INDIA DAILY

October 09, 2007

EQUITY MARKETS

India	8-Oct	Change, % 1-day	1-mo	3-mo
Sensex	17,491	(1.6)	12.2	16.3
Nifty	5,085	(1.9)	12.8	15.1
Global/Regional indices				
Dow Jones	14,044	(0.2)	7.1	2.9
Nasdaq Composite	2,787	0.3	8.6	4.4
FTSE	6,541	(0.8)	5.6	(2.6)
Nikkie	17,222	0.9	6.8	(5.1)
Hang Seng	27,755	(0.1)	15.7	21.6
KOSPI	2,013	0.0	6.8	6.9

Value traded - India

	8-Oct	Moving avg, Rs bn 1-mo	3-mo
Cash (NSE+BSE)	229.2	218.6	181.8
Derivatives (NSE)	698.4	386.7	346.1
Deri. open interest	822.6	768.3	720.7

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News Roundup

Corporate

- Reliance Industries (RIL) has sought a three-year drilling holiday from exploring in nine deep sea blocks it had won in NELP auctions, saying it has been hit by an acute paucity in supply of drilling rigs worldwide. (BS)
- IT Services majors Accenture and Wipro have evinced interest in acquiring Dell's captive BPO business outside of the US. (ET)
- Hindalco Industries has announced that Utkal Alumina Inernational has become its 100% subsidiary after the acquisition of the entire shareholding of Alcan Inc in the joint venture. (FE)
- Moawe Baer, India's largest optical storage manufacturer, announced the acquisition of Hindi and Gujarati titles from one of India's largest home video labels, Ultra Video. (FE)

Economic and political

- The government scaled down its export target for this fiscal by over 12.5% to US$140 bn, acknowledging the impact of the rising rupee on shipments. (FE)
- The department of telecommunications (DoT) has decided that the marketshare of operators after a merger or acquisition should not exceed 30%. (FE)

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

Forex/money market

	8-Oct	Change, basis points 1-day	1-mo	3-mo
Rs/US$	39.5	0	(119)	(92)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	(2)	7	(6)

Net investment (US$mn)

	4-Oct	MTD	CYTD
FIIs	141	1,453	14,472
MFs	(135)	(210)	390

Top movers -3mo basis

Best performers	8-Oct	Change, % 1-day	1-mo	3-mo
Reliance Energy	1,380	(4.7)	62.2	124.1
Neyveli Lignite	98	(10.1)	17.6	49.5
SAIL	192	(5.2)	14.4	44.6
IPCL	483	-	25.3	42.0
Reliance Inds	2,417	(2.7)	23.2	41.3
Worst performers				
i-Flex	1,832	(3.4)	(6.9)	(27.3)
Polaris	117	(3.1)	(1.1)	(24.5)
Novartis India	303	(5.3)	1.6	(19.0)
Punjab Tractors	226	(2.7)	(4.4)	(18.6)
Britannia	1,434	1.2	(8.7)	(16.3)

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Strategy

Sector coverage view	N/A

September 2007 quarter results preview

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- **September 2007 quarterly preview of 116 stocks and 21 sectors under our active research coverage**
- **Sales growth of 25.6% yoy and profit growth of 26.5% yoy for our coverage universe ex-energy**
- **Earnings growth will likely be led by Telecom, Cement and Industrials**

Earnings growth for September 2007 quarter will likely exceed revenue growth on account of higher profitability in Banking, Telecom and Cement. For the September 2006 quarter, earnings growth will likely be led by Telecom, Cement and industrials, but weighed down by the Automobiles, Metals and Energy sectors.

