28 February 2007

Union Budget 2007-08

- *Increased thrust on rural development; focus on infrastructure continues*
- *Disappointments on direct tax proposals, other sector-specific announcements*
- *Markets have reacted negatively, with the BSE-Sensex closing down 540 points*
- *We remain positive on equities; use the recent correction as a buying opportunity*

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Budget highlights

The Union Budget 2007-08 was presented in the backdrop of an exceptional year of economic and corporate profit growth but short-term worries like rising inflation and interest rates driving the markets down by 8% in the preceding two weeks. Markets fell another 4% today, driven by a global sell off in equities coupled with several sectoral budget announcements impacting either earnings estimates in some cases or just sentiment in most other cases. At the end of it all, our Sensex EPS estimate for FY08 stands downgraded by 0.6% to Rs830 (from Rs835 earlier), still a YoY growth of 17.7%!

Considering the limited impact on fundamentals and positive long-term outlook, we once again recommend taking advantage of the sharp correction to buy stocks. Our top bets are Bharti Airtel, Reliance Communication, Maruti Udyog, ICICI Bank, Punjab National Bank, Infosys Technologies, Dr Reddy's, SAIL, and Grasim. We are also upgrading our ratings of HDFC Bank, Satyam Computers, HCL Technologies and Larsen & Toubro from Neutral to Buy after the recent correction.

Riding the strong economic upcycle, government finances have continued to improve. Total revenue collections for FY07 grew by 27% v/s estimated growth of 20%. This is led by strong growth of 45% in corporate tax collections. For FY08, the budget estimates a modest corporate tax growth of 15%. Fiscal deficit in FY07 at 3.7% is below the target of 3.8% and the budget sets a target of 3.3% in FY08. With flat market borrowings, we believe that bond yields could decline in FY08, as demand for G-Secs would far outstrip supply. Banks would be forced to buy G-Secs in FY08, as they have largely exhausted the excess SLR holdings.

On the tax proposals, the key changes were the dual excise duty in cement, reduction in peak customs duty to 10%, imposition of service tax on lease rentals. Withdrawal of Section 80IA benefit will increase tax rates of construction companies, driving sharp reduction in earnings estimates. Reduction in exemption under Sec 36(1)(viii) will increase tax rates of a few financials. The budget increased the education cess and dividend distribution tax on companies. Overall, the tax proposals will lead to lowering of earnings estimates in a few sectors, although the impact on aggregate corporate profitability will be negligible. While no specific capital market announcement was made (except allowing delivery-based short selling), fears of increase in STT or capital gains tax were unfounded. We expect continued strong performance of the Indian corporate sector, with greater investment in infrastructure and agriculture.

Budget highlights (Contd.)

Important tax proposals

Peak customs duty reduced: The budget has reduced the peak rate of customs duty from 12.5% to 10%. The new peak rates in customs are in tune with the industry expectations. The move is also seen as a measure to deal with rising inflation and comes after a cut in duties on capital goods, project imports, metals and inorganic chemicals by 2.5-5% and by 12.5% on cement earlier this month. Due to rising imports, the customs collection target for FY08 has been set at Rs988b, a growth of 20% over FY07. There has also been a reduction in customs duty on coking coal of all ash content, DMT, PTA, MEG, medical equipment, etc. The budget has also imposed duty of Rs300/mt on export of iron-ore and concentrates.

Differential excise duty in cement imposed, changes in other sectors also: Excise duty structure has been changed for a number of sectors. The government has announced differential duty structure for cement prices at Rs350/mt for retail prices below Rs190 per bag and Rs600/mt for cement prices with MRP of over Rs190/bag. Our interaction with industry indicates that they will fully pass this hike. Excise on cigarettes has been hiked by 5% and we expect companies to pass this also. Positive for cigarette is no mention of VAT as was widely feared. Ad valorem excise duty has been reduced on petrol and diesel from 8% to 6%.

