

Contents

Updates

ICICI Bank: ICICI Subsidiary valuation higher than expected, ICICI Bank to benefit

Economy: India's rising yield mystery: When even paper transactions bite!

News Roundup

Corporate

- Maruti Udyog Ltd. (MUL) has substantially increased discounts on several models ranging from Rs10,000 on entry level models to Rs35,000 on the higher end models. (BL)
- The Directorate General of Hydrocarbons (DGH) has stated that ONGC's gas reserves in UD-1 in the KG basin is 2.09 tcf of proven reserves, while that of Gujarat State Petronet Corporation (GSPC) is 1.38 tcf of proven reserves at the KG-OS well in block KG-OSN-2001/3. (FE)
- Tata Tea has sued Hindustan Unliver Ltd (HUL), over a patent the latter has acquired from the Indian government on the method of making instant tea from cold water. Tata Tea's contention being that the method of making tea has been known to Indians for centuries and is not an invention. (BS)

Economic and political

- Election for the next president of India will be held on July 19 and counting of votes will be held on July 21, as declared by the election commission. (BS)
- The Bombay Stock Exchange (BSE) has submitted a proposal to the Forward Markets Commission (FMC) to purchase a stake in the National Multi-Commodity Exchange, for the regulators approval. (BL)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

India	Change, %			
	13-Jun	1-day	1-mo	3-mo
Sensex	14,003	(0.9)	0.3	11.8
Nifty	4,113	(1.0)	(0.5)	13.0
Global/Regional indices				
Dow Jones	13,482	1.4	1.0	11.1
Nasdaq Composite	2,582	1.3	1.4	8.9
FTSE	6,560	0.6	0.1	9.3
Nikkie	17,838	0.6	0.9	7.0
Hang Seng	20,579	(0.3)	(1.9)	9.2
KOSPI	1,746	1.4	8.8	24.1
Value traded - India				
		Moving avg, Rs bn		
	13-Jun	1-mo	3-mo	
Cash (NSE+BSE)	121.9	144.2	128.3	
Derivatives (NSE)	340.1	387.0	274.3	
Deri. open interest	662.1	534.5	564.3	

Forex/money market

	Change, basis points			
	13-Jun	1-day	1-mo	3-mo
Rs/US\$	41.0	-	18	(321)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.3	-	17	33

Net investment (US\$m)

	12-Jun	MTD	CYTD
FIs	129	(17)	3,930
MFs	(83)	(78)	(179)

Top movers -3mo basis

Best performers	Change, %			
	13-Jun	1-day	1-mo	3-mo
Balaji Telefilms	207	(3.2)	11.8	84.0
Reliance Cap	970	0.6	19.3	60.0
GESCO	291	1.0	11.6	47.4
Moser Baer	426	(0.7)	12.6	41.8
SBI	1,289	(3.2)	6.9	36.1

Worst performers

Bajaj Auto	2,098	(0.3)	(21.4)	(17.0)
Tata Motors	646	0.7	(9.6)	(13.3)
United Phos	278	1.2	(4.3)	(10.6)
Cipla	208	0.1	(1.3)	(9.7)
Maruti Udyog	720	0.1	(10.4)	(8.9)

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Banking**ICBK.BO, Rs913**

Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,000
52W High -Low (Rs)	1007 - 442
Market Cap (Rs bn)	820.7

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	135.6	172.4	220.4
Net Profit (Rs bn)	31.1	35.7	48.0
EPS (Rs)	34.6	39.7	53.4
EPS gth	5.6	14.9	34.4
P/E (x)	26.4	23.0	17.1
P/B (x)	3.4	3.1	2.7
Div yield (%)	0.9	1.0	1.3

Shareholding, March 2007

	% of		Over/(under)
	Pattern	Portfolio	weight
Promoters	-	-	-
FIs	71.5	9.2	6.5
MFs	4.4	3.5	0.8
UTI	-	-	(2.7)
LIC	7.8	5.5	2.8

ICICI Bank: ICICI subsidiary valuation higher than expected, ICICI Bank to benefit

