. Fiscal considerations have historically been a key determinant of supply chain structuring in India with manufacturing bases and distribution networks engineered primarily to harness fiscal benefits. The availability of tax exemptions/benefits and the prevalence of differential taxes based on geographical locations have influenced the structuring of supply chains, procurement patterns and distribution networks. The dual GST would significantly impact supply chains from procurement through manufacturing to distribution.

With the proposed goods and services tax (GST) in the works, the government is looking to redefine import and export of services. The move is aimed at rectifying procedural anomalies that have led to large scale litigation in the service tax regime. Currently, tax on manufacturing goods is 20% while services tax is 10.2%. The proposed 14-16% GST tax would bring incremental revenues to the government as contribution of services to the GDP is higher. We believe that successful implementation of the GST would add 1-1.5% to the GDP. However, a delay in implementation to March 2011 would mean a rollback of indirect taxes, which would increase the government revenue from indirect tax in FY11. This, in turn, would help in curbing the fiscal deficit.

Direct tax code (DTC)

The government has released a comprehensive draft of the new direct tax code that seeks to revamp and simplify the Direct Tax Law and its administration in the country through several radical changes. The code, which the government plans to enact and implement from FY2012 onwards with suitable changes if required, envisages a meaningful reduction in tax rates while simultaneously being revenue neutral for the government. It aims to achieve this by increasing the tax base and rationalising the myriad tax incentives prevalent under the current law.

In our view, the overall changes proposed will be quite beneficial for a number of sectors and companies, albeit definitively withdrawing tax holidays being currently enjoyed by different sectors. This is something that has been contemplated and proposed often in the past. Therefore, this should not come as a major negative surprise. If a roadmap is spelled out in this regard it will be highly beneficial.

However, a delay in implementation to March 2011 would mean a rollback of indirect taxes, which would increase the government revenue from indirect tax in FY11. This, in turn, would help in curbing the fiscal deficit.

If a roadmap is spelled out with respect to DTC it will be highly beneficial.

Deregulation of oil sector

A roadmap on the deregulation of petroleum product prices is expected from the current Budget. The under recoveries in petroleum product prices for 2009-10 are currently estimated at Rs 45,571 crore. The under recoveries would be Rs 20,448 crore (FY11E) if all the recommendations of the Kirit Parikh Committee are implemented. Thus, the under recoveries would come down by 70% (Rs 47,287 crore).

However, we believe that complete implementation of the committee would be difficult as an increase in prices of kerosene and diesel would require a lot of political courage. We expect that some freedom in pricing of auto fuels (petrol and diesel) could be approved by the Cabinet. For 2010-11, the under recoveries for petroleum prices is estimated at Rs 67,335 crore. If deregulation of auto fuel prices is implemented, the under recoveries would come down by Rs 17,885 crore to Rs 49,450 crore.

Exhibit 13: Under recoveries under current tax regime

(Rs crore)	2009-10	2010-11
Petrol	5103	8395
Diesel	8894	18980
Kerosene	14084	22230
LPG	17490	17730
Total	45571	67335

Source: Government of India, ICICIdirect.com Research

Exhibit 14: Under recoveries if government fully deregulates petrol prices and diesel prices partially

	2009-10	2010-11
Petrol	0	0
Diesel	4447	9490
Kerosene	14084	22230
LPG	17490	17730
Total	36021	49450

Source: Government of India, ICICIdirect.com Research

In the above case, we expect the government to save ~Rs 17,000 crore. If implemented, this will reduce the subsidy burden by the said amount and help shave the fiscal deficit by 0.25% in FY11.