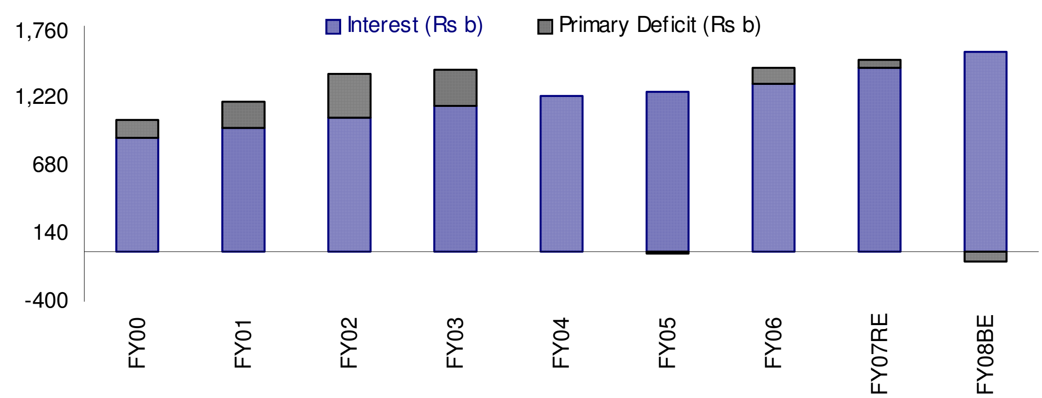
Service tax extended to other services, tax rate unchanged: Service tax rate has been kept unchanged at 12%. However, the budget has extended the imposition of this tax on new services such as renting of immovable property for commercial use, development and supply of content in telecom and advertising, asset management services by individuals, etc. We believe that service tax on lease rentals will significantly impact the retailing companies.

No major changes in direct taxes, few exemptions withdrawn: The budget did not provide any relief on direct taxes. While the personal and corporate tax rates were kept unchanged, the surcharge also continues (against expectations of a reduction). Education cess has been raised from 2% to 3%. Dividend distribution tax has been raised from 12.5% to 15%. The budget has also lowered the exemptions available under Sec 36(1)(viii), which will increase the tax rates for HDFC, IDFC, etc. Also, MAT is now extended to incomes which were hitherto fully exempt from taxes under Section 10A and 10B. The budget also withdrew benefit to work contracts under Sec 80IA with retrospective effect from FY00, which will lead to significant earnings downgrades for IVRCL, Nagarjuna Construction, Gammon, etc.