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- **ICICI Bank has received firm commitments from investors for investing Rs26.5 bn for a 5.9% stake in ICICI Financial Services (formerly ICICI Holdings)**
- **Value ascribed by investors for the subsidiary is higher than our expectations**
- **Retain IL rating on the stock with a price target of Rs1,000.**

ICICI Bank has informed the stock exchanges that it has received firm commitments from investors for investing Rs26.5 bn for a 5.9% stake in ICICI Financial Services (formerly ICICI Holdings). Based on this valuation this subsidiary of ICICI Bank will be valued at Rs449 bn (close to US\$11 bn) and will house four subsidiaries - ICICI Prudential Life Insurance Company Limited (74% stake held by ICICI Bank), ICICI Lombard General Insurance Limited (74% stake held by ICICI Bank), Prudential ICICI Asset Management Company Limited (51% stake held by ICICI Bank) and Prudential ICICI Trust Limited (51% stake held by ICICI Bank). The deal is subject to ICICI Bank receiving the necessary regulatory approvals. The value ascribed by investors for these subsidiaries is significantly higher than our current estimate of US\$7 bn for these subsidiaries. We find these valuations stretched and are using a 20% discount for arriving at our fair value estimate of ICICI Bank. In Exhibit 1, we provide a valuation of ICICI Bank with a 20% discount as well as ascribing full value to ICICI Bank stake in ICICI Financial Services (i.e. use the value assigned by investors to ICICI Financial Services). We believe that post the US\$5 bn of equity issuance ICICI Bank (standalone) valuations would fall further to around 1.6X PBR FY2008 from 2.1X PBR FY2008 (pre-issue). While we also expect ICICI Bank RoE post the issuance to fall to around 12%, we believe the market will likely assign a higher PBR multiple to ICICI Bank stock given its strong brand, franchise and potential to gain market share in a growing economy. Hence, our current fair value estimate of ICICI Bank of Rs1,000 likely carries an upside risk.

Exhibit 1: ICICI Bank pre-issue SOTP (Rs/share)

	ICICI Share (%)	Based on FY2009E (previous estimates)	Ascribing full value to ICICI Bank stake in ICICI Financials (US\$10.3 bn)	Ascribing 20% discount to ICICI Bank stake in ICICI Financials (US\$8.2 bn)	Valuation methodology adopted
Value of ICICI standalone	100	570	570	570	Based on Residual growth model
Subsidiaries					
ICICI Financial Services		316	470	376	
ICICI Prudential Life	74	250			Appraisal value analysis = Embedded value + 18X NBAP FY2009
General Insurance	74	46			PBR of 6X FY2007 BVPS
Mutual Fund	51	20			6% of AUM value in FY2009 of Rs575
Venture capital/MF	100	24	24	24	15% of AUM FY2009E of US\$2.6bn
ICICI Securities	100	23	23	23	PBR of 4.5X FY2006 BVPS
ICICI One Source	25	13	13	13	3X FY2008E revenues
NCDEX	8	1	1	1	Valued at US\$300 mn based on last transaction
ARCIL	29.7	2	2	2	Based on value assigned by IDFC at Rs7.15bn
NSE	6.5	8	8	8	Based on value assigned by recent divestment
Value of subsidiaries		387	542	448	
Value of company		957	1,111	1,017	

Source: Kotak Institutional Equities estimates.

Exhibit 2: ICICI Bank post-issue SOTP (Rs/share)

	ICICI Share (%)	Based on FY2009E (previous estimates)	Ascribing full value to ICICI Bank stake in ICICI Financials (US\$10.3 bn)	Ascribing 20% discount to ICICI Bank stake in ICICI Financials (US\$8.2 bn)	Valuation methodology adopted
Value of ICICI standalone	100	587	587	587	Based on Residual growth model
Subsidiaries					
ICICI Financial Services		249	371	297	
ICICI Prudential Life	74	197			Appraisal value analysis = Embedded value + 18X NBAP FY2009
General Insurance	74	36			6x FY2007 BVPS
Mutual Fund	51	15			6% of AUM 2009
Venture capital/MF	100	19	19	19	US\$2.2 bn of funds in 2008 US\$2.6bn in 2009 valued at 10%
ICICI Securities	100	18	18	18	For 2008 - PBR of 4x FY2006 BVPS and for 2009 - 10% growth in value
ICICI One Source	25	9	9	9	3X FY2008E revenues
NCDEX	8	1	1	1	Valued at US\$300mn based on last transaction
ARCIL	29.7	2	2	2	Based on value assigned by IDFC at Rs7.15bn
NSE	6.5	6	6	6	Based on value assigned by recent divestment
Value of subsidiaries		303	425	351	
Value of company		890	1,012	938	