Exhibit 15: Under recoveries on implementation of Parikh committee

	2010-11
Petrol	0
Diesel	0
Kerosene	12168
LPG	7880
Total	20048

Source: Government of India, ICICIdirect.com

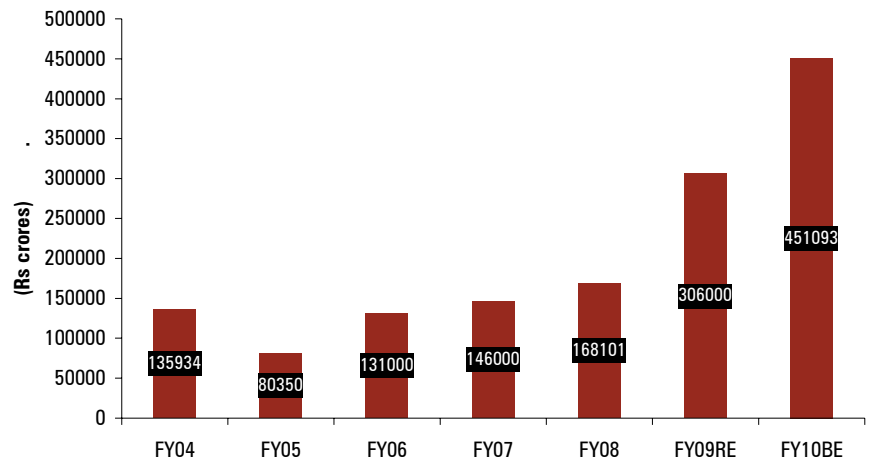
If only some of the Parikh committee recommendations are implemented (full deregulation of petrol prices and partial deregulation of diesel prices). This will reduce the subsidy burden by the said amount and help shave the fiscal deficit by 0.25% in FY11

Borrowings & disinvestment: Will stay high

Like FY10, gross market borrowings and disinvestments will stay high in FY11 as well

Like FY10, gross market borrowings and disinvestments will stay high in FY11 as well. In FY10, the government successfully completed the borrowing programme without impacting bond yields much and crowding out the private sector. However, in FY11, we expect the yields to harden further, at least in H1FY11, on the back of the high borrowing programme coupled with an up tick in credit offtake. Also, rising inflation will keep the yields on the high side. The recent up tick in bond yields have been factored in, to some extent, in the high government borrowing. However, if the forthcoming budget factors in higher-than-anticipated borrowings then yields may shoot up aggressively. We expect government borrowings to increase by 2-5% in FY11BE over FY10BE.

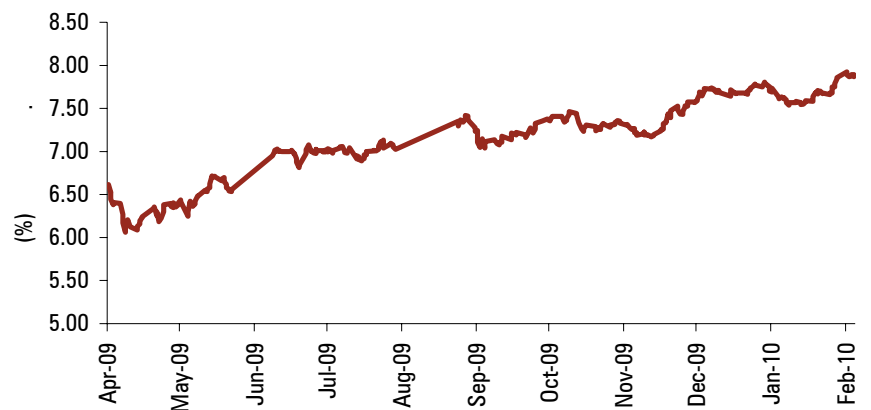
Exhibit 16: Government borrowings to stay high (gross)



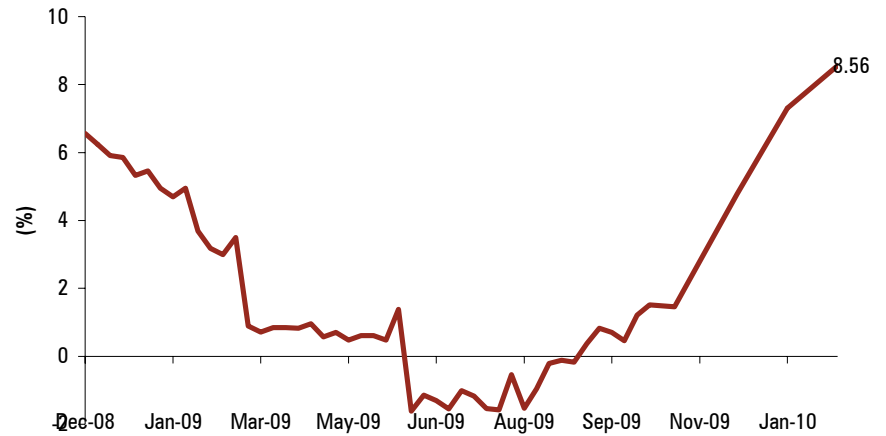
Source: Budget documents, ICICIdirect.com Research