Sales growth of 14% yoy and profit growth of 21% yoy for BSE-30 universe

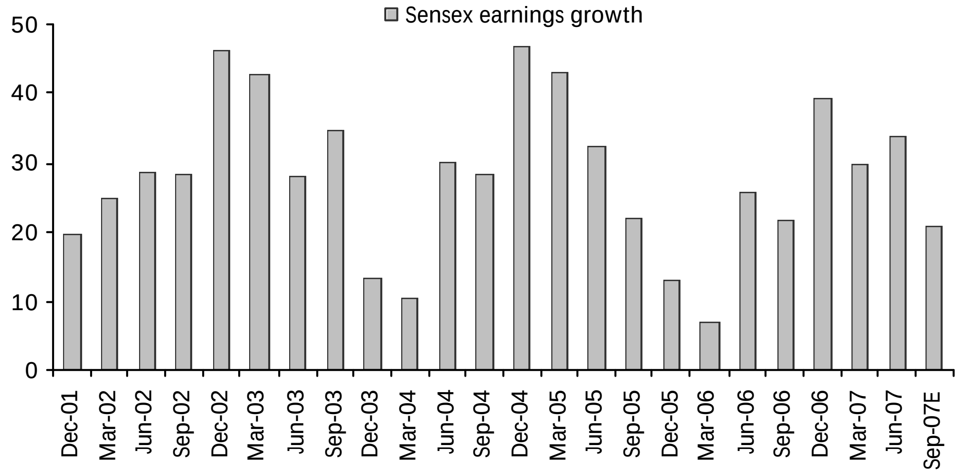
	Sales growth (%)		OPM (%)			PAT growth (%)	
	yoy	qoq	Sep-06	Jun-07	Sep-07 (E)	yoy	qoq
Automobiles	12.6	9.1	15.4	15.5	14.3	(4.4)	(8.0)
Banking	26.3	10.1	42.9	48.9	40.0	21.3	11.6
Cement	26.3	(5.2)	29.4	33.4	33.8	49.0	(8.3)
Construction	45.1	23.5	7.2	9.3	9.7	57.8	20.5
Consumers	13.5	1.2	21.6	22.4	22.2	13.8	1.7
Diversified	18.6	19.4	18.4	16.7	18.7	29.0	41.1
Education	90.2	36.3	47.0	48.6	50.0	93.1	63.8
Energy	(0.4)	6.6	12.5	11.0	14.5	4.3	32.3
Industrials	41.7	33.8	12.5	9.2	12.9	36.8	82.9
Infrastructure	—	(8.2)	0.0	29.1	32.0	—	30.4
Media	26.6	7.0	18.9	29.2	31.6	32.1	26.2
Metals	11.5	5.3	31.3	31.2	30.8	1.1	(11.9)
Pipes	23.9	4.3	10.2	13.4	13.4	77.1	(3.5)
Property	113.0	1.8	32.2	56.1	54.4	236.2	(8.5)
Shipyards	35.0	11.5	28.8	27.1	29.0	47.0	19.1
Technology	22.7	6.6	25.4	22.9	23.4	20.4	2.6
Telecom	51.4	9.8	34.1	37.9	38.2	92.3	6.4
Textiles	8.5	8.6	17.4	17.0	17.2	(29.5)	3.8
Transmission	31.3	13.5	12.7	13.7	13.3	57.4	21.1
Transportation	14.6	3.2	19.4	24.1	22.3	(25.2)	(55.6)
Utilities	8.7	(13.5)	25.9	27.1	27.9	10.2	(24.6)
Kotak coverage	**10.1**	**7.0**	**17.9**	**18.5**	**20.0**	**17.9**	**10.2**
Kotak ex-Energy	**25.6**	**7.6**	**25.8**	**27.4**	**26.4**	**26.5**	**1.3**
BSE 30 Universe (a)	**13.8**	**4.3**	**27.9**	**30.2**	**29.6**	**21.1**	**(1.2)**
BSE 30 Universe-ex-Energy (a)	**15.2**	**3.9**	**24.7**	**26.7**	**26.0**	**22.6**	**(2.5)**

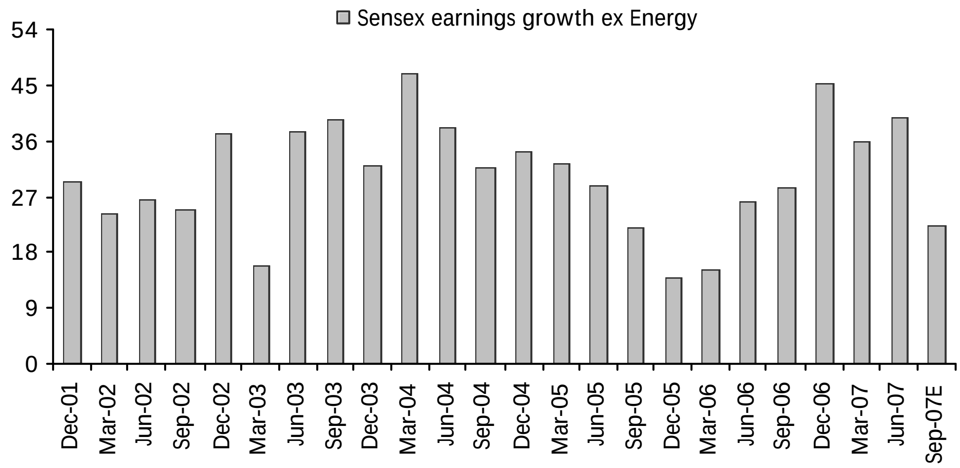
Note:
(a) Pro forma excluding pharmaceutical and select automobile companies.
(b) Companies excluded include Cipla, Dr Reddy, Ranbaxy, Tata Motors and M&M.

