Overall sectoral impact of the Indian Budget 2006

Auto ancillaries **Neutral**

The peak duty reduction on components is likely to result in a moderate pricing pressure on domestic manufacturers for OEM supplies (OEM demand accounts for 65 per cent of the industry). Imports in the replacement market (accounts for about 18 per cent of the industry) is unlikely to increase due to the levy of 4 per cent CVD. The expected increase in demand for cars, on account of the cut in excise on small cars, will have a positive impact on auto ancillary demand.

Banking **Positive**

Overall, the budget is positive for the banking industry. On the liabilities side, the move to include bank fixed deposits with a maturity period of 5 years and above under Section 80C of the Income Tax Act will aid deposit growth, as they will now qualify for tax exemption. On the assets side, the budget has attempted to provide additional resources to banks for lending, by proposing to unwind the non-tradable special securities. This will allow banks to increase their advances by 200 bps. Further, the mandate to provide agricultural credit at 7 per cent will put bank spreads under pressure. The reduction in excise duty on small cars to 16 per cent will provide a boost to car demand and to the car financing business. Exempting 90 per cent of the interest portion of instalments received by the leasing and hire purchase industry will help revive this industry.

Capital goods **Positive**

The peak customs duty has been brought down from 15.0 per cent to 12.5 per cent. Notably, domestic capital goods manufacturers servicing the power sector already have the peak customs duty pegged at 10 per cent. In addition, a special additional duty (SAD) of 4 per cent would be levied on all imports, barring some imports in the power sector. These are mega power projects, which are already exempt from paying the basic and countervailing duty; and non-mega power projects, transmission and distribution projects, and high voltage transmission projects. Taking into account all the aforementioned factors, the effective customs duty on the import of products, excluding the power sector, has gone up by 2.5 per cent.

On the input front, reduction in customs duties on copper, aluminium and alloy steel from 10.0 per cent to 7.5 per cent will have a marginally positive impact. Power-generation capacity addition of 34,000 mw has been announced, to be completed by the end of the tenth plan period - this is 83 per cent of the total planned target, notably the highest-ever achievement in any plan period.

Besides, greater incentives for the food processing sector, an increased outlay for the refinery and irrigation sectors, and the continued emphasis on infrastructure-building projects will boost demand in the capital goods sector. Overall, the impact of all these measures will be positive on the sector.

Cars and utility vehicles **Positive**

The abolition of special excise duty on passenger cars with a length less than 4,000 mm and engine capacity of 1,200 cc (petrol) and 1,500 cc (diesel) will result in a reduction in final prices by Rs 13,000 to Rs 22,000. The above will be passed on to customers in the form of price cuts on passenger cars. This can result in an additional demand for passenger cars by 2-3 per cent. The reduction in peak customs duty from 15 per cent to 12.5 per cent, will result in lower prices of imported components, resulting in a marginal improvement in operating margins. The above benefit is expected to be passed on to customers by OEMs manufacturing large cars. The reduction in customs duty on raw materials such as non-ferrous metals and alloy steel will have a marginally positive impact on OEMs.

Cement **Positive**

The cement industry will benefit from the government's focus on infrastructural development (roads, ports, urban infrastructure and irrigation). Increase in budgetary support to the Bharat Nirman programme to Rs 187 billion (by 54 per cent); increase in outlays for rural irrigation and sanitation projects; and road development programmes in the north-eastern region will lead to higher cement demand. The government has also proposed to amend the definition of captive consumption to allow producers with captive coalmines to sell surplus coal to steel, cement and power companies. The custom's duty cut on pet coke will benefit players like Grasim and Shree Cements. The reduction of peak customs duty on project imports would be beneficial for the industry. Overall, the impact of the budget on the cement industry is positive.

Commercial vehicles **Neutral**

The reduction in peak customs duty on raw materials, such as non-ferrous metals and alloy steel, will have a marginally positive impact on OEMs.

Consumer durables **Neutral**

Overall, the impact of the budget is neutral on the sector. However, the sector is expected to benefit marginally from the customs duty cuts on some key inputs. Customs duty reduction and the potential decline in the domestic prices of polymers and copper (for air-conditioners) will benefit the industry, marginally. The reduction in the customs duty on colour picture tubes (CPTs) by 2.5 per cent is not expected to result in a decline in the domestic prices of colour televisions (CTVs), as the decline in input costs is marginal.

