



February 2011 – Newsletter

The month of February was action packed for Indian equity markets. Series of events like crisis in Libya and Egypt, announcement of Railway Budget, Economic Survey and Union Budget 2011-12 turned Indian equity market volatile. All these events had a huge bearing on the sentiments of the investors in Indian equity markets.

Overhang of concerns like increased interest rates due to high inflation, rising oil prices due to concerns in Egypt and Libya. The crisis in Egypt had raised concerns of a disruption to supply of Middle East oil shipped through Egypt and of unrest spreading across the Middle East and North Africa, which combined produce more than a third of the world's oil. The crisis resulted in Brent and Nymex Crude Oil reaching more than US\$100 per barrel, posing a serious threat on India's import oil bill, leading to concerns on a higher fiscal deficit.

FII's turning net sellers..

The above concerns resulted in FII outflow. In February, 2011, FIIs sold worth Rs. 37.5 bn. On the other hand, domestic Mutual Funds remained buyers and purchased worth Rs. 14.3 bn.

With FII outflow, Nifty witnessed a decline of 1.55% on M-o-M basis to touch 5,333.25 points on 28th February 2011. On the other hand, Sensex registered a decline of 1.12% to touch 17,823 points on 28th February, 2011.

Major domestic events in February 2011

A) Economic Survey:

The Economic Survey for 2010-11, tabled in Parliament by Finance Minister Pranab Mukherjee, had pegged the economic growth at 8.6 per cent for the current fiscal, helped by broad-based rebound in agriculture and "continued momentum" in manufacturing and private services.

Indian economy is poised to grow by 9 per cent in 2011-12 despite risks of global events like volatility in commodity prices, exacerbated by political turmoil in the Middle East, according to Economic Survey. Following are the highlights of the Economic Survey:

- a) Gross Fiscal Deficit stood at 4.8 per cent of GDP in, down from 6.3 per cent last year.
- b) Inflation expected to be 1.5 per cent higher than what it would be if the economy were not on growth path.
- c) Economy witnessed broad-based growth; rebound in farm and continued momentum in manufacturing, private services.
- d) Fundamentals strong with growing savings and investments, rapid rise in exports.

- e) Industrial output registered growth of 8.6 per cent; manufacturing sector witnessed growth 9.1 per cent, Exports in April-December 2010 were up by 29.5 per cent; imports up by 19 per cent.
- f) Trade gap narrowed to US\$82.01 billion in April-December 2010.
- g) Food inflation, higher commodity prices and volatility in global commodity markets, remain a cause of concern, need to monitor emerging trends in inflation on a sequential monthly basis.
- h) To check food inflation, the government should improve delivery mechanisms by strengthening institutions and addressing corruption.
- i) Savings rate has gone up to 33.7 per cent, while the investment rate is up at 36.5 per cent of GDP.
- j) Rising food inflation underlines need for larger investment in farming, enroute to 2nd Green Revolution.
- k) Net bank credit registered growth of 59 per cent.
- l) Social programme spending was stepped up by 5 percentage points of GDP over past five years.
- m) Production of foodgrains estimated at 232.1 mn tons.
- n) Forex Reserves estimated at US\$297.3 bn.
- o) Accelerated investments needed in infrastructure to address delays, cost overruns, regulatory impediments.
- p) Telecom sector did exceedingly well; role of services sector as the potential growth engine laudable.
- q) Policies needed to promote new areas such as accounting, legal, tourism, and education, financial and other services.

B) Railway Budget:

Railway Minister Mamata Banerjee presented her third Railway Budget in Parliament in February 2011. The budget announced was a populist one. There were no major reforms announced in this budget. The key features of Railway Budget 2011 are as follows:

- a) Railways has got 85 proposals for PPP, would setup single window for PPP approval.
- b) Annual plan for FY12 at Rs. 576.3 bn.
- c) Annual gross budgetary support at Rs. 200 bn.
- d) Aiming 700 km of annual rail line addition as compared to the current 150 kms.
- e) Aim to complete dedicated freight corridor by December 2016.
- f) To raise Rs 100 bn via tax free bonds, to spend Rs 95.8 bn for new lines in FY12.
- g) To allocate land worth 12,000 acres for dedicated freight corridor.
- h) Freight loading aimed at 993 mn tons in FY12.
- i) Wagon procurement target at 18,000 units in FY12.
- j) FY12 operating ratio pegged at 91.1%.
- k) Expect railways financial health to revive in FY12, railway earnings set to top Rs 1 lakhs crore. mark in FY12, expected savings of Rs 52.6 bn in FY12.
- l) Freight target reduced by 20 million tonne to 924 mn tons.
- m) To complete 1,075 kms new rail lines in FY12, to double-line 867 km of rail tracks in FY12.