Note: Assumes the equity issuance of US\$5 bn will be made at Rs850 per share.

Source: Kotak Institutional Equities estimates.

Exhibit 3: Forecasts and valuation pre equity issuance of US\$ 5bn, March fiscal year-ends,2005-2010E (Rs mn)

March y/e	Profit after tax (Rsmn)	EPS (Rs)	P/E (x)	BVPS (Rs)	P/B (x)	RoA (%)	RoE (%)	EPS excl treasury & dividend (Rs)	P/E ICICI Bank Standalone (X)	BVPS (adjt for subsidiaries) (Rs)	P/B ICICI Bank standalone (X)
2005	20,052	27.2	33.8	170.3	5.4	1.4	19.5	17.3	27.3	142.3	3.3
2006	25,401	32.8	28.0	249.6	3.7	1.2	14.6	21.2	22.3	217.4	2.2
2007	31,102	34.6	26.6	270.4	3.4	1.0	13.4	18.1	26.1	213.3	2.2
2008E	35,732	39.7	23.1	299.0	3.1	0.9	14.0	29.6	15.9	229.9	2.1
2009E	48,012	53.4	17.2	338.1	2.7	1.0	16.8	43.9	10.7	260.3	1.8
2010E	60,457	67.2	13.7	387.2	2.4	1.1	18.5	59.5	7.9	309.5	1.5

Share price	919
Value of ICICI Financials (our estimate, 20% discount to valuations based on current deal)	448
ICICI Bank Standalone	471

Source: Bloomberg, Company, Kotak institutional Equities estimates.

Exhibit 4: Forecasts and valuation post equity issuance of US\$ 5bn, March fiscal year-ends,2005-2010E (Rs mn)

March y/e	Profit after tax (Rsmn)	EPS (Rs)	P/E (x)	BVPS (Rs)	P/B (x)	RoA (%)	RoE (%)	EPS excl treasury & dividend (Rs)	P/E ICICI Bank Standalone (X)	BVPS (adjt for subsidiaries) (Rs)	P/B ICICI Bank standalone (X)
2005	20,052	27.2	33.8	170.3	5.4	1.4	19.5	24.6	23.1	142.3	4.0
2006	25,401	32.8	28.0	249.6	3.7	1.2	14.6	22.5	25.3	217.4	2.6
2007	31,102	34.6	26.6	270.4	3.4	1.0	13.4	19.9	28.6	213.3	2.7
2008E	42,822	37.6	24.5	420.0	2.2	1.1	11.9	30.6	18.6	365.6	1.6
2009E	61,561	54.0	17.0	459.5	2.0	1.3	12.3	47.6	11.9	398.2	1.4
2010E	74,643	65.5	14.0	507.4	1.8	1.3	13.5	59.9	9.5	446.1	1.3

Share price	919
Value of ICICI Financials (our estimate, 20% discount to valuations based on current deal)	351
ICICI Bank Standalone	568

Note: Assumes the equity issuance of US\$5 bn will be made at Rs850 per share.

Source: Bloomberg, Company, Kotak institutional Equities estimates.

