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FOR PRIVATE CIRCULATION

PRE-BUDGET ANALYSIS

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Pre-Budget Note - February 2008

Focus on sustained, balanced growth.

The Indian economy has been one of the best-performing economies globally in CY07. The Government of India and the Reserve Bank of India (RBI) have been able to mitigate the threat of rising inflation and inflationary expectations through several fiscal and monetary measures. While this has resulted in a moderation of GDP growth rate, the economy is still expected to clock a healthy 8.7% growth in FY08 (source: CSO advance estimates). However, recent weaknesses in other developed economies, internationally, have added an element of uncertainty.

To that extent, we opine that the priorities have changed from reducing the inflation rate in the previous Budget to sustaining a high GDP growth rate in the current Budget. Needless to say, these twin issues will remain high on the priority list of the Finance Minister, as he gives final touches to the Budget document. Along with these, increased allocations for a balanced and inclusive growth will be important for him in his last full Budget before the general elections in 2009. We also note that Assembly elections are scheduled across 10 states over the next few months.

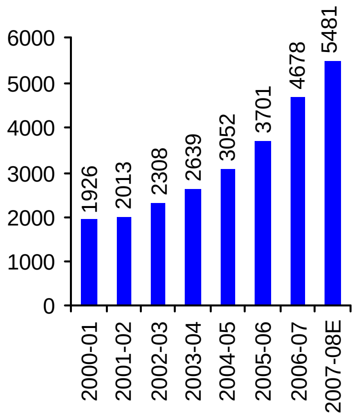
We expect the focus of the Budget to be on sustaining high growth and promoting inclusive growth, while continuing its focus on inflation control. We also expect further initiatives on tax reforms and fiscal discipline.

In our opinion, the Budget will seek to promote inclusive growth through continued focus on social initiatives like employment, education, agriculture, rural upliftment and public health. Initiatives on agriculture also normally help in easing supply side constraints and sustaining the GDP growth rate.

Continued focus on investments is expected to be a cornerstone of the Budget as the Government seeks to sustain high GDP growth rates in FY09 and beyond. Infrastructure (roads, highways, airports, ports, power, etc) is expected to receive continued attention as bottlenecks here can hamper future growth.

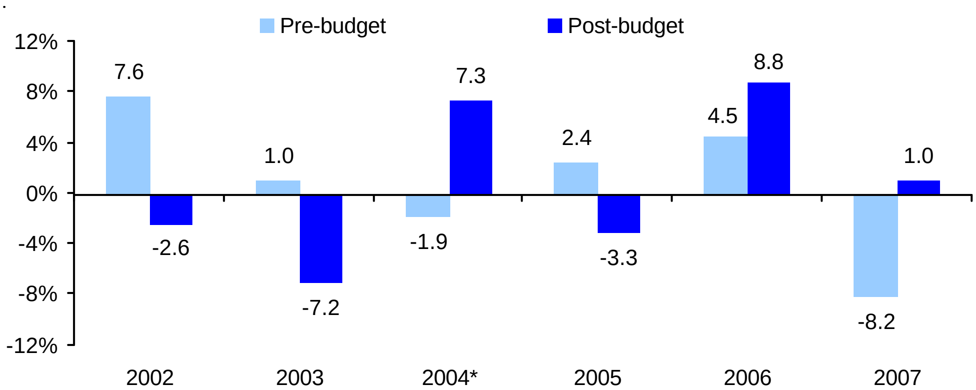
With inflation again inching up over the past few weeks, further measures to restrict inflation are also expected to be announced in the Budget. These can be in the form of removing supply side bottlenecks for commodities and encouraging more imports (except in agricultural commodities) through duty rationalization. Control on fiscal deficit indirectly helps in containing inflation.

Revenue receipts (Rs bn)



Source: Economic Survey

Sensex movement - one month before and after Budget



*Source: Bloomberg; Note: * indicates 2004 budget was presented on 8th July*

With buoyant direct tax collections (up 40% in April 2007-January 2008 period), we expect some relief for smaller taxpayers in the Budget. An increase in the basic exemption limit, enhancing deductions from total income (through infrastructure bonds), etc can be considered by the Finance Minister. While the former should ensure better and higher compliance, the latter is expected to bring in more funds for infrastructure development.

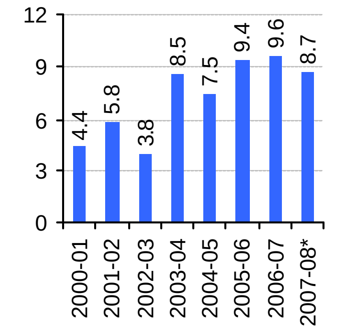
We opine that the Government will strive to adhere to the FRBM targets. We will watch out for this parameter in the backdrop of expected increase in allocations to social issues, likely implementation of the sixth pay commission and tax benefits. While buoyant tax receipts and strict check on non-plan expenditure may continue to help in FY09, we expect some burden on the stock markets in the form of higher STT and also a widening of the service tax net.

For stock markets, we do not expect any major negative surprise (apart from the expected STT increase). We will be surprised in case there is a change in capital gains tax rates. Thus, we believe the focus of the markets will be more on fiscal discipline and on sectors, which are positively impacted by Budget proposals.

We believe the Budget may have positive implications for Auto, Banking, Capital goods, Construction, Fertilizers, FMCG, Healthcare, Hotels, Logistics, Metals & Mining, Power and Retail sectors.

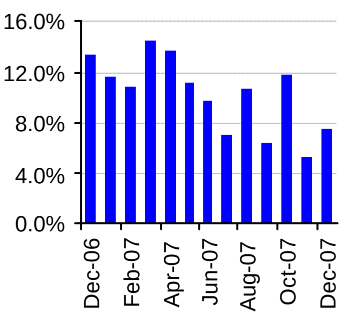
Focus on sustaining GDP growth...

GDP growth (%)



Source : CSO
** CSO advance estimates*

IIP growth (%)



Source : MOSPI

India's GDP growth has averaged about 8.8% over the past four years. This has been made possible by continued investments over these years, ably supported by growing consumption.

FY08 has seen a moderation in the growth rate though it is expected to be a healthy 8.7% v/s 9.6% in FY07. The GDP growth in H1FY08 had averaged 9.1% v/s 9.9% in the corresponding previous half. More importantly, the IIP growth rate in the past few months has moderated. The growth in bank credit is also at about 22% v/s 28% in FY07. This is partly due to the higher base and the conscious decision of the Government to reign in inflation, which had reached 6.75% towards the end of FY07. The recent weakness in global economies has added an element of uncertainty to the prospects of sustained high growth rates in the future.

We expect the Budget to contain measures which will facilitate sustenance of healthy GDP growth rates. We note that the target GDP growth rate for the Eleventh Five Year Plan is 9%. Towards this, continued measures for the power, roads, highways, ports and other infrastructure are expected. The fund requirement for this purpose is put at more than $450 bn (Rs.18 trn) over the 2007-12 Five Year Plan. Of these, the estimated requirement in the transport infrastructure segment alone is over Rs.6 trn comprising railways (Rs.2.5 trn), roads (Rs.3 trn), ports (Rs.740 bn) and airports (Rs.350 bn).

The Government has till now awarded three ultra mega power projects (UMPPs). On the other hand, India Infrastructure Finance Co Ltd, a wholly-owned Indian Government enterprise is likely to receive $250 mn from RBI (Forex reserves) by end of February 08 only for infrastructure import requirements.

While the intent is there, the implementation needs to further speed up. We expect measures towards this end. Conferring the status of a priority sector to the power industry may lead to significant financing from banks and attract more investments from the private sector. Also, looking at the potential delays in UMPPs, extension of tax benefits for UMPPs coming on stream post 2010 is expected. Currently, tax benefits under section 80IA are available only to UMPPs starting power generation by 2010.

The approach paper for the Eleventh Plan period has hinted at a need for another green revolution for sprucing up agricultural growth. A restructuring of agricultural policies is required to make another Green revolution possible. We expect the Government to spell out plans for improving the agricultural growth rate.

...AND PROMOTING EQUITABLE GROWTH

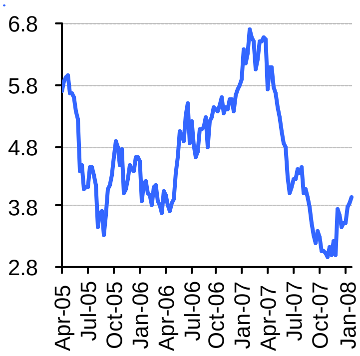
This Budget will be the last full Budget by the Government before the 2009 General Elections. Assembly elections are also expected to be held in about 10 states over the next few months.

In this backdrop, we expect greater focus and allocations to several social initiatives like rural upliftment, employment, education, agricultural growth and public health. Initiatives on agriculture also help in easing supply side constraints and sustaining the GDP growth rate. There is a growing concern regarding job losses in labor-intensive export-oriented industries like textiles, rubber, jewelry, leather, IT, etc.