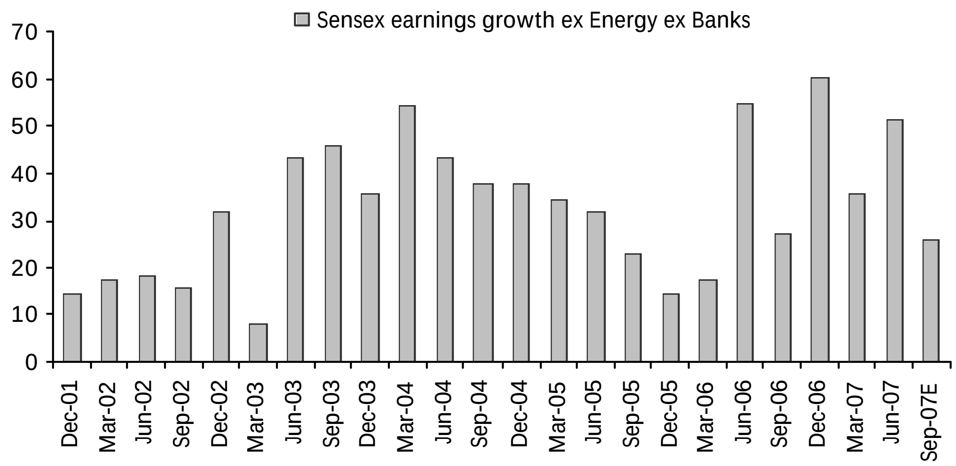
Source: Kotak Institutional Equities.

Sensex earnings to grow at 21.1% yoy

Earnings growth of BSE Sensex companies







Energy

CAIR.BO, Rs171	
Rating	U
Sector coverage view	Neutral
Target Price (Rs)	145
52W High -Low (Rs)	188 - 111
Market Cap (Rs bn)	302.1

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	18.3	20.0	23.0
Net Profit (Rs bn)	4.0	3.3	2.9
EPS (Rs)	2.3	1.0	1.7
EPS gth	*27.7*	*(59.2)*	*73.3*
P/E (x)	74.8	175.8	102.7
EV/EBITDA (x)	38.5	34.0	31.1
Div yield (%)	-	-	-

Shareholding, June 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	69.0	-	-
FIIs	11.1	0.4	0.4
MFs	0.6	0.1	0.1
UTI	-	-	-
LIC	2.2	0.4	0.4

Cairn India: Approval for inclusion of pipeline cost in FDP likely, but on payment of cess

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- **Cairn may have to pay cess for recovery of its pipeline cost**
- **Valuations expensive in light of likely negative developments**
- **Maintain assumption regarding non-payment of cess, revise estimates to reflect changes in other key assumptions**

According to press reports, Cairn India may be asked to pay its share of cess in lieu of inclusion of pipeline cost in the FDP. We are not sure about the correlation of the two issues but presumably the government may use the pipeline issue to resolve the contentious cess issue. We expect Cairn to start arbitration proceedings if the government asks it to pay cess on its portion of crude oil. The cess development, if confirmed, could have a significant impact on the valuations of Cairn India stock. We have previously highlighted the pending issue of crude evacuation as a key downside risk; however, we have viewed this more as a financial issue (cost recovery). We maintain our assumption that Cairn will recover the cost of the pipeline and will not be required to pay any cess or royalty pending the confirmation of this development. We have revised our 12-month DCF-based 12-month target price to Rs145, from Rs140 previously, upon the incorporation of the CY2006 annual report and roll-forward and to reflect our revised assumptions of (1) higher crude price and (2) stronger rupee.

Approval for cost recovery of pipeline likely, but only on payment of cess. According to media reports, Cairn India may have to pay Rs2,575/ton (US$9/bbl) as cess in lieu of inclusion of its pipeline cost in the field development plan (FDP). Some media articles had earlier reported that the company had obtained approval for the pipeline to evacuate crude oil from its Rajasthan block RJ-ON-90/1 as well as for the recovery of the cost. The stock price had also rallied on the back of this development perhaps allaying the street's concern on evacuation of crude oil. We would clarify the approval to include the cost of the pipeline in the FDP (for cost recovery) is still pending and the government has granted only the rights of use (RoU) which allows Cairn to secure access to the land to build the pipeline from Rajasthan. Pending the confirmation of the development, we continue to include the cost of the pipeline (US$500 mn net to Cairn) as part of the upstream capex and assume that Cairn will recover both capex and opex related to the pipeline as part of the overall production sharing contract for the block without payment of any cess.