Exhibit 5: Impact of divestment in ICICI Holding on valuations of ICICI Bank standalone**ICICI Bank valuations pre-issue**

	(Rs)	2008E	2009E	2008E	2009E
		P/B standalone		P/E standalone	
		(X)		(X)	
ICICI Bank current price	919				
ICICI Bank price adjusted for subsidiaries value					
Ascribing full value to ICICI Bank stake in ICICI Financials	377	1.6	1.4	12.7	8.6
Ascribing 80% value to ICICI Bank stake in ICICI Financials	471	2.1	1.8	15.9	10.7

ICICI Bank valuations post equity issuance of US\$5 bn by parent company

	(Rs)	2008E	2009E	2008E	2009E
		P/B standalone		P/E standalone	
		(X)		(X)	
ICICI Bank current price	919				
ICICI Bank price adjusted for subsidiaries value					
Ascribing full value to ICICI Bank stake in ICICI Financials	494	1.4	1.2	16.1	10.4
Ascribing 80% value to ICICI Bank stake in ICICI Financials	568	1.6	1.4	18.6	11.9

Source: Bloomberg, Company, Kotak Institutional Equities estimates.

Economy

Sector coverage view

N/A

India's rising yield mystery: When even paper transactions bite!

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- **Indian 10-year hits 8.3%; expect remission to 8.1%; 7.75% by March 2008E**
- **Why did yields spike? SBI stock sale from RBI to government routed via market**
- **Why should it reverse? RBI repatriation of profits**
- **PSU bank stocks? Continue to like valuations, interest rate regime switch**

We expect the present spike in 10-year yields to reverse to our short-term 8.1% target. It is a measure of the growing communication gap between monetary policy and gilt markets that an innocuous paper transaction such as the SBI stock transfer from the RBI's books to the government's books can result in a 15-20 bp spike in yields at a time inflation is receding. We had earlier expected this to be effected through an off-market transaction. The government instead, it now appears, is borrowing from the markets to pay the RBI for the SBI stock, sucking out liquidity and pushing up yields. The RBI will reportedly refund the money—reportedly Rs400 bn/ US\$10 bn—to the government—there is, of course, no official communication in the best spirit of transparency—as an extraordinary dividend when it closes its books as at end-June 2007. Once it actually receives the money in August, the government, so the story runs, will pay back the market—either by retiring Treasury Bills or cancelling auctions—easing liquidity and yields. This backs our house call favoring PSU bank stocks by our banking analysts, Tabassum Inamdar and Ramnath Venkateswaran, on favorable valuations. Although there could be temporary volatility on account of a spike in yields, especially during advance tax flows ahead, we believe that our basic hypothesis of a PSU bank-friendly regime switch to stable yields and rising lending rates from rising yields and cheap lending rates still holds good.

Why is the government buying out the RBI's SBI stake? Effective supervision. The government proposes to buy out the RBI's 59.7% stake in the State Bank of India (and in the National Bank of Agriculture and Rural Development) by June 2007. This will remove the anomaly of the central bank and banking supervisor also owning a majority stake in the country's largest commercial bank. This presumably assumes that the government will amend the SBI Act by ordinance to enable a transfer of ownership from the RBI to itself.

- The government has reportedly valued the RBI's SBI stock at Rs404 bn (US\$10 bn) at Rs1,300 a share. The SBI holding is currently valued at Rs.12.2 bn in the RBI's books.
- We had originally expected the RBI to revalue the SBI stock in its books to augment reserves to strengthen its balance sheet which is expanding rapidly because of higher cash reserve requirements and the Market Stabilization Scheme. The RBI's capital adequacy ratio has already slipped below its own 12% of assets target. In return for the SBI stock, we had also expected the government to provide the RBI gilts for sterilization operations. It now appears that this kind of 'private placement' could be precluded by the Fiscal Responsibility and Budget Management Act, 2003.
- This means that the transaction will now be in cash. Apart from establishing an arm's length between the supervisor and the supervised, the transaction set will achieve little material purpose since neither will the RBI's reserves be augmented nor will there be an addition to the RBI's sterilization tools.
- Matters are complicated by the fact that the government has slipped into a seasonal deficit in contrast to the position of a large surplus at the time the SBI stake share deal was conceived a few months ago. We would have thought that the transaction – essentially an accounting matter – could have been effected by a simple temporary liquidity-neutral grant of ways and means advance from the RBI to the government. The decision to fund the deal through the market implies that a paper transaction has an unnecessary liquidity impact.