According to reports, the implementation of various programs under schemes like Sarva Shiksha Abhiyan, National Rural Employment Guarantee Scheme, Rajiv Gandhi Vidyutikaran Yojana, etc needs to gain momentum. We expect measures to provide further impetus to these schemes.

We do not expect any major changes in the subsidy scheme for various commodities. However, we believe tax-incentives to promote investments in fertilizers will be announced, to increase domestic capacity additions. Also, the sector may witness attempts at import-parity pricing for efficient manufacturers, operating at high utilization rates.

Inflation (%)



Source: Bloomberg

PAUSE INFLATION

In the previous Budget, the Finance Minister had announced measures to ease supply-side bottle-necks in primary commodities. These related to higher production and productivity in these commodities.

During FY08, the inflation rate had come down to near 3% levels. In recent weeks, it has risen to 4.11%. We expect further long term measures to increase production of foodgrains, mainly pulses and oilseeds, of which India is a major importer.

We also expect changes in customs and excise duties with a view to moderate prices of various commodities and their raw materials (except agricultural commodities). Specifically, inputs for steel have seen significant price hikes in international markets and changes in the duty structure can lighten the load on non-integrated steel manufacturers.

Reducing the fiscal deficit in line with the targets set by Fiscal Responsibility and Budget Management Act (FRBM) can indirectly help in inflation control.

FISCAL PRUDENCE

We expect P Chidambaram to strive for fiscal prudence and follow the targets set by the FRBM Act. Under FRBM, the fiscal deficit is proposed to be brought down by 0.30% and the revenue deficit by 0.50% every year. The original targets for FY08 were 3% and Nil for fiscal deficit and revenue deficit, respectively.

We expect the Government to strive for fiscal prudence through higher tax collections and lower allocations for non-plan expenditure. We expect some increase in the coverage of service tax and also some increase in STT - measures directed at improving tax collections.

We will watch this measure closely in the backdrop of the expected rise in spending for social initiatives, likely implementation of the sixth pay commission and other tax incentives. We believe any major deviation from FRBM targets may be viewed negatively from the reforms perspective.

TAX REFORMS TO CONTINUE

We expect the Budget to continue with the process of tax reforms.

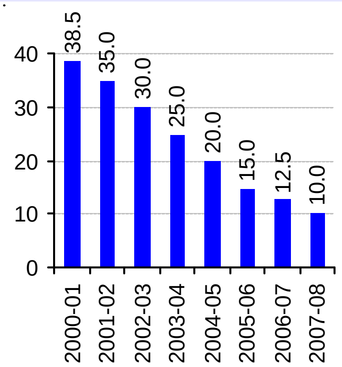
Tax collection

(Rs bn)	(Apr 07-Jan 08)	(Apr 06-Jan 07)	Growth (%)
Direct Tax	**2185.38**	**1555.76**	**40.5**
Corporate Tax	1338.51	973.15	37.5
Income Tax (including FBT, STT & BCTT)	843.49	579.90	45.5
STT	67.93	36.58	85.7
FBT	51.61	39.48	30.7
BCTT	4.60	4.01	14.7

(Rs bn)	(Apr 07-Dec 07)	(Apr 06-Dec 06)	Growth (%)
Indirect Taxes			
Custom	744.55	636.55	17.0
Excise	754.85	718.16	5.1
Service Tax*	331.73	242.25	36.9

*Source: Ministry of Finance, CGA; * Including wealth tax*

Peak customs duty (%)



Source: Bloomberg

Indirect taxes

In the previous Budget, the peak import duty was brought down to 10%.

The Government is committed to bringing down import duties to Asean levels. In addition to this, currently there is an overriding concern of rising inflation. On the other hand, adequate protection is needed for several emerging/weaker sectors. Moreover, the Finance minister also has to consider the revenue implications. The slowing global growth can impact India's GDP growth, going ahead and consequently tax collections also. Taking into account these factors, we expect moderation in import duties with continued protection to few sectors.

The Finance Minister has already indicated that diverse rates of excise duty on various goods are expected to converge at the Cenvat rate of 16%. We expect further steps in this direction. Growth in excise duty collections in the first nine months of FY08 has been about 5.1%, which is lower than the target growth of about 11% for the fiscal. Thus, there may not be significant reduction in excise duty rates.

We also expect the CST rate to be further reduced from 3% levels, in line with the process started in the previous Budget.

The contribution of service tax to overall tax revenues of the Government is lower when compared to the fact that services account for more than 50% of the GDP. For 9MFY08, collections from service tax were up about 37% YoY v/s a targeted rise of 32% for FY08. We believe the Finance Minister will bring in more services under the tax net to increase the contribution of services to tax revenues.

Direct taxes

Direct taxes have been the high point of FY08, with collections having grown by 40% in the first 10 months against the fiscal target growth of 17%. The Government's initiatives for bringing in more people under the tax net have paid dividends with an increase in the number of taxpayers. The rising income levels of Indians have also resulted in more taxpayers.

In the backdrop of a strong growth in tax collections, we expect some relief to smaller taxpayers in the form of a higher exemption limit. Investments in long-term savings instruments may be encouraged with specifically directed tax exemptions. We do not expect any reduction in the surcharge as it is not levied on smaller tax payers.

There have been representations from the industry about the fringe benefit tax (FBT). We believe the Budget will continue with the FBT while making an attempt to further exempt genuine business expenditure from the tax net. We also expect some reduction in dividend distribution tax (DDT).

Stock markets

For the stock markets, we do not expect any major negative surprise (apart from the expected STT increase). We will be surprised in case there is a change in capital gains tax rates and surcharge. Thus, we believe the focus of the markets will be more on fiscal discipline and on sectors which are positively impacted by Budget proposals.

Any significant divergence from the FRBM Act may be viewed negatively, especially by foreign investors.

Sectoral implications

We expect the Budget's focus to be on sustained balanced growth, while addressing inclusive growth through measures and allocations towards social initiatives. We also believe tax reforms and fiscal discipline will continue to be addressed.

We expect the following sectors to be positively impacted by the Budget:

Auto, Banking, Capital goods, Construction, Fertilizers, FMCG, Healthcare, Hotels, Logistics, Metals & Mining, Power and Retail.

We expect the Budget to be largely neutral for the following sectors:

Cement, Information Technology, Media and NBFCs.

Sectorwise expectation

AUTOMOBILES

EXPECTED BUDGET IMPACT: Positive

Current view

- The auto industry is facing a pressure on growth rates because of the higher interest rates. Two-wheeler have witnessed negative growth in past few months.
- The margins are also under pressure due to increasing raw material prices.
- In this scenario, changes in excise duties can give the much needed relief to the industry

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Excise duty applicable for cars.	■ Expects uniform duty rates of 16% for all cars- large and small. Currently, small cars are levied 16% excise duty whereas all other cars and SUV's are levied 24%.	■ Likely	■ Government may address this duty disparity. Lower excise duty sop for small cars has helped India become a small car/ engine hub, evident in case of investments committed by Maruti, Hyundai and recently Fiat.	■ Positive, if industry expectations met.
Excise duty applicable for two wheelers	■ Expecting a cut in duty on two wheelers from 16% to 12% or 8%.	■ Likely	■ Industry has faced headwinds of high interest rates and slowing sales momentum. ■ To further promote domestic industry and growth given India's emergence as second largest two-wheeler market in the world after China.	■ Positive, if industry expectations met.
R&D deductions for auto component makers.	■ Extension of deductions to auto component makers who source it from abroad for use in India.	■ Status quo to be maintained.	■ Government has made clear its intention to gradually do away with deductions, across industries.	■ Neutral
Import duty rates	■ Expects import duty rates to remain at 10%.	■ Likely	■ Cheap imports from China, post last year's cut in import duties are a concern. Also, an appreciating rupee offers not much reason to further cut import duties.	■ Neutral

Source: Kotak Securities - Private Client Research, SIAM

Top picks

Company	Price (Rs)	EPS (Rs)		PE (x)		Recommendation
		FY08E	FY09E	FY08E	FY09E	
NOT UNDER ACTIVE COVERAGE						

BANKING

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- The moderating credit growth (22-23% YoY) and a relatively higher deposit growth would make RBI comfortable. The headline inflation has also moderated in the last couple of months. We believe the interest rates have almost peaked and are likely to move southward from the next quarter purely due to demand and supply factors. Even though RBI has not given any signal by cutting benchmark rates, banks are expected to start reducing rates in due course of time. This is also evident from recent moves by many banks like SBI, Canara Bank, Allahabad Bank and Bank of India.

  In a falling interest rate environment, financial sector benefits on two fronts - 1) The demand for credit increases with the fall in the interest rate. 2) The liability of the banks get re-priced at a relatively lower rate vis-à-vis its asset side. Therefore, banks see their cost of funds falling faster than their yield on funds, leading to increase in the margin.