Exhibit 17: Bond yields to stay high

The recent up tick in bond yields have been factored in, to some extent, in the high government borrowing. However, if the forthcoming budget factors in higher-than-anticipated borrowings then yields may shoot up aggressively

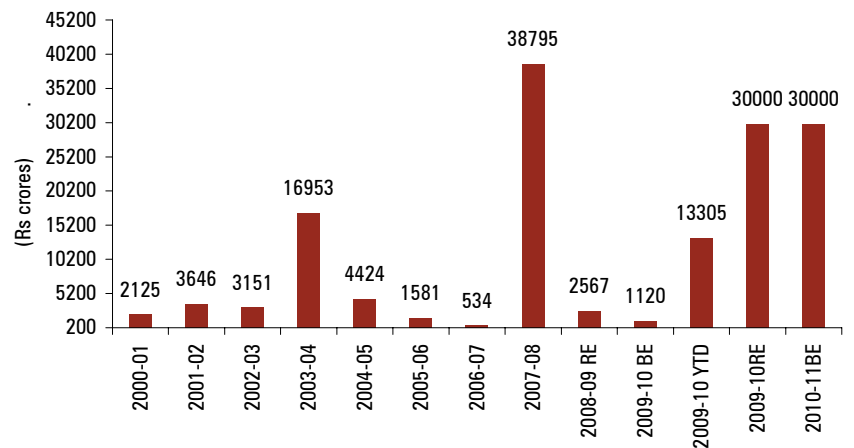


Source: Reuters, ICICIdirect.com Research

Exhibit 18: Inflation a concern in the near term

Source: Reuters, ICICIdirect.com Research

Disinvestments, on the other hand, will also stay high in FY11. We expect some big bang issuances in FY11 to help the government to tide over the issue of fiscal deficit. We believe the government will be able to garner at least Rs 30,000 crore from the same in FY11BE.

Exhibit 19: Trends in disinvestment proceeds

Source: Government of India, ICICIdirect.com Research

Exhibit 20: Big bang disinvestments in FY11E (IPO/FPOs)**Proposed Disinvestment during FY11 through the FPO/IPO's**

Name	Govt Holding (%)	Stake (%)	Amount (Rs Cr)
MMTC	9.3	9	16,000
SAIL		5	4,450
BSNL	100.0	10	NA
Coal India	100.0	10	NA
Manganese Ore	100.0	10	NA
Kudremukh Ore	100.0	10	NA

Source: ICICIdirect.com Research

We have factored in Rs 30,000 crore of disinvestment proceeds | 2010-11BE

Sectoral Expectations

Auto and auto ancillary

Key expectations	Impact	Our View
Rollback of excise duty	Negative	After a stormy 2009, passenger vehicles (PV) sales grew at a healthy rate of 25.2% in 10 months of FY10. This gives us good reason to believe the government will roll back the 4% cut in excise duty. This would make cars (small and big) dearer by Rs 2,000 to Rs 1 lakh. Negative for all PV manufacturers
Removal of accelerated depreciation for all commercial vehicles post March 31, 2010.	Negative	Negative for Tata Motors, Ashok Leyland, Mahindra and Mahindra and Eicher Motors.
Increase in spend on road infrastructure and state transport	Positive	To benefit passenger as well as commercial vehicles industry. Key beneficiaries - Maruti Suzuki, Mahindra and Mahindra and Hero Honda Motors
Increased allocation to JNNURM scheme for public transportation	Positive	Allocation to benefit Tata Motors and Ashok Leyland

Banking

Key expectations	Impact	Our Take/View
Passing resolution for allocation to PSU banks on account of recapitalisation	Positive	We believe this will be beneficial for public sector banks like Dena Bank, Oriental Bank of Commerce
Abolishing STT	Positive	We believe STT will not be abolished but at best it may be tweaked as cutting down on revenue streams may not augur well for the health of public finances. Any positive surprise in terms of abolishing/tweaking the STT will be positive for the entire Indian broking sector and markets also