Cotton and cotton yarn **Negative**

Excise duty on cotton spinners at either 4 per cent or 0 per cent has been maintained. However, the excise duty on polyester staple fibre and polyester filament yarn has been reduced from 16 per cent to 8 per cent; this will make polyester yarns more competitive, when compared with cotton yarn.

This would not only boost the volumes of polyester yarns at the cost of cotton yarn, but would also compel the cotton spinners to reduce cotton yarn prices. Thus, the volumes as well as the margins of cotton spinners would be under pressure post-Budget. Enhancement of Budget allocation for the TUF Scheme from Rs 4.35 billion to Rs 5.35 billion is the only positive measure for the cotton spinners
in this Budget.

Fertilisers **Neutral**

No impact on the sector

Hotels **Marginally positive**

The hotel industry is set to benefit from the government's focus on the development of 15 tourist destinations, development of 50 villages with core competency in handicrafts, handlooms and culture and the increase in plan outlay from Rs 7.86 billion to Rs 8.30 billion. The establishment of four new hotel management institutions is expected to improve availability of adequate skilled manpower. A reduction in Fringe Benefit Tax (FBT) from 20 per cent to 5 per cent in valuing the benefit of 'tour and travel' in general and 'hospitality' and 'the use of hotel boarding' in the case of airline companies and the shipping industry will prove to be a booster. The increase in service tax from 10 per cent to 12 per cent is not expected to have a major impact on the industry as the services offered by the hotel industry under this purview are few.

Housing **Neutral**

Establishment of new towns around specific themes is likely to boost housing activities. Increase in service tax to negatively affect margins of developers who outsource a significant portion of construction activities and have contracted delivery prices.

Information technology

Software ***Neutral***

The government has announced planned urbanisation schemes and establishment of new towns for specific industries such as information technology (IT). Tier 1 cities have not been able to keep pace with the rapid growth in the IT and ITES industry. This has led to severe stress on the existing infrastructure in these cities. The above initiative will help spread the IT growth story to Tier 2 cities and ease the pressure of increasing infrastructure costs for IT and ITES companies. The Fringe Benefit Tax (FBT) on 'tour and travel' expenses has been reduced from 20 per cent to 5 per cent. This will have a marginal impact on BPO players.

IT-enabled services ***Negative***

The services tax exemption for taxable services provided by call centre and medical transcription centres have been withdrawn. We believe the outbound-voice and medical transcription services account for about 20 per cent of the BPO industry in India. The margin impact of the new levy will be 9 per cent for pure outbound-voice service providers and 1.8 per cent for players having a 20 per cent outbound-voice component.

Hardware ***Positive***

The government plans to use existing vehicles of viability gap funding and India Infrastructure Finance Company Limited (IIFCL) to create a window to provide equity participation and/or viability gap funding to the new ventures. This will help in developing the small- and medium-scale ICT manufacturing entities in the domestic market and aid in the development of India as a manufacturing hub for the ICT industry. The re-imposition of excise duty at 12 per cent on computers increases the competitive advantage of domestic manufacturers vis-à-vis importers, since they can now avail of credit of excise duty paid on inputs. Exemption of excise duty has also been given for DVD Drives, Flash Drives and Combo Drives.

Man-made fibres **Positive**

Tax proposals are: excise duty on all man-made fibres decreased from 16 per cent to 8 per cent; excise duty on feedstocks viz PTA, DMT and MEG remain unchanged at 16 percent; Customs duty reduced from 15 percent to 10 percent for all made-made fibres and feedstocks. The reduction in excise duty would bring down the prices of polyester (as the benefit is expected to be passed on to customers), improving the competitiveness of polyester as against cotton and thereby increasing polyester demand. The drop in operating margins due to reduction in custom duties will be marginal. The overall impact on net profits will be positive due to higher demand.

Media and entertainment **Neutral**

The revamping of excise and customs duties on set-top boxes is expected to result in an increase of 4-5 per cent in their prices. The imposition of 12 per cent service tax on the sale of space or time for advertisements, other than in the print media, is expected to be marginally negative for television and radio broadcasters. In addition, all kinds of sponsorship services, except sports events, have been brought under the service tax net. This move is expected to adversely affect the live entertainment industry. The reduction of the fringe benefit tax with respect to tours and travel is marginally positive for broadcasting companies.