- Steps like exemption of interest income coming from saving deposits, or restoration of tax exemption on interest income up to Rs.15,000 under section 80L, or reduction in the lock-in period for savings under section 80C from the current stipulated five years would increase the attractiveness of term deposits and bring it at par with other investment instruments.

- Spurt in asset growth coupled with the expected introduction of Basel-II norms is squeezing capital for the industry. There is also a growing asset-liability mismatch in the industry as banks are focusing on short-term demand deposits to meet their long-term asset growth creation.

- In a competitive scenario, PSU banks are facing problem of trained specialists. On the other hand, automation has made many jobs quite redundant. If the Government allows another round of VRS and permits banks to recruit specialists, it would be beneficial for the banks.

- There is a great appetite for bank stocks in the system. However, FII/FDI limits are acting against it. We would rate a relaxation in this limit as a positive. However, we do not expect FII/FDI limit in PSU banks to be hiked in this Budget from the current cap of 20%. We also do not expect any relaxation in voting rights (Cap 10%) in private banks.

- Last, but not the least, consolidation in the industry has so far only been restricted to roundtables. Now is the time to act on it, as duplication of IT infrastructure, manpower and capital is becoming prohibitively costly.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Relaxation in the lock-in period for savings to qualify for tax benefits (Under section 80C)	Reduce from five year lock-in period to three years.	Likely	Increase the attractiveness of term deposits and make it at par with other investment instruments	Positive as this would help the banks in correcting the asset-liability mismatch.
Increase in ceiling for TDS on fixed deposits	Increase the ceiling from Rs.5000 to Rs.10,000	Likely	Increase the relative attractiveness of deposits.	Positive in facilitating the growth of deposits
Tax exemption on Infrastructure financing	Reintroduce Section 10 (23G) of Income Tax Act, 1961	Likely	Increase attractiveness for lending to infrastructure sector.	Positive, it will reduce the effective tax rate depending on the exposure to this sector.
Increase in FII/FDI limit in PSU Banks	Increase the limit from 20% to 49%	Status quo likely to be maintained	Will attract higher FII/FDI in PSU banks which are starving for quality capital	Positive as this will help banks in raising capital for funding their growth and meeting the Basel-II requirement

Banking (contd...)

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Rightsizing of Manpower	■ Allowing another round of VRS and more powers to attract suitable talent	■ Status quo likely to be maintained	■ In a competitive arena the need of specialists to be fulfilled.	■ Positive as this would help getting world class product and services at competitive rates

Source: Kotak Securities - Private Client Research, Indian Banking Association

Top picks

Company	Price (Rs)	P/E (x)		P/ABV (x)		Recommendation
		FY08E	FY09E	FY08E	FY09E	
Axis Bank	995	34.2	25.8	4.1	3.6	BUY
HDFC Bank	1539	32.8	25.2	5.0	4.6	BUY
ICICI Bank	1162	28.5	24.9	2.9	2.6	BUY
IOB	176	7.9	6.7	2.1	1.7	BUY
J&K Bank	694	8.7	7.1	1.6	1.4	BUY
PNB	620	9.2	7.7	1.9	1.6	BUY

Source: Kotak Securities - Private Client Research

Capital Goods

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- In the power sector, India expects to add a capacity of 80,000 MW by 2012 and provide power for all. To attain this ambitious target, the Government had outlined a proposal for nine ultra mega power projects (each project having a capacity of 4,000 MW or more). Till date, only two of these UMPPs have taken off.
- In addition, there is an acute shortfall of power equipment and also skilled manpower. However, the Union Power Ministry is positive that the power sector's target capacity addition of 80,000 MW could be reached in the Eleventh Five Year Plan. So far, orders have been placed for 56,000 MW, while the remaining is slated to be completed by March 2008.
- Investments in key industrial sectors are expected to soar to Rs.6924 bn over the next five years as compared with Rs.2274 bn worth of investments made over the past five years. Over the next five years, growth in investments will be driven by strong capacity additions, led by healthy growth in demand and high existing operating rates across some of the key industries.
- Electrical equipment companies have grown at a rapid pace in the last three years. However, going by the order inflows of engineering companies in Q3FY08, we expect the growth to moderate from current levels.
- **Reduction in excise duties on power equipment:** Currently, while there is zero customs duty on mega power projects and 5% customs duty on non-mega size projects, excise duty continues to stay at 16%. Project developers are demanding reduction in excise duty to 8%, which is intended to translate into lower operational cost for consumers.
- **Reduction in excise duty on energy efficient ACs:** With a view to promote energy conservation, it is expected that the Government may reduce excise duty from 16% to 8% for ACs meeting Bureau of Energy Efficiency (BEE) standards. This should benefit consumer durables manufacturers like Voltas and Blue Star.
- **Maintain status quo on customs duty:** Continuation of peak customs duty as 10% appreciation in the rupee has already made imports cheaper in the past twelve months.
- With spiraling of fuel prices, there is an urgent need to support and incentivize energy production through renewable and non-conventional sources of energy like biomass, rice husk and wind power. We expect this to have a positive impact on Thermax (sells boilers for various non-conventional feedstock).
- With an eye on channelizing domestic savings into the power sector, the Finance Ministry is considering granting income tax exemptions for individual investments up to Rs.50,000 in power infrastructure bonds. It is also considering issuing Vidyut Vikas Patras as a small saving instrument to mobilize savings to meet the envisaged funding gap of Rs.4506.5 bn for the sector during 2007-12. If implemented, these measures should catalyze greater flows into power sector. Key beneficiaries include ABB, Siemens, Areva T&D, Easun Reyrolle, Indotech Transformers, Emco, Bharat Bijlee, Crompton Greaves, Bhel and Suzlon.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Customs duty on project imports	Maintain status quo at 7.5% duty	Unlikely.	With a view to promote infrastructure investment, the govt may further like to bring down cost of capital goods	Marginally negative
Excise Duty on ACs	To be reduced from 16% to 8% on ACs meeting energy efficiency guideline	Likely	Govt remains committed to promoting energy efficient devices	Positive
Excise Duty Duty on power equipment	May be reduced from 16% to 8%	Likely	Govt's focus on bringing down cost of power	Positive

Source: Kotak Securities - Private Client Research, CII, IEEMA

Capital Goods (contd...)

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
BHEL	2,232	61.0	87.0	36.6	25.7	BUY
Areva T&D	1,820	46.0	64.0	39.6	28.4	BUY
Suzlon Energy	338	9.0	15.0	37.6	22.5	BUY
Voltamp Transformer	1,421	82.0	106.0	17.3	13.4	BUY
Cummins India	331	15.1	18.4	21.9	18.0	BUY
L&T	3,507	97.0	129.8	36.2	27.0	HOLD
Blue Star	474	18.3	24.5	25.9	19.3	BUY
Hindustan Dorr Oliver	134	6.3	9.7	21.3	13.8	BUY
AIA Engineering	1,497	66.4	98.1	22.5	15.3	BUY
EKC (FV2)	296	10.5	15.4	28.2	19.2	BUY
Nitin Fire Protection	465	20.1	41.0	23.1	11.3	BUY
Numeric Power	662	77.1	94.2	8.6	7.0	BUY

Source: Kotak Securities - Private Client Research

CEMENT

EXPECTED BUDGET IMPACT: Neutral

SECTOR OUTLOOK: Negative

Current view

- The Union Budget 2008-09 is expected to be neutral for the cement industry. Industry has witnesed a lot of issues such as removal of import duty, CVD, SAD, price freeze demands coupled with higher excise duties in FY08. The Government is continuously using measures to enhance the cement supply in domestic markets to check rising prices.
- However, cement prices have moved up significantly since the last Budget due to demand supply mismatch. But, correspondingly, power and fuel cost and other expenses of the companies have also increased. Thus, higher cement prices could not result in proportionate increase in the profitabilities of the companies.
- Though we expect cement prices to rise till Q2FY09, higher supplies are expected to restrict further increase in cement prices. On the other hand, we expect the costs to increase thereby impacting margins negatively.
- Thus, we maintain our negative view on the sector due to upcoming supplies as well as rising cost pressures.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Abatement on excise duty	35% abatement on excise duty as against no abatement allowed currently	Status quo maintained	Indirect tax collections may be impacted negatively	Neutral. However, if it happens, it would be positive for cement manufacturers and benefits can be passed on to end users
Excise duty	Reduction in excise duty from three slab structure currently- Rs.350 per ton (for cement priced up to Rs.190 per bag); Rs. 600 per ton (for cement priced above Rs. 250 per bag) and ad valorem duty of 12% on MRP between Rs.190 to Rs.250	Status quo maintained	Indirect tax collections may be impacted negatively	Neutral. However, if it happens, it would be positive for cement manufacturers and benefits can be passed on to end users
Import duty on coal and pet coke	Abolish import duty on coal and pet coke as against 5% currently	Expected to be abolished	Enhance the efficiencies of the cement companies	Result in saving the power costs for the companies
Re-imposing CVD and SAD on cement imports	Re-imposing 12% CVD and 4% SAD on cement imports as against NIL currently	Status quo maintained	Feasibility of imported cement and increasing the supply of cement	No impact