Cement

Key expectations	Impact	Our Take/View
Excise duty increasing to 10% from current rate of 8%	Negative	We expect that an increase in excise duty would have a negative impact on cement players as they will find it difficult to increase their net realisation in the current oversupply scenario
Reduction of VAT for cement to 4% from 12.5%	Neutral	We do not expect this demand to be met by the government
We expect the import duty on inputs (coal, petcoke and gypsum) to remain unchanged at 5%. However, the industry is demanding import duty on inputs to be abolished	Neutral	In order to balance its indirect tax revenues, we do not expect this demand to be met by the government

Construction

Key expectations	Impact	Our Take/View
Higher allocation for key infrastructure schemes	Positive	Given the government's thrust on infrastructure spending, we expect higher allocation on key schemes such as JNNURM, PMGSY & AIBP
Status quo for Section 80 IA	Neutral	We do not expect tax benefits under section 80IA to get extended to construction players. Hence, construction players would continue to pay full tax rate
Could provide some tax benefits on PPP projects in the road segment	Positive	In order to expedite the work on the ambitious target of 20 km/day, the government may provide some tax incentives or breaks on PPP projects in order to attract more participation from private players

FMCG

Key expectations	Impact	Our Take/View
Rural areas have been the growth drivers in recent times. FMCG companies want the government to continue its focus on the rural sector in the forthcoming Budget	Positive	With low penetration, a huge consumer class and rising rural income, FMCG companies are banking on rural areas for volume growth
Control the prices of commodities, key raw materials for the FMCG industry	Positive	Recently, prices of most raw inputs have gone up significantly. The companies want the government to take measures to control the prices and give higher focus to increased production

Media

Key expectations	Impact	Our Take/View
Relaxation in FDI norms	Positive	Increase in FDI limits for DTH operators, print companies, news broadcasters and radio companies would be beneficial. Companies to benefit: All DTH operators, print and radio companies. Stocks like Dish TV, Jagran Prakashan, HT Media, Deccan Chronicle, DB Corp, ENIL and Sun TV
Reduction in import duty on set-top boxes	Positive	Reduction in import duty on set top boxes used in DTH and digital cable would reduce the cost of digitalisation. It would be positive for all DTH companies
Reduction in service tax	Positive	Broadcasters are subject to levy of service tax @12.24% unlike print media companies. It would be positive for broadcasters, if the service tax is withdrawn
Reduction in Directorate of Advertising & Visual Publicity (DAVP) rates	Negative	Last year, the government had increased DAVP rates in light of the bleak advertisement scenario for the print Industry. Given the robust ad growth in FY10, the government can roll back the hike

Hospital

Key expectations	Impact	Our Take/View
Healthcare sector should be recognised as a "priority sector"	Highly Positive	Looking at the huge potential and investment incentives in the sector, the accordance of infrastructure status would further boost the desired investment flow. This would not only help in narrowing down the demand and supply gap, which is currently very huge but also would help to prevent brain drain to some extent by creating additional 0.7-0.9 million jobs in the sector. However, in our view, this is unlikely to happen
Extension of tax holiday period from five years to 10 years	Positive	Keeping in mind the high capital intensive nature of the industry and long gestation period, it is suggested that the healthcare sector should be covered under section 80-IA of the Act, which provides a 10-year tax holiday period. Currently, this sector is covered under section 80-IB of the Act, which provides a five year tax holiday for setting up hospitals, particularly in Tier II and Tier III cities
Mandatory insurance for employees and families in the organised sector	Positive	Making insurance cover mandatory for employees in the organised sector would help in making health related expenditure affordable. This would also enhance the health insurance penetration. In our view, this move can be expected in this Budget

Telecom

Key expectations	Impact	Our Take/View
Rationalisation of license fee and spectrum charges.	Positive	Reduction in license fee and spectrum charges would keep the momentum going in the sector, especially in rural areas
Effective deployment of USO fund	Positive	Facilitation of effective deployment of USO fund would ensure speedy roll out of telecom infrastructure in rural areas to increase the rural penetration, which stands at less than 15% currently. This move would be positive for all telecom operators
Speedy auction of 3G and WIMAX spectrum	Neutral to negative	Speedy auction of 3G/WiMax spectrum would be beneficial for all incumbent operators. However, if the floor price for 3G spectrum is fixed at Rs 4040 crore it would be negative for operators participating in the auction

