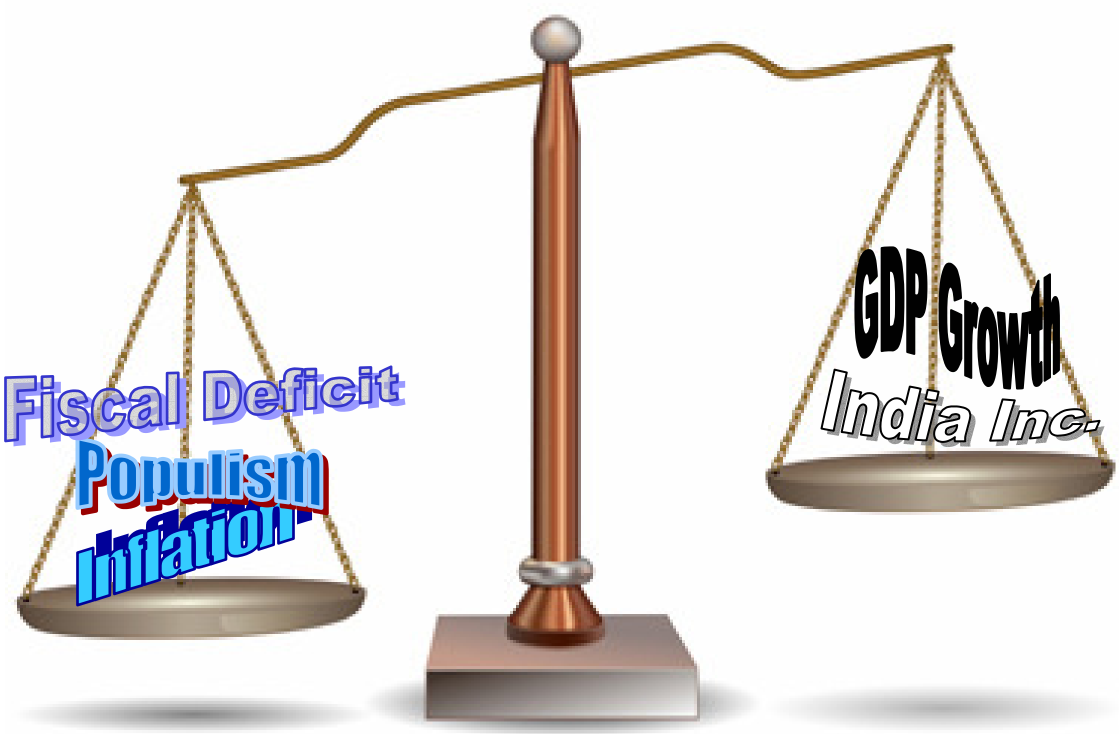
BNK Securities Pvt. Ltd

Union Budget-2011
Pre-Budget Expectations and analysis



As the country awaits the Finance Minister's speech for Union Budget 2011 on the 28th February, it seems like he is going to have a tough time in striking the balance between controlling inflation and limiting the fiscal deficit to bare minimum. The industry and the various trade bodies have put forward their demands and we give a sector wise analysis of their wish list. All eyes rest on the FM now as only 28/02/2011 will tell whose demands will be fulfilled.

The FM will present the General Budget for fiscal year 2011-12 on February 28 in the lower house of the Parliament in the backdrop of a faster-than-expected economic recovery marked by highly elevated inflation, somewhat uncertain global economic scenario, the ongoing political controversy regarding the 2G issue that washed away the previous session of Parliament, and dwindling hopes of the India Inc of some key reforms in the economic policy arena amidst a near stand-still in policy making. The acumen of the finance ministry will also be on a test on how it brings down the fiscal deficit further to 4.8%, as promised under the 'Fiscal Policy Strategy Statement' of the FY11 Budget amidst rising global commodity prices and surging subsidy burden and the fact that there will be no one-time bumper revenue like 3G auction in next fiscal. Further, there are issues like the goods and services tax (GST) and the direct tax code (DTC) regarding which the forthcoming Budget will provide important details, in particular a revised timeline for the GST. The government will also try to reaffirm its reformist credentials in the budget as some serious doubts have been raised on the slow pace of reforms despite the UPA coming back into power without the support of the left parties in its second term. Overall, the Budget-2011 will describe the strategy that the UPA government adopts to mould its scandal hit image amidst the most difficult period it has had to face in nearly seven years of rein in power. There is a strong case for the government to reaffirms its industry friendly image by bringing down the fiscal deficit and announcing new reform initiative as well as to continue aggressively its inclusive growth agenda with substantial hikes in allocation for social sector schemes. The task of the Union Finance Minister Pranab Mukherjee in this wake will be to draw a balance between reformist ambitions of an economist turned Prime Minister Dr. Manmohan Singh and aggressive social inclusion agenda of the UPA Chair Person Sonia Gandhi.

Key themes for Budget 2011-12

- **Inflation**

  Indian economy is currently facing one of the worst inflation shocks since the deregulation started in 1990s. Following the commodity rally and subsequent financial crisis of late-2008, inflation went down globally. Similar trend was witnessed in India as well, but in the food commodities space, inflation never really went down much. This is reflected in the fact that even though the wholesale prices index (WPI) had reached below the zero level around the middle of the 2009 calendar year, the consumer prices indices continued to remain significantly high. The failed monsoon of 2009 further boosted the already sticky food prices, and since then food inflation has remained at highly elevated levels. Since the monetary policy has little impact on food prices, the only solution is to boost the supply side which rests on the government. Not only the continued high inflation hits the marginal section of society very hard, it can also derail the domestic demand story of the Indian economy. Therefore, the Budget is likely to include a host of steps aimed at bringing down inflation. Announcements may range from some short term measures like tweaking the import/export duties or greater imports by public sector companies to long term vision like boosting capacity and efficiency of food storage facilities and raising productivity through promoting greater farm sector capital formation etc.

- **Fiscal consolidation**

  Fiscal consolidation will also continue to be one of the most important aspects of the Budget. The government had in last Budget accepted the revised timeline for fiscal consolidation as recommended by the Thirteenth Finance Commission (TFC). The finance ministry is in pretty good position to meet the deficit target for current fiscal despite higher spending on subsidies, due to bumper revenue on the non-tax frontier from the third generation (3G) telecom spectrum auction. However, things will be much more difficult in the next fiscal. There will be no onetime major receipt like the one from spectrum auction this fiscal. Spending on the other hand, will continue to surge as allocation for social sector schemes is likely to show substantial increase. With commodity prices surging, fuel and fertilizer subsidy will also remain high. Overall, while the finance ministry will manage deficit target for current fiscal easily, it will be significantly challenging to bring it further down for the next fiscal in line with TFC's recommendations. However, going by the statements of finance ministry so far, it does seem very much inclined to follow the TFC's time path for fiscal consolidation.

- **Subsidies**

Another fiscal policy issue that is once again the key talk in the public policy arena is Subsidies. The recent surge in commodities has already thrown all estimates of fuel subsidy for current financial year out of the gate. Thanks to the nutrient based subsidy (NBS) policy initiated at the start of the fiscal, the surge in fertilizer subsidy is not as drastic, but it too will be significantly higher compared with the fuel subsidy. International crude oil in Asia and Africa edged passed the $100 a barrel mark in early February as the unrest in Egypt raised apprehension of similar issues spreading into more countries in middle-east, something that could hit oil supplies substantially. Even if that does not happen, the possibility of crude remaining close to $90 a barrel is high. In this light, the government will be under-pressure to bring in some sustainable solution to the problem of under-recovery like the introduction of NBS in fertilizer space. Long term energy security of the country is the most important aspect facing the country and a permanent subsidy sharing mechanism should be specified in the budget so that the oil companies, both upstream and downstream, can have better clarity of their financials and plan their investments accordingly.

- **Social sector spending**

The government had substantially increased allocation to various social sector schemes like the NREGS and JNNURM etc. This year too, the government will be under pressure to substantially hike allocations for these schemes to reiterate its social inclusion agenda. However, the compulsion to keep the deficit in check will also be there. As such, it will be interesting to see how well the finance ministry manages the balance between its commitment to the social inclusion and fiscal consolidation.

- **Infrastructure investment**

Over the last few years, boosting investment is infrastructure has become one of the most important challenges of the Union government. It is well established that in order for the country to continue on its growth trajectory of 8-9% or to breach the 10% barrier over the coming years, the requirement for sustainable infrastructure investment is paramount. The Planning Commission has estimated that over $1 trillion will be required to be channelized into the infra sector over the next Five Year Plan (FYP) beginning April 1, 2012. For that target to be achieved more ground work in raising funding capacities will be needed and the finance ministry is expected to make some announcements in this regard. This may be in form of a more liberal FDI regime, further refinements in PPP policies, particularly in the road and transport sector, or in form of greater tax relief for infra funding.

- **Reforms and the Budget**

When the UPA government won the last General Elections in 2009 and formed a government without the support of the left wing parties, it was hoped that it will aggressively pursue the economic reform agenda and clear key reform steps. However, over the last 4-6 quarters, the government has taken serious hit on its reformist credentials as it has so far failed to do anything significant other than some partial reforms in the fertilizer and fuel sectors. These jobs too are incomplete though and much more needs to be done here and elsewhere. Following are the major areas that analysts will be watching for possible reform announcements.

- **Foreign Direct Investment**

FDI is one of the most hotly debated topics currently in public policy space currently. While the Indian government has been gradually liberalizing the FDI regime, it still continues to either bar or restrict the entry of foreign players in some of the key sectors like multi-brand retail, legal services, defence manufacturing and insurance etc. Most of the domestic agencies in economic policy arena, including the Planning Commission and the Commerce Ministry, too are in favour of greater FDI in these sectors in order to create more capacities and promote competition. While political oppositions remain, individual cases for most of these sectors are reasonably strong. With sharp decline in overseas direct investment seen in the last calendar year, the case for further liberalization of the FDI regime becomes all the more stronger. Although it is unlikely that FM will implement any liberalization in FDI policies in the Budget, even if he presents a roadmap to this end, as was done for the NBS in 2009-10 budget and banking licenses in 2010-11 budget, it will constitute a significant step and bring some momentum in policy making, which seems to have halted completely over the last six months or so.

- **DTC and GST**

Indian economy is on the threshold of biggest taxation reforms since the independence. The direct tax code (DTC) and goods and services tax (GST) cover nearly the whole gamut of central and state taxation and promise to bring groundbreaking changes the tax sphere. Even though DTC could have been implemented in 2011-12, the government has cleared that it will only be implemented in 2012-13. However, some aspects of the DTC could be seen in the FY12 itself, for instance, tax exemption limit could be raised to Rs 2 lakh, the level mentioned in the DTC, to give some relief to common public in wake of high inflation seen in the current fiscal. The GST on the other hand is facing much more controversy with the states failing to reach a consensus. The ambitious indirect tax reform seeks to unify the vast Indian market by replacing the multiple indirect levies (most of them) by a single nationwide tax application in dual rates on goods and services. This will result in massive gains in efficiency for the industry and the country will be able to achieve the full potential benefit of scale and size of its large domestic market.