Source: Kotak Securities - Private Client Research, Companies, CMA, DIPP

Stock recommendations

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
ACC*	754	76.6	73.6	9.8	10.2	REDUCE
Ultratech cement	867	81.1	89.2	10.7	9.7	REDUCE
India Cements	206	26.9	28.4	7.7	7.3	HOLD
Shree Cements	1220	122.2	144.9	10.0	8.4	REDUCE

*Source: Kotak Securities - Private Client Research; *ACC year ending is Dec, EPS corresponds to CY07 and CY08 EPS*

Construction

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- We expect Union Budget 2008-09 to be positive for the infrastructure sector with higher budgetary allocations in different segments such as roads, irrigation, ports, airports, power etc. With infrastructure development requiring around $492 bn in the next five years, we expect companies with significant experience in executing projects in key segments to benefit significantly.
- We are positive on the construction sector given the robust order books, de-risked business models, improvement in margins and diversification across geographies. Adequate net worth and significant investment in capex in the past few months have enabled companies to bid for large sized projects in different segments.
- Key beneficiaries from higher order inflows are expected to be Punj Lloyd, IVRCL, Nagarjuna Constructions, Patel Engineering, Era Constructions and Unity Infraprojects.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Roads	Simplification of policy and regulatory framework for faster implementation;Increasing VGF cap for supporting non-viable projects;Higher budgetary allocation.	Increase the limit; simplify procedures for implementation; higher allocation in budget	Increased order flows and private participation will enhance modernisation and upgrading of highways	Positive for players having adequate experience and networth to bid for large size projects
Irrigation	Faster environmental clearances; Higher fund allocation through Accelerated Irrigation Benefit Programme	Increased fund allocation	Result in increasing levels of irrigation	Positive for players having expertise in irrigation and water projects
Real estate	Simplification of income tax structure; lowering of FDI below 50,000 sq meters	Lowering of FDI below 50,000 sq meters	Result in making housing affordable to common man	Positive for real estate developers as well as common man
SEZ	Lifting of the cap on SEZ size which is presently 5000 hectares; Continuation of tax sops	Status quo maintained	SEZ's generate employment opportunity, Huge investments from players have happened on account of tax sops.	Positive for large players who had planned mega multi product SEZs

Source: Kotak Securities - Private Client Research, Companies, Plan documents

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Punj Lloyd	366	11.2	19.0	32.7	19.3	BUY
IVRCL	415	14.3	19.3	29.0	21.5	BUY
Unity Infraprojects	716	47.0	57.4	15.2	12.5	BUY
Sunil Hi tech	275	13.5	24.0	20.4	11.5	BUY

Source: Kotak Securities - Private Client Research

FERTILIZER

EXPECTED BUDGET IMPACT: Positive

Current view

- Agriculture has been a thrust area for the Government with programs like 'Bharat Nirman' and the accelerated irrigation program that entail significant additions in farm land required to be irrigated. This provides a positive macro backdrop for the fertilizer sector. The industry, though, has grappled for long with issues like regulated pricing, an increasing disparity between costs of production and selling, which are to be compensated through irregular subsidy disbursals by the Government.
- Delayed payments or suspension of payment of subsidies due to inadequate Budget allocations has caused a severe cash crunch for the industry and impeded fresh investments in the domestic industry; resulting in higher dependence on imports and a rising subsidy bill for the Government. The fertilizer subsidy bill is expected to touch Rs.450 bn from Rs.224.5 bn at the start of the financial year.
- While increasing farm-gate prices seem unlikely given its political inconvenience, industry is looking at a mixture of below mentioned measures to incentivize fresh domestic capacity additions in the industry. Fresh capacity additions by domestic players will not only cater to extant demand but will also help the Government to manage the growing subsidy burden more effectively, in our opinion.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Promoting capacity additions, in domestic industry	■ Withdrawal of customs duty on fertilizer project imports including projects for expansion, revamp etc. and the spares used. ■ Benefit of tax holiday for a period of 15 years should be extended to all future fertilizer projects. ■ Allocating gas to fertilizer sector on a priority basis at reasonable prices, and rationalizing pricing of inputs like naphtha, fuel oil/LSHS etc. which are sold at prices unrelated to cost or export parity. ■ Capital subsidy scheme for conversion of FO/ LSHS based urea plants to gas under the policy for Stage III of the NPS to be announced.	■ Promoting domestic industry to add fresh capacities is a possible option Government has had to manage a growing subsidy bill. ■ Industry has had number of demands to this effect, which have not passed the Government's muster, yet. ■ Given the growing magnitude of the fertilizer subsidy and the state of domestic players, Government has reason to look at a mixture of attached industry demands more favorably.	■ Introduction of such measures will be helpful in attracting investment in general and the private sector in particular. ■ Fresh domestic capacity additions, non-existent since 1997 will help in reducing dependence on costly imports in addition to helping productive growth in the agriculture sector. ■ The subsidy on urea is heavily dependant on the availability and prices of hydrocarbons; such measures could help reducing the burden of subsidy for the Government.	■ Positive.
Input tax credits	■ Input tax credit should be allowed for excise duty paid on the inputs used for manufacture of intermediate products like ammonia, when these products are sold and not used in the production of finished urea, which is exempted from the excise duty.	■ Likely	■ Would help in reducing cost of urea production and also the Government's subsidy burden.	■ Positive.

Fertilizer (contd...)

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Customs Duty	■ Reduction/removal of duties currently levied on inputs like LNG. ■ Reduction in duty on sulfuric acid to 5% from 7.5%.	■ Likely	■ Would help in reducing cost of urea production and also the Government's subsidy burden. ■ Would bring it on par with other raw materials/intermediates like ammonia, rock phosphate and sulfur etc.	■ Positive.
GST	■ Basic raw materials (feed/fuel) like natural gas, LNG, naphtha, fuel oil, LSHS etc. should not be subjected to ■ Higher rates of central GST, when used for fertilizer manufacture.	■ Likely	■ Would help in reducing cost of urea production and also the Government's subsidy burden.	■ Positive.

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
NOT UNDER ACTIVE COVERAGE						

FMCG

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- India continues to remain a domestic consumption driven economy. To some extent, this insulates the Indian economy from global shocks in the form of a possible US recession or a financial credit crunch gripping other developed economies. Last year, the FMCG sector grew to Rs.750 bn at 10-15%, backed by growth in urban markets and a surge in demand for premium products.
- Cost pressures have resulted in price hikes during the last year. This underscored the strength of different brands in various categories. Some relief on the tax front is high on the Government agenda to maintain demand buoyancy and keep consumption strong.
- The FY08-09 Budget will be the final budget to be presented before the General elections. Pro-rural policies are expected to be a thrust area for the Government, which will drive the demand for consumer goods in rural India.
- There are indications that the Sixth Pay Commission, expected to be passed this year, will recommend salary hike of over 3x. This will put more purchasing power in the hands of the 4 mn strong central government work force and induce households to upgrade to premium brands in personal care and non-durable consumer goods.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Excise Duty	Relief on existing 16% excise on soaps & detergents	Unlikely	Most manufacturing relocated to tax-free zones	No significant impact
Central Sales Tax (CST)	Hoping for a complete exemption	To reduce from 3% to 2%	To boost consumption and demand buoyancy	Positive for the food processing
Service tax on lease rentals	Removing the 12.36% service tax or allowing set off against sales tax	Status quo maintained	Government may want to continue mopping up taxes from high growth sectors such as retail.	Neutral for FMCG companies entering retail ventures
Dividend Distribution Tax (DDT)	Reduction in Dividend Distribution Tax	Marginal reduction	No significant hike in revenues due to higher rates last year	None; Positive for shareholders FMCG high dividend paying entities
Value-Added Tax (VAT)	Rationalization across the food processing industry	To reduce from 12.5% to 4% on some items	Only biscuits, cigarettes and pan masala have 12.5% VAT; wheat and milk prices have moved up significantly	Positive for biscuits manufacturer

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Marico Ltd.	64	2.8	3.7	23.3	17.4	BUY
Colgate Palmolive (India) Ltd.	370	17.6	21	21.0	17.6	BUY