Payment of cess, if confirmed will be negative for Cairn's valuation. We highlight that the valuation of Cairn's Rajasthan asset (where bulk of the value resides) is highly dependent on (1) the assumed price of crude and (2) quantum of royalty and cess, if any (Exhibit 1). Our model currently assumes that Cairn will not be required to pay any cess or royalty and it will be allowed to recover the capex and opex related to the pipeline as part of the overall production sharing contract for the block. On our base assumptions of crude price of US$50/bbl dated Brent for CY2013E and beyond and no payment of cess and royalty, the value from Rajasthan assets comes to US$3.7 bn. However, if Cairn were to pay the cess of Rs2,575/ton for cost recovery of its pipeline, the value of its Rajasthan assets declines to US$3.1 bn (-17%). Thus, confirmation of this possible negative development can have meaningful impact on Cairn's valuation.

Key changes to and major assumptions behind earnings model

We have revised our earnings estimates for the incorporation of the CY2006 annual report and to reflect changes to our key assumptions as discussed below.

1. **Higher crude prices up to CY2012E; no change in normalized crude price.** We have revised our assumptions for Dated Brent crude price for CY2007E-CY2012E to US$70/bbl from US$69/bbl for CY2007E, US$68/bbl for CY2008E, US$66/bbl for CY2009E, US$70/bbl for CY2010E, US$70/bbl for CY2011E and US$70/bbl for CY2012E. We continue to maintain a US$5/bbl discount for Cairn's Rajasthan crude given the heavy, waxy nature of Cairn's crude (API is 27° although sulfur content is low), which may preclude consumption by several Indian refineries. As of now, MRPL has indicated its interest to lift 1-1.2 mtpa of crude oil out of the likely 7.5 mtpa plateau production. However, the government has directed MRPL to involve IOC and HPCL for lifting of crude oil.
2. **Exchange rate.** We have revised our rupee-dollar exchange rates for CY2008E and CY2009E to Rs40/US Dollar and Rs39/US Dollar versus Rs41/US Dollar previously for all the years. We have revised our rupee-dollar assumption to Rs38/US Dollar for CY2010E and beyond versus Rs41/US Dollar previously.

Valuations continue to be expensive in the light of possible negative developments. Assuming Cairn is unable to discover more crude oil and gas and its recoverable reserves in Rajasthan block do not increase, our reverse valuation exercise suggests that Cairn's current stock price is discounting US$75/bbl crude oil Dated Brent price in perpetuity at Rs38/US Dollar. We find this very aggressive even though forward strip crude oil prices suggest high prices for the next several months. We note that we do not currently assume any potential liability for Cairn from the imposition of cess or royalty on its portion of crude oil.

Cairn's Rajasthan field's enterprise value is highly leveraged to crude prices, regulations

Enterprise value sensitivity of Cairn to key variables (US$ bn)

	Sensitvity of current valuation		Sensitvity of +1-year valuation	
	Enterprise value (US$ bn)	Change from base case (%)	Enterprise value (US$ bn)	Change from base case (%)
Average crude prices (2011 and beyond)				
Dated Brent price (US$70/bbl)	4.4	19	5.4	18
Dated Brent price (US$60/bbl)	4.1	10	5.0	9
Dated Brent price (US$55/bbl)	3.9	5	4.8	5
Dated Brent price (US$50/bbl)	**3.7**		**4.6**	
Dated Brent price (US$40/bbl)	3.4	(10)	4.2	(9)
Dated Brent price (US$30/bbl)	3.0	(20)	3.7	(19)
Cess, royalty				
Royalty (Rs0/ton), Cess (Rs0/ton)	**3.7**		**4.6**	
Royalty (Rs0/ton), Cess (Rs927/ton)	3.5	(5)	4.3	(5)
Royalty (Rs0/ton), Cess (Rs2,575/ton)	**3.1**	**(17)**	**3.9**	**(15)**
Royalty (Rs481/ton), Cess (Rs927/ton)	2.5	(32)	3.2	(30)
Royalty (Rs481/ton), Cess (Rs2,575/ton)	2.0	(47)	2.6	(44)

Source: Kotak Institutional Equities estimates.