Economy: key trends

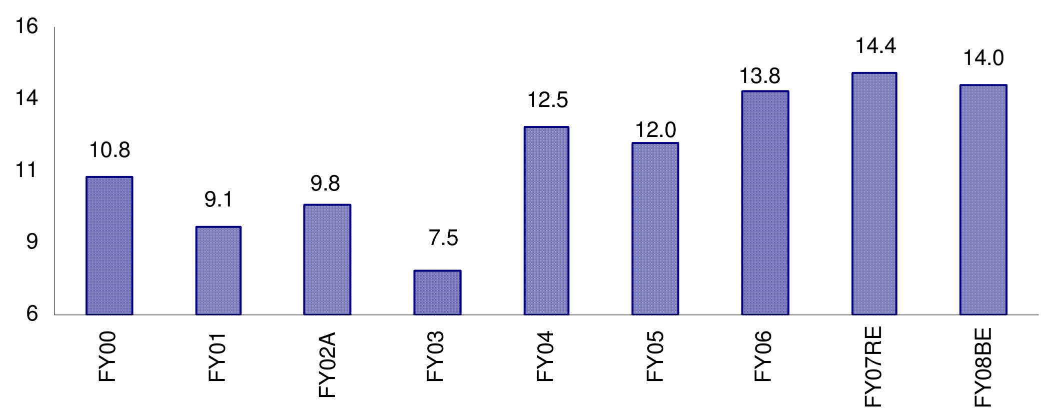
Interest expenses mounting

PRIMARY DEFICIT AND INTEREST COMPONENTS OF FISCAL DEFICIT



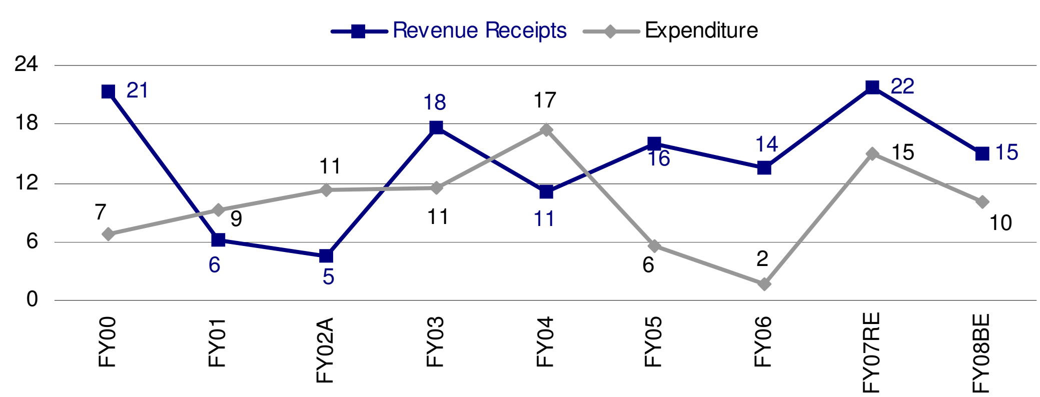
GDP growth to remain strong for the next year as well

NOMINAL GDP GROWTH (%)



Growth in revenue and expenditure to moderate

GROWTH TREND IN REVENUE RECEIPTS AND TOTAL EXPENDITURE

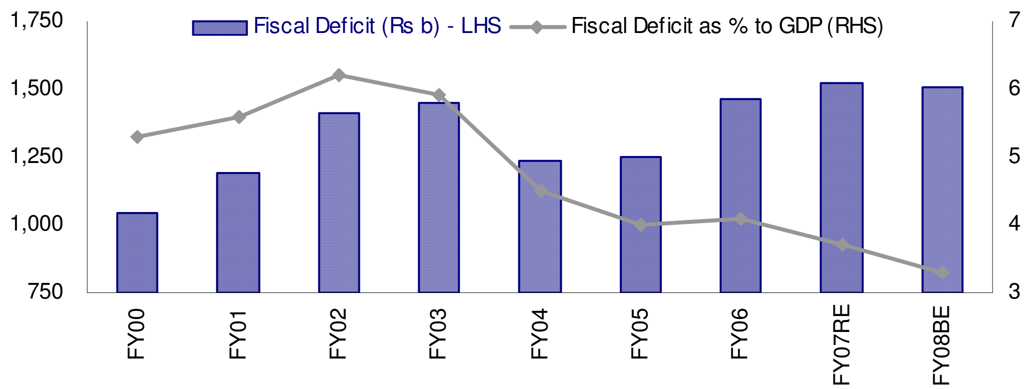


Source: Budget Documents/Inquire

Economy: key trends (Contd.)

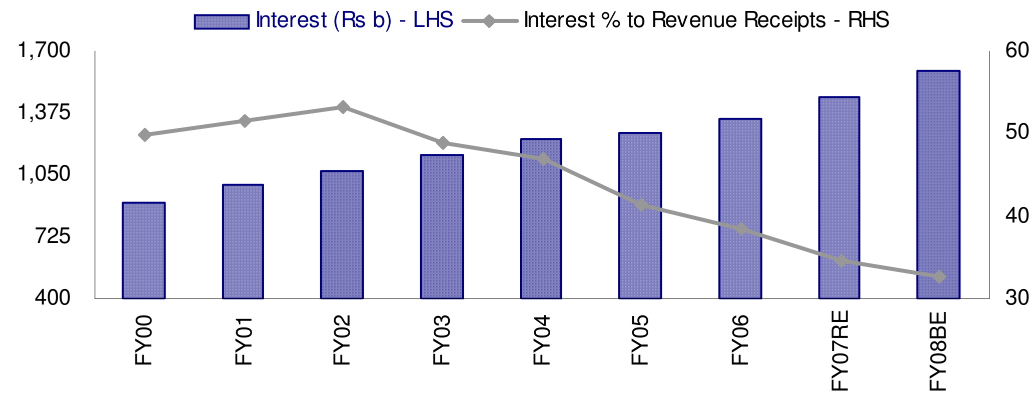
Fiscal deficit to continue falling as a percentage of GDP