Major Event of February 2011 - Union Budget 2011-12

Union Budget 2011-12 was announced with a background of challenges like structural concerns on inflation management and fiscal deficit concerns. The budget announced was an attempt to balance growth and inflation. The budget met street expectations on various areas which are as follows:

- a) Budget fiscal deficit of 2010-11, which was 5.5% of GDP has been brought down to 5.1% of GDP, targeted 4.6% for FY12.
- b) Divestment target of Rs. 40,000 cr for 2011-12.
- c) FY11 revenue deficit seen at 2.3%.
- d) Indian economy expected to grow at 9% in 2011-12.
- e) Direct Tax Code will be effective April 1, 2012, preparation of GST rollout in final stages.
- f) *Foreign Investors compliant with KYC norms of SEBI can invest in Mutual Funds.***
- g) Surcharge reduced from 7.5% to 5%, new companies bill to be introduced on current session.
- h) UID project on track, set to achieve daily enrollment of one million by October 2011.
- i) Central electronic registry for property.
- j) Approval being given to set up 15 more Mega Food Parks during 2011-12, Additional banking license to private sector players proposed.
- k) Five fold strategy to be put into operation to deal with the problem of generation and circulation of black money.

Union Budget 2011-12 on Direct Taxes front:

- a) The budget proposed increase in the income tax exemption limit for general tax payers (excluding women and senior citizens) to Rs 1.8 lakhs per annum would translate into a benefit of Rs 2,000 for all tax payers.
- b) It introduced a high new tax slab for senior citizens of 80 years and above. The budget proposed to reduce the age limit for consideration as senior citizens from 65 years to 60 years. Senior citizens will get tax exemption for income up to Rs 2.5 lakhs, higher from Rs. 2.4 lakhs now.

SECTORAL IMPACT

Sectors	Steps taken	Impact
Aviation	Propose to raise service tax on air travel	Negative for all aviation companies
Banking	a) Net market borrowing at Rs3.43tn in FY12 b) Recapitalization of Rs. 6,000 cr c) Credit limit to farmers in the form of direct lending increased from Rs. 3,75,000 cr to Rs. 4,75,000 cr	Recapitalization to act as a positive to all the banking companies, but increased credit limit to farmers may result in higher NPAs which may act as a concern in the future
Cement	Import duty on gypsum and coal from 5% to 2.5%	Positive for cement companies
Education	Allocated Rs. 52,057 cr	Positive for companies like Educomp, Everonn, NIIT
Fertilizers	Cash subsidy for Urea, mulling over Nutrient based subsidy	Positive for all fertilizer companies
Infrastructure	Tax sops of Rs. 20,000 for infrastructure bonds to be continued	Positive for all infrastructure companies
IT	No mention of STPI and Sec 80IA and 80IB IT SEZs to be charged MAT	Negative for IT companies
Insurance	To tax life insurance service providers	Negative for insurance companies like Bajaj Finserv
Mining and Minerals	Iron ore Ad Valorem at 20%	Negative for leading mining companies like NMDC and Sesa Goa
Oil and Gas	No changes in the oil sector	Positive for Oil Marketing Companies (OMCs)
Power	No excise duty on equipments for UMPPs	Positive for Reliance Power and Tata Power
Shipping	Ship owners allowed duty free spare imports	Positive for shipping companies
Textiles	10% excise duty on branded garments	Negative for textile companies



Fertilizer sector

Past

- a) FY11 budgeted fertilizer subsidy of Rs. 500 bn, was lower than subsidy of Rs. 530 bn in FY10. The government had assured of disbursing all subsidy in cash as against partial payment in bonds in previous years.
- b) It also introduced Nutrient Based Subsidy scheme on DAP/complex fertilizers resulting in fixed subsidy – floating price regime – enabling all complex fertilizer companies to charge their own prices to the farmers.
- c) With effect from April 2010, Urea prices were increased by 10% to the farmers
- d) Excise duty was rolled back from 8% to 10%

Expectations of the industry

Industry expects Urea to be brought under the preview of NBS, to reward efficient players. Gas based players can be compensated through gas pooling arrangements while non-gas based players should be compensated for their high input cost, until adequate infrastructure is in place.

Actual

Government actively considering extension of the NBS regime to cover urea, Government to move towards direct transfer of cash subsidy to people living below poverty line in a phased manner for better delivery of fertilizers.