Non-ferrous metals **Neutral**

The customs duties on aluminium, copper and zinc have been reduced to 7.5 per cent from 10 per cent, while a 4 per cent special countervailing (CV) duty has been imposed. The impact of the CV duty stands neutralised, as credit for CV duty can be taken against payment of excise duties. Hence, the reduction in basic custom duty will reduce the effective landed costs.

Aluminium

The reduction in duty will result in lowering of effective import parity prices by around Rs 3,500 per tonne. However, domestic prices will not decline as the current prices will still remain significantly lower than the reduced import parity prices. The sector will benefit in the medium-to-long-term from the demand front, with the boost given to construction, auto and food processing industry.

Copper

The impact of the reduction in customs duty on copper has largely been neutralised on account of the reduction in customs duty on copper concentrates. While import prices of copper could reduce by around Rs 7,000 per tonne, the comparable gains from the reduction in duties on concentrates will keep the profitability of the sector intact.

Zinc

The customs duty cut will result in domestic prices being lower by around Rs 1,900 per tonne. Therefore, it will have a marginally negative impact on Hindustan Zinc.

Oil and gas **Neutral**

Upstream ***Negative***

The cess on crude oil production has been increased from Rs 1,800 per mt to Rs 2,500 per mt. This will have a negative impact on ONGC to the extent of Rs 18 billion, if the existing scheme of sharing of subsidy burden continues. ONGC will also be impacted by the increase in service tax rate, which was levied on survey and exploration activities in the oil and gas sector, from 10 per cent to 12 per cent. This will increase the exploration costs of other exploration and production companies.

Downstream ***Positive***

The accordance of declared goods status to LPG, resulting in a uniform rate of 4 per cent, will reduce the incidence of sales tax (which ranges from 12.5 per cent to 8 per cent across states). If the final price is left unchanged, this will result in subsidy burden reducing by around Rs 20.5 per cylinder (using Mumbai prices as reference). Thus, the impact on OMCs, IOC, HPCL and BPCL, will be positive (a reduction in subsidy under recovery by around Rs 10 billion on LPG sales as cooking fuel). This move will benefit even GAIL and ONGC indirectly as these companies have been shouldering one-third of the subsidy under recovery. The customs duty has been reduced on petcoke from 10 per cent to 5 per cent and naphtha (for polymers production) to nil from 5 per cent. This will have a negative impact on refining companies, as their realisations will get impacted. The customs duty on propane, butane and natural gas has also been brought down to 5 per cent. Importers of propane (such as IPCL) will benefit. The concessional project duty of 10 per cent has been extended to pipeline projects for natural gas, crude and petroleum products. This will be positive for the players (GAIL, GSPL, IOC and others) who are implementing pipeline projects.

Other infrastructure **Positive**

The Union Budget 2006-07 lays significant thrust on the overall development of infrastructure, especially rural infrastructure. This is evident from the following Budget announcements: 54 per cent hike in budgetary support to the Bharat Nirman Programme, amounting to Rs 186.96 billion; increase in outlays for rural irrigation and sanitation projects; and increase in the corpus of Rural Infrastructure Development Fund (RIDF XII) to Rs 100 billion. On the other hand, provision of grant for the Jawaharlal Nehru National Urban Renewal Mission is a positive step towards increasing investments in urban infrastructure. The plan allocation for the Department of Shipping has been increased by 37 per cent to Rs 7.35 billion, to facilitate investment in the National Maritime Development Programme.

Paints **Marginally positive**

The reduction in peak customs duty on inputs will increase the operating margins by about 40 basis points for manufacturers of decorative paints. While players who cater to the auto or industrial sector benefit more (by 100-140 basis points), due to higher import content of raw materials, they are also expected to pass on a significant portion of the benefit. The expected increase in demand for cars following the excise cut on small cars will have a moderately positive impact on demand for auto paints. The peak duty cut on paints will not affect the industry.