Source: Kotak Securities - Private Client Research

Food Processing

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- India has tremendous potential for development of the food processing industry. This is primarily due to the changing preferences towards healthy lifestyles, increase in disposable incomes, break-up of joint families into nuclear families, double income families and robust growth in organized retail. All this is leading to increased demand for processed food items in India.
- We also expect the growth in rural demand to be the major growth trigger for processed food items in India.
- India is the second largest producer of fresh fruits and vegetables. However, more than 35% of it is wasted due to lack of cold storage and proper warehousing facilities.
- Going forward, we expect some investments in cold storage in India that would open up tremendous opportunities for exports of processed fresh fruits and vegetables.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Excise duty	To reduce excise duty from 16% to 0%	Some reduction in excise duty on processed food products	Reduction in excise duty could lead to growth in consumption of processed and packaged foods.	Positive
Customs duty on high technology food processing machinery	To reduce peak customs duty to 5%	Some reduction in customs duty for sophisticated food processing machinery	Reduction in customs duty would lead to import of high tech food processing machinery, which would lead to growth of the overall food processing industry.	Positive
EOU export benefits	Eliminate the payment of duty as in the case of SEZ	Status quo to be maintained	To encourage setting up of more SEZ	No impact
Tax incentives	Tax incentives for R&D in food processing industry	Some tax concessions to be announced	Tax concession on R&D would help the companies to invest in R&D and evolve new standards and practices in food processing	Positive

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Gujarat Ambuja Exports (Face Value Rs.2)	60	6.5	8.5	9.2	7.1	HOLD
Riddhi Siddhi Gluco Biols	248	22.8	48.2	10.9	5.1	BUY

Source: Kotak Securities - Private Client Research

HEALTHCARE

EXPECTED BUDGET IMPACT: Positive

Current view

- For the coming Budget, the healthcare sector hopes the annual poll for incentivizing research and development will be heard. The sector is also hoping for tax benefits in order to enhance healthcare service/delivery. We expect that large and established healthcare providers/chains will benefit most from Budget proposals. Significant medical needs of the Indian population provide huge potential for Indian healthcare service/ delivery sector. The Finance Minister may provide a boost to the sector's prospects by qualitative measures like, infrastructure status, increasing health spending allocation and providing incentives for the sector to grow.

- Healthcare has emerged as one of the largest service sectors in India. Strong economic growth, along with increasing per-capita income, growing healthcare awareness and expanding insurance coverage is creating a new and continuously expanding group of consumers. These are key growth drivers for the Indian healthcare markets. In 2004, national healthcare spending equaled 5.2% of GDP, or about US$34.9 bn. We expect domestic healthcare spend to scale up to about 5.5% of GDP, or US$60 bn by FY10. In our estimates, we have assumed 12% growth, which is in line with real GDP growth of 8% plus inflation.

- We believe the sector will need enormous investment over the next five years (approximately US$5 bn for bed additions). Medical tourism appears to have high potential though it is still difficult to quantify. We believe key beneficiaries of this would be large corporate hospital chains like Apollo, Fortis, Max healthcare and Wockhardt hospitals.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Infrastructure status for hospitals	■ Healthcare sector should be given infrastructure status at par with other infrastructure industries.	■ Expect with certain eligibility norms	■ Huge spending planned on new hospitals & research centres	■ Lower tax outgo ■ Easy availability and softening of interest rates on loans
Automatic route for dollar based loans i.e. ECB/FCCB	■ Automatic route for dollar based loans for hospital funding including land funding	■ Expect with certain eligibility norms	■ To fund planned capex for new hospitals	■ Lower cost of fund
Mergers & Amalgamation (Section 72A of Income Tax Act)	■ Tax shelters on mergers & amalgamation	■ Certain conditions may be relaxed	■ To make the amalgamation viable and to facilitate effective re-organisation	■ Positive
Separate license for health insurance	■ Separate license for health insurance and promoting healthcare players to get into health insurance	■ Expect with certain eligibility norms	■ 80% of healthcare cost is out-of-pocket ■ Need for significant growth of health insurance network	■ Positive

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs)		PE (x)		Recommendation
		FY08E	FY09E	FY08E	FY09E	
NOT UNDER ACTIVE COVERAGE						

HOTELS

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- We expect the companies in the hotel sector - which has a huge assets base and big expansion plans over the next few years - to benefit from the Budget proposals. The industry has demanded infrastructure status for the hotel industry to be extended to all categories of hotels across India. This would spur the required investment in the sector. Furthermore, industry has demanded an increase in depreciation rates and relaxation in FBT, service tax and conditions for merger and amalgamation to get the full benefits from reorganization.
- **Outlook remains positive from medium-term perspective:** The tourism sector in India is making a major contribution in the growth of the national economy. For the fourth consecutive year in 2006, the sector has recorded double-digit growth in the number of foreign tourist arrivals and foreign exchange earnings.

  The hotel Industry in India is on a dream run with steadily rising occupancy rates and average room rates (ARRs) due to increased tourist inflows and business travelers witnessed over the past four to five years. This has resulted in demand for rooms outstripping supply. We expect this scenario to continue for the next three to four years benefiting the overall hotel industry in India in the medium-term. Factors like medical tourism and increased sports and business activities are contributing to the growth of the hotel industry

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Infrastructure status for Hotel Industry (Section 80 IA of Income Tax Act)	■ Hotel industry should be brought on par with the other infrastructure industries. ■ To be extended to all categories of hotels across the country	■ Status quo maintained	■ Government may not view hotel industry at par with infrastructure sectors like airport, seaports, power projects etc	■ No direct impact
Amalgamation & Mergers (Section 72A of Income Tax Act)	■ Relaxation from fulfillment of certain conditions	■ Certain conditions might be relexed	■ To make the amalgamation viable and to facilitate effective re-organisation	■ Positive
Depreciation on Hotel Buildings	■ Depreciation on hotel building should be restored to 20% from current 10%	■ 20% rate of depreciation to be restored.	■ Hotel buildings constitute Plants for the hotel indsutry and it has to make heavy investments in renovation and upgradation	■ Positive, lower tax outgo
Service tax on services received outside India (i.e. Commission paid to Foreign Travel Agents)	■ Hotels should be expempted from paying service tax on services received from Foreign Tour Operators	■ Hotels may be expempted from service tax on outside services	■ Hotel Industry is one of the prime foreign exchange earners and is recognised as a service export industry.	■ Positive

Source: Kotak Securities - Private Client Research, HAI

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Indian Hotels	130	6.2	7.3	20.9	17.9	BUY
Hotel Leela	49	3.9	4.1	12.7	11.8	BUY

Source: Kotak Securities - Private Client Research

INFORMATION TECHNOLOGY

EXPECTED BUDGET IMPACT: Neutral

SECTOR OUTLOOK: Positive

Current view

- The IT/BPO services industry is expected to achieve 25% growth in FY08 to about $50 bn. Of these, exports are expected to grow by more than 26% to nearly $40 bn.
- The sector has been facing significant challenges in FY08. Over the past three quarters, the challenge has been in the form of an appreciating rupee. The rupee has appreciated by about 10% in FY08, posing challenges for the sector and more so, for smaller companies. Since Q3FY08, the economic growth in the US has been slowing with an increasing probability of a recession. In case there is a prolonged recession in the US, the volume growth for Indian IT services/BPO sector can be impacted.
- In this backdrop, the Budget is expected to focus on maintaining an environment conducive to the future growth of this largely export-oriented industry. The sector has asked for an extension in the tax holiday (under section 10A/10B of the Income Tax Act, 1961) beyond FY10. We believe this may not come through because of the revenue implications for the Center.
- We expect the focus on the Budget to be on enabling issues like promoting higher technical education (so as to meet the potential demand for employees from the sector), promoting better infrastructure facilities in Tier-II cities and other related issues.
- There are the abovementioned challenges, which the sector will have to face in the near term. While the rupee is expected to appreciate against the US dollar, we expect the appreciation to be gradual. Also, we believe a recession in the US, if it happens, will not be a prolonged one.
- With these assumptions and at the current low valuations, we remain bullish on the sector. However, we prefer the large cap stocks and only selected mid-caps. Large companies, we feel, will be in a better position to minimize the impact of these challenges. Also, focused smaller companies with expertise on select verticals will be able to move up the value chain and attract larger clients, thereby improving their longer-term prospects.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Tax exemption U/S 10A/ 10B	■ Extention of Tax exemption beyond FY10	■ Status quo maintained	■ Future revenue implications for the government	■ No direct impact
Facility under Large tax - payer scheme	■ Companies with atleast Rs.100mn advance - tax are eligible ■ Industry wants this limit relaxed	■ Will relax the limit	■ Expected to lead to faster tax collection and better compliance	■ Marginally positive
Fringe benefit tax (Software services cos)	■ Genuine business expenditure be exempted	■ Some business expenditure may be made exempt	■ Taxation of some genuine expenditure currently ■ Industry facing headwinds	■ Marginally positive impact
Fringe benefit tax (BPOs)	■ Deemed fringe benefit at higher levels v/s IT services companies - should be treated at par	■ BPO units may be brought at par with IT services units	■ Ensure parity with S/W services companies ■ Industry facing headwinds and needs to be encouraged	■ Positive for BPO companies

Source: Kotak Securities - Private Client Research, Nasscom, Industry

Information Technology (contd...)