Outlook on Fertilizer Sector

We believe, domestic demand for fertilizers would continue to remain high. This would result in higher imports, leading to low off take risks for domestic manufacturers as their entire production is likely to find ready buyers. The government has already declared its intention to continue with its nutrient-based subsidy (NBS) in FY12 for phosphate-based and potassium-based fertilizers (P and K), albeit at reduced rates. The adequacy of these rates will depend upon the international prices of relevant commodities and the industry's ability to secure these commodities at competitive rates. The NBS has received an enthusiastic response from the industry since its introduction in FY11. The next step for the government would be the inclusion of urea under the NBS. Our top pick in this space is GSFC Ltd.

Banking and Housing Finance Institutions

Past

- a) Increase in recapitalization of funds for banks to Rs. 165 bn
- b) Take out financing by IIFCL was continued
- c) Credit to agriculture sector was increased by 15% to Rs. 3,750 bn
- d) Signals of issuing banking licenses to NBFCs were given
- e) Extension of interest subvention on export credit of 2% on pre-shipment credit and Interest subvention on farmers credit increased to 2%

Expectations of the industry

- a) Continuation of interest subvention scheme – This would help banks to participate infrastructure projects and improve the asset – liability mismatches.
- b) Package for State Electricity Boards as they are facing liquidity crunch

Actual

- a) Credit limit to farmers in the form of direct lending increased from Rs. 3,75,000 cr to Rs. 4,75,000 cr
- b) Rs. 6,000 cr to be provided during 2011-12 to enable public sector banks to maintain a minimum of Tier I CRAR of 8%
- c) Rs. 500 cr to be provided to enable Regional Rural Banks to maintain CRAR of atleast 9% as on March 2012
- d) Amendments proposed to the Banking Regulation Act in the context of additional banking licenses to private sector players
- e) Existing scheme of interest subvention of 1 per cent on housing loan further liberalized
- f) Existing housing loan limit enhanced to Rs. 25 lakhs for dwelling units under priority sector lending
- g) Provision under Rural Housing Fund enhanced to Rs. 3,000 crore

Outlook on Banking Sector and HFIs

We maintain our positive view on Banking sector. The announcement of increasing credit limit to the farmers in agriculture sector may pose challenges to the banks in the form of higher NPAs. In Q3FY11, PSU banks have reported higher NIMs on account of improving CASA ratio. We believe, with improved credit growth, private sector banks are going to witness pressure on operating profit front as employees cost would spike up and banks would have to provide for pension liabilities. Our top picks in the sector are SBI, Bank of Baroda, Central Bank of India, IOB, Bank of India and Axis



Bank. Steps taken for HFIs would be beneficial for companies like HDFC, LIC Housing Finance, GIC and Dewan Housing.

Power, Capital goods and Infrastructure sector

Past

Budget 2010-11 had addressed Infrastructure problems with number of allocations as per the various aspects of the sector. The Finance Minister had announced Rs 100 bn allocation towards Indra Awaas Yojna and Rs 480 bn towards Bharat Nirman. 25% of the planned allocation was towards rural infrastructure. There was also an interest subvention for housing loans up to Rs 1 lakhs.

It also included the allocation towards the NREGA scheme which was enhanced to Rs 410 bn. A fund of Rs 51.3bn was set aside for the power sector.

Industry expectations

- a) Policy to accelerate award of coal mines.
- b) Issue like fuel availability to State Electricity Board (SEBs) is an extremely critical issue which is getting highlighted or focused by the market at this point of time. Any support fund to SEB would be an extremely welcome relief for the power sector.
- c) Extension of time limit under section 80IA and 80IB to avail fiscal benefits for projects been commissioned beyond March 2011.
- d) Improved allocation and thrust to flagship programs of Bharat Nirman, JNNURM, APDRP and NHDP.

Actual

- a) Allocation was increased by 23.3 percent of Rs. 2,14,000 crore for infrastructure sector in 2011-12, accounting for 48.5 per cent of total planned allocation.
- b) Government to come up with a comprehensive policy for further developing PPP projects, low withholding tax of 5% for notified infrastructure funds
- c) IIFCL to achieve cumulative disbursement target of Rs. 20,000 crore by March 31, 2011 and Rs. 25,000 crore by March 31, 2012.
- d) Under take out financing scheme, seven projects sanctioned with debt of Rs. 1,500 crore. Another Rs. 5,000 crore will be sanctioned during 2011-12.
- e) To boost infrastructure development, tax free bonds of Rs. 30,000 crore proposed to be issued by Government undertakings during 2011-12.