- **Other Reforms**

The fuel deregulation, which has been on the cards for long, has so far been only implemented on petrol, leaving out all the major contributors to the fuel retailers' revenue looses. In the fertilizer sector, the government took a positive step in terms of introducing the NBS, but still needs to extend the same to urea, the most consumer fertilizer in India and a major subsidy consumer. Another important issue is land procurement policy for infra projects. Lack of a nationwide policy has been inhibiting infra projects across the country and finance ministry will have the opportunity to move further here by announcing some comprehensive compensation policy. Pro-reform lobby will also love to see some announcements on much awaited labour reforms, but probability is rather low in present atmosphere. Overall, the UPA has enough opportunities to repair its reform credentials, even if it stays away from some of the more controversial issues like labour reforms, but to what extent such opportunities are used will be only known on Feb 28.

Key Indian Economic Indicators	
Fiscal Year (%)	**2010-2011**
GDP	**6.7**
Agriculture	**1.1**
Industry	**2.3**
Services	**9.7**
Calendar Year (%)	**2008**
GDP	**7.5**
Wholesale prices	**9.1**
Consumer prices	**8.3**
Cash Reserve Ratio	**5.5**
Reverse Repo	**5**
Repo Rate	**6.5**
10 year yield	**5.3**
INR/USD	**48.8**

Source: BNK Securities Pvt. Ltd

Expenditure on Social Sector & Rural Development				
	FY 09RE	**% of Total Exp**	**FY 10BE**	**% of Total Exp**
Social	**896.92**	**10**	**942.89**	**9.9**
Rural Development	**488.84**	**5.4**	**427.74**	**4.5**
Total	**1385.76**	**15.4**	**1370.63**	**14.4**

India's Consolidated Deficit				
(As % of GDP)	**FY 07**	**FY 08**	**FY 09RE**	**FY 10BE**
Fiscal Deficit	**3.4**	**2.7**	**6**	**5.5**
Revenue Deficit	**1.9**	**1.1**	**4.4**	**4**
Primary Deficit	**-0.2**	**-0.9**	**2.5**	**1.8**

Source: Budget Documents, BNK Securities Pvt. Ltd

Auto and Auto Ancillary -

Industry Overview

Indian automobile sector can be categories into several segments like two-wheelers (motorcycles, geared and ungeared scooters and mopeds), three wheelers, commercial vehicles (light, medium and heavy), passenger cars, utility vehicles (UVs) and tractors. After witnessing an extreme turnaround in FY10, the auto sector continued with its strong performance in FY11 as well. However, the volume growth levels are likely to slow down from the current levels as auto demand is driven by factors such as economic growth and rise in income levels. Also, aspects such as the prevailing interest rates (especially for the CV segment), fuel costs and commodity prices have roles to play in determining auto volumes.

Union Budget 2010- 2011 Announcements

- Excise duty on small cars, 2- wheelers, 3 wheelers and buses & chassis, Commecial Vehicles increased to 10%.
- Excise duty on hybrid cars, large cars, Sports-Utility Vehicles (SUVs) and Mutli-Utility Vehicles (MUVs) increased by 2% to 22%. The additional duty component retained at Rs. 15,000 for passenger vehicles with 1,500-1,999cc engine capacity and Rs. 20,000 for passenger vehicles having engine capacity of greater than 2,000cc + Rs. 15000 as a special Component.
- Excise duty on all electrically operated vehicles, including two and three wheeled electric motor vehicles and battery operated cars is increased from NIL to 4%. The concessional rate of 4% would apply to all electric vehicles including electric motor-assisted cycle rickshaw even if the batteries for such vehicles are recharged using solar power.
- Excise duty exemption is withdrawn and 4% is levied on the following parts (i) Battery Pack (ii) Battery Charger (iii) AC or DC Motor (iv) AC or DC Motor Controller used in manufacturing of electrical operated vehicles.
- Excise on tyres increased to 10%.
- Custom duty for crude petroleum increased from NIL to 5%.
- Custom duty on Carbon Black Feed Stock is exempted.
- Allocation for road transport increased by over 13 % to Rs.19,894 Cr. from Rs.17,520 Cr
- Allocation of Rs. 1,73,552 Cr. provided for infrastructure development
- Weighted deduction on in-house R&D expenditure increased from 150% to 200%

Impact of Union Budget 2010 – 2011 Announcements

The Union Budget announced by the Finance Minister, is all set to have a direct impact on the automotive sector of the country. Buying and maintaining a car or bike was costly with a hike of 2% in the excise duty which has already led to an immediate and corresponding increase in the prices of automobiles and component. Running cost of bikes and cars too were get dearer with the suggested increase in excise duty on petrol and Diesel. Price of the car was gone up with the increase in excise and Maruti Car’s price was dearer by 2% across the board. The entire model range of Maruti was come at revised rate with a hike between Rs. 3,000 and Rs. 13,000. Hyundai hike’s its cars price range between Rs, 6,500 and Rs. 25,000. The price of the Santro was up by Rs. 6,500, the i10 by Rs. 6,700 and the i20 by Rs. 9,500.

Automobile Industry wish list

- **Two Wheeler**
  - Lower on excise duty.
  - Credit availability to 2 wheeler loans at reasonable interest rates.
  - The customs duty on steel, aluminum, etc. should not be raised as it will put pressure on the pricing of two wheelers.
- **Green Vehicle**
  - Incentives for production of green vehicles.
- **Utility Vehicles**
  - Subsidize in terms of excise relief to some specific vehicles that have a mass market in rural areas. It is looking at options to de-classify these from other vehicles that are in highest tax net so that rural users can enjoy competitive prices like tractors and other farm equipment.
- **Big Cars**
  - Big cars attract excise duty of 22 % plus an additional tax of Rs 15,000 for those with engines above 1500 cc. It seeks to lower on excise duty and removal of the additional Rs 15,000 tax imposed on big cars to minimize the gap with small cars.
- **Small Cars**
  - Retention of existing excise levels on small car.
- **Hybrid Cars**
  - Hybrid cars, which runs both on the conventional fuel as also electricity charged battery, are at present imported in India. Industry seeks some excise duty concessions to encourage manufacturing of hybrid cars in India to protect environment and reduce the country's dependence on fossil fuel.
  - It seeks some incentives for research and development work for development of the hybrid vehicle in India.
- **Electric Vehicles**
  - The government should scrap all import duties of components used in manufacturing e-vehicles. Since a significant chunk of inputs going into electric vehicles, higher import duties substantially jack up the prices of electric vehicles, thereby making them all the more uncompetitive.
  - The government's hiking the import duty on pre-assembled electric vehicles. Since the foreign suppliers of electric vehicles often do not

have to pay the local levies in their home countries, and also do not face cost escalation due to imported equipment, as is the case with Indian producers, having a higher import duty on pre-assembled electric vehicles will help domestic producers face global as well as established rivals in an efficient way. Finally, given the strong growth potential of electric vehicles in India, the industry would also like to see the scope of MNRE scheme being extended by increasing its allocation in the forthcoming budget.

Auto Ancillary Industry wish list

- **Reduction of CST**

As cascading impact of taxes is hurting the auto component industry. GST to be introduced at the earliest. In the absence of introduction of GST, the government should consider abolishing CST or reducing it to 1%. It has demanded to nullify the import duty on steel and aluminum alloys. Steel and aluminium alloys account for 60% of the raw material costs in the auto component sector. The duty reduction in steel and aluminum alloys would mitigate the inverted duty structure caused by FTAs. This would also help the Indian auto industry access such raw material at international market prices. China, which is a major threat, accords lower than LME prices on both steel and aluminum for manufacturers for value added products.

- **No interest on disparity duty due to price revision subsequent to the removal of goods**

In the auto component industry, it is usual that the prices are first fixed provisionally and subsequently after protracted negotiations, the final prices are mutually decided between the supplier and the customer. Supplementary invoices are raised after the final price is decided which could take between three months to one year. Currently, the Excise Department levies interest on the duty payable on the supplementary invoices raised due to revision of price subsequent to the removal of goods. However, considering that the aforesaid is a standard business practice of auto component industry, no such interest should be levied on differential Excise Duty. Further, the aforesaid interest paid by the auto component manufacturers on supplementary invoice is not eligible for CENVAT Credit and hence adds to the cost of the product.

- **100% CENVAT Credit on Capital Goods**

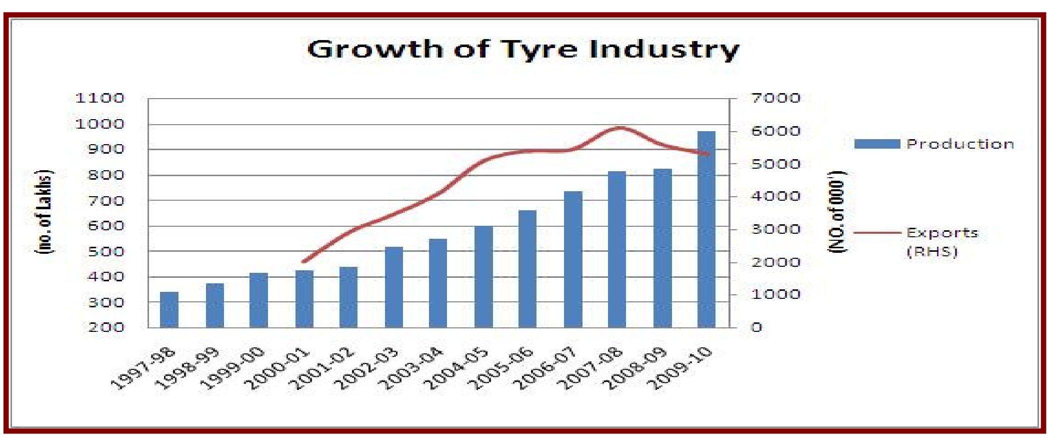
CENVAT Credit Rules were announced in 2004 and allow for only 50% CENVAT credit on capital goods in year of purchase, balance 50% can be availed in subsequent year. This causes cash flow problems and accounts need to be maintained to keep track of credit availed. It is recommended that CENVAT credit Rules may be amended to permit availing 100% of CENVAT credit immediately on receipt of goods. It urges to set up of Technology Upgradation & Development fund (TUDF) for the long-term competitiveness of the industry. A major concern is the ability of the industry to invest in technology upgradation, especially among the smaller companies. The industry urgently needs a corpus of Rs 7,500 crores to be spent over a 5 years period as a soft-loans, to begin with Rs 1,000 crores for the fiscal 2011-12, for purposes of technology development and upgradation. The beneficiary company would contribute an amount equal to the amount received as soft loan from the government. The industry needs to put emphasis on new product development, process improvements, modernisation of manufacturing technologies with focus on energy efficiency and environment. There is also a major threat of imports that are already at a very high level and increasing. Critical areas that need technology intervention to stay competitive include light weighting, engine & power train and manufacturing technologies.

Tyre industry wish list

- **Correction of the import duty distortion between tyres and natural rubber**

  There has been an import duty of 20% on raw rubber. But the import duty on finished tyres is only 10% which leads to an inverted duty structure with raw material being difficult to import compared with finished. Although the government has cut the import duty on rubber recently to 7.5%, it is only for import of 50,000 tonne of the raw material, beyond which again the regular 20% import duty would kick in. This is a classical case of inverted duty structure as exporters face lower duty compared with domestic producers, which erodes the efficiency of the domestic producer and impacts its long run growth. The situation has been further complicated by the sharp increase in rubber prices. Over the last 5-6 quarters, rubber prices have increased by nearly 150% which is putting huge pressure on tyre makers' margin. A permanent reduction in import duty on rubber in this wake will help ease cost pressures facing the industry.