Cairn's earnings are highly leveraged to crude prices

Earnings sensitivity of Cairn to key variables

	2009E			2010E			2011E		
	Downside	Base case	Upside	Downside	Base case	Upside	Downside	Base case	Upside
Average crude prices									
Crude price (US$/bbl)	68.0	70.0	72.0	68.0	70.0	72.0	68.0	70.0	72.0
Net profits (Rs mn)	19,809	20,790	21,772	58,818	60,739	62,661	45,093	46,985	48,876
Earnings per share (Rs)	11.2	11.8	12.3	33.3	34.4	35.5	25.5	26.6	27.7
% upside/(downside)	**(4.7)**		**4.7**	**(3.2)**		**3.2**	**(4.0)**		**4.0**
Exchange rate									
Rs/US$	38.0	39.0	40.0	37.0	38.0	39.0	37.0	38.0	39.0
Net profits (Rs mn)	20,027	20,790	21,553	59,131	60,739	62,348	45,528	46,985	48,441
Earnings per share (Rs)	11.3	11.8	12.2	33.5	34.4	35.3	25.8	26.6	27.4
% upside/(downside)	**(3.7)**		**3.7**	**(2.6)**		**2.6**	**(3.1)**		**3.1**

Source: Kotak Institutional Equities estimates.

We value Cain India stock at Rs145

EV and equity value of Cairn (US$ mn)

	Now	+ 1-year	+ 2-years
RJ-ON-90/1	3,717	4,570	5,678
CB-OS-2	170	126	85
Ravva	365	337	303
Upside potential (KG-DWN-98/2, RJ-ON-90/1)	843	945	1,058
Total	**5,094**	**5,978**	**7,125**
Net debt	(1,241)	(346)	61
Equity value	**6,335**	**6,324**	**7,064**
Equity shares (mn)	1,765	1,765	1,765
Equity value per share (Rs/share)	**149**	**143**	**156**

Source: Kotak Institutional Equities estimates.

Profit model, balance sheet, cash model of Cairn 2006-2013E, calendar year-ends (Rs mn)

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E
Profit model (Rs mn)								
Net sales	18,306	20,032	23,026	46,521	103,834	105,193	101,941	69,113
EBITDA	**5,288**	**7,054**	**9,254**	**32,284**	**77,897**	**60,579**	**42,377**	**26,422**
Other income	1,100	1,408	536	513	830	1,398	2,048	2,504
Interest	(201)	(25)	(47)	(282)	(220)	—	—	—
Depreciation	(497)	(4,020)	(5,042)	(6,644)	(8,047)	(7,606)	(7,726)	(7,708)
Pretax profits	5,690	4,417	4,701	25,871	70,460	54,371	36,698	21,218
Extraordinary items	—	(1,544)	—	—	—	—	—	—
Tax	(1,629)	(1,091)	(1,676)	(4,093)	(8,650)	(6,851)	(4,934)	(2,989)
Deferred taxation	(22)	(64)	(83)	(988)	(1,070)	(535)	(114)	142
Net profits	**4,039**	**1,719**	**2,942**	**20,790**	**60,739**	**46,985**	**31,651**	**18,372**
Earnings per share (Rs)	**2.3**	**1.0**	**1.7**	**11.8**	**34.4**	**26.6**	**17.9**	**10.4**
Balance sheet (Rs mn)								
Total equity	292,804	294,523	297,465	318,255	337,688	351,627	361,017	366,468
Deferred tax liability	4,258	4,322	4,405	5,393	6,463	6,998	7,112	6,970
Total borrowings	5,122	4,985	13,780	8,780	—	—	—	—
Currrent liabilities	39,716	1,755	1,886	1,963	3,728	6,552	8,812	6,277
Total liabilities and equity	**341,900**	**305,585**	**317,536**	**334,391**	**347,878**	**365,177**	**376,942**	**379,715**
Cash	61,348	19,327	11,358	18,057	29,483	50,595	66,735	76,700
Current assets	6,470	1,921	2,208	4,461	9,957	10,087	9,775	6,627
Total fixed assets	17,609	28,161	47,648	28,345	26,007	23,701	21,291	18,944
Net producing properties	2,354	2,057	2,202	29,408	28,312	26,674	25,021	23,324
Investments	4	4	4	4	4	4	4	4
Goodwill	254,115	254,115	254,115	254,115	254,115	254,115	254,115	254,115
Deferred expenditure	—	—	—	—	—	—	—	—
Total assets	**341,900**	**305,585**	**317,536**	**334,391**	**347,878**	**365,177**	**376,942**	**379,715**
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	2,897	2,117	4,856	25,477	66,877	52,278	35,993	21,983
Working capital changes	34,256	(33,411)	(156)	(2,176)	(3,731)	2,694	2,572	613
Capital expenditure	(5,619)	(11,998)	(22,000)	(12,115)	(2,463)	(2,213)	(2,213)	(2,213)
Investments/Goodwill	(252,717)	—	—	—	—	—	—	—
Other income	1,100	1,408	536	513	830	1,398	2,048	2,504
Free cash flow	**(220,083)**	**(41,884)**	**(16,764)**	**11,699**	**61,513**	**54,157**	**38,400**	**22,887**
Key assumptions								
Gross production ('000 boe/d)	91.0	92.1	91.8	120.8	206.8	203.8	194.4	186.1
Net production ('000 boe/d)	25.1	26.3	29.3	53.7	117.5	118.3	114.1	110.9
Dated Brent (US$/bbl)	65.3	70.0	70.0	70.0	70.0	70.0	70.0	50.0
Discount of Rajasthan crude to Dated Brent (US$/bbl)	2.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0

Source: Kotak Institutional Equities estimates.