Outlook

We believe actions taken would benefit infrastructure players. Players having diversified order book to mitigate the risk of sector specific slowdown, no concerns on the corporate governance front, strong execution capabilities; healthy cash flows would be good for investments. Our top picks in this space include Larsen and Toubro, BHEL and Pratibha Industries. In the power sector, we believe companies (Reliance Power and Tata Power) having UMPP would benefit.

Auto sector

Past

Increase in excise duty by 2%

Industry expectations

- a) No increase in excise duty
- b) Reduction in disparity of excise duty between small cars and large cars/UVs

Actual

- a) Excise duty unchanged

Outlook on Auto Sector

Indian automobile sector, on account of its integration with other key segments of the economy, the industry is a key growth driver for India. During January 2011, passenger car segment and three wheeler segment reported MoM growth of 14.3% and 8.3% respectively. On the other hand, commercial vehicle segment and two wheelers segment witnessed decline in sales on MoM basis of 3.9% and 2.2% respectively. Three wheelers industry is back on its feet after a sharp fall in sales in the month of November and steering ahead to breach the highest ever sales achieved in October 2010.

We believe, no rollback in excise duty would act as key positive to the sector. Although there may be pressure on auto companies due to increasing metal prices, long term consumption story on account of burgeoning middle class disposable income would give fillip to the sector.

In the auto space, we are bullish on companies like Bajaj Auto, Maruti Suzuki.



Pharmaceuticals sector

Past

- a) Allocation on Pharma sector was increased by 13.7% to Rs. 223 bn
- b) Weighted average deduction on in-house R&D was increased from 150% to 200%
- c) Excise duty was hiked from 8% to 10%
- d) MAT was increased from 15% to 18%

Industry expectation

- a) Reduction on excise duty from 10% to 8%
- b) Five year tax holiday for healthcare infrastructure in tier II and tier III cities should be extended to 10 years
- c) Concessional rate for certain categories of life saving drugs
- d) Key expenses incurred on trials conducted overseas, dossier preparation, ANDAs conducted outside R&D labs should be eligible for weighted average deduction
- e) Infrastructure status to healthcare sector

Actual

- a) Health care spend to be increased by 20% in FY12.
- b) Centralized air conditioned (AC) hospitals with more than 25 beds and even diagnostic service providers are brought under 10% service tax. The effective service tax would be 5%, as there is a 50% rebate.
- c) There was no extension provided on the weighted deduction on the in-house R&D which stands at 200% and available till FY12 only, which was a disappointment for the Pharma companies actively involved in R&D activities.
- d) MAT levied on the SEZ developers would impact the companies that were placed to benefit from the same. There were no indications on the extension of the EOU benefit which is available only till FY2011, which could be a negative for the sector, especially companies that have been not or have been slow in expansion through SEZ.

Outlook

Considering the market conditions, we are bullish on defensive space like pharma. Our top picks include Sun Pharma, Dr Reddy's, Lupin, Aurobindo Pharma, Opto Circuits and Panacea Biotech. With ~119 USFDA approved manufacturing facilities in India, Indian companies are well equipped to tap the US\$96bn generic opportunity on account of expiry patents.



Ajcon's view on Union Budget 2011-12 and equity market

No roll back of fiscal incentives given earlier at the time of global economic meltdown, has improved the the market sentiment. It was one of the most motivating factor for the industry on whole and Auto industry in particular.

The most important and effective step taken in the Budget is Foreign Investors who are compliant with SEBI KYC norms are allowed to invest in Indian Mutual Funds.

While there was some relief in direct taxes to both individuals and corporates, the increase in MAT by 0.5% and lifting of SEZ benefits to the extent of MAT even to the IT sector is little dampening.

On the whole, we consider the budget a good one, considering the prudent fiscal management bringing down the fiscal deficit estimate for 2010-11 to 5.1% from 5.5% estimated earlier. Even the targeted deficit for 2011-12 is also 4.6% only.

Post budget announcement, we are bullish on sectors like Auto, Banking, Infrastructure, Fertilizers, FMCG, Food processing and Education.

Outlook on Indian Equity Market

We believe that there would be cool down in crude oil prices in the coming quarters, with improved situation in Libya. This would be only possible, on acceptance of peace plan by Mr. Gaddafi - President of Libya. Positive outcome would provide a huge sigh of relief on rising interest costs front, leading to higher earnings for the companies.



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