- Increase in Customs Duty on Chinese tyres - from current 10% to suggested 20%.
- Waiver of Customs Duty on all raw materials not manufactured domestically.
- Reduction in Customs Duty on key raw-materials of Tyre Industry where production is insufficient to meet the domestic demand.
- Customs duty reduction of principal raw materials which are not adequate to meet growing domestic demand, thereby necessitating imports.
- Include 'Tyre Manufacturer' as a class of Exporters under Rule 20 of Central Excise Rules, to allow them procure tubes and flaps without payment of duty for exports.



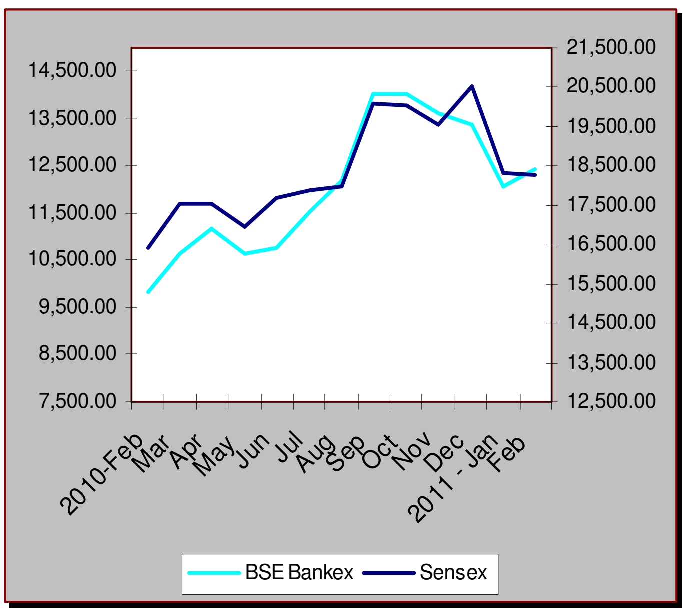
Battery Industry wish list

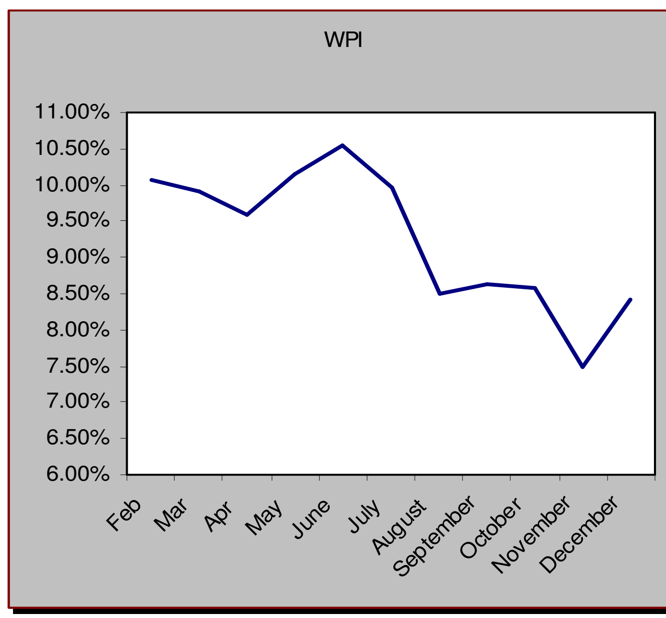
- A major demand of the industry is imposition of anti-dumping duty on batteries imported from China. While Chinese batteries often fail to match the Indian ones in terms of performance, these manage to undercut Indian products on prices as Chinese producers do not have to pay any local levies. The industry therefore wants to impose an anti-dumping duty in order to help the domestic producers compete on level footing.
- The industry also wants the government to reduce the import duty on capital goods related to this industry to ease technology import.
- As used industrial battery is 99% recyclable, the industry being highly fragmented, most of the used batteries finds their way to backyard smelters in the unorganized sector. This not only reduces the recycled value of battery but also is environmentally unwelcome. Hence, the industry is hoping that government will provide some tax incentives to boost recycling of batteries by OEM manufacturers.

Banking & Financial Services –

Industry Overview

FY 2011 started with a bang for the Banking sector with most banks posting excellent Q-o-Q results. Inflation continued to be a cause of grave concern and it was on the rise for most of the month. While it was above 10% at the time of last budget, it did not cool down majorly for 6 months post budget. However, a change of base year to calculate the WPI did get some moderation in the figures. However this party did not last long as food prices continue to increase increasing the inflationary pressure. The RBI was compelled to hike rates as much as 6 times in the year with the Repo rate touching 6.5% and Reverse Repo touching 5.5% in the last monetary policy review in January 2011. The impact of these rate hikes on the performance of the banks was marginal as most banks have posted consistent growth in NII's and Net Profits. In Q3, the banks posted a growth of ~ 24% in deposits. The NII grew by 38% Y-o-Y and 9.2% Q-o-Q. The net profits grew by 24.4% Y-o-Y. The PSU banks delivered a growth of 20.5% in spite of names of some PSU banks like PNB and Bank of Baroda being dragged into the whole fiasco of bribery scam which got unearthed in November 2010. The private banks posted a robust growth of 33.4%. The year was tough for the financial services industry especially for companies engaged in Housing Finance and Micro Finance businesses. While the interest rate was on the rise for most of the year, the housing finance space was rocked by unearthing of a bribery scam in November. It was more of an individual level fault rather than that inherent in the system. But it created quite a panic in the markets and stocks like LIC Housing Finance, HDFC, PNB and Bank of Baroda got beaten down mercilessly.





Key rates	Sep 16th 2010	Nov 2nd 2010	Jan 25th 2011
CRR	6	6	6
Repo Rate	6	6.25	6.5
Reverse Repo	5	5.25	5.5

The Way Forward

While the inflation seems to be peaking out, it gives a sense of relief that the RBI might not have to increase rates any further. However, the current state of liquidity remains tight and banks are bowing at a high rate of 10% plus. We expect this to impact the NIM's in Q4 of this financial year and may be Q1 of the next financial year. Obviously this situation is temporary and as the liquidity improves, the NIM's will eventually improve. As far as the Micro finance companies are concerned, it is extremely important to hear some policy guidelines from the MoF.

Industry wish list

- **Relaxing the norms for overseas M&A**

  India Inc wants the government to ease the rules for overseas merger and acquisition (M&A) in order to let the growing industry expand its footing overseas rapidly. The Industry body CII has taken the demand to the government and urged the finance ministry to come up with requisite changes in forthcoming General Budget to be presented on Feb 26. The CII has submitted a memorandum to the Department of Industrial Policy and Promotion (DIPP), which is the apex body framing the foreign direct investment (FDI) norms for the country, saying that the current provisions in Companies Act, Competition Act and SEBI Takeover Code have a lot of confusion due to contradicting clauses and leaves the Indian companies in grey over this important emerging trend. Even as the DIPP will have to address the technical part, the finance ministry should go ahead and announce the agenda in the forthcoming Budget so that the companies can have clarity on the matter at the earliest.
  This would be beneficial for the entire industry, and even more to the financial services sector as it will result in a sharp increase in M&A activities. This would eventually translate into increase in the fee based component of their incomes.

- **Insurance industry wants high tax deduction, liberal FDI policy**

  India's insurance industry has had a difficult year in 2010 which was marred by the IRDA versus SEBI fight on ULIP. Also, the much awaited insurance amendment bill remained in the limbo due to political opposition and no further movement could happen on further liberating the foreign direct regime in the sector. In this wake, the insurers have a lot of expectations from the forthcoming budget and is hoping that these measures will help push up the growth trajectory of the industry.
  First, the biggest demand of the industry is increase in ceiling on FDI. At present only 26% of FDI is allowed in insurance sector, but most experts feel that this leaves little incentive for the foreign partner. As such, the demand for hiking the limit to 49% has been a long pending one and the government has even looked at it favourably. The industry is hoping that while the limit might not be hiked in budget itself, an announcement to this regard should at least be made. Further, the industry is saying that the current ceiling of investments in saving instruments including risk cover, pension products, etc that are eligible for aggregate deduction at Rs 1 lakh is too little and must be increased in line with rapidly rising overall national incomes and per-capita income in the country. Further, the proposed Direct Tax Code (DTC) provides deduction of Rs 50,000 for life cover, health cover and tuition fees. Life insurance industry feels that as the limit is clubbed with tuition fee, there would be little left for life cover. As such, the industry has suggested that first

the limit should be increased and second it should be wholly and exclusively for life insurance products.

Another demand is that as proposed DTC, amount received as proceeds from a life insurance policy will be taxable as income from residuary source. The industry wants that payments on maturity should be allowed as deduction without any condition. Survival benefits, that is, the interim payments should also be treated as payment on maturity. In other words, the exempt-exempt-exempt (EEE) regime should be fully protected under the DTC as well.

- **Incentives for banks to enter rural areas**

The government is expected to set up a fund that would to an extent help the banks to fund their operations in rural areas. Apart from this, the government is expected to hike the farm credit substantially in this fiscal owing to high food inflation. There seems to be a need to improve the supply side by augmenting the capacity of farm sector. It is expected that farm credit will be hiked as much as 20% in FY 12 to Rs. 450000 crores. We might also hear some announcements for PPP schemes to improve farm infrastructure. In this matter, a guideline on processes of microfinance companies is also expected and this would clear the air of ambiguity that is surrounding them at the moment.

- **Clarity on issues like new banking licenses, listing norms for insurance companies and data like government borrowing program should be key announcements to watch out for.**

Cement -

Industry Overview

Last year was quite exigent for the entire cement industry. Demand off-take was weaker than expected due to lower realty and infrastructure spending. Prolonged monsoons and logistical constraints further dampened the construction activity. The fall in demand during the last few months has largely been due to the slowdown in the housing sector which accounts for about 65 % of cement consumption. Real estate companies had to go slow on projects as bank borrowings have turned costly.
On the supply front, overcapacity continued to spate the industry. Cement prices remained under pressure and caused margins to contract severely. The cement industry, already reeling from an oversupply situation, is expected to add 23.3 million tonnes (mt) of capacity in 2011-12 with the southern region accounting for a share of 9.2 million tonnes.
The East is next with 4.1 mt while the north will see 3.7 million tonnes being added. The western and central regions will add 3.3 mt and 3 mt each.
Cement companies have added a capacity of 89 mt in the last three years taking their installed capacity to 265 mt per annum. The companies are expected to add 35 mt of capacity by FY-13. Consumption was 179 million tonnes last fiscal.
The demand-supply mismatch is here to stay for quite some time as the total industry cement capacity is expected to increase even further over the next 18-24 months.
The industry's capacity utilisation currently hovers around 78 %, down from 87 % last fiscal. It may fall to 77 % in 2011-12. On the cost front, key raw material costs, especially prices of coal show no signs of abating. Going forward, rising interest costs remain a challenge for the construction industry. Much will depend on government's housing and infrastructure initiatives. Given this backdrop, over the next couple of years, the margins of the cement companies will continue to remain under strain.