Paper **Marginally positive**

The paper industry will benefit from the reduction in excise duty from 16 per cent to 12 per cent. With healthy demand growth and higher operating rates, producers will be able to retain the benefit gained from the decline in excise duty, rather than pass it on, resulting in improved margins. The decline in the peak rate of custom duty from 15 per cent to 12.5 per cent will adversely affect higher-end coated paper manufacturers, as a fall in landed costs will result in increased imports and correspondingly exert pressure on domestic coated paper prices. However, the impact will be offset due to the imposition of a 4 per cent CVD on imports.

Petrochemicals: Basic and Polymers **Negative**

The customs duty on naphtha has been cut from 5 per cent to nil, while the duties on intermediates (styrene, EDC and VCM) and polymers have been decreased to 2 per cent and 5 per cent, respectively. An additional CVD of 4 per cent has been introduced on imports of the products. Thus, the changes in effective duty will be positive for IPCL and HPL, whereas it will be neutral for RIL (which uses its own naphtha, besides importing crude oil and exporting a substantial quantity of polymers). GAIL, which uses natural gas, will be negatively affected by the duty cut on polymers. For non-integrated producers (Chemplast and DCW), the impact will be negative, as the duty differential has fallen. However, the duty cut will provide marginal relief to downstream plastic processors (such as Cosmo Films, Supreme Industries and Jain Irrigation). Union Budget 2006-07 has laid emphasis on accelerating irrigation development. The government has increased the outlay from Rs 45 billion to Rs 71 billion under the Accelerated Irrigation Benefit Programme (AIBP). Meanwhile, 25 projects are expected to be completed before the end of the year. We expect that these measures will have a positive impact on the manufacturers of PVC pipes and fittings.

Petrochemicals: Downstream **Negative**

The customs duty on the downstream petrochemical products (carbon black, linear alkyl benzene, phthalic anhydride, maleic anhydride, phenol and acetone) has been reduced from 15 per cent to 12.5 per cent, and by 10 per cent on methanol and vinyl acetate monomer. However, the customs duty on the feedstock remains unchanged at 5 per cent. A special additional customs duty of 4 per cent has also been imposed. The effective duty protection has reduced and will have a negative impact on players. Margins of players like Thirumalai Chemicals, Tamilnadu Petroproducts, Hindustan Organic Chemicals Ltd and Schenectady Herdillia, Phillips Carbon Black Ltd and Vinyl Chemicals are expected to decline. The concession given to the export-oriented units (EoU) to sell in domestic markets after paying 3.1 per cent (25 per cent of basic customs duty), will provide relief to IG petrochemicals, which is an EOU.

The lower customs duty of 5 per cent for import of phenol and acetone for the production of bis-phenol will benefit Kesar Petroproducts, the only domestic producer of bis-phenol-A.

Pharmaceuticals **Neutral**

The overall impact on pharmaceuticals is neutral. The exemption of Fringe Benefit Tax (FBT) on medical samples to doctors is expected to marginally benefit the pharmaceutical players. The reduction in customs duty on certain life-saving drugs (10 anti-AIDS and 14 anti-cancer drugs) will marginally benefit MNCs.

Power **Marginally positive**

The budget did not have any major initiatives for the power sector. The only positives were the extension of the 80 IA tax exemption till 2010 for five ultra mega power projects, and increased thrust on non-conventional power projects (Rs 570 crore to be allotted in 2006-07) benefiting bagasse, bio-mass and wind-based projects. The government has decided to open coal reserves to the tune of 20 billion tonnes for power projects, to curb coal shortage, after reserving blocks for Coal India Ltd and its subsidiaries. Further, the government has proposed to amend the definition of captive consumption, to allow companies with captive coal mines to sell surplus coal to steel, power and cement companies through firm supply contracts. These proposals are expected to have a positive impact on the availability of coal for the power sector in the long term. The Minimum Alternate Tax (MAT) rate has been increased from 7.5 per cent to 10 per cent. As a result, companies paying tax under MAT, such as Reliance Energy and CESC, will be impacted negatively.