FISCAL DEFICIT AS A % OF GDP



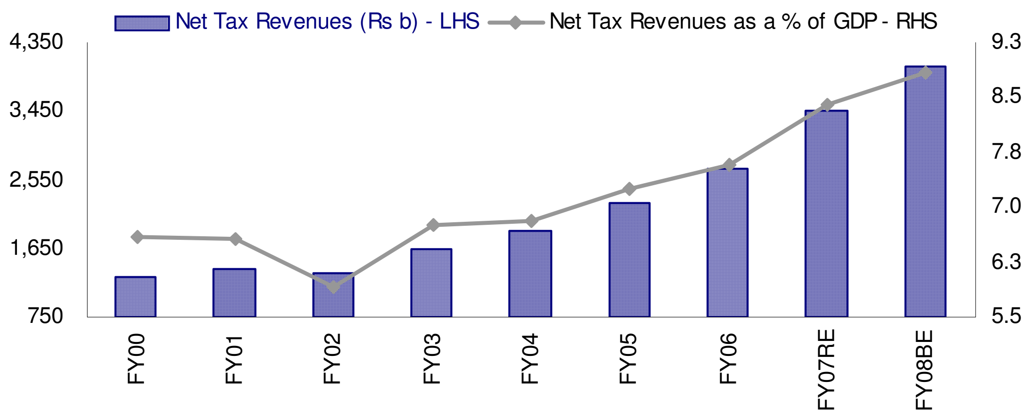
Interest expenditure as a percentage of revenue receipts will keep falling