A walk through the SBI stake transfer to the government from the RBI

- Step 1: RBI will revalue the SBI stock (currently at Rs12.2 bn) to Rs404 bn. This will inflate the RBI's credit to banks (Exhibit 1).
- Step 2: The revaluation will likely be parked in the RBI's contingency reserve. This will correspondingly increase the RBI's net non-monetary liabilities (net worth). There will thus be no impact on reserve money or liquidity.
- Step 3: The Government now says that it is borrowing from the market to pay the RBI (Exhibit 2). This will transfer funds from banks' deposits with the RBI to the Government's deposits with the RBI. This will contract reserve money/ liquidity (as is now the case).
- Step 4: The RBI will then transfer the SBI stock to the Government. The Government, in turn, will transfer Rs404 to some SBI-share-sale account in the RBI's net non-monetary liabilities (Exhibit 3).
- Step 5: The depletion of Government deposits at the RBI will then increase net RBI credit to Government and this will offset the decline in the RBI's credit to banks. This transaction will thus be liquidity neutral.
- Step 6: The RBI will run down the Contingency Reserve on the transfer of shares in favor of the SBI-share-sale account. This transaction set too will also be liquidity neutral since the transactions do not impact the RBI's net non-monetary liabilities in the net.
- Step 7: The RBI, it is rumored, will transfer the SBI share sale money to the government on its balance sheet date of June 30, 2007. The actual transfer will be effected in mid-August 2007 after due clearance by the RBI's board.
- Step 8: Funds will thus move back from the RBI's SBI share sale account to the Government deposits account (Exhibit 4). This transaction set will also be reserve money neutral.
- Step 9: The Government will then run down its surplus to pay off banks by either retirement of T-Bills or cancellation of auctions (Exhibit 5).
- Step 10: Funds will move back from the RBI's government deposits account to banks' deposits with the RBI. This will enlarge reserve money, reversing the earlier contraction of liquidity in Step 3. The transaction set will thus be liquidity-neutral over time.

Exhibit 1: The RBI will likely revalue the SBI stock in its books

Liabilities	Assets	
L.1. Currency in circulation	A.1. Net RBI credit to Government (a-b)	
L.2. Bank deposits with the RBI	a. Ways and means advances (WMA)	
L.3. Other deposits with the RBI	b. Government deposits	
	A.2 RBI credit to banks/commercial sector	392
	SBI stake	392
	A.3 RBI's net foreign assets	
	A.4 Government's currency liabilities to the Public	
	A.5 RBI's net non-monetary liabilities	392
	Contingency reserve	392
	SBI share sale account	
Reserve money (L.1+L.2+L.3)	Reserve money (A.1+A.2+A.3+A.4-A.5)	0

Exhibit 2: Government borrowing to fund the SBI sale contracts liquidity, pushes up

Liabilities	Assets	
L.1. Currency in circulation	A.1. Net RBI credit to Government (a-b)	-404
L.2. Bank deposits with the RBI	a. Ways and means advances (WMA)	
L.3. Other deposits with the RBI	b. Government deposits	404
	A.2 RBI credit to banks/commercial sector	
	SBI stake	
	A.3 RBI's net foreign assets	
	A.4 Government's currency liabilities to the Public	
	A.5 RBI's net non-monetary liabilities	
	Contingency reserve	
	Government account	
Reserve money (L.1+L.2+L.3)	-404 Reserve money (A.1+A.2+A.3+A.4-A.5)	-404

Exhibit 3: Paper transactions transfer the SBI stock to the government from the RBI

Liabilities	Assets	
L.1. Currency in circulation	A.1. Net RBI credit to Government (a-b)	404
L.2. Bank deposits with the RBI	a. Ways and means advances (WMA)	
L.3. Other deposits with the RBI	b. Government deposits	-404
	A.2 RBI credit to banks/commercial sector	-404
	SBI stake	-404
	A.3 RBI's net foreign assets	
	A.4 Government's currency liabilities to the Public	
	A.5 RBI's net non-monetary liabilities	
	Contingency reserve	-404
	SBI share sale account	404
Reserve money (L.1+L.2+L.3)	Reserve money (A.1+A.2+A.3+A.4-A.5)	

Exhibit 4: The RBI could transfer the SBI sale proceeds to the government as profit