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Infosys	1,547	79.6	93.2	19.4	16.6	BUY
Satyam	438	25.8	30.7	17.0	14.2	BUY
TCS	874	52.1	60.9	16.8	14.4	BUY
Infotech Enterprises	255	15.6	19.7	16.5	13.0	BUY
KPIT	80	7.6	9.8	10.5	8.2	BUY

Source: Kotak Securities - Private Client Research

LOGISTICS

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- India is fast emerging as a global manufacturing hub with strong infrastructure growth.
- Organized retail is growing at a rapid pace throughout the country.
- Growing export import trade is leading to more transportation of containers through rail and road.
- Express cargo consisting of both documents and parcels is also growing at an aggressive pace.
- Indian companies are now accepting outsourcing of logistics functions to specialized players.
- Organized cold chain logistics is also on a robust growth path.
- All the above developments are leading to robust demand for logistics services. Thus, we feel that logistics will be one of the fastest growing businesses, going forward.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Tax concessions for M&A	To be extended to private airlines	Would be allowed	Recently such concessions were given for the merger of state owned Air India and Indian Airlines	Positive
Sales Tax on ATF	To be reduce form 30% in some states to 4%	Status quo to be maintained	Future revenue implications	No impact
Customs duty on ATF	To be reduced from 10% to 5%	Status quo to be maintained	Future revenue implications	No impact
Rationalization of taxes	From various taxes from state to state to common tax across the country	Status quo to be maintained	Future revenue implications	No impact
Infrastructure related to roads and ports	Some more initiatives to be taken for faster development of the roads and ports	Some firm steps for better infrastructure related to ports and roads	Efficient infrastructure is the key to the growth of the logistics industry as it facilitates faster and smoother transportation of goods across the country.	Positive
Dedicated rail freight corridor	Fixed schedule for implementation to set up rail freight corridor	Some firm steps for implementation	The new freight corridor can have speed that is at-least double then the current average goods train speed, which would reduce the overall requirement of wagons and locomotives thereby resulting in minimizing logistics and transportation costs. A dedicated rail freight corridor can boost the trade activities as the transit time will come down considerably between two cities and thus will lead more transportation of goods and services giving additional business to the logistics service providers.	Positive

Logistics (contd...)

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Incentives for Warehouses	Some form of incentives for building vertical modern warehouses	Some tax incentives	Vertical modern warehouses would save land and also will help to avoid creation of cluster of go downs	Positive
Customs duty on import of cold chain equipments	To be reduced form peak customs duty to 5%	Customs duty would be reduced on hi tech cold chain equipments	Lower customs duty would help the companies to import hi tech cold chain equipment that would in turn help to grow the organised retail and perishable products market.	Positive

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Allcargo (December end)	696	35.4	52.6	19.7	13.2	BUY
CONCOR	1,717	120.1	145.1	14.3	11.8	BUY
Gateway Distriparks	111	7.4	10.5	15.0	10.6	BUY
GATI (FV Rs.2) - June end	114	4.6	6.7	24.8	17.0	HOLD
Redington	362	15.8	22.4	22.9	16.2	BUY
TCI (FV Rs.2)	110	3.6	7	30.6	15.7	BUY

Source: Kotak Securities - Private Client Research

MEDIA

EXPECTED BUDGET IMPACT: Neutral

SECTOR OUTLOOK: Positive

Current view

- We expect the Budget to have a neutral impact on the prospects of the media sector as a whole, and companies operating within it. A thrust on promoting domestic production of set top boxes, which will aid the acceptance of distribution platforms like DTH/CAS could be expected from the budget. These, in our opinion, will eventually lead to greater transparency in subscriber reporting and possibly higher entertainment tax revenues for the Government.

- From a longer-term perspective, we believe that on the back of greater spending power, growing consumerism - offshoots of the healthy economic growth being projected - consumer discretionary sectors like media and entertainment will continue to enjoy healthy growth prospects. India's evolving demographics, with a high proportion in the income earning age, is expected to support consumption growth. Our top picks within the sector would be PVR, ENIL, UTV Software and Balaji Telefilms.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Service Tax: Broadcasters are subject to levy of service tax@12.24% unlike print media that is exempt from the levy of service tax.	■ Broadcasters expect parity to be drawn between the print and electronic medium.	■ Status quo will be maintained	■ Classification for print in terms of industry status- (not considered a rendered service) is different.	■ Neutral. Positive for broadcasters, negative for print companies if there is any revision.
Service tax, on lease rentals	■ Multiplex operators along with the retail industry expect removal of the 12.36% service tax or allow a set off against sales tax.	■ Status quo will be maintained	■ Government may want to continue mopping up taxes from high growth sectors like retail. Also with expected favorable tinkering in rates of personal income tax, aimed at driving consumption spends, Government may leave tax rates unchanged for consumption based sectors.	■ Neutral.
Customs duty	■ Digital exhibition equipment to be made 'nil' duty items.	■ Likely	■ To act as a facilitator in growth of digital exhibition segment. ■ Growth of this format could reduce revenue losses incurred due to piracy and boost Government's tax collections.	■ Positive.
Excise Duty: 16% levied on equipment like set top boxes	■ To be made 'nil' duty items.	■ Likely	■ To bring broadcasting equipment like set top boxes on par with rates applicable on telecom equipment and provide a fillip to platforms like DTH that use set top boxes. ■ To encourage domestic production of set top boxes.	■ Positive.

Source: Kotak Securities - Private Client Research, Companies

Media (contd...)

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
ENIL	418	-	15.0	-	29.3	BUY
PVR	246	8.9	17.4	27.6	14.1	BUY
UTV	789	25.0	36.0	31.6	21.9	BUY
Balaji Telefilms	217	13.0	16.2	16.7	13.4	BUY

Source: Kotak Securities - Private Client Research

METALS & MINING

EXPECTED BUDGET IMPACT:
Marginally Positive

SECTOR OUTLOOK:
Selectively Positive

Current view

- Indian steel consumption is growing at a record rate of 12.6%. This is almost twice the 6.6% growth in supply (April-December 2007 period).
- India will turn net importer of steel for the first time in a decade as Indian steelmakers are struggling with greenfield expansions, primarily due to problems in mine allocations and land acquisition.
- We expect steel product prices to rise sharply(>15%) during the year. However, unlike in the past, it would not boost the net profits of most of the Indian steel companies as the price rise is mainly driven by sustained raw material cost pressures.
- The environment is extremely positive for companies engaged in key raw materials of steel like coking coal, ferroalloy ores and iron ore. These companies are price takers and dependant of international product prices. They stand to gain immensely as we expect significant rise in annual contract prices, which should be settled in the next two months.
- Coal is fast emerging as a scare commodity (majority of new power projects would be coal-based). There has been sharp surge in coal prices globally driven by a massive fall in inventory levels and emerging supply constraints.
- India has iron-ore as the primary competitive advantage for the Indian steel industry. Given the cost pressures witnessed across key raw materials, the need to enhance the value of iron-ore reserves seems to be the present thinking of the Government.
- Ferroalloys and aluminum prices would stay firm during the year given that both are power intensive sectors. Coal shortage would limit their production in the key nations of China and South Africa.

Steel - Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Excise duty cut	Cut in excise duty from present 16% to 8% on finished steel products	Likely for long steel products	Long products, which are used in construction activities, facing maximum raw material cost pressures, in turn resulting in higher price jumps.	Positive
Reducing financing cost	Removing restrictions on external commercial borrowing	Unlikely	Overall restrictions on external commercial borrowing, unlikely to be lifted	No impact
Remove double taxation	Remove taxation of dividends received from overseas subsidiaries.	Unlikely	-	No Impact
Scrapping of custom duty	Scrap 5% custom duty on import of coke and refractories	Likely	Necessary as Indian steel industry is unable to cope up with the humungous jump in coke prices, which is a critical raw materal and Indian steel industry is import dependant at large.	Positive
Scrapping of custum duty	Scrap 5% custom duty on import of scrap	Likely	Necessary as Indian steel industry is unable to cope up with the humungous jump in scrap prices, which is a critical raw materal for long products and India is net importer	Positive

Source: Kotak Securities - Private Client Research, Companies

Metals & Mining (contd...)

