

# Stock Analyser

Analysis of Budget 2007-08

February 28, 2007

FM Chidambaram's fourth Budget turned out to be largely a non-event from the capital market point of view. It was anyway unfair to expect too much out of him year after year. With most tax reforms in place and emphasis on agriculture largely expected due to its subdued performance and the rising inflation due to supply side constraints, very few path breaking announcements could have been announced. The only leeway that the FM had was to target specific areas within the agriculture and social sectors for spending.

As far as the fiscal assumptions are concerned, FM has assumed tax revenues to rise 16.8% in FY08. This is based on a GDP growth of 13.0% (in nominal terms) expected in that year. This could signify a real GDP growth of close to 9% and inflation rate of 4%. Among the tax revenues, Corporate taxes are expected to rise 14.9% and Income taxes expected to rise 19.6%. Increase in Customs duties collections by 21% (despite levy of export duty of Rs.3,200 cr on export of ores and concentrates) and that of Service tax by 31.7% seems to be a bit aggressive. Excise duties are assumed to rise 11.1% in FY08, after rising 5.4% in FY07. On the expenditure side, non-plan expenditure could overshoot the planned 5.8% increase, while plan revenue expenditure growth of 21% is encouraging.

Among revenue expenditure, no significant increases has been provided for Defence or Subsidies. Among Central Plan Outlay by sectors, sharp increases have been provided in Industry and Minerals, Transport (incl Rural roads), Communications, Science Technology and Environment and Social Services. As far as Central Plan by Ministries is concerned, Telecom, Health and Family Welfare, Heavy industries, Housing, HRD (School Education & Higher Education), Mines, Power, Rural Development, Science & Technology, Shipping, Steel, Textiles, Urban Development have seen an increase in allocation in FY08. Among Capital Account disbursements, Police, Public works, Medical and Public Health, Urban Development, Power Projects, Atomic Energy Industries, Roads and Bridges, Space Research are seeing a rise in allocations. For the first time a sum of Rs.40,000 cr has been allocated towards Investment in Agricultural Financial Institutions.

Plan Revenue expenditure has been estimated to grow from Rs.1,43,762 cr to Rs.1,74,354 cr in FY08 (up 21.3%). This is mainly due to enhanced Budgetary allocations in social sector, in particular school education, women and child development, health and family welfare, rural employment, Integrated Child Development schemes, agriculture, waste land development, drinking water and for physical infrastructure including roads. Though a part of this increase is due to re-statement, this increase is anyway welcome.

The adherence of the Govt to the FRBM targets is impressive. The revenue and fiscal deficit numbers for FY07 have turned out to be better than that envisaged by FRBM Act. This has been possible due to high economic growth, increased revenues and prudent expenditure management policies.

Sector specific, Cement and EOUs (including Tech) companies are affected sentimentally due to the excise and MAT provisions respectively. The persistent efforts by the Govt to rein in cement prices could affect the P/E ratios of these companies more than affecting their earnings. As far as exporting companies are concerned, the incremental earnings impact could be 3-5% (as most companies already pay some tax in India or abroad). As per back-of-the-envelope calculations, the combined impact on the Sensex / Nifty earnings for FY08 of these two measures could be 2.5-3.5%. While our markets have already fallen by more than this, any de-rating of P/Es due to a possible emerging markets sell-off could result in further weakness. Banks could be benefited due to a hike in the dividend distribution tax on Money Market Mutual Funds/Liquid Funds. This could mean better and direct access to funds for banks. Cigarettes manufacture has seen a less than expected rise in excise duty and hence stocks in this sector performed well today.

Apart from the sectoral impact discussed above, some other companies could be affected by the provisions in the Budget.

Company	Provision in the Budget	Impact
Sesa Goa / NMDC	Export duty of Rs.300/MT of Iron Ore/concentrates exported	Will feel the impact unless the contract with buyers allow pass through of this, which is unlikely
Reliance, GAIL and Pipeline mfg companies like Jindal Saw, Welspun Guj, Man Inds, Mah Seamless	Section 80IA benefits extended to companies engaged in Gas distribution network	The benefit could spur faster rollout of pipelines and resultant demand for pipes.
Nestle	Excise duty fully exempt on instant food mixes	Margins and/or volumes could go up depending on extent of benefit passed over to consumers

Meltdown in the global markets could affect risk appetite of investors and lead to liquidity issues in our markets. This combined with the fact that Indian markets quote at a P/E ratio that is higher than the other emerging markets could in the near term lead to a gradual erosion in values of stocks despite the fact that the Budget has no negatives on a broader basis.

Markets elsewhere seem to have stabilized today. Chinese markets are up 3.94% on Feb 28 after falling 8.84% on Feb 27. European markets after opening lower have recovered part of the losses but are still in the red at the time of writing this piece.

Technically, the Indian frontline indices have fallen with a downgap on Feb 28 following weak global cues. A lot of indices (including Nifty) have tested their 200 DEMA and bounced there from. Tomorrow, markets after falling in the early part of the day and making some sort of double bottom, could bounce back. They could retrace about 38.2% of the fall from 4,178 to 3,674 on the Nifty in the next couple of days. A lot however depends on how the global markets behave as Indian markets cannot perform in isolation. The sectors that could outperform in this bounce include IT, Capital Goods, Oil & gas and Telecom while Healthcare, Auto, Metals, Cement and Contracting/construction could under perform.

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