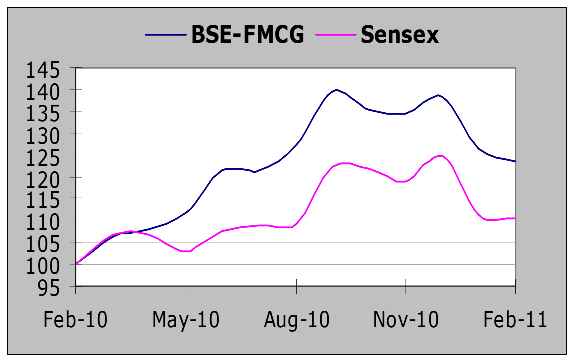
Industry wish list

- Value-added tax (VAT) on cement and clinker should be brought on par with other building materials like steel. While steel attracts 4 % VAT, for cement it is as high as 12.5%.
- A uniform rate of excise duty should be levied on cement. Currently, different rates of Excise Duty are levied for bagged Cement
- An abatement of 55% on Excise duty levied on MRP basis
- Import duty on coal, pet coke, gypsum and other fuels should be scrapped. All the three inputs attract 5% duty if imported, while there is no duty on cement import. So this is contrary to the established principle that import duty on inputs should not be higher than on the finished product.
- Royalty paid on limestone and duty/cess paid on indigenous coal (` 50/tonne) be allowed as credit – either as Cenvat credit or as VAT credit.
- Abolishing the Export ban on Cement

FMCG -

Industry Overview

FMCG market in India is growing at a fast pace despite of the economic slowdown and rising inflation. The increasing disposable income and improved standard of living in most tier II and tire III cities are spearheading the FMCG growth across the nation. The changing profile and mind set of the consumers has shifted the thought to "Value for Money" from "Money for Value". Over the years companies improved performance with innovation and strong distribution channels. Their key categories have strengthened their presence.



In first two quarters, GDP growth is 8.9% and estimated to grow with 8.75% in FY11, increased in rural income, growing urbanization and changing lifestyle of consumers would be key growth drivers for companies. The sector is likely to remain attractive investment destination for medium to long term. Rural market for FMCG is also expected to swell in the same period. The Rural FMCG market is expected to swell more than ten times to reach the $100 billion mark by 2025, according to a fresh study by the marketing and advertising research firm, The Nielsen Company.

BSE-FMCG index performed very well in last one year. The BSE Sensex has given 11% return in last one year where as FMCG index has surprised the investor with 24% return in the same period.

Issues to be addressed

There are some near term challenges like inflation and irregular monsoon during the year for sector companies. We are expecting this situation will be reversed after harvesting of Rabi crop. The rising raw material costs heavily impacted the operating margin by ~ 200 bps to 500 bps.

Industry Wish list

- Companies are hoping for full or partial exemption in excise duty on commodities such as biscuits, condensed milk, sugar confectionary and packaged water.
- Excise on cigarettes should remain constant.
- The industry is expecting the allocations under various schemes such as NREGA (National Rural Employment Guarantee Act) to continue as for all FMCG companies 30-50 per cent of their consolidated revenues come from rural India.

- No change in Cenvat rate, considering the high inflation and rising input prices
- No change in excise rate on tobacco products, considering revamp in duty structures and changes implemented in previous union budget
- Increase in service tax from 10% to 12%
- Roadmap for FDI in retail sector
- Implementation of GST

Outlook and Future Prospect

Rising rural consumption on the back of higher crop realizations and rising wages on account of various kind of allocation by the Govt for rural development. The expenditure on Life's Good increased substantially because the Disposable income in hand of rural and sub-urban people is increasing. We have positive view on the sector.

Stocks to Watch

- ITC Ltd
- Colgate – Palmolive (India) Ltd
- Hindustan Unilever Ltd
- Dabur India Ltd
- Godrej Consumer Products Ltd.

Hospitality -

Industry Overview

This year (FY11) is considered as the turnaround of the hotel industry as the economy recovered after the financial crisis. The industry saw rapid recovery as the year progressed. While foreign tourist arrival increased over 2009 levels, domestic travelers also provided a big boost to the hospitality industry. As a result of sharp increase in demand, occupancy and average room rent (ARR) returned to levels before the slowdown.

Foreign tourist arrivals (FTA's) reached a all time high in December 2010, yet again. The number of FTA's rose to 6.6 lakh in December 2010, 1.4 % higher than the previous all time high a year ago. FTAs are generally higher during this period due to higher number of leisure guests. The month also recorded highest ever dollar earnings of USD 1,558 million, a rise of 3.2 % compared to December 2009. Rupee earnings remained flat at around Rs.70 billion due to an appreciation of Indian rupee against dollar. Also, this was the second consecutive month with number of FTA's being greater than six lakh indicating a pick up in number of tourists coming in the country. During April-December 2010, FTA's have risen by eight % to 40 lakh tourists.

ICC World Cup has scheduled during the March 2011 quarter will attract more foreign tourists to the country. Global economic scenario is likely to remain healthy this will bode well for tourism, thus, more business and leisure travelers to visit the country.

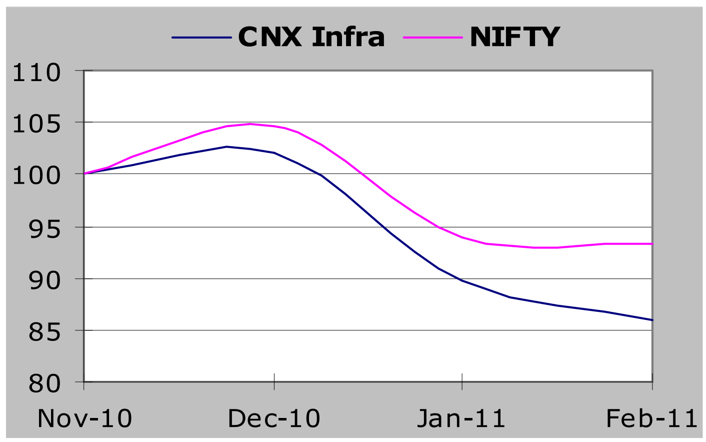
Industry wish list

- Infrastructure status for the hospitality industry for quick completion of the ongoing projects and loans at lower rates for future capital expenditure and be included under section 80IA
- Rationalization of the tax structure to provide a level playing field to all participants
- Single window clearance of all tourism projects
- Depreciation rate for hotel buildings to 20%
- Drastic reduction in the luxury tax and a uniform rate of 5-6% at all-India level.

Infrastructure -

Industry Overview

The Infrastructure sector is backbone for a developing nation like India and has registered a double digit growth during the last few years and percentage contribution in GDP has increased considerably as compared to the last decade. The infrastructure investment is a key factor to attain nine percent or higher economic growth. It remains the focus area of GOI for sustaining economic growth over and above 8.5%+. Considering the potential of this sector, this sector has received 46% of total planned allocation in budget 2010-11 with a provision of Rs.1, 73,552 crores for upgrading infrastructure in both rural and urban areas. Major emphasis has been given to development of high quality physical infrastructure such as roads, ports, airports and railways.



The Indian government has taken an initiative to develop the infrastructure sector, with huge emphasis on Roads, Bridges, Railway systems, Ports, Airports, Electricity, Telecommunications, Gas distribution, Water supply, Irrigation, Sanitation and storage. India is a fast-growing economy with a dynamic and robust financial system. The government has identified infrastructure as a key driver for 9-10 percent growth during the 12th Plan ending 2017. The Prime Minister's mid term appraisal of the 11th five-year plan suggests that investment in infrastructure during the 12th plan would need to be almost double to US$ 1025bn compared to US$ 514bn 11th Plan. Out of the US$ 1,025 billion, 50 per cent investment is expected from private sector where as 36 per cent in the 11th Plan and only 18 percent in 10th five-year plan. This huge investment plan clearly points to the fact that infrastructure would continue to be the growth engine for the economy in the near future. Therefore, the strategy for infrastructure development will involve a combination of public investment supplemented by private investments wherever feasible.

NSE-Infra sector performance very bad because of high beta and high cost of funding and also input cost is very high. NSE index has down by 7% in last four months where as infrastructure sector is down by 14% for the same period.

Issues to be addressed

Difficulties in land acquisition, higher funding cost, getting statutory and environment clearance takes high time which increase the total cost and spiraling input cost.

Industry Wish list

- Continued thrust on infrastructure investment i.e. higher allocation to flagship programs of Bharat Nirman, JNNURM, APDRP, NHDP, AIBP and renewable energy resources
- Enabling policies along with clear roadmap to expedite roll-out of infrastructure projects i.e. clearance of land, statutory, environment should be less time spending, etc
- Reduction in MAT rate - currently applicable at 18%
- Section 80IA and 80IB – extension of time limit to avail fiscal benefits for projects been commissioned beyond March 2011
- To eliminate the cascading effect of double taxation in case of dividend distribution tax
- Selectively raise import barriers for capital equipment, especially power equipment to facilitate domestic players
- Tax exemption of Rs 20,000 over an excess of Rs 1 lac U/S 80c should be increased to Rs 30,000.

Outlook and Future Prospect

Infrastructure sector is backbone of an economy country llike India. For sustaining the growth rate of 9% or higher, huge investment is required in infrastructure sector and it should be the main attraction area of an investment for next decade. The estimated investment in 12th five year plan is about USD one trillion. Private sector is expected to contribute 50% of total investment in 12th Five year plan. In current year Private sector contributed 34% investment. We are positive on infrastructure sector because of future capital investment in the sector, the need of infrastructure and finally the thrust for a world class infrastructure. Future prospect of infra sector is good.

Stocks to watch:

- IRB Infrastructure Ltd.
- Reliance Infrastructure
- NHPC
- GVK Power and Infrastructure Ltd
- Jaypee Infratech Ltd

IT & IT Enabled Services –

Industry Overview

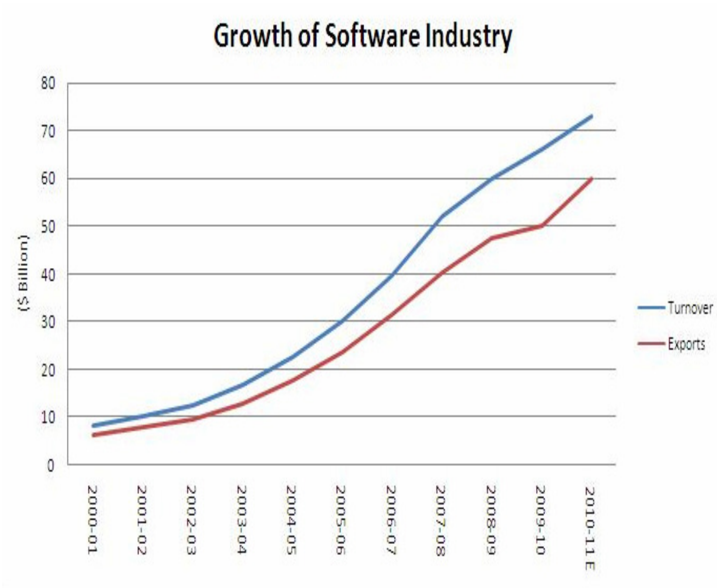
The Information Technology (IT) industry has become a synonym with India's growth story. Software success changed the outlook of India from the poverty ridden, illiterate and backward nation into a tech-savvy, educated and fast growing democracy. The IT industry has played a key role to put India on the global map. Looking at the current scenario, the Indian IT industry has witnessed a strong recovery over last few quarters after facing a bleak outlook following the onset of global economic slowdown in the last quarter of 2008. The industry faced a difficult year but started moving towards recovery by second half of the last fiscal and operating atmosphere for the industry has continuously improved since then.

