

Outlook - Budget 2011



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Key Highlights

- Total expenditure proposed for FY11 stands at Rs.1108749 cr up by 8.6%. Plan expenditure up by 15%. Non plan expenditure up by 6%.
- Fiscal Deficit estimated at 5.5% for FY11 (from 6.9%FY10), 4.8% in FY12 and 4.1% in FY13.
- Government would be in a position to implement the Direct Tax Code and the Goods and Services Tax by April, 2011
- Direct tax proposals in form of lower income tax slabs would lead to a loss of Rs.26,000cr.
- Indirect tax proposals would lead to a gain of Rs.46,500 cr.
- Overall budget proposals on taxation would lead to Revenue Gain of Rs.20,500cr.
- Corporate Tax: MAT increased from 15% to 18%
- Surcharge on corporate tax reduced from 10% to 7.5%.
- Partial withdrawal of fiscal stimulus measures through roll back of excise duties
- Excise duty on all non oil products increased from 8% to 10%.
- Service Tax rate retained at 10%



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- Subsidy to oil companies to be given in cash and included in budgetary estimates.
- Subsidy on Fertilisers to be reduced.
- Divestment receipts expected to be more than Rs.25,000 cr in FY10. Disinvestment targets for FY11 to the tune of Rs. 40000 crs.
- Government to provide Rs 16,500 crs to PSU banks for shoring capital base.
- To provide additional capital to RRB's to support increased lending to the rural economy.
- Extension of interest subvention of 2% to exporters covering handicrafts, carpets, handlooms and small and medium enterprises.
- Credit flow into the agricultural sector target set at Rs 3,75,000 crs for FY11.
- The period for repayment of the loan amount extended by six months from December 31, 2009 to June 30, 2010 under the debt wavier and Debt Relief Scheme for Farmers.
- Rs 1,73,552 crs provided for infrastructure development.
- The spending on the social sector has been gradually increased to Rs 1,37,674 crs in 2010-2011, which is 37% of total plan outlay.
- Infrastructure spending pegged at Rs. 1, 73,552 crs, which is 46% of plan outlay.
- Net borrowing for FY11 set at Rs 3,45,000 cr ; Gross borrowing at Rs 4,57,000 cr



Impact on Equity – Summary Views

- Hike in excise duty has been on expected lines.
- Reduction in surcharge to 7.5% would reduce tax incidence by ~75 bps and increase profits by ~1%.
- Increase in MAT would impact some corporates.
- Increase in tax slabs for individuals will give more money in hand of consumers is a key positive as it would enhance consumption.
- Hike in petrol prices by ~Rs. 2.50 on account of increase in duties would lead to inflation spike in near term.
- We believe that the budget would push higher consumption and over a period of time private capex would pick up. Economy could thrive without the requirement of large government expenditure over medium term.



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Sectoral Impact



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Automobiles- Neutral

Measure	Current Status	Budget Proposal	Overall Impact
Increase in excise duty by 2%	Small cars, 2 wheelers, 3-wheelers and commercial vehicles at 8%	Small cars, 2 wheelers, 3-wheelers and commercial vehicles at 10%.	Neutral: All the automobile companies will pass on this increase to customers and this will make products costly by approx 2-2.3%. However we don't expect major dent on demand due to this.
Increase in Ad-valorem duty by 2%	MUV/ SUV/ Large cars 20% + Rs 15,000 (upto 2000 cc) or Rs 20,000 (more than 2000 cc) respectively	MUV/ SUV/ Large cars 22% + Rs 15,000 (upto 2000 cc) or Rs 20,000 (more than 2000 cc) respectively	Neutral: All companies will pass on the increase, hence no impact of financials
Realignment of income tax slabs			Positive: With realignment of income tax rates, tax liability on an income beyond Rs 800,000 will reduce by Rs 50,000
Increase in weighted deduction for R&D	150%	200%	Positive: All the companies who do in-house R&D activity in India will benefit as this will lead to reduction in tax liabilities.
Reduction in income tax surcharge	10%	7.5%	Positive: All the companies will be a beneficiary. This will lead to marginal reduction in tax liability by 75bps to 33.22%.
Increase in MAT rate	15%	18%	Neutral: Most of the auto companies are paying taxes at a rate higher than MAT threshold and thus will not be impacted by this.