INTEREST EXPENSE AND INTEREST AS % OF REVENUE RECEIPTS



Net tax revenue as a percentage of GDP to continue rising

NET TAX REVENUE TO GDP



Source: Budget Documents/Inquire

Budget at a glance

	FY00	FY01	FY02	FY03	FY04	FY05	% CH.	FY06	% CH.	FY07BE	FY07RE	% CH.	FY08BE	% CH.
Revenue (Rs b)														
Gross Tax Revenue	**1,718**	**1,886**	**1,967**	**2,219**	**2,543**	**3,060**	**20.3**	**3,662**	**44.0**	**4,422**	**4,679**	**27.8**	**5,481**	**17.2**
Corporation Tax	307	357	391	447	636	827	30.1	1,013	22.5	1,330	1,465	44.6	1,684	15.0
Income Tax	256	318	344	373	414	509	509.3	639	25.6	774	825	29.1	988	19.7
Excise Duty	619	685	745	874	908	1,007	11.0	1,112	10.4	1,190	1,173	5.4	1,302	11.0
Customs	484	475	432	455	486	563	15.7	651	15.7	771	818	25.7	988	20.7
Other Tax Revenues	51	51	55	70	100	155	54.6	247	59.3	357	398	61.4	520	30.6
Devolvement to States and UTs	**435**	**517**	**630**	**561**	**658**	**796**	**21.0**	**944**	**18.6**	**1,134**	**1,204**	**27.5**	**1,425**	**18.3**
Net Tax Revenues	**1,283**	**1,369**	**1,337**	**1,642**	**1,870**	**2,248**	**20.2**	**2,703**	**20.2**	**3,272**	**3,460**	**28.0**	**4,039**	**16.7**
Non-tax Revenues	532	557	678	728	769	812	5.6	772	-4.9	763	774	0.2	826	6.7
Net Revenue Receipts	**1,815**	**1,926**	**2,014**	**2,369**	**2,639**	**3,060**	**16.0**	**3,475**	**13.5**	**4,035**	**4,233**	**21.8**	**4,864**	**14.9**
Non-debt Capital Receipts	**119**	**174**	**200**	**216**	**842**	**665**	**-21.1**	**122**	**-81.6**	**118**	**60**	**-51.1**	**432**	**621.8**
Recovery of Loans	101	149	164	183	673	620	-7.8	106	-82.8	80	55	-48.8	15	-72.5
Other Receipts	17	25	36	34	170	44	-73.9	16	-64.3	38	5		417	
Total Revenues	**1,934**	**2,068**	**2,215**	**2,585**	**3,481**	**3,725**	**7.0**	**3,597**	**-3.4**	**4,153**	**4,293**	**19.4**	**5,296**	**23.4**
Expenditure (Rs b)														
Revenue Expenditure	**2,490**	**2,835**	**3,016**	**3,416**	**3,621**	**3,844**	**6.1**	**4,398**	**21.4**	**4,882**	**5,068**	**15.2**	**5,579**	**10.1**
Interest	902	1,007	1,072	1,157	1,241	1,269	2.3	1,318	6.2	1,398	1,462	11.0	1,590	8.8
Prem. for Prepayment of Ext. Debt						74								
Defense	352	397	400	411	453	759	67.5	483	6.6	515	515	6.7	541	4.9
Subsidies	247	269	305	446	443	437	-1.4	442	-0.1	462	535	20.9	543	1.6
Admin. & Social Services	521	631	622	687	699	504	-27.9	1,036	48.3	1,069	1,110	7.1	1,161	4.6
Plan Expenditure	468	531	617	716	786	875	11.3	1,119	42.2	1,438	1,446	29.3	1,744	20.6
Capital Expenditure	**490**	**520**	**608**	**745**	**1,092**	**1,133**	**3.8**	**664**	**-39.2**	**758**	**749**	**12.8**	**1,226**	**63.8**
Defense	119	148	162	150	169	225	33.3	344	103.8	375	345	0.2	419	21.7
Other Non-plan Expenditure	77	41	51	197	487	461	-5.5	32	-93.4	94	123	282.5	500	307.2
Plan Expenditure	294	331	395	399	436	448	2.6	288	-34.1	290	281	-2.2	307	9.2
Total Expenditure	**2,980**	**3,256**	**3,624**	**4,162**	**4,714**	**4,977**	**5.6**	**5,061**	**7.4**	**5,640**	**5,816**	**14.9**	**6,805**	**17.0**
Deficit Trends														
Fiscal Deficit	**1,046**	**1,188**	**1,410**	**1,576**	**1,233**	**1,252**	**1.5**	**1,464**	**18.8**	**1,487**	**1,523**	**4.0**	**1,509**	**-0.9**
% to GDP	*5.4*	*5.7*	*6.1*	*5.9*	*4.5*	*4.0*		*4.1*		*3.8*	*3.7*		*3.3*	
Revenue Deficit	**675**	**852**	**1,002**	**1,047**	**983**	**783**	**-20.3**	**923**	**-6.1**	**847**	**834**	**-9.6**	**715**	**-14.3**
% to GDP	*3.5*	*4.1*	*4.3*	*4.3*	*3.6*	*2.5*		*2.6*		*2.1*	*2.0*		*1.5*	
Primary Deficit	**144**	**195**	**335**	**420**	**-82**	**-18**	**-78.6**	**138**	**-268.4**	**89**	**61**	**-55.6**	**-80**	
% to GDP	*0.7*	*0.9*	*1.5*	*1.2*	*0.0*	*-0.1*		*0.4*		*0.2*	*0.1*		*-0.2*	
Financing the Deficit	**1,046**	**1,188**	**1,410**	**1,576**	**1,233**	**1,252**	**1.5**	**1,464**	**18.8**	**1,487**	**1,523**	**4.0**	**1,509**	**-0.9**
Market Borrowings	703	779	915	1,000	830	710	-14.4	1,004	21.0	1,138	1,075	7.0	1,096	2.0
Other Internal Financing	331	403	474	712	520	451	-13.3	385	-25.9	266	370	-4.0	323	-12.8
External Assistance	12	6	21	-135	-117	90	-	75	-164.1	83	79	5.2	91	15.4
Key Indicators														
Int Expenses / Fiscal Deficit	86.2	84.8	76.1	73.4	100.6	101.4		90.0		94.0	96.0		105.3	
Int Expenses / Revenues Receipts	49.7	52.3	53.2	48.8	47.0	41.5		37.9		34.7	34.5		32.7	
Defense / Total Expenditure	15.8	16.7	15.5	13.5	13.2	19.8		16.3		15.8	14.8		14.1	

FY08BE numbers adjusted for SBI stake purchase Rs400b *Source: Budget Documents/MOSt*