Ferroalloys - Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Cut in Import Duty on nickle	Stainless steel industry has demanded a complete withdrawal of duty on nickel.	Likely cut in import duties from present 5% to 2%.	Move would rationalize the import duty structure for the product segment and facilitate imports of ferronickel, which is not produced in the country and entire requirement is imported.	Very positive
Ceiling on chrome ore export	Current ceiling of 0.40 MMT to be reduced to 0.30 MMT	Likely	Neccesary to contain huge jumps in prices of this key raw material	Positive
Increase in import duty of ferroalloys	Increase in import duty on ferroalloys from 5% presently to 7.5%	Unlikely	International prices are already high	No impact
Increase in export taxes on key raw materials for steel	Increase in export taxes from present Rs1500/t to Rs 2500/t	Likely	Neccesary to contain exports of the key raw material for Indian steel industry whose prices are rising sharply	Positive

Source: Kotak Securities - Private Client Research, Industry

Minerals - Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
1. Under Section 80-IA (2) of the Income Tax-Act, a deduction of 100% profit is available to companies for any 10 consecutive years of the first 15 years. **2. Cheaper credit from financial institutions.** **3. Import capital equipment and spares at concessional rates.**	Captive coal mining to get infrastructure status	Likely	Necessary for the industry to achieve economies of scale and increase production of coal to reduce demand supply mismatch.	Very positive
Increase in export taxes	Steel Ministry has proposed 10% to 15% export taxes on Iron Ore FOB prices	Likely	Increase competive advantage of Indian steel industry and limit export of presumed scare resource	Negative but impact to be limited by booming environment

Further we expect some royalty increase on several minerals. Quantum and mode are uncertain though.

Source: Kotak Securities - Private Client Research, Industry

NBFCs

EXPECTED BUDGET IMPACT: Neutral

SECTOR OUTLOOK: Positive

Current view

- Union Budget 2008-09 is expected to be positive for non-banking finance companies, as the sector is the second best proxy to the strong growth in the economy after the banking sector. The expected robust capex in the infrastructure sector, amounting to $450 bn during the Eleventh Five Year Plan, offers huge potential for infrastructure financing companies.
- We continue to maintain our positive view on the NBFC sector, mainly due to strong growth from the housing and infrastructure developments sectors. The increased participation in the capital market would continue to be positive for market intermediaries/ stock brokering companies.
- We believe the income tax benefits on housing loan interest and principal re-payment u/s 80C and u/s 88, respectively, are likely to continue. The rebate, which has been increasing over the years, has been a major driver of growth in housing loan disbursements. In view of lower penetration and higher disposable income, the business growth outlook for mortgage finances companies remains positive.
- In case of the newly launched product, reverse mortgage, for senior citizens, NHB has requested that the loan given to senior citizens be exempt from income tax. Also, banks and HFCs also await clarity on the provisioning requirement for such loans.
- We expect the securities transaction tax (STT) and service tax (ST), to further increase from the current levels of 0.017%-0.25% as this is passed on to clients. This may not have any direct financial impact on stock broking companies. We feel that since companies are now focusing more on fee income, this would act as a buffer for overall profitability.
- Meanwhile, the much awaited increase in FDI/FII investment limit in the Insurance business from current cap of 26% to 49% remains one of the prime expectations. Being capital intensive in nature, the industry is expecting sops in the current budget for a consistent future business growth. Insurance companies like ICICI Prudential Life insurance, HDFC Standard Life Insurance etc are approaching 10th year of operation and are likely to go public sooner. Hence, we expect some benefit to the industry would be granted in the current budget.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Tax benefits on Housing Loans	Tax exemption on interest paid on home loans to continue	Tax benefit to be continued	The tax rebat u/s 80E and 88 id expected to continue, since it is important to improve the affordability in housing in India.	Positive for Housing Finance Companies (HFC's)
Tax benefit on NPA provisions for NBFCs	Provide NBFCs with tax benefits on NPAs as available in the case of Banks.	Status-quo likely to be maintained	Treating NBFC's at par with Banks. This would also facilitate NBFC's in making efficient use of capital	Positive for all NBFCs
ECBs for HFCs	Allowing HFCs to raise ECBs	Status-quo likely to be maintained	Allowing HFC to raise funds via ECB's facilitate access to low cost of funds and hence will reduce overall cost of funds	Positive for all HFCs
Withholding tax rate of 20% on payment of Interest on ECBs for Infrastructure Financing companies u/s 10 (15) (iv) (c)	Restoration of Withholding tax on Interest payment on ECB u/s 10 (15) (iv) (c) for infrastrucutre financing institutions.	Status-quo likely to be maintained	Withholding tax on Payment of interest on ECB was impelented in June 2001. Reinstatement of benefit under the same would lead to decline in the cost of funds of Infrastructure financing NBFCs.	Positive for Infrastructure Financing companies.

NBFCs (contd...)

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Tax benefit u/s 36 (1) (vii) for Special Reserve	■ Alternative benefit to compensate for the reduction in tax benefit u/s 36 (1) (viii) for Special Reseve from 40% to 20%	■ Status-quo likely to be maintained	■ The alternative benefit would reduce the effective tax rate of the companies	■ Positive for all NBFC's
Increase in FDI/FII limit	■ Currently FDI capped at 26%, FII Nil	■ Likely to be allowed	■ Being a capital intensive industry, the insurers have higher capital requirement. Since the industry is approaching 10th year of operation some sops are likely to be announced	■ Positive for Insurance companies

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	P/ABV (x) FY08E	P/ABV (x) FY09E	Recommendation
PFC	185	10.5	12.8	2.3	2.1	BUY
LICHF	277	33.9	41.4	1.3	1.1	BUY
HDFC	2862	86.5	94.1	7.1	6.1	HOLD

Source: Kotak Securities - Private Client Research

OIL & GAS

EXPECTED BUDGET IMPACT: **Positive**

SECTOR OUTLOOK: **Neutral**

Current view

- The Oil Ministry is seeking a series of tax and duty changes related to petroleum products retailing and energy exploration in a bid to reduce prices, subsidies and attract greater investment.
- Oil - FY08 has been negative for the Indian oil industry. With rising crude prices, the industry did quite well at the upstream front. However, the downstream sector faced severe problems regarding subsidies, taxes and pricing. OMCs continue to remain dependent on oil bonds. The practice of issuing oil bonds does not resolve the problem as it only defers the resolution while compounding economic and financial costs.
- Gas - The country's natural gas supply by FY10 is likely to more than double from current levels due to expected supply from the KG basin. Currently, a majority of the gas consumption in India is industrial, with city gas distribution (CNG and PNG) accounting for less than 10% of the total consumption. We believe that with easing supply side constraints and to lower the dependence on oil, the Government would provide incentives to increase the share of city gas distribution and transmission.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Specific excise duties on petrol & diesel	Form Petrol -6% + Rs13.26/litre, Diesel - 6%+ Rs 3.32/litre to specific duty	Status quo to be maintained	Future revenue implications	No impact
Infrastructure status to E&P business	12.5% service tax on companies offering drilling, surveying and offshore vessels for logistics to be reduced	Some concession on the service tax and extension of tax holiday from 7 to 10 years for oil & gas discoveries	E&P investments need to be encouraged to secure energy supplies	Positive for upstream companies, ONGC, RIL, Cairn.
Declared goods' status to Diesel	Reduce sales tax i.e. up to 29% to 4% like LPG and SKO	Status quo to be maintained	Future revenue implications	No impact
Sales tax cut in gas	From up to 20% ST in most states to flat 4%	Some reduction in sales tax	It will facilitate development of a national gas grid and ensure that the cost of gas to end customers is kept low	Positive for gas dist. Companies. GGCL, IGL, GSPL
Tax concessions for city gas distribution	From nil to some Tax holiday on new pipelines	Some tax holiday on new pipelines to be announced	Gas distribution companies have to incur heavy capex to lay the pipelines. Tax holidays would attract capital and facilitate sector growth	Positive for gas dist.Companies. GGCL, IGL, GSPL
Differential import duty structure on crude and petroleum products	The import duty on crude at 5% while petroleum products at 7.5% - to be equalized	Status quo to be maintained	Future revenue implications	No impact

Source: Kotak Securities - Private Client Research, Industry

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
IGL	139	12.2	13.6	11.4	10.2	BUY
GSPL	71	1.6	2.8	44.4	25.4	BUY

Source: Kotak Securities - Private Client Research

PHARMACEUTICALS

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- We expect that companies, which are well diversified in formulations, customs research and new drug discovery and development, will benefit most from the Budget proposals. The pharmaceutical industry is facing several challenges like an appreciating rupee against foreign currencies, domestic pricing pressure and pressure on finding and developing new molecules. Given the huge potential held by the Indian pharma sector, the Finance Minister is likely to give a boost to the sector's prospects by qualitative measures like reduction in duties, extending time line for exemption in respect of profits of a 100% EOU, tax exemption on income from intellectual properties.
- We believe companies, which are well diversified are likely to post stronger sales and have better operating margins. Custom research and manufacturing services (CRAMS) would be a huge opportunity for low cost manufacturers like Indian companies. MNCs would concentrate more on their Indian subsidiaries and make India a global manufacturing hub. Major players would invest more in R&D to boost their dry product pipeline. Thus, companies with a thrust for acquisition and alliances, CRAMS, low cost structure, scalability and good products pipeline, would be able to sustain themselves in this highly competitive environment.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Excise duty on drugs	Reduce MRP based excise duty on drugs from 16% to 8%	Moderate probability to reduce it to 12%	Maintain competitiveness and to generate cash flow for R&D spending	Positive for majority of pharma company
Income tax on profits of scientific R&D companies u/s. 80IB of Income Tax	Extend income tax exemption by another 5 years or till 2012	Benefit should be extended	To encourage companies to focus on NCE/NDDS research and R&D related activities	Positive for companies which incur high expenditure on NCE/ NDDS research
Relaxation in certain conditions to avail 150% weighted average deduction on R&D expenditures	150% weighted average deduction should be availble to demerged R&D division/entity	No	Separate R&D entities gets income tax exemption u/s. 80IB	No impact
Deduction for profits of 100% EOU u/s. 10B of Income Tax Act	Exemption u/s. 10B for profits of a 100% EOU should be extended beyond FY 2009-10	Exemption may not be extended	Revenue implications	No impact
Exhaustive definition of R&D for tax benefits by including clinical trials and patent filing spend	Expenditure on clinical trials and patent filings should be eligible for tax benefits	Expect to widen R&D definition to cover these expenses	These activities are integral part of NCE/ NDDS research	Positive for companies with higher spending on IND, ANDA and DMF filings
Income from intellectual property/NCE	A deduction/exemption should be provided in respect of royalty and other income related to IPR/NCE	Fair probability to exempt from tax	Will help in improving trade balance and also keeps the emerging IPRs in India	Positive for R&D oriented companies