The recovery in IT space started with pent up demand from major global vendors as the global economy started to get back on its feet and discretionary budgets started to get un-frozen in early 2010. The cost cutting initiatives taken by many large MNCs also supported the recovery and major clients across the verticals have been hiking IT budgets gradually. The performance of majority of industry leaders has been particularly on the upside in first half of FY11 and while recovery is slower in the mid-cap space, here too things have been improving continuously for last one year or so. Global economy has improved considerably over the calendar year 2010, and has surprised most of the economists on the upside. Although some slowdown is apprehended in China due to high inflation and ongoing monetary tightening there, both the US and Europe, key demand centres for the Indian IT industry, have a better outlook now than what was the case a year ago. Most of the big IT players are optimistic on improvement in IT spending going forward which will continue to support the recovery in this space.

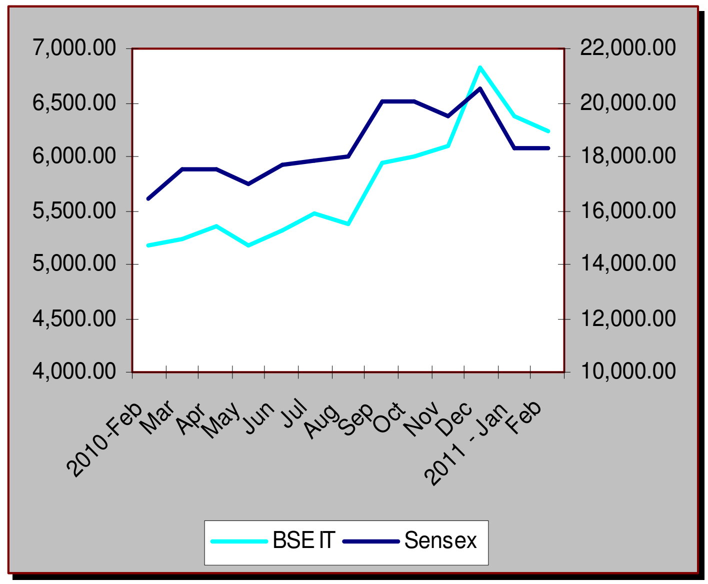
Further, notwithstanding the fact that IT majors have historically generated better part of their revenue from exports, the industry is set to renew its focus on opportunities at home. India's domestic market has become a force to reckon with and the existing IT infrastructure is evolving in terms of both technology and penetration. The trend is changing slowly and local demand is becoming an important market for tech majors. A strong boost in this regard has also come from the General Budget for FY11. A substantial Rs 1,900 crore has been earmarked for the unique identification (UID) project, indicating it will pick up steam during the year and will create opportunities for local companies. There are also opportunities in implementing the GST and other government initiatives. With the government emerging as a major driver of IT demand, we believe India's domestic IT consumption will begin to increase. Long term prospects of domestic market are also visible from the fact that currently per-capita consumption of IT services is just $10 a year compared to $1,000 a year in the US. As the Indian economy continues to grow rapidly at 8-9%, we expect the demand for IT services to increase swiftly in India, which provides a huge opportunity to the IT industry.

The Way Forward

The Indian IT sector continues to be one of the sectors showing rapid growth and promise. According to a report prepared by McKinsey for NASSCOM called 'Perspective 2020: Transform Business, Transform India', the exports component of the Indian industry is expected to reach US$ 175 billion in revenue by 2020. The domestic component will contribute US$ 50 billion in revenue by 2020. Together, the export and domestic markets are likely to bring in US$ 225 billion in revenue, as new opportunities emerge in areas such as public sector and healthcare and as geographies including Brazil, Russia, China and Japan opt for greater outsourcing.



Source: www.bnkcapital.com



Industry wish list

- **Extension of STPI**

The biggest expectation of the IT industry is that the government will extend the Software Technology Parks of India (STPI) scheme till the proposed Direct Taxes Code (DTC) is implemented. The STPI scheme, extended in the last Budget, will expire on March 31, 2011 and industry insiders say the extension will help consolidate recovery in the IT space. While many companies and industry associations have recommended that the STPI benefits be continued for a longer period and to be treated at par with SEZ benefits, industry insiders are saying that at least one more years' extension will be extremely helpful. In such a case, the issue about continuance of STPI benefits under DTC can be taken up separately when the new code is discussed and passed by the parliament.

- **Clarity on software taxation.**

One issue that has been pending for quite a while is that of the taxation of packaged software. At present there is a lot of confusion as to how software should be taxed, whether it is services or goods and whether service tax or VAT should be applicable on it. This issue certainly gets addressed with the introduction of GST however since there are lot of uncertainties around GST implementation, immediate clarity of this issue from the government will be appreciated by the industry.

Reduction in MAT

Another key demand of the industry is with regard to the minimum alternative tax (MAT). The MAT represents the minimum liability of a company which has otherwise got tax exemption due to various reasons. The MAT regime started with a tax rate of 7.5% of book profits and now this rate has been increased gradually to a whopping 20%. Such a high rate of MAT defeats the purpose of original tax concession and analysts have been pointing out that MAT should be renamed to 'maximum alternate tax'. The industry wants it to be lowered to around 15-17% to maintain a sense of tax related benefit.

SOP's for small companies

The India story, and more so the story of software industry, is all about the bottom up approach, unlike say a Chinese top down approach. It was the success of small entrepreneurs in the software that made this space the biggest success of India Inc. The industry contends that the government must look at stimulating the formation of small companies, and hence stimulating entrepreneurship. It is through success of small enterprises, particularly in software space, that one gets big ideas, and new products and technologies. The government may announce some tax breaks for the first couple of years or tax breaks till certain threshold revenue is reached for smaller companies.

Media and Entertainment

Industry Overview

The media sector has emerged as one of the fastest growing sectors of India. The industry comprises of print, electronic, radio, internet and outdoor segments. The Indian Print and Media industry offers attractive growth potential on account of mass urbanization and an increase in disposable income has brought a multifold increase in the potential customers. This along with the structural changes in the industry like a rapid adoption of satellite based television services via DTH and digital cable, and the improving spending trend of the urban and rural Indians augurs well for the growth of the sector in the coming years. For the Print industry, regional print has remained strong on back of increasing regional demand .However, rising newsprint prices could play a spoiler going forward.

In June 2010, India's Telecom Regulatory Authority of India, which also regulates broadcasters, had recommended higher foreign direct investment in the broadcasting sector, particularly in direct-to-home (DTH) and cable network operators and FM radio.

Currently, foreign direct investment in cable networks and loss-making DTH operators is capped at 49 %, while investment in FM radio is at 20 %

Industry wish list

- The sector is overburdened with multiple tax duties along with different tax treatments for companies falling under different sub segments. It is expected that the tax duties for the sector will be simplified and rationalized.
- The Indian advertising industry expects the withholding tax rate on advertising contracts to be rolled back as it already operates on thin margins and high taxes subject it to aggravated cash flow issues.
- In 2010-11 Budget, the digital head end equipment by Multi system operators was granted a project import status at a concessional rate of 5 % with full exemption from special additional duty. However, this has not helped industry since the basic customs duty for imported digital headend equipment still varies from 7.5 % to 10 %. The Government is expected to bring it down to zero % to boost digitization in the country.
- Considering the tremendous growth potential in the country, there is also a demand for tax concessions to animation, gaming and VFX industry.
- For the print sector, duty exemption is expected in standard and glazed newsprint Light Weight Coated (LWC) paper that serves as a key raw material for magazines and accounts for 60% of the production costs. The Government is also expected to exempt the cover paper used by magazines from custom duty.
- Removal of the 5 % basic customs duty on imported set-top boxes
- Waiver of service tax charged on transportation of publications by rail or road
- Abolishment of all import duty on cinema exhibition equipment and service tax on property rentals, through implementation of the Goods and Services Tax (GST). Entertainment tax needs to be included in the GST.

Metals and Mining –

Industry Overview

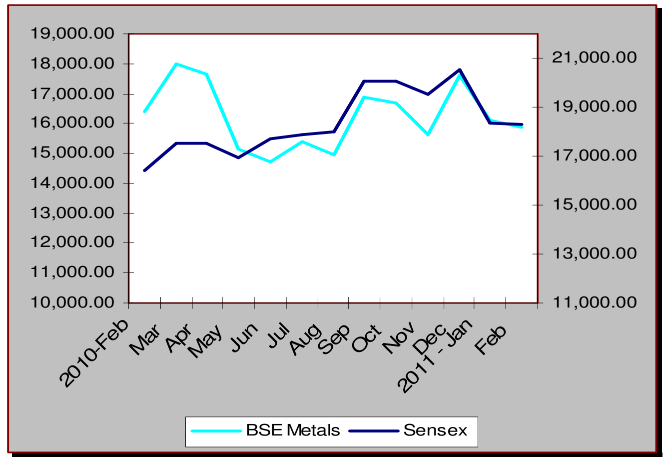
India became the fourth largest producer of crude steel in the world in 2010 as against the eighth position in 2003 and is expected to become the second largest producer of crude steel in the world by 2015. India also maintained its lead position as the world's largest producer of direct reduced iron (DRI) or sponge iron. Led by strong demand for autos and engineering services, the domestic steel demand in India remains robust, as per Moody's sectoral analysis on Asia's steel sector. According to the analysis, the outlook for the domestic operating environment is positive, driven by robust growth in infrastructure, autos and construction and constrains on additional supply by 2011. A lot of capacity expansion is underway in the steel sector and the companies do hope that the thrust on Infrastructure spending continues. PSU producers like Steel Authority of India Ltd. (SAIL) and Rashtriya Ispat Nigam Ltd. (RINL) are in the process of expanding their crude steel capacities. SAIL has targeted increasing its crude steel production from existing 12.84 Mt to 21.40 MT per annum by 2012-13 at an approximate estimated cost of US$ 15.23 billion including cost of mine development. RINL is expanding its existing capacity of 2.9 MT of crude steel production to 6.3 MT per annum to be completed by December, 2011 at an estimated cost of US$ 26.60 million. Another one is NMDC Ltd. which is to setting up a 3 MT per annum integrated steel plant at Nagarnar, Chhattisgarh at an estimated investment of US$ 33.78 million. The Plant is likely to be commissioned in 2014.

Apart from Steel, India has strong reserves of bauxite and thus is the sixth largest producer of aluminum in the world. The reserves stand at approximately 2.4 billion tones which is 5th highest in the world and approximately 7% of total world reserves. The consumption side mostly comprises of the Transport, Infrastructure and Construction sectors and with the continuing thrust of infrastructure development we expect the demand to remain robust in coming years. Currently the aluminum players in India are Hindalco, Nalco and Vedanta. They are most likely to benefit if there is a reduction in custom duty of ores. As far as copper is concerned, India does not have adequate reserves and most of the consumption is imported. Since the industry is heavily dependent on imports, the companies want the basic customs on copper concentrate to be waived off. If that is done stocks like Hindustan Copper and Sterlite will benefit. Also since Railways are the biggest consumer of copper products, we need to keep a close watch at the allocations in the railway budget.

LME Copper in last one year. Source: www.lme.com

LME Aluminum in last one year Source: www.lme.com

LME Steel for last one year Source: www.lme.com



The Way Forward

The international prices for Steel, Copper and Aluminum have been on a strong upward trajectory since the lows touched in May 2010. The fall was mostly attributed to the steel fall in Euro owing to the Sovereign Debt crisis in some countries of the EU. However, since the Euro zone in well on the way of recovery, we don't expect that hitting metal prices. Coming to domestic factors, we expect that the government spending on infrastructure will continue to be of prime focus and demand will increase for metals.