Hotel

Key expectations	Impact	Our Take/View
Infrastructure status	Highly positive	In order to accelerate the pace of growth of hotel rooms, infrastructure status has been a top priority for the industry. The country is currently experiencing a shortage of ~1,00,000 hotel rooms to meet the accommodation needs of foreign and domestic tourists. However, we feel this move is less likely in the coming Budget, considering the loss of revenues to the government as granting this status would enable tourism to secure several benefits in terms of financing, tax exemption and subsidised power tariffs among others
Extension of tax holiday u/s 80ID of IT Act	Positive for five star hotels	This move will be beneficial for all five star hotels as they are currently not covered under section 80ID of the IT Act. We feel this move is likely in the coming Budget as it would not only be beneficial for hotel players but also for the government since capacity expansion of five star hotel rooms will take place at the desired speed to accommodate a large number of travellers to India during the 2010 games
Roll back of depreciation rate for hotel buildings to 20%	Positive	It is recommended that the earlier rate of depreciation of 20% be restored. The rationale behind this is that hotel buildings constitute 'plants' for hotel industry as their usage is round the clock for 24 hours. The industry has to make heavy investment in renovation, upgradation and upkeep of hotel buildings. Hence, the need for higher rate of depreciation. We feel this move is more likely in this Budget
Clarification regarding payment made to hotels under 194-I of IT act is required	Neutral to Positive	CBDT may issue an appropriate circular clarifying that the payment made to hotels are not covered within the ambit of section 194-I as it is not a rent per se. Exclusion of payment to hotels from 194-I would ease the working capital requirement of hotel companies to some extent. We feel this move is likely in this budget

Information Technology

Key expectations	Impact	Our Take/View
Increase in outlay related to National e-governance programme (NeGP)	Positive	NeGP is estimated to be in the range of Rs 40,000-42,000 crore over the XIth Plan of which Rs 20,000 crore worth projects have already been executed or are in implementation phase. An increase in outlay will help all system integrators like Infosys, TCS, Wipro, HCL Technologies, Patni, etc to get incremental business from the domestic market. Also, companies like Rolta and ICSA benefit as more outlay happen towards GIS and scaling down of AT&C losses, respectively under RAPDRP
Unchanged treatment on tax breaks for exports from SEZ under the new direct tax code	Positive	This will help all IT companies who have invested into SEZs heavily to commission the new contracts from the same and recover their investments faster in the form of lower tax rates
Extension of sunset clauses by one more year for tax benefit under the STPI scheme u/s 10A/10B	Positive	The extension of STPI benefit by another year i.e. the window of 10 years will aid the profitability for companies across the board as tax rates will remain in the 16-20% range or else the effective tax rates will shoot beyond 25%, which has been factored for all companies as of now. This will help companies to continue to avail tax breaks on exports for the ongoing longer term contracts, which cannot be moved to SEZs
Increase in education outlay	Positive	Increase in outlay for technology enabled education sector reform i.e. higher allocation to public-private partnership (PPP) projects to encourage schools to get technological equipped for teaching. This will benefit education companies like NIIT, Educomp, Everonn, etc

Logistics

Key expectations	Impact	Our Take/View
Railways – To encourage private sector players to procure more wagon	Positive	Indian Railways is on track to achieve its freight target of 880 million tonnes (MT) in FY10E (730.4 MT in 10MFY10). Higher freight traffic will boost the demand for wagons. Increased private sector participation in wagon procurement will further enhance the growth prospects for wagon manufacturing companies like Texmaco and Titagarh Wagons
Implementation of Kirit Parekh Committee recommendation - Decontrol of auto fuel prices	Negative	This action will increase diesel prices sharply. Fuel cost is the major cost for road transport players like Transport Corporation of India (TCI). With this step, TCI will take a hit on its profit margin. However, we do not see immediate de-regulation of fuel prices but expect some framework to be designed in this aspect. De-regulation will lead to a shift of traffic from road to rail and benefit players like Concor and Gateway Distriparks
Extension of 80IA (Tax holiday for enterprises engaged in infrastructure development and operation) beyond March 2011	Positive	This will provide additional incentives for making investments in infrastructure and power sector. This is positive for Sanghvi Movers, which provides cranes for construction
Higher fund allocation for building roads, ports and other utilities	Positive	This will prove positive for all companies in the logistics space.