Strategy

Sector coverage view	N/A

Mid-term elections look increasingly likely; good to get it out of the way

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- **Mid-term elections a distinct possibility after UPA chairperson's statements**
- **Short-term issues for oil & gas, telecom, infrastructure; expect further slowdown in real estate sales**
- **May not be a bad thing to get it done now; anyway, market appears fully valued**

We believe the chances of mid-term elections or early elections ahead of the current mid-2009 schedule have increased. The UPA Chairperson has taken a tough stance in the standoff with the left parties on the India-USA nuclear deal. It appears increasingly likely that the Left parties will withdraw support to the ruling coalition government unless the government back's down from the issue; the latter appears unlikely in our view. However, we do not think this would be a bad thing; the Indian market appears fully valued and it would be a good thing to get national elections out of the way. In the short-term, we could see crucial policy decision in certain sectors such as oil & gas and telecom getting delayed unless the government can resolve them quickly.

Mid-term elections look increasingly likely

The statements of the UPA chairperson and leader of the Congress (I) party, Mrs. Sonia Gandhi, over the weekend lead us to believe that the government is prepared for early elections if pushed into doing so by the Left parties. At a public meeting, she rather forcibly stated that 'We must understand that such elements are not only the enemies of the Congress but they are also enemies of progress and developments. We have to give them a befitting reply.' We do not think this leaves much scope for the Left parties to maneuver.

We also note that the government appears to be planning for elections. It announced a series of social packages recently—(1) National Rural Employment Guarantee Scheme extended to all 604 districts from 330; (2) Rashtriya Swastha Bima Yojna (health insurance) for unorganized sector workers; (3) extension of midday meal scheme to upper-primary students; (4) increase in dearness allowance to central government staff; and (5) National Old Age Pension Scheme eligibility criteria changed to include more families. The winter session of the parliament (starting in November) may be crucial. If the 'nuclear' standoff continues, we could expect the government to decide in favor of early elections after the FY2009 budget in February 2008. The government may be emboldened by the results of a poll survey done by Indian Express-CNN/IBN (see Exhibit 1).

Mid-term elections may not mean much for the market normally but stretched valuations and political uncertainty are a bad combination

We believe early elections, if held, need not be bad for the Indian stock market apart from the interim uncertainty on certain policy issues. Anyway, a dysfunctional government may not have been able to legislate on critical economic and social issues. The composition of the current government (see Exhibit 2) makes it difficult for the government to legislate on certain important economic and social issues. We could see the formation of a more 'cohesive' government, which may be positive from a legislative perspective. The formation of a government with a full majority or of a coalition government with parties with similar ideologies may result in a more conducive working environment.

Historical data does not really give much evidence about the behavior of the markets pre and post national elections (see Exhibit 3). It is anyway a short event. More important, we do not think the economic agenda will change meaningfully with any of the major political parties or groups of parties forming the government. However, increased political uncertainty and the current full valuations of the market may lead to a moderate correction in the market. We would recommend investors buy into 'India' sectors (investment and domestic consumption plays) once the market corrects to more reasonable levels due to (1) reversal of liquidity and (2) heightened political uncertainty. We would refer investors to our October 5, 2007 report titled *"Be in the right boats when the tide goes out"* for more details.

We think it is too early to speculate on the composition of the government and economic policies. However, we could see some positive developments on divestment in the 'right' political environment. Early elections may potentially open this opportunity but this would depend on the outcome of the elections and the composition and ideology of the new government. The composition of the current government has made divestment of minority stakes difficult; privatization is unthinkable. However, it is fruitless to speculate on any change in divestment policy without the formation of a new government; even at the best of times, divestment is fraught with political and legislative difficulties.

Short-term impact on certain sectors (discussed in our strategy report dated October 5, 2007)

We expect the oil and gas and telecom sectors to be the worst hit by early elections unless the government can resolve the pending issues quickly. The infrastructure sector may tide over a period of potential low government orders given their healthy order books. We discuss the impact on various sectors.