Liabilities	Assets	
L.1. Currency in circulation	A.1. Net RBI credit to Government (a-b)	-404
L.2. Bank deposits with the RBI	a. Ways and means advances (WMA)	
L.3. Other deposits with the RBI	b. Government deposits	404
	A.2 RBI credit to banks/commercial sector	
	SBI stake	
	A.3 RBI's net foreign assets	
	A.4 Government's currency liabilities to the Public	
	A.5 RBI's net non-monetary liabilities	
	Contingency reserve	
	SBI share sale account	-404
Reserve money (L.1+L.2+L.3)	Reserve money (A.1+A.2+A.3+A.4-A.5)	

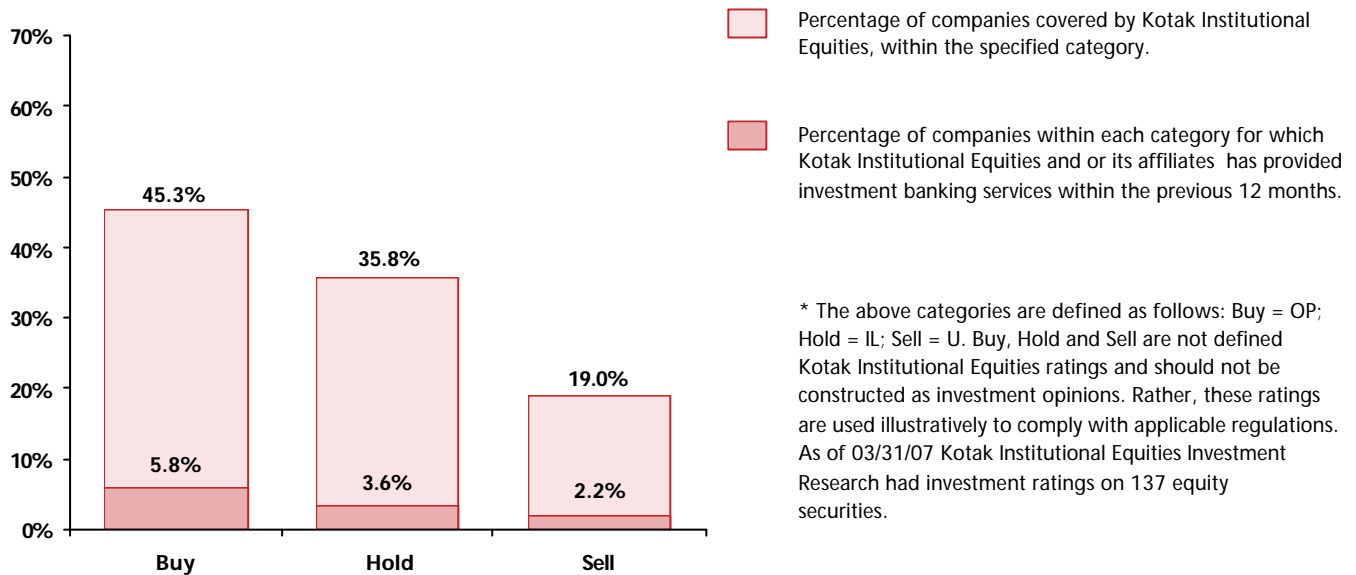
Exhibit 5: The government will now restore market liquidity by running down the

Liabilities		Assets	
L.1. Currency in circulation		A.1. Net RBI credit to Government (a-b)	404
L.2. Bank deposits with the RBI	404	a. Ways and means advances (WMA)	
L.3. Other deposits with the RBI		b. Government deposits	-404
		A.2 RBI credit to banks/commercial sector	
		SBI stake	
		A.3 RBI's net foreign assets	
		A.4 Government's currency liabilities to the Public	
		A.5 RBI's net non-monetary liabilities	
		Contingency reserve	
		SBI share sale account	
Reserve money (L.1+L.2+L.3)	404	Reserve money (A.1+A.2+A.3+A.4-A.5)	404

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Source: Kotak Institutional Equities.

As of March 31, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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Our target price are also on 12-month horizon basis.

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