Oil and Gas

Key expectations	Impact	Our Take/View
Clarification on income tax benefit under Section 80IB on natural gas production for pre NELP and NELP I-VII blocks	Positive	The income tax exemption would be beneficial to E&P companies having huge gas reserves. This would benefit Reliance Industries, ONGC and Cairn India
The exact timeline for deregulation of auto fuel prices and pricing of other petroleum products	Positive	Freedom in pricing of auto fuels would be beneficial for OMCs. We believe such an announcement may not come for all petroleum products. Positive for oil marketing companies (IOC, BPCL and HPCL)

Real Estate

Key expectations	Impact	Our Take/View
Reintroduction of section 80 IB	Positive	The reintroduction of Section 80 IB for the housing sector would improve the after tax cash flow for developers. However, in our view, this is unlikely to happen
Increase in limit for tax benefits for housing loan	Positive	If the limit for deduction of interest (Rs 1,50,000 p.a. currently) & principal repayment (Rs 1,00,000 p.a) gets revised upward this would effectively lead to higher demand for residential units. Nonetheless, given the higher likely fiscal deficit burden, probability of this reform happening is lower

Metals and Mining

Key expectations	Impact	Our take/ view
Increase in excise duty on steel products by 2% from the current level of 8%	Negative	Increase in excise duty would lead to an increase in steel prices through pass on from steel companies and may have a negative effect on demand
Increase in export duty on iron ore lumps and fines by an additional 5%	Mixed	We believe that a 5% increase in export duty on iron ore lumps and fines would hurt the profitability of mining companies like Sesa Goa but would help to increase the availability of iron ore for domestic non-captive steel companies like JSW Steel
Final divestment plan outline for SAIL, NMDC	Positive	Divestment in the range of 8-10% through book building process will be marginally positive for both NMDC and SAIL
No change in customs/import duty on steel products from the present level of 5%	Neutral	Continuation of existing customs duty structure to have a neutral impact on steel companies across our coverage universe
No change in ad-valorem royalty rates for various mined ores	Neutral	Royalty rates were hiked in August 2009 and are likely to be kept stable. This will have neutral impact on mining majors like Sesa Goa and Hindustan Zinc
Increase in rural infrastructure spend	Positive	Per capita steel consumption in rural areas expected to go up from the current level of 2 kg as compared to the national average of 47 kg

Pharmaceuticals

Key expectations	Impact	Our Take/View
Excise duty on drugs and pharmaceuticals restored to 8% from 4%	Positive	This should be maintained in the current Union Budget as this will help manufacturers based in excise free zones to go for increased sourcing from these zones
Exemption of customs duty on all life saving medicines like antibiotics and anti-cancer	Positive	Exemption in customs duty for life saving drugs would benefit MNC subsidiaries like GlaxoSmithkline Pharma, Pfizer, Novartis, Aventis Pharma etc. Exemption in customs duty and services tax will benefit frontline players like Glenmark, Ranbaxy Laboratories, Piramal Healthcare and Sun Pharmaceuticals
Weighted average deduction on R&D to be increased to 200% and other outsourced studies such as clinical trials and other	Positive	This will encourage Indian pharma companies to invest more in the R&D of innovative molecules such as new chemical entities and novel drug delivery systems

Power

Key expectation	Impact	Our Take/View
Extension of 80IA (tax holiday for enterprises engaged in infrastructure development & operation) beyond March 2011	Positive	Will provide additional incentive for making investments for generation, distribution and transmission space
Aggressive divestment agenda	Positive for PSU	* Divestment candidates - Neyveli Lignite * Follow on public offering (FPO) - Power Grid, REC * Initial public offering (IPO) - SJVNL
Streamlining of the reforms recommended by the Chaturvedi committee - Clarity on distribution of unallocated power kept by central government	Positive	Allowing a percentage of unallocated power to the merchant market may improve returns for the generator. Positive for CPSUs like NTPC, NHPC, Neyveli Lignite