Industry wish list

- **Steel industry wants infra tag, higher import duty on HR coils**

  Steel industry in India performed well in early months of the year 2010 as well but has been impacted by some slowdown in demand and surging costs. Although demand side has already given signals of improvement in 2011, cost side remains a major worry and the industry has already implemented three price hikes over last couple of months. As the costs continue to surge, the industry has demanded a series of measures from the government to be implemented in the forthcoming General Budget.

  The foremost demand of the industry is grant of an infrastructure status. This would ensure long term funds and tax holidays for the steel industry. In fact, this has been a long pending demand and even as the government considers steel production as a core sector activity, it is not allowed the benefits that a formal infra tag attracts. Another key demand of the industry is increase in import duty on the benchmark product - HR coils. For the growth of industry, steel makers along with Associated Chambers of Commerce and Industry has called on the finance ministry to raise import duty on HR coils to 10% from the current 5%. Surging imports, mainly from China have been the biggest trouble for the industry in calendar year 2011 and higher import duty is the only remedy against the issue. The ASSOCHAM has said in a statement that pro active policy measures adopted by government of India can help extend

HR coil capacity by an additional 8 million tonne during 2011-12, making India surplus for HR coils by more than 6 million tonne.

Steelmakers have also urged the finance ministry to increase the export duty on iron ore. Iron ore is the most important raw material for making steel and it has seen a lot of volatility internationally over the last one year or so. Prices have surged to record high levels in international markets and with low export duty on iron ore, the associated volatility is also imported into India through greater export of the commodity. This has also forced the steel makers to hike prices. In order to contain further hike in steel prices, particularly given the rising cost and high inflation domestically, the government should consider increasing the export duty on iron ore. The government had last year raised export duty on iron ore lumps to 15% but fines continue to attract an export tax of 5% only. The industry expects at least a 5% increase on the export of iron ore lumps, but would also like to see the duty on limps to be increased to 20%. The two steps will increase domestic availability of the raw material, thus helping steel makers bring down the cost of production.

- **Miners seek tax concessions, consistent policies and better logistics**

India’s mining industry has been off late deeply impacted by high tax incidence, a lot of policy uncertainty and corruption related aspects. The mining industry therefore has urged the government to take a number of steps to help ensure a positive growth atmosphere. In the taxation sphere itself, a key expectation of the industry is deduction for expenditure on mine closure. As per the current regulations, a miner can surrender the leased area only after restoring the same by carrying out reclamation, surface back filling, removing dumps, plantation over waste rock dumps, etc. These activities involve substantial expenditures known as ‘Final mine closure expenditure’. The industry wants a deduction for such expenditure on lines of deduction allowed to the petroleum industry under section 33ABA of the Income-tax Act. The industry also wants the government to come up with a transparent policy regime that should be consistent across states. The ban on exports of iron ore imposed by the state of Karnataka, for example, has impacted the iron ore industry heavily in the current fiscal.

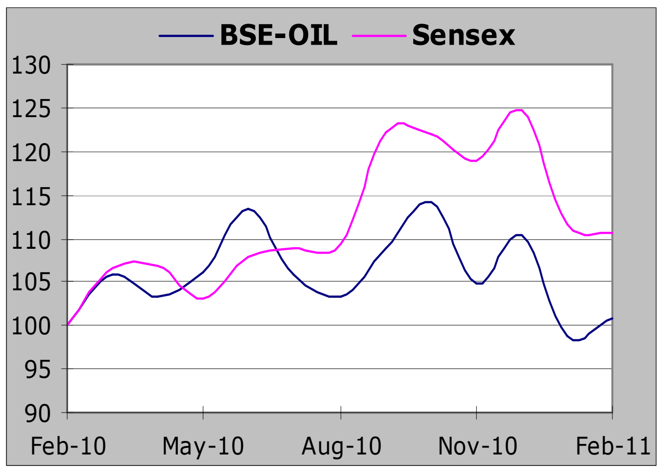
Another demand of the miners is captive berths at major ports. Since large chunk of minerals are exported, captive space will help the industry cut costs as well as time to ship orders. Miners also want the government to shield the sensitive segments from sharp global commodity price swings. The industry also wants improvement in logistics across the board which will help it cut cost of transportation. The industry in this regard would like to see the dedicated freight corridor moving forward.

- **The Metals sector is looking for decrease in customs duty of raw materials and ores and increase import duties that would prevent Chinese makers to flood the markets.**

Oil & Gas Sector -

Industry Overview

The India is a net importer of almost all forms of energy. India heavily depends on imports with over 75% of oil and 16% of gas consumption. This fact, coupled with the country's growing energy needs, has intensified discussions on energy security for the country. The government of India is thus actively seeking private participation in the energy chain to bring in the required investment and technologies and is also promoting acquisition of oil & gas reserves overseas.



The oil and gas industry is one of the most important sectors for any economy and it directly impacts the energy security of a country which translates into higher inflation and high raw material cost. India accounts approximately 3.9% of world consumption. Driven by strong economic growth, energy consumption in Indian Oil & Gas sector has been growing at a CAGR of around 6.0% over the last two decades. India's per capita energy consumption is 22% of average world consumption i.e., India's consumption is 383 kgoe compared to the world average of 1,737 kgoe, that indicates growth potential for this sector.

Crude oil demand is expected to remain strong and we also expect crude price to remain high which is negative for OMCs Companies. Uncertainty regarding subsidy continues to bleed the oil marketing companies. The three OMCs will end this fiscal with around INR 750bn of revenue losses on selling diesel, domestic LPG and kerosene below cost, compared to ~INR 440 bn last year. The focus laying natural gas and gas transmission pipelines continues with transmission and distribution companies like GSPL, IGL, GAIL and GGCL having performed very well over the last year. With issue of coal availability, ramp up of KG basin production and government's thrust on cleaner fuels, natural gas business is expected to grow very rapidly.

To increase upstream investments, the Ministry of Petroleum & Natural Gas formulated New Exploration Licensing Policy (NELP) in 1999 providing investors a level playing field and incentives to attract investment & technology. After the introduction of NELP, GOI permits foreign companies to hold 100 percent equity ownership in oil and natural gas projects. Despite this, international oil and gas companies currently operate a small number of fields. The latest round of auctions, NELP IX, was launched in Oct, 2010 in which 34 blocks are allowed for bidding and in NELP VIII was launched in April, 2009 and attracted nearly $1.1 billion in investment. With this we can expect import dependency will be lesser in coming year.

BSE Oil index has remained flat in last one year. The BSE Sensex has given 11% return in last one year where as Oil index has given 1% in the same period.

Industry Wish list

- Clarity on Subsidy sharing among Government, Upstream Companies and downstream Companies
- Diesel deregulation
- Abolition of customs duty on crude oil and cut in excise duty on diesel to avoid more fuel price hikes

Outlook & Future Prospect

India is the fifth largest consumer of energy in the world with 6% annual growth in demand for petroleum products. Oil & Gas industry estimated at about US$ 140 billion, a large domestic market where demand outstrips supply. India is emerging as one of the largest gas markets in the Asia-Pacific, share of gas in energy mix likely to go up from 9% currently to 20% by the year 2025. Huge potential exists for the expansion of pipelines, transportation and infrastructure segments. India's per capita consumption is 22% of world consumption, therefore we expect a very good potential to grow. We are positive on the sector.

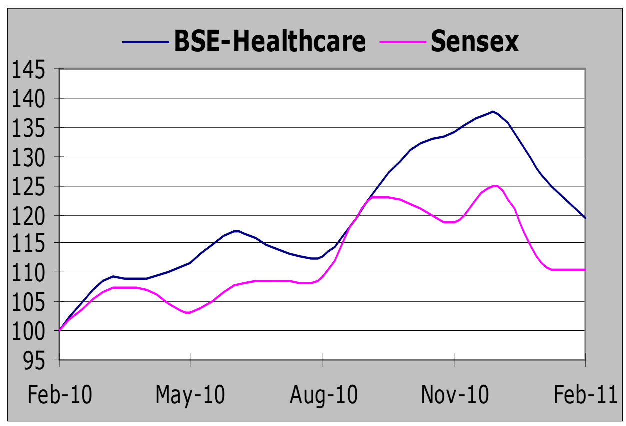
Stocks to Watch

- IOC
- HPCL
- BPCL
- IOC
- RIL
- Essar Oil

Pharmaceuticals -

Industry Overview

Pharmaceuticals industry is growing phenomenally and expects to grow 14-15% where as 4-5% growth globally. This sector has emerged as one of the most progressive and largest service sectors in India with an expected GDP spend of 8 per cent by 2012 from 5.5 per cent in 2009. It is believed to be the next big sector after IT and predicted to become a US$ 280 billion industry by 2020.



The government's Vision 2015 statement indicates an 18% plus CAGR for the pharma sector, translating to a doubling of revenues to US $40bn over the next five years. Growth will be driven by all verticals: domestic formulations, generics exports, and outsourcing (CRAMS). The government has recently announced the setting up of a venture fund that will target the infusion of INR 20 bn into the sector.

As per a study by an industry body and Ernst & Young, India would require another 1.75 million beds by the end of 2025. The Contribution of public sector is only around 15-20 per cent of the required US$ 86 billion investment. The corporate India is therefore, leveraging on this business potential and various health care brands have started aggressive expansion in the country. Some of the companies that plan to increase their footprints include Anil Ambani's Reliance Health, the Hindujas, Sahara Group, Emami, Apollo Tyres and the Panacea Group.

BSE healthcare index performed very well in last one year. The BSE Sensex has given 11% return in last one year where as Healthcare index has given 19% return in the same period.

Industry Wish list

- The 5 yr tax holiday for healthcare infrastructure in tier-2 and tier-3 towns should be extended to 10 yrs
- Increase in allocation on healthcare infrastructure and healthcare sector be given infrastructure status

- Expenses incurred outside R&D facility like those on overseas trials, preparations of dossiers, consulting & legal
- Excise Duty on API to be reduced from 10% to 4%
- Tax Holiday for hospitals to be increased from current 5 consecutive years to 10 yrs or option to select 5 consecutive yrs out of the 10 yrs.
- Custom duty on life saving drugs, medical devices, API to be abolished from current 5%
- Custom duty on formulations to be reduced from current 10% to 5%
- Extension of the list for life saving drugs- List should be expanded to cover more drugs

Outlook and Future Prospect

The Pharmaceutical industry is one the most important sector for India's growth. The outlook for the Indian Pharmaceutical Market remains mixed with the Generic companies seeing stupendous growth while growth of the CRAMS companies remain muted. With innovator drugs worth $160 bn going off patent over the next five years, high growth in the domestic market which has been registering strong growth rates of 14-15% and is expected to reach $20 billion by 2015 and increasing focus on low cost generics in order to reduce the high medication cost in the developed countries. We believe companies having a strong hold in the domestic market along with Niche/FTF opportunities would continue to trade at a premium. We have positive view on Indian Pharmaceuticals Industries.