Oil and gas (government-owned companies). We can rule out price increases on auto fuels in case of early elections. Forthcoming state elections also reduce the flexibility of the government to raise prices; it would need to time the price increase astutely after considering inflation and state elections. Early elections would also put the issue of oil bonds to the downstream oil companies in jeopardy since issue of oil bonds requires parliamentary approval; the government will likely give Rs240 bn oil bonds in FY2008E. We are hopeful that the government can take parliament approval for a certain amount of oil bonds before it dissolves the parliament/calls for early elections.

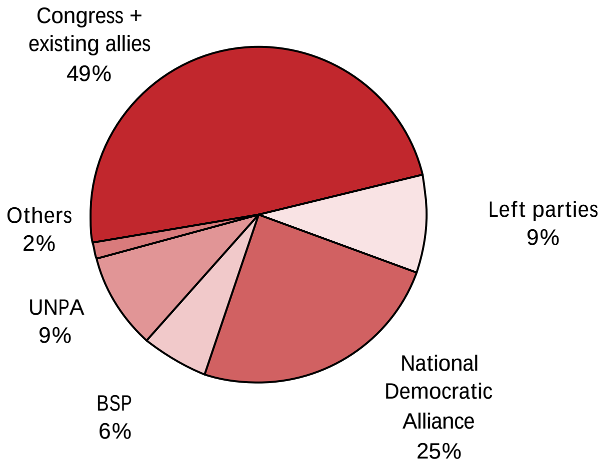
Telecom. Early national elections may result in the government deferring crucial decisions on spectrum allocation for 2G wireless service or awarding licenses for 3G service although press reports suggest that the government may finalize a licensing and spectrum allocation policy over the next few days. A delay in the award of spectrum would be negative for all players as operators would need to install more cell sites to compensate for the lower spectrum. However, the incumbents (Bharti Airtel, Reliance Communications) may be better off since the new entrants would not be able to start services; in any case, we note that the incumbents may not get much additional spectrum if the government accepts the revised spectrum allocation policy recommended by the regulator.

Real estate. The sector could see a further slowdown in sales of residential properties and correction in prices (we anyway expect a 10-20% decline in residential real estate prices). We expect the following factors to impact the sector negatively—(1) withdrawal of speculative money from the residential sector; we expect the maximum impact in the NCR area, (2) delays in closure of land deals (both private and government auctions) and (3) increased re-sale of real estate properties.

Infrastructure. The government may not award contracts for government projects (power projects, highways, ports) close to national elections in order to conform to the electoral code of conduct. However, we expect the strong order books of all infrastructure-provider companies to tide over a potential lean phase of fresh government-related orders (see Exhibit 4).

Results of poll survey for national elections done by Indian Express-CNN/IBN

Break-up of Lok Sabha seats as per the Indian Express-CNN/IBN survey



Source: Indian Express-CNN/IBN.

Left-supported coalition at the center

Lok Sabha composition of ruling coalition and left parties (# of seats)

Party	
INC or Congress - Indian National Congress	**150**
RJD - Rashtriya Janata Dal	24
DMK - Dravida Munnetra Kazhagam	26
NCP - Nationalist Congress Party	11
LJP	4
JD(S)	3
Congress allies	**68**
Congress + allies	**218**
CPI (M) - Communist Party of India (Marxist)	43
CPI - Communist Party of India	10
Other Left parties	6
Left parties	**59**
Congress+allies+Left	**277**
Simple majority	**272**

Source: Election Commission of India, India Elections, NIC, Kotak Institutional Equities.

Historical data does not give evidence about behaviour of the markets
Performance of the Sensex pre, post and during election poll dates (%)

	Performance of the Sensex (%)			
	1996	1998	1999	2004
1 month prior to the commencement of elections	16.1	0.2	2.4	8.1
During the election poll dates	(3.3)	(0.4)	(2.8)	(4.3)
1 month post election dates	2.4	13.7	(7.3)	(7.2)

Source: Bloomberg, Election Commission of India.

Strong order book of infrastructure companies to provide earnings visibility
Order book of major infrastructure companies

Company	Current order book (Rs bn)	FY2008E revenues (Rs bn)	FY2008E visibility (X)
ABB	46	66	0.7
AIA Engineering	4	8	0.5
Bharat Electronics	91	48	1.9
Bharat Heavy Electricals	**624**	**220**	**2.8**
JSL	29	38	0.8
Larsen & Toubro	**423**	**264**	**1.6**
Nagarjuna Construction Co.	78	41	1.9
PSL (1)	23	20	1.1
Punj	152	87	1.7
Siemens	108	92	1.2
Suzlon Energy	135	131	1.0
Welspun Gujarat Stahl Rohrer	45	37	1.2

Note:
(1) September fiscal year-ends.

Source: Kotak Institutional Equities estimates.