Retail

Key expectations	Impact	Our Take/View
Abolition of service tax on renting of immovable property	Positive	We believe the government would not take up the issue in the Budget. Stocks to benefit, if any such measure is taken: Pantaloon Retail, Shoppers Stop, Trent and all other retail companies
Clarity on applicability of Press notes 2, 3 and 4 of 2009 for the retail sector. This deals with calculation of FDI in step down subsidiary of an Indian investing company having FDI	Positive	We believe that the government would not take up the issue in the Budget. Stocks to benefit if any such measure is taken: Pantaloon Retail, Shoppers Stop, Trent

Shipping

Key expectations	Impact	Our Take/View
Granting infrastructure status to shipping industry	Positive	Infrastructure status would mean tax holidays and easier access to long term borrowings. However, it is a long pending demand likely to be ignored once again. Positive for all shipping, offshore and shipbuilding companies if the demand is met
Notification of shipyards as special economic zones (SEZs)	Positive	Reduce tax outgo as the entire income will be tax exempt. There is a marginal likelihood that SEZ notification would be issued. Positive for shipbuilding companies i.e. ABG & Bharati Shipyard
Extension of subsidy scheme to shipyards	Positive	Industry expects an extension of subsidy scheme for a 10-year period. Extension of the scheme for another five years is likely with 20% subsidy. Positive for shipbuilding companies i.e. ABG & Bharati Shipyard
Increase in allocation to defence	Positive	The defense ministry has proposed ~ 20% hike in Budget allocation. A part of the orders are expected to flow to shipyards for procuring coastal patrol vessels including speed boats
Increased allocation towards development of port infrastructure	Positive	The government has laid a lot of thrust on development of port infrastructure. It is likely that more allocation would be made towards development of ports and public private partnership model could be the preferred vehicle for implementation. Positive for shipping companies operating port terminals i.e. Essar Shipping, Mundra Port

Sugar

Key expectations	Impact	Our Take/View
The government doing away with the release order mechanism	Positive	The sugar industry wants the government to let the market govern the prices of the sweetener, by partially decontrolling the industry and re-introducing sugar futures trading. Removal of the release mechanism would help the industry to sell sugar without government permission
Tax exemption: With power shortage in the country, the sugar industry is hoping to get extension for income tax exemption for cogeneration projects by another five years i.e. up to March 31, 2015	Positive	Currently co-gen projects get tax exemption benefit for 10 years if power generation commences before March 31 2010. The move is needed to encourage fresh investments
Implementation of 10% mandatory ethanol blending	Positive	The industry expects the government to cover the ethanol projects under Section 80-IA of the Income Tax Act. The companies want the exemption as well extension of the income tax benefit to the ethanol projects

Textiles

Key expectations	Impact	Our Take/View
Increase in allocation of technology upgradation fund scheme (TUFS) from Rs 3140 crore to Rs 4500 crore, which includes Rs 1500 crore for interest backlog	Positive	We believe the government may increase the allocation to TUFS. However, the quantum may be lower. Stocks to benefit: Bombay Rayon Fashions
Continuation of interest subvention rate of 2% till March 2011	Positive	We believe the government would continue with the interest subvention of 2% to exporters till March 2011 from March 2010. This would be positive for exporters. Stocks to benefit: exporting companies like Bombay Rayon Fashions, Welspun India, Alok Industries, Vardhaman Textiles
Downward revision of excise duty on the polyester segment to 4% from 8%	Positive	The government has raised the excise duty in the previous Budget and we do not expect any write back in duties in this Budget. Any downward revision in duties is expected to be positive for companies like Alok Industries, Indorama Synthetics

Technical View

Sensex: Tendency of hitting tops prior to Budget

In the history of the Sensex, all major tops and bottoms have happened closer to every alternate March, with tolerance of one or two month, as can be seen below.

In the history of the Sensex, every year the Sensex has shown the market topping out in the first quarter. Following is the list of major tops since 2000

- Topped at 6151 in February 2000
- Topped at 4462 in February 2001
- Topped at 3758 in February 2002
- Topped at 6249 in January 2004
- Topped at 6696 in January 2005
- Topped at 14724 in February 2007
- Topped at 21206 in January 2008

On the flip side, the Sensex has exhibited bottoming process during the March-May period in majority years as can be seen below

- Bottom of 2903 was hit in May 2003
- Bottom of 4227 was hit in May 2004
- Bottom of 6140 was hit in May 2005
- Bottom of 8799 was hit in June 2006
- Bottom of 12316 was hit in March 2007
- Bottom of 8047 was hit in March 2009

Exhibit 21: Sensex monthly chart: 2000-2010



Source: ICICIdirect.com Research

In summary, if we witness a major top around the current time zone, the next bottom is likely to be between March and May 2010.