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Banking & Financial Services - Positive

Measures	Current Status	Budget Proposal	Overall Impact
Net market borrowings announced at Rs. 3.45 tn (V/s. Rs. 3.97 tn in FY11) lower than the expectations.	-Rs 3,970bn in FY10	Rs 3,450bn	Positive: Pressure on longer term bond yields would reduce over medium term. In short run, bond yield may hardened with uptick in inflation following hike in petro-product prices, However, over medium term we see bond yields would remain in range of 7.50-7.75%.
RBI to mull issue of new branch licenses to private players and NBFCs.			Positive: Some of the NBFC, which would meet RBI criteria for banking licenses, would be able to convert to banks enabling them to reduce their cost of funding over medium to long term.
Deduction of Rs. 20,000 allowed for investments in long term infra bonds over and above INR 0.1 mn limit available.			Positive: Infrastructure finance companies would be able to raise funds at relatively lower cost.
Extension of six months for the repayment of loans under the agri-debt relief scheme.			Positive: The move would be positive for PSU Banks.
Interest Subvention			Neutral: The amount would be re-imbursed to banks through RBI
a) Agriculture loans paid on time	1%	2%	
b) Exports (extended to 31st March 2011)	2%	2%	
c) Housing Loans - extended to 31st March 2011 (for house value of Rs 20 lakhs and Loan value of Rs. 10 Lakhs)	1%	1%	



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Retail Sector - Neutral

Measure	Current Status	Budget proposal	Overall Impact
Change in customs duty on gold and platinum	Rs.200 per 10 gms	Rs.300 per 10 gms	No Impact
Reduction in excise duty on Rhodium	10%	2%	Marginal Positive
Special Additional Duty on watches and garments	4%	0%	Marginal Positive



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Pharmaceuticals-Positive

Measure	Current Status	Budget proposal	Overall Impact
Higher weighted average R&D deduction (in-house)	150%	200%	Positive
Higher weighted average R&D deduction (specified outside)	125%	175%	Positive
Increased allocation to healthcare	Rs.19583 crore	Rs.22300 crore	Positive
Increase in MAT rate	15%	18%	Negative from cash flow perspective



Logistics-Marginal Positive

Measure	Current Status	Budget proposal	Overall Impact
ECB funding to be made available for cold storage facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.	Not applicable	Proposed	Marginal Positive



Construction-Positive

Measure	Current Status	Budget proposal	Overall Impact
Higher budget allocation for Roads	Rs.17520 crore	Rs.19894 crore	Positive
Higher budget allocation for Railways	Rs.15802 crore	Rs.16752 crore	Positive
Power	Rs.2230 crore	Rs.5130 crore	Positive
Urban Development	Rs.3000 crore	Rs.5400 crore	Positive
Increase in MAT	15%	18%	Negative from cash flow perspective
Increase in IIFCL disbursement targets	Rs.9000 crore	Rs.20000 crore	Positive



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IT Services-Neutral

Measure	Current Status	Budget proposal	Overall Impact
Increase in MAT Rate	15%	18%	Negative from cash flow perspective



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Power- Positive

Measure	Current Status	Budget proposal	Overall Impact
Planned allocation for power sector increased(excluding RGGVY)	Rs 22.3bn	Rs 51.3bn	Positive
National clean energy fund to be established to fund R&D in clean energy	No cess on coal	a cess of Rs. 50 per tonne to be levied on domestic and imported coal.	Will impact profitability of private power sector companies.
Plan outlay for the Ministry of New and Renewable Energy increased by 61 per cent	Rs.620 crore	Rs.1,000 crore	Positive
Provide a concessional customs duty on machinery, instruments, equipment and appliances required for the initial set up of photovoltaic and solar thermal power generation plants	10%	5%	Positive
Exemption of excise duty on key components for manufacture of rotor blades for wind power	8%	NIL	Positive
MAT	15%	18%	Will impact few corporates currently paying MAT.



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Media – Marginally Positive

Measure	Current Status	Budget proposal	Overall Impact
To grant project import status for Setting up of digital headends,		a concessional customs duty of 5% with full exemption from special additional duty to the initial setting up of such projects	Positive
News agencies (that meet certain criteria) which provide news feed online	Service tax paying	to be exempt from service tax	Positive



FMCG- Neutral

Measure	Current Status	Budget proposal	Overall Impact
Increase in cenvat rate	8.0%	10%	Hike will be passed on to the consumer
Change in personal income tax slab			Positive impact, will increase consumer purchasing power
Increase in excise duty for cigarette and tobacco products			Negative for ITC 12-15% price increase will be required to neutralise the impact which will impact volume growth



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Telecom-Neutral

Measure	Current Status	Budget proposal	Overall Impact
Increase in MAT by 3%	15.0%	18.0%	Negative for the mobile telephony players .
Higher Rural spend and higher disposable income			Positive for the sector as robust growth in subscriber base will continue