Readymade garments **Positive**

Excise on cotton-based garments at either 4 per cent or zero per cent and on non-cotton garments at either 8 per cent or zero per cent has been maintained. The government has allocated Rs 1.9 billion for promoting integrated textile parks which will provide better infrastructural facilities, including power, water, road and drainage system. The reduction in customs duty on fabrics from 15 per cent to 12.5 per cent would benefit garmenting units using imported fabrics. Enhancement of budget allocation from Rs 4.35 billion to Rs 5.35 billion for the TUF Scheme would benefit companies planning expansions.

Roads **Positive**

The Union Budget 2006-07 has provided a significant fillip to the roads sector, given its higher focus on infrastructure. The rise in allocations for the National Highway Development Programme (NHDP) from Rs 93.20 billion in 2005-06 to Rs 99.45 billion in 2006-07 will result in more funds for the programme. Besides the NHDP, budgetary allocations set aside for Rural Roads and for the Accelerated North East Road Development Programme will further help in improving the overall road connectivity. In addition, private participation will be further encouraged on account of the following measures:

- Announcement of six Access Controlled Expressways entailing a total length of 1,000 kms to be implemented on the Design, Build, Finance and Operate (DBFO) basis
- In-principal approval to provide loans to three road projects in Gujarat, by the special-purpose-vehicle (SPV)

- India Infrastructure Financing Company Limited - formed to provide funds for PPP (public private partnership) projects. The SPV has become operational, and thus, will encourage private participation in the roads sector.

Steel **Neutral**

Customs duty on alloy and stainless steel has reduced to 7.5 per cent from 10 per cent. At the same time, a special countervailing (CV) duty of 4 per cent has been imposed. The impact of this duty stands neutralised as the credit for the CV duty can be taken against the payment of excise duties. Hence, the net impact of reduction in basic customs duty will prevail on the import parity prices of the products. The reduction in duty will result in the lowering of effective import parity prices of stainless steel by around Rs 2,700 per tonne. This will have a marginal negative impact on the alloy steel industry as the import threat to the industry will be accentuated. Though customs duties on the various inputs to the steel industry (such as iron ore, ferro-alloys, refractories, and zinc) have been reduced, the cumulative impact of these measures will be marginal. Iron ore costs for the industry are not expected to come down as global contract prices are expected to increase in the near future, wiping out gains made from duty cuts. With the import duty on melting scrap raised from 0 to 5 per cent, input costs for players using the electric arc furnace (EAF) process and for players using imported melting scrap will increase. Sponge iron players may not benefit from the increased import parity prices of melting scrap (due to increased customs duty on melting scrap), because of the prevailing over-capacity situation in the industry. De-reserving coal blocks for power, cement and steel will ease coal shortages in the country over the medium to long term, and hence are a long-term positive factor for the steel sector.

Sugar **Neutral**

No impact on the sector.

Tea and Coffee **Neutral**

The allocation of Rs 1 billion towards the Special Purpose Tea Fund will have a positive but very marginal impact on the industry. The reduction in customs duty on packaging machinery will benefit branded tea players.

Telecom equipment (including telecom cables) **Neutral**

The Budget is not expected to have any major impact on the telecom equipment and cables sector.

Telecom services **Neutral**

The increase in service tax from 10.20 per cent to 12.24 per cent is viewed as marginally negative for the industry, as it would increase the cost of subscription. The imposition of service tax on internet telephony services is viewed as marginally negative for Sify Ltd. The budget also restated the government's emphasis on fostering the growth of telecom services in rural areas and e-governance.

Tractors **Neutral**

The government's continued thrust on the rural and agricultural sector, and on irrigation will continue to support tractor demand.

Two-wheelers **Neutral**

The reduction in peak customs duty on raw materials such as non-ferrous metals and alloy steel will have a marginally positive impact on OEMs. Reduction in customs duty on auto components will marginally reduce the input costs of two-wheeler manufacturers such as Hero Honda, HMSI and TVS Motor.

Tyres **Positive**

The reduction in peak customs duty on raw materials is expected to improve the operating margins of tyre manufacturers by about 50 bps. Import prices of tyres in the replacement market (which accounts for about 60 per cent of the industry) are expected to increase marginally due to the levy of 4 per cent CVD. However, this will not ease competition from imports, as the benefit is only marginal. The expected increase in demand for cars, on account of the cut in excise on small cars, has a positive but marginal impact, as demand from car OEMs accounts for only a small portion of tyre demand.