Stocks to Watch

- Cipla Ltd
- Sun Pharmaceuticals Industries Ltd
- Ranbaxy Laboratories Ltd
- Apollo hospitals
- Cadila Healthcare Ltd
- Lupin Ltd

Power -

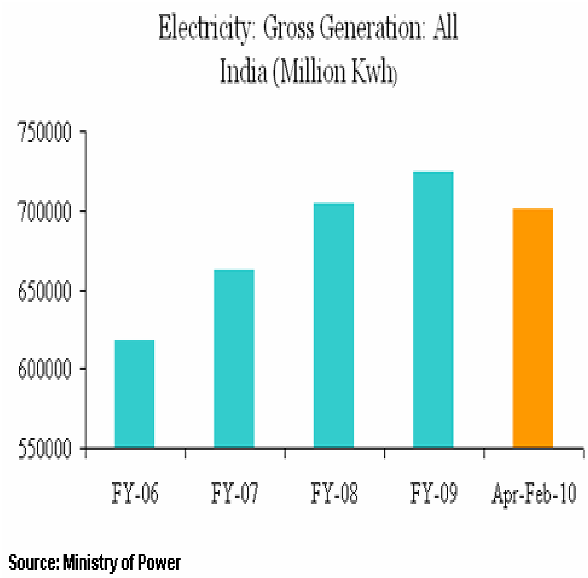
Industry Overview

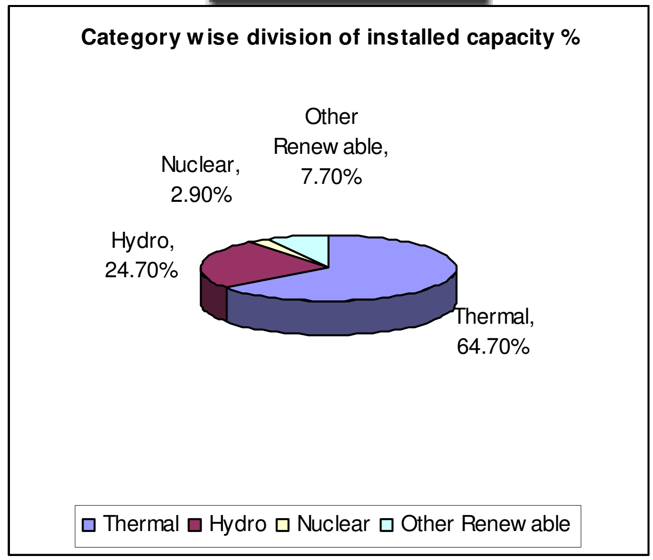
The power sector in India has been expanding concurrently to support the growth rate of the economy. The demand for power is growing exponentially and the scope for the growth of this sector is immense. The overall power generation in the country has increased from 723.793 billion unit (BU) during 2008-09 to 771.551 BU during the year 2009-10. The overall growth in power generation across all categories (thermal, hydro, Nuclear etc) is 6.6%. The Indian power sector has the fifth largest electricity generation capacity in the world and the world's third largest transmission and distribution network. The power sector in the country is poised for record capacity addition of 15,000 MW during the present financial year, said Mr Sushilkumar Shinde, Minister of Power. According to the Central Electricity Authority (CEA), Ministry of Power, India's total installed capacity as on January 31, 2010 is 1,70,228.86 mega watt (MW). Thermal power plants account for 1,11,294.48 MW, followed by hydro power plants with a capacity of 37,367.40 MW. Renewable energy sources provide 16,786.98 MW of power and the remaining 4,780 MW comes from nuclear energy. Within the thermal power plants, coal-based power plants have an installed capacity of 92,638.38 MW, gas-based have a capacity of 17,456.35 MW and oil-based have a capacity of 1,199.75 MW.

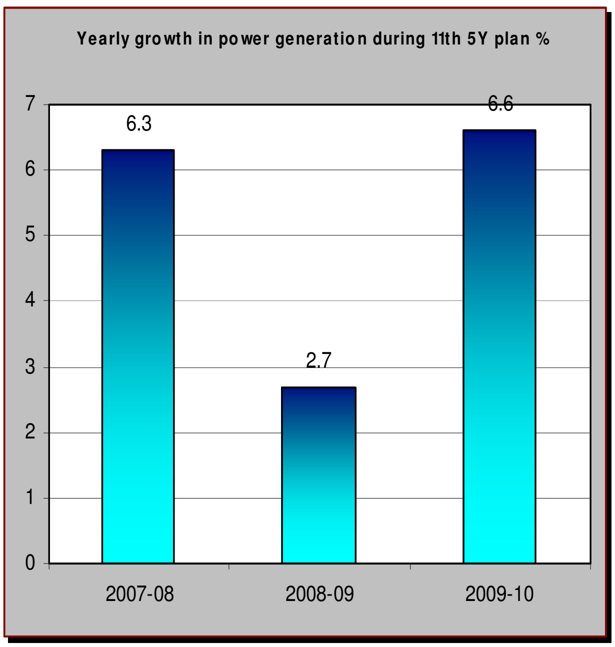
India has launched its ambitious solar energy mission which aims to generate 20,000 MW of solar power by 2022. Mr Sushilkumar Shinde, Minister of Power, said that the scope for investment in the power sector over the next few years is over US$ 300 billion and given the large expansion programme in this sector, the country would definitely need and welcome a large amount of Foreign Direct Investment (FDI). Mr Farooq Abdullah, Minister of New and Renewable Energy said the government is targeting to electrify 10000 remote villages across the country with an investment of US$ 112.14 by March 2012. According to the Department of Industrial Policy and Promotion (DIPP), the power sector has attracted foreign direct investment (FDI) worth US$ 1,028 million during April to December 2010. The cumulative FDI received by the power sector between April 2000 and December 2010 was US$ 5.65 billion.

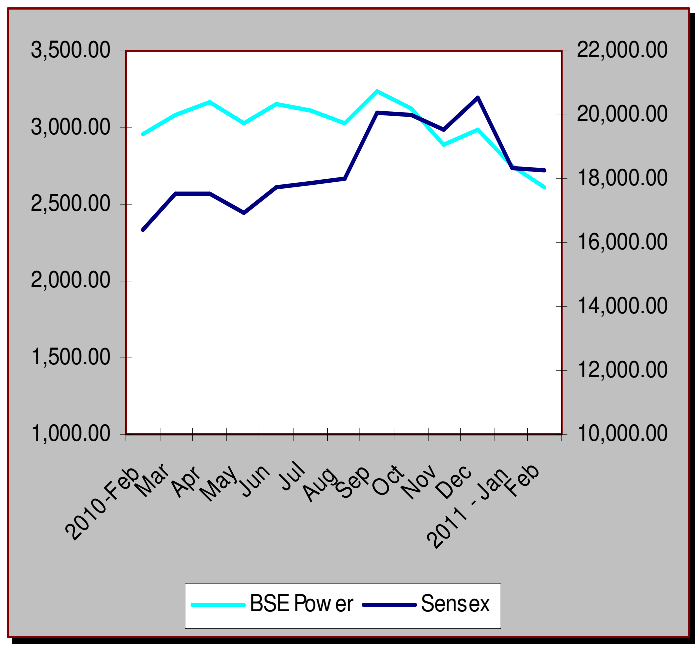
The Way Forward

India requires an additional 90,000 MW of generation capacity in the next 7 years with an equally huge investment in the transmission and distribution network. Key growth drivers for this segment include large demand supply gap, renovation and modernization of old thermal and hydro power plants, large untapped hydro power and increasing privatization of distribution networks. With the government's focus still strong on infrastructure development, we expect that there will be no changes in import duties or customs that would be harsh on power producers. Instead any increase in indigenous investments or FDI would be good for the power producers and companies engaged in T&D. Stocks to watch out for are **Reliance Power, Jayprakash Power, Tata Power, Power Grid, Areva T&D.** With the increasing pressure from environment enthusiasts worldwide and depleting renewable resources, chances are that a lot of thrust would be given to solar and hydro power projects. Stocks to watch out for are **JP Hydro, Reliance Infra, Moser Bear.**









Industry wish list

- **Continue of duty free equipment imports**

India's power industry wants the government to continue with the duty-free import of equipment used in electricity generation projects. Private sector power producers have approached the government to urge that no change in duty structure takes place in the unfavorable direction in the forthcoming Budget, contending that it was necessary to achieve ambitious power capacity addition targets. Association of Power Producers, the newly formed industry body of power producers, has written to the commerce and industry minister that restrictions on import of equipment will not only result in an increase in project costs but also delays in project implementation and will therefore harm the overall objective of enhancing power generation capacity in the country. Power equipment makers on the other hand have been lobbying for import duty on imported power equipments as major producers like China were doling out export sops and increase in shipments into India was reducing the sale of local producers. Some quarters in the government also are of the view that keeping long term development of industry in mind, imports should be restricted. As a result, the government has been contemplating a levy between 11% and 14% across the board on foreign power generation equipments. While no one can answer the question that whether the policy to restrict import will yield any benefits in developing local capacity in long run, the government is certainly divided on whether local producers be given more space to grow, or focus be shifted on speeding up power generation projects for a while.

- **Semiconductor industry to get major boost in Budget**

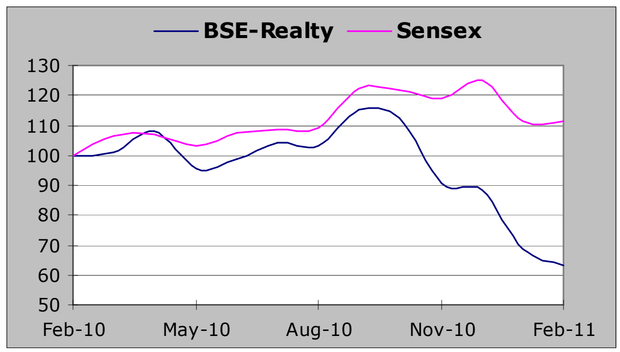
The new incentive scheme that the government is expected to announce in Budget was introduced under its semiconductor policy - 2007, which has very much failed in its broader objectives of boosting semiconductor industry in India. In 2007, the government had offered 20-25% subsidies to large investments of Rs 1,000 crore to Rs 2,500 crore in semiconductor fab units and eco-system units. However, the policy mainly attracted investments by solar photovoltaic segment only. Industry insiders have been saying that the government should minimize the threshold for manufacturing units to ensure that any benefits of such policy reach to the young technocrat entrepreneurs. Since it is not practical for small companies to invest huge sums exceeding Rs 1,000 crore, the government will have to revisit the threshold to follow a bottom up approach, as has been the case with the software industry. In fact the government had asked for recommendations of the industry and the new policy is being formulated accordingly. It is understood that the new incentive scheme would no longer be totally focused on large projects, rather, it would try to give some sops to the entire value chain of electronic systems. If all these segments are brought under the incentive net, it will surely generate positive currents in the industry. This would, to a great extent reduce the cost of running a Solar Power plant. The key part of the solar cell is the photovoltaic semi conductor and its maintenance. This incentive would reduce the cost of producing solar cells and hence solar power. We might see some new players entering this area.

- **Continued focus on rural electrification and increased allocation to schemes like RGVY.**
- **More investment in schemes like R-APDRP to improve the infrastructure for T&D. This is only way to cut losses in that area.**
- **Reduction of import duty on Coal**

Real Estate -

Industry Overview

For the real estate sector we do not expect any major changes in this upcoming budget. The real estate sector in India is of great importance. According to a report 'Emerging trends in Real Estate in Asia Pacific 2011, released by PricewaterhouseCoopers (PWC) and Urban Land Institute (ULI), India is the most viable investment destination in real estate. The report, which provides an outlook on Asia-Pacific real estate investment and development trends, points out that India, in particular Mumbai and Delhi, are good real estate investment options for 2011. Residential properties maintain their growth momentum and hence are viewed as more promising than other sectors.