Derivative view

Rationale

- To benefit from a broad expiry range by keeping strategy delta at zero
- To give a broad profitable range as there may be broad movements on either side depending on the Budget announcements, which will result in an upsurge in volatility. To counter this likely upsurge in volatility, the strategy gamma is near zero

Highlights

Profitable range	4806-4994
Maximum Profit	4700
Maximum Loss	300
Risk Reward	1:16

Strategy benefits:

- The strategy is profitable in the Nifty range of 4806-4994
- The strategy will have maximum profits of Rs 4700, if the Nifty March expiry happens at 4900
- The strategy will have maximum loss of Rs 300, if the Nifty March series expires beyond the profitable range

Buy 1 lot each of Nifty March 4800 Put at 122 and Nifty March 5000 Put at 216. Sell 2 lots of Nifty March 4900 Puts at 166. Execute the strategy with maximum net debit of 6 points.

With the Budget in the near horizon, market participants are uncertain on the future market trend. This likely scenario demands a strategy, which will remain insulated from the large swings in the market. The total gamma value of the given strategy is near zero resulting in the delta value of the strategy getting almost frozen no matter how strong the underlying moves

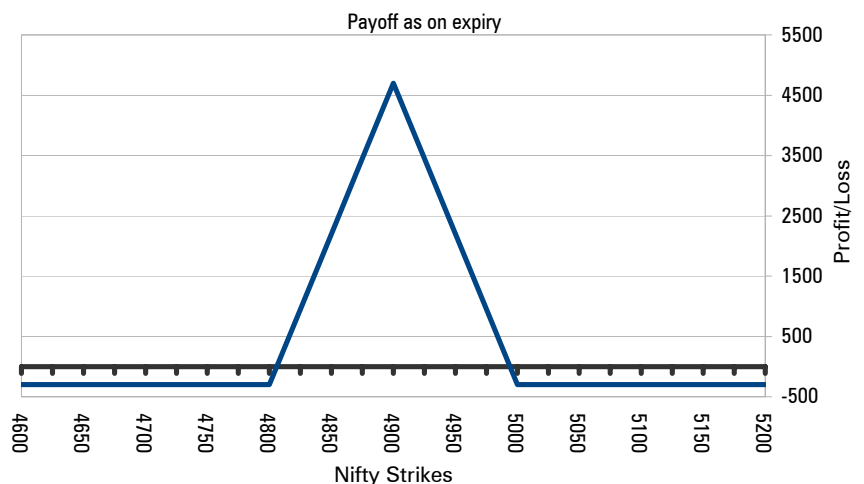
High gamma values lead to big changes in delta value, resulting in exponential gains or losses on wild swings in the market. In the given strategy, the high gamma value of sell positions of two lots of 4900 Put options is reduced by buying 4800 and 5000 Put options

Exhibit 22: Strategy Payoff

Instrument	Action	Strike	Prem	Lots	Spot closing at expiry					
					4500	4806	4850	4900	4994	5200
Put (March)	B	4800	122	1	178	-122	-122	-122	-122	-122
Put (March)	S	4900	166	2	-468	144	232	332	332	332
Put (March)	B	5000	216	1	284	-22	-66	-116	-210	-216
Profit/Loss per share					-6	0	44	94	0	-6
Total Profit/Loss					-300	0	2200	4700	0	-300

Source: ICICIdirect.com Research

Exhibit 23: Strategy chart



Source: ICICIdirect.com Research

Exhibit 24: Greeks analyser

Greeks/Puts	4700	4900	4900	5000	Strategy
Delta	0.4	0.5	0.5	0.6	0.00
Gamma	5.85	6.03	6.03	5.82	0.39

Source: ICICIdirect.com Research

Definitions:

Vega: It measures the effect of volatility on option premiums

Delta: It measures the effect of underlying movement on option premiums

Gamma: It measures the effect of underlying movement on change in delta

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