Economy

Sector coverage view N/A

RBI's inflation concerns recede, but do not dissipate; Likely to dither on policy rate cut

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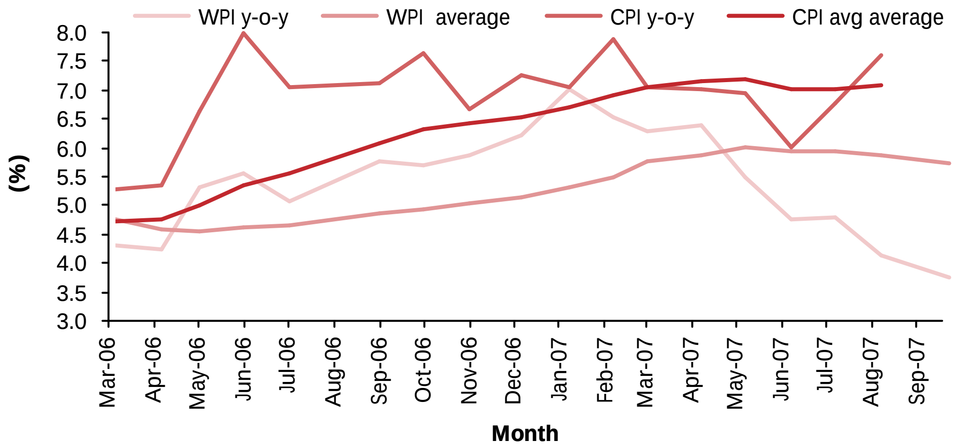
- **WPI inflation numbers for the week-ended Sep 22, 2007 show that the headline inflation rate (point-to-point WPI) has risen to 3.4% from 3.2% in the previous week**
- **Inflation rate likely to remain in the 3.0-3.5% band in FY2008 as some demand side pressure could be absorbed by favourable base effects in the rest of FY2008**
- **The central bank concerns on inflation have receded considerably, but not dissipated yet. Given the possibility of an early election, keeping inflation low could be a priority for Government and the central bank could use this fear to keep its monetary policy stance neutral ahead even as Finance Ministry might want it to cut rates for short-term gains**
- **Rate sensitive sectors unlikely to be hurt by CRR hike as it could be more than offset by liquidity infusion from forex route. Banks could absorb another CRR hike by lowering deposit rates aggressively and protecting interest margins. The lending rates could also soften from here**

The increase in the headline inflation rate has been triggered by the jump in inflation for manufactured products to 4.5% from 4.0%, mainly a result of the increase in prices of basic metal alloys and metal products and manufactured food products over the week. Over the year, manufacturing inflation has come about from cement, basic metal alloys & metal products and chemical and chemical products.

We believe a rise in manufacturing inflation bothers the central bank more than other commodities. It signifies demand side pressures. But the rise this week appears to have come from select manufacturing items that do not suggest a wider trend, in our view. Manufacturing inflation has come down from 6.4% at start of FY2008 to 4.5% now and is only marginally higher than 4.3% a year ago. However, CPI inflation (for industrial workers) remains high (Exhibit 1).

Exhibit 1: WPI inflation eases, but CPI inflation remains high

Movement in wholesale & consumer price Inflation

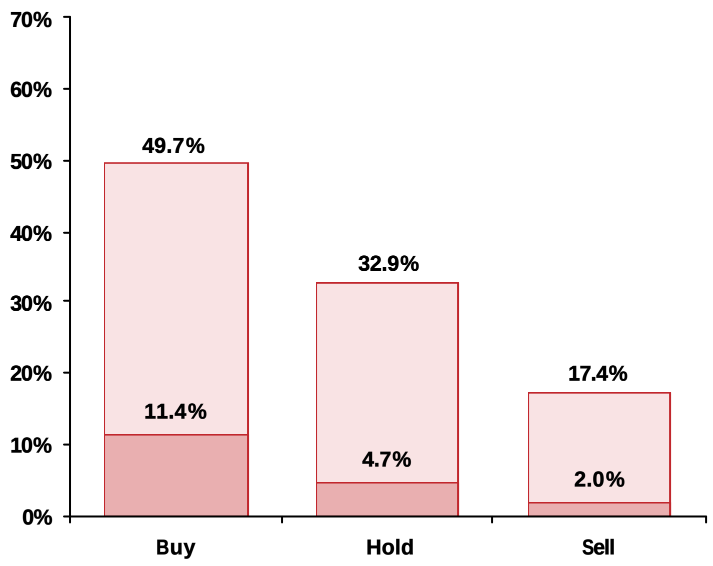


Source: WPI & CPI Inflation Rates.

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Sanjeev Prasad, Mridul Saggar."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 06/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities. As of June 30, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.
IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.
U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

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

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

Other ratings/identifiers

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