Real estate companies are coming up with various residential and commercial projects to fulfill the demand for residential and office properties in Tier-II and Tier-III cities. We believe over the past one year the concerns have shifted from supply side (liquidity issues) to demand side. To revive the demand, the developers will have to adopt reasonable pricing strategies so as to capture the interest of the buyers/tenants. Nevertheless, incentives for affordable housing, higher income tax exemptions for home loans and infrastructure status for the realty segment rank high on the wish list of real estate developers.

BSE Realty sector performed very badly in last one year. BSE index has given return of 11% (as on 23rd Feb, 2011) where as BSE Realty index down by 37% in the same period.

Industry Wish list

- Some measures should be taken so that the rate of interest should come go down on home loans, reduction in stamp duty and rollback of service tax on projects under construction.
- Industry expects that the deduction of interest payment on housing loans is Rs 1.5 lakhs that should be increased to Rs. 3.0 lakhs.
- It is also likely that interest subvention of 1% on loans of up to Rs1 million on property of Rs2 million will be extended by another year.
- Developers who are raising funds at high interest rates also expect to get an infrastructure status to access funds at lower rates.
- Builders that focus on ultra-low-cost housing should be given further concession.

- Expect to introduce GST and include the Real Estate sector

Outlook and Future Prospect

We believe that the sector is facing very low demand because of unrealistic price. To revive the demand, developers will have to adopt reasonable pricing strategies so as to capture the interest of the buyers/tenants. Margin of this sector has been shrinking and if developers adopt the strategy of lower price, the margin will down substantially because of high funding cost and also very high input cost. Nevertheless, incentives for affordable housing, higher income tax exemptions for home loans and low interest rate could revive the demand. We are not positive in Realty sector till housing demand revive.

Stocks to Watch

- DLF Ltd
- HDIL
- Indiabulls Real Estate Ltd.

Telecommunications –

Industry Overview

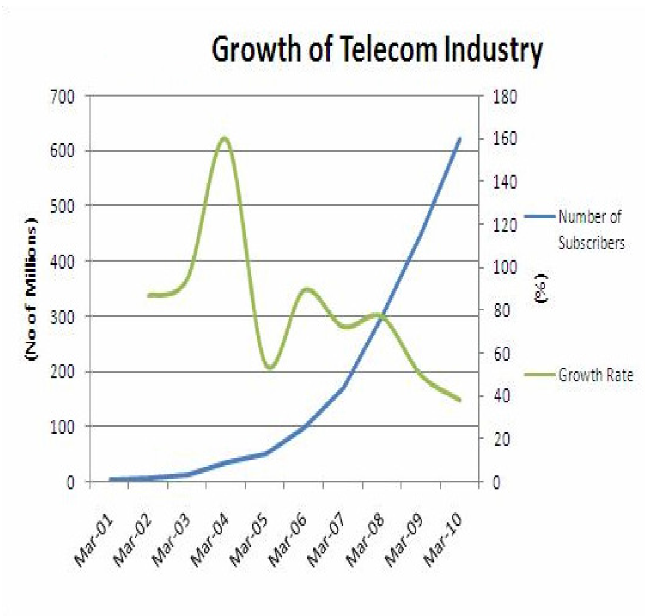
India has one of the fastest growing telecom industries in the world. It is the third largest telecom market in world after China and US contributing 2.1% to the national GDP and is largest IT absorber after banks. The measures taken by the government to deregulate the industry led to the foundation stone of telecom revolution in the country and the industry started witnessing fast track growth from the start of the current decade. In last few years the telecom industry has grown at unprecedented pace and has been crossing one after other milestones. Telephone subscribers in India increased from three million to 300 million through 2001 to 2008 and further to over 500 million by the end of July 2009. By the end of 2010, the number has further surged to over 700 million. The industry also witnessed structural changes. After initial phases most of the growth has been provided by the wireless segment while fixed line segment has off late started contracting mildly. Today India has second largest number of mobile subscribers after China.

As far as current scenario in concerned in spite of intensifying competition and newcomers starting operations, the subscriber addition has only accelerated over the last fiscal. In the last fiscal, India's telecom operators added 192.56 million wireless customers, taking the total subscriber number to 584.32 million compared to 391.76 million a year ago, thus exhibiting a growth of nearly 50%. Average subscriber addition per month for FY10 works out to be 16 million compared with 14.5 million in the previous fiscal. In the current fiscal, the growth has continued unabated and the industry surpassed yet another mile when the total subscribers crossed the 700 million mark in the month of August. As per the latest available data, total telephone subscriber base reached 787.28 million at the end of Dec 2010, with wireless subscribers reaching 752.19 million.

However, it should be noted that even as the subscriber numbers are growing sharply, the actual growth rate is also coming down. This is because the growth rate is being computed on higher base. The growth rate has consistently declined in last three years, reflecting that the industry is reaching a mature stage. The industry has continued to add subscribers at an increasing pace, but these additions are not transforming equally into revenue. Even as the user base increases rapidly, the hyper-competition scenario has resulted in consistently declining tariffs that has led to continued drop in average revenue per user (ARPU). Although tariffs should decline when volume increases, the pace of decline has been too sharp in some of the segments and has hit the profitability of operators. It should however be noted that decline in ARPU as a phenomenon was present even before the competition intensified in 2009 and therefore perhaps reflect at a more subtle level the fundamental dynamics of Indian market. Finally, on a positive note, the declining trend seems to be tapering off, probably indicating that as the industry matures, ARPUs will stabilize in next few quarters.

The Way Forward

The 3G auction that yielded huge surprises early in the year is behind us and the country is now getting ready to enjoy the high-end services that the third generation (3G) spectrum can bring. At present, most players in the industry are ruling out any tariff war in the 3G space as each one of them has paid hefty sums to get the coveted spectrum and therefore need to get decent increase in revenue. On the other hand, a very high tariff rate in the price sensitive Indian market can kill demand. The industry therefore will have to find a right mix of premium and volume in the 3G space. Even as the operators get ready to launch high-end services based on the 3G spectrum, the extra-ordinary competition in the sector continues to prevail. Although the competition will probably be not as stiff in terms of tariff wars in the 3G space, in the medium term, some consolidation in necessary for the industry to stabilize. India currently has 14 operators, the highest in any country. The incumbent players such as Bharti or Reliance could still look at acquiring one of the smaller players. The other rider is that the merged entity shall not hold more than 14.4 MHz spectrum in case of GSM players and 10 MHz in case of the CDMA players. Further, M&A will not be allowed if post the merger the number of operators in a circle reduces below six.



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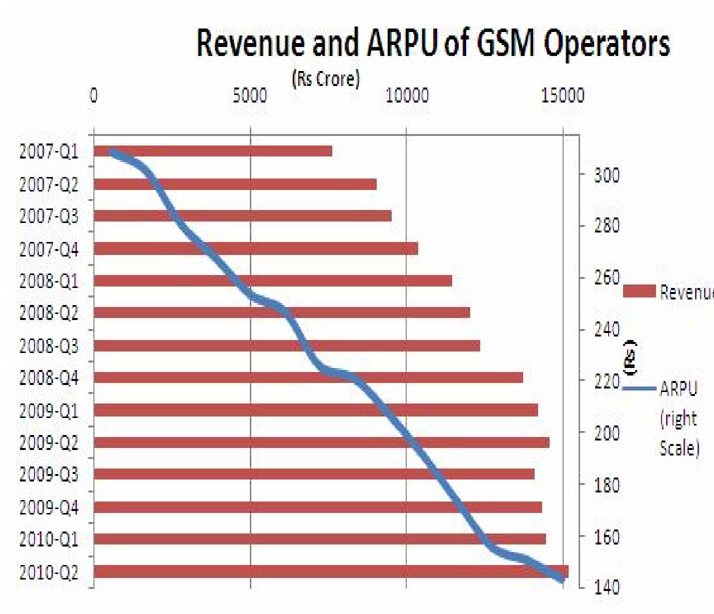

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Industry Wish List

➢ **3G spectrum be treated as tangible asset**

The first and foremost demand of the telecom players is clarity in relation to treatment of upfront spectrum payment and interest cost on borrowed funds in terms of taxation. The Cellular Operators Association of India (COAI), umbrella body of GSM only players has demanded that the government should in the forthcoming Budget come out with an amendment in IT rules to clarify that the 3G spectrum fee payment would qualify as 'Intangible asset'. Since there has been a long gap between payment of spectrum and delivery of spectrum and start of services, it has also urged the finance ministry for a specific amendment to provide for capitalization of interest cost incurred on capital borrowed for payment of the 3G spectrum, at least up to the date of commencement of the 3G services. The COAI has also asked for an amendment with respect to deductibility / taxability of foreign exchange fluctuation on ECB's raised for spectrum payment.

- **Continuation of tax holidays after M&As**

The industry body has also asked for continuation of the tax holiday benefits in case of mergers/ amalgamations between two operators. In light of the above discussion, it is clear that the industry has a high number of players in the voice domain and is going through a phase of super-competition. Some consolidation is necessary for stability of the sector at this stage. This fact has even been acknowledged by the telecom regulatory authority of India (TRAI). The COAI has in this wake suggested that government can bring in effective provisions to prevent misuse instead of doing away with the tax benefits in case of mergers.

- **Infrastructure status**

Another demand for the industry from forthcoming budget is grant of infrastructure status. Under the proposed Direct Tax Code (DTC), the telecom sector does not fall within the purview of the definition of Infrastructure projects. COAI contends that the telecom industry is an unalienable part of the overall physical infrastructure and a critical requirement for long term economic growth of the country and. Further, the penetration in rural areas is still inadequate at best and therefore the telecom sector should be classified as part of Infrastructure and associated benefits should be available to this industry as well.

- **Transparent policy regime**

Finally, the industry wants a clear cut policy direction to end the ongoing uncertainty. While the new telecom policy would be announced by the telecom department separately, the government should give a roadmap towards this in the forthcoming budget and also assure that growth supportive policies would continue that will help the industry maintain a high growth trajectory for another couple of years.

Textiles –

Industry Overview

This year has been reasonably good for the Indian textile industry as the export demand from the US and Europe have shown an up tick and realizations have been better for the larger players due to vendor consolidation. However, the forex losses due to the volatility in the rupee against the US dollar as well as higher interest costs going forward are key risks to the sector. The Clothing Manufacturers Association of India (CMAI) estimates that 500,000 to 600,000 jobs are at risk. As exporters struggle to secure profitable orders, the Ministry of Textiles' US$ 28 bn export target for the fiscal year seems well beyond reach. Companies are also trying to add niche value-added material to their product mix to stabilise their margins. Some firms that have ventured into retail chains are finding rising commercial real estate prices an impediment to their ability to roll out with the speed necessary to attain critical mass.

India's textile industry has sought measures to boost exports of apparels and textile products in a cost-competitive market and easier access to funds for cotton buyers as it peaks in a year of global shortage

India has restricted exports of cotton yarn at 720 million kg for 2010/11 season that began on Oct 1. India's apparel exports volume may crimp by at least 15 % in FY11 as sky-rocketing cotton prices shrivel demand. US cotton futures early this month rallied to a record high of $2.1102 per lb. While cotton prices in india are still near a record high touched on Feb 10.

Industry wish list

- Abolish duties on all machinery for textile and clothing industry until domestic industry is able to supply products of global standards.
- Reduction of excise duty on polyester fibre from 10% to 4%.
- Considering the rising interest cost scenario and in order to make Indian textile exports competitive in international markets, interest subvention of 2% is expected to be extended until the end of March 2012.
- Working capital needs for cotton purchase to textile mills be given at lower margins, cheaper rates and a longer credit-period.

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