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Ranbaxy Labs*	380	22.8	26.5	16.7	14.3	BUY
Cipla Ltd	180	8.9	10.1	20.1	17.9	BUY
Glenmark Pharma	471	21.7	26.7	21.7	17.6	BUY
Nicholas Piramal	330	17.2	21.4	19.2	15.4	BUY
Jubilant Organosys	372	30.3	27.4	12.3	13.6	BUY
Panacea Biotec	300	18.1	26.3	16.6	11.4	BUY

Source: Kotak Securities - Private Client Research

POWER

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- In the Eleventh Five Year Plan period, the Government is aiming to add 78 GW capacity and another 80 GW during the Twelfth Five Year plan. Of the Eleventh Five Year Plan's additions, 50 GW of capacity is already under construction and the orders for the rest are expected to be placed in the next six months. The Government has awarded three ultra mega power projects (UMPPs) and has plans to award another four projects.
- To fully realize the hydro potential in the country a new hydro policy is being designed to address various issues and encourage more private participation
- We see continued thrust on the reduction in transmission & distribution (T&D) losses and a renewed focus on transmission projects. This is expected to not only reduce the acute power deficit the country is facing but also improve the financial health of the SEBs.
- The recently awarded UMPPs and the other upcoming ones are expected to get an extension of tax holidays from 2010 to 2017, though they will continue to pay the Minimum Alternate Tax (MAT). The decision to extend is mainly due to non-commissioning of any of the UMPP units by the stipulated period.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Venture Capital Funds	Lift all restrictions pertaining to the inflow	Likely to get a pass-through status	Huge resource gap to the tune of Rs.4500 bn yet to be mobilized	Positive for the sector as more projects will come on-stream
Power Infrastructure Bonds	Recommended I-T exemptions	Likely	Higher investments in these tax-free investments to provide funding for infrastructure projects	Fulfill the huge funding requirements
Continuation of 80IA benefits	Extension till 2017 for UMPPs	Likely	Almost none of the units of UMPPs will be commissioned till 2010	Private players to remain interested and more competitive bidding expected
With-holding tax	Removal of tax on the money borrowed from foreign infrastructure companies and financial organizations	Status quo maintained	Imposed to counterbalance evasion of taxes by international and domestic players and hence a good source of revenue	None. As the entire tax paid is a pass through, but the generation tariffs will remain high

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
NOT UNDER ACTIVE COVERAGE						

RETAIL

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Positive

Current view

- Out of the total retail market of US$320 bn, organized retail penetration in India is one of the lowest in the world at 3-4%. The organized retail penetration is expected to touch 9% of the total industry by 2011 and is estimated to grow at a CAGR of 25-30%.
- Organized retail companies have been expanding at a rapid pace over the past few years. Companies have also been facing stiff opposition in several states, due to the fear of organized retailers impacting the livelihood of 'kirana' stores. Hence, organized retailers are lobbying for an 'industry' status, so that they can deal with such problems in a better way and also deal with other manpower issues and have easier access to loans, as retail is a working capital intensive business and funds are needed for expansion as well.
- **Outlook:** With the focus on ensuring higher consumption levels, we expect the retail sector to be the biggest beneficiary. Rising consumerism and higher disposable incomes are key drivers for the sector. Also, increasing urbanization, favorable demographics, easier access to credit and a change in consumption patterns of the society, are all fueling the growth of the sector. We expect the sector to grow at a scorching pace, going forward.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Service tax on lease rentals	Removing/Lowering the 12.36% service tax or allowing input service tax credit to be set-off against sales tax collected from customers	Status quo maintained	Government may want to continue mopping up taxes from high growth sectors such as retail. Also since government may be looking on reducing rates of personal income tax to drive consumption	Neutral
Industry Status	Accord "Industry status" to retail	Government likely to give “industry status”	Organized retail has now gained mass and with entry of all large business houses the government may have to accord this status as the sector will be creating huge employment over the next few years	Positive. Provision of Industry status will ensure retailers have greater access to funds, more transparency with regard to infrastructure, supply chain etc. Will also help retailers to deal with issues of man power and protests in a better way.
Tax structure	Retailers currently pay VAT as well as CST at 3% in case of inter state purchase/sale of goods. This leads to double taxation as they cannot set off VAT with sales tax	Will not change current tax structure	With CST to be phased out and GST to be implemented, at present we do not see any changes to tax structures	Neutral
Claim input credit on capital goods	Most of the capital goods are in negitive list. This deprives companies from input VAT credit benefits on capital goods. Hence retailers want to be allowed to claim input credit on capital goods for development of retail infrastructure	Status quo to be maintained	We do not view retail companies at par with manufacturing companies as manufacturing is more capital intensive	Neutral

Source: Kotak Securities - Private Client Research, ISMA

Retail (contd...)

Top picks

Company	Price (Rs)	EPS (Rs) FY08E	EPS (Rs) FY09E	PE (x) FY08E	PE (x) FY09E	Recommendation
Vishal Retail	760	20.7	34.3	36.6	22.2	BUY
Shoppers' Stop	386	2.9	6.6	133.1	58.5	HOLD

Source: Kotak Securities - Private Client Research

TEXTILES

EXPECTED BUDGET IMPACT: Positive

SECTOR OUTLOOK: Neutral

Current view

- The textiles sector has been negatively impacted during the last year due to significant rupee appreciation against the US dollar. Those textiles companies that had substantial exports to the US have been badly impacted as they were unable to fully renegotiate the prices and also due to slowing demand in the US.
- However, certain exporters with higher exports to Europe have been less impacted. Those who were focused on the domestic market have continued to do well.
- With expected high domestic growth in consumption of textile products the incremental demand of man-made fiber is expected to grow at a much faster pace as against cotton yarn. Going forward, we see strong demand for man-made fibers leading to more demand for POY.

Key budget expectations

Issues	Industry wish-list	Our expectation	Rationale for our expectation	Impact of our expectation
Allocation under TUF	■ To be increased form Rs. 40 bn in 10th plan period to Rs.110 bn in 11th plan period	■ Allocation under TUF would be increased	■ Increase in allocation of TUF scheme would lead to large inflow of investment in the textile industry thereby improving the productivity and efficiency.	■ Positive
Excise duty on man made yarn i.e. POY	■ To be reduced form 8% to 4%	■ Excise duty would be reduced to some extent	■ The duty anomaly in the textile sector would be corrected as while cotton yarn attracts 4% excise duty man made yarn i.e. POY attract 8% excise duty.	■ Positive
Excise duty on PTA /MEG (key input for POY)	■ To be reduced form 8% to 0%	■ Excise duty would be reduced to some extent	■ The duty anomaly in the textile sector would be corrected as while cotton being an agricultural product attracts 0% duty while PTA/MEG used to make man made fibre attract 8% excise duty.	■ Positive
NCCD on PFY	■ To be reduced form 8% to 0%	■ Status quo maintained	■ Future revenue implications	■ No impact
Margin money for cotton purchases	■ To be reduced form 25% to 10%	■ Would reduce the margin money to some extent	■ This would help to reduce the working capital requirements.	■ Positive
Labour reforms	■ To allow contract labour	■ Some amendments would be done	■ Rigid labour laws have led to operational inflexibility. Contract labour norms should be liberalized for textiles and garments so that units can hire laborers for a few months without the compulsion of having to absorb them permanently. This would boost the productivity and investments in the textile sector	■ Positive

Source: Kotak Securities - Private Client Research, Companies

Top picks

Company	Price (Rs)	EPS (Rs)		PE (x)		Recommendation
		FY08E	FY09E	FY08E	FY09E	
JBF	151	18	29.1	8.4	5.2	BUY

Source: Kotak Securities - Private Client Research

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