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Oil and Gas - Negative

Measure	Current Status	Budget proposal	Overall Impact
Hike in custom duty			
Crude Oil	0.0%	5.0%	Positive for upstream companies
Petrol and Diesel	2.5%	7.5%	Negative for refineries, but Oil marketing companies will pass on the increase to consumer
Other refined products	5.0%	10.0%	
Hike in excise duty by Re 1			
Petrol	13.35/lt	14.35/lt	Neutral, hike will be passed on to consumers
Diesel	14.5/lt	15.5/lt	Neutral, hike will be passed on to consumers
Increase in MAT by 3%	15.0%	18.0%	Negative for Reliance Industries and Cairn. Impact on EPS by 1.5-2.0%



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Cement-Negative

Measure	Current Status	Budget proposal	Overall Impact
Excise Duty hike	8%	10%	Negative
Increased allocation to infrastructure			Positive
Introduction of cell on coal	0	Rs.50 / tonne	Negative



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Real Estate- Negative

Measure	Current Status	Budget proposal	Overall Impact
Real estate developers developing complexes to be brought under Service tax net	Not applicable	Proposed	Huge Negative to real estate developers if implemented as developers might not be able to pass on the entire service tax to buyers
Extension of interest subvention of 1% for property cost of Rs 2mn and loans up to Rs 1mn	Valid for March 2010	Extended by a year	Positive for affordable segment
Increase in allocation for Rajiv Awas Yojana (RAY) for slum dwellers and urban poor segment	Rs 150 crore for FY10	Rs.1270 crore	Positive for slum developers
Pending projects given another year for claiming deduction on profits u/s 80IB (10)	Up to 4 years	Upto 5 years	Positive
Higher allocation for housing and urban poverty alleviation	Rs.850 crore	Rs.1000 crore	Positive
Change in the basic Income tax rate of personal tax			Boost to the residential segment as it leaves higher income for payment of EMI



Market Outlook - Conclusion

- Overall, we rate the budget as positive for equity markets on the back of its thrust on
 - promoting consumption and
 - creating a more conducive environment for investments.
- Proposals of the budget would lead to increased investments in rural and infrastructure segments of the economy, which would be positive from medium to long term perspective.
- While the Finance Minister has started the gradual process of reversal of stimulus, he has struck a fine balance between fiscal prudence and growth momentum.
- Managing growth with moderate inflation would be a key challenge for the year.
- Even with the proposals for rollback of stimulus, we believe that consensus earnings estimates for the Sensex for next year would remain intact.

- Post budget, we expect market focus to shift to global events. Any correction in markets due to global developments should be used as an opportunity to aggressively increase exposure in equities on back of a) reasonable valuations, b) Continuation of growth momentum and c) Clear direction on fiscal prudence which would add to valuation premium compared to peers.

Impact on Bond Markets

- The much awaited Budget for the FY11 has estimated a Gross Borrowing of Rs. 4.57 lakh crs. Though the numbers were on the lower side of the market expectations, bond prices gave up early gains on fears of higher inflation expectation on account of higher excise duty & hike in petrol prices. Also the net borrowing of Rs. 3.45 lakh crs along with approximately Rs.1 lakh of State Loans expected during the next financial year is high in absolute terms. Assuming a deposit growth of 20% & banks maintaining a 28% SLR ratio the demand from them would be in the range of Rs.2.2 lakh crs. The remaining Rs.2.25 lakh crs would have to be absorbed by non bank entities like Insurance companies and provident funds.
- The current financial year's net borrowing of Rs.3.98 lakh crs was supported to the extent of approximately Rs.1.45 lakh crs by RBI through OMO's, de-questing & maturity of MSS Bonds. For most part of the current financial year, more than adequate liquidity was maintained along with a soft interest rate bias against a backdrop of interest rate & CRR hikes expected in the next financial year.
- Thus if the economy continues to recover, higher demand for funds from the private sector along with high borrowings by the government could push up interest rates. The budgeted numbers also face the risk of higher subsidy allocation in a scenario of high crude prices in the international markets & poor monsoons.
- Due to the above concerns we expect yields to be volatile in the near future & to move up in the next financial year. The 10 year benchmark government of India security could move up in the range of 8.25% - 8.50% once fresh issuances start hitting the market. Corporate bond yields may also move up likewise, however if supply is relatively lower then credit spreads could narrow. The five year corporate bond may trade in a range of 8.25% to 9.00%. Short term rates are expected to move up as RBI starts hiking key rates to quell inflation, the first phase of which has already begun with a 75 bps CRR hike.



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