Macro-economic indicators

ANNUAL	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07E
National Income (Growth %)									
Gross Domestic Product	6.5	6.1	4.4	5.8	3.8	8.5	7.5	9.0	9.2
Agriculture	6.2	0.3	-0.2	6.3	-7.2	10.0	0.0	6.0	2.7
Foodgrains (M Ton)	203.6	209.8	196.8	212.8	174.8	213.9	198.4	208.6	209.2
Industry	3.7	4.8	6.4	2.7	7.1	7.4	9.8	9.6	10.0
Manufacturing	4.4	7.2	7.7	2.5	6.8	6.6	8.7	9.1	11.3
Services	8.4	10.1	5.7	7.2	7.4	8.5	9.6	9.8	11.2
Money and Banking (%)									
Money Supply (M3) Growth	19.4	14.6	16.8	14.1	14.7	16.7	12.3	21.2	21.1
Non-food credit Growth	13.0	21.9	14.1	9.4	30.1	18.9	26.7	39.6	28.0
Deposit Growth	19.3	19.3	16.2	11.5	18.9	17.6	10.8	23.4	23.0
Yield on 10-year G-sec	12.3	10.9	9.8	7.4	6.2	5.2	6.7	7.5	7.9
External Sector									
Exports (US$ b)	33.2	36.8	44.1	44.0	52.8	63.9	83.5	102.7	119.3
Change (%)	*-5.1*	*10.7*	*20.1*	*-0.4*	*20.2*	*20.9*	*30.7*	*23.0*	*16.2*
Imports (US$ b)	42.4	49.8	50.1	51.6	61.5	78.2	111.5	149.2	175.0
Change (%)	*2.1*	*17.5*	*0.5*	*3.0*	*19.3*	*27.1*	*42.5*	*33.8*	*17.3*
Forex Reserves (US$ b)	29.5	35.1	39.6	51.0	71.9	107.4	135.6	145.1	188.2
Average Exchange Rate (Rs/US$1)	42.1	43.3	45.6	47.6	48.3	45.9	45.0	44.3	45.5

MONTHLY	MAY '05	JUN '05	JUL '05	AUG '05	SEP '05	OCT '05	NOV '05	DEC '05	JAN '06	FEB '06
IIP Growth (%)	*11.7*	*9.7*	*13.2*	*10.3*	*11.4*	*4.4*	*14.4*	-	-	-
Non-food Credit Growth (%)	*32.8*	*32.6*	*32.6*	*32.8*	*31.6*	*29.9*	*35.9*	*31.0*	*30.3*	*30.2*
Deposit Growth (%)	*20.1*	*19.7*	*21.3*	*21.2*	*19.7*	*19.8*	*21.4*	*23.0*	*22.8*	*23.2*
Forex Reserves (US$ b)	156.1	156.0	157.2	158.9	158.3	160.2	168.4	170.2	172.0	181.9
Exchange Rate (Rs/US$1)	45.4	46.1	46.5	46.5	46.1	45.5	44.9	44.6	44.3	44.2
Exports (US$ b)	9.9	10.4	10.5	10.8	10.8	9.6	9.7	9.9	-	
Imports (US$ b)	14.4	14.0	14.6	14.8	16.8	15.8	15.9	15.6	-	
Wholesale Price Index (% Change)	4.8	5.1	4.8	5.1	5.4	5.5	5.5	5.4	6.6	6.3
Yield on 10-year G-sec (%)	7.7	8.1	8.2	7.9	7.6	7.6	7.4	7.6	7.8	7.9

Inquire model portfolio

SECTOR WEIGHT / PORTFOLIO PICKS	BSE-100	MOST WEIGHT	WEIGHT RELATIVE TO BSE-100	EFFECTIVE SECTOR STANCE	
Banks	**17.7**	**19.0**	**1.3**	**Overweight**	
ICICI Bank	6.5	5.0	-1.5	Buy	
HDFC Bank	2.1	5.0	2.9	Buy	
PNB	0.5	5.0	4.5	Buy	
Bank of India	0.2	2.0	1.8	Buy	
Federal Bank	0.0	2.0	2.0	Buy	
Information Technology	**15.9**	**17.0**	**1.1**	**Overweight**	
Infosys	8.7	5.0	-3.7	Buy	
Wipro	1.4	5.0	3.6	Buy	
TCS	2.0	4.0	2.0	Buy	
Satyam Computers	2.3	3.0	0.7	Neutral	
Auto	**7.1**	**12.0**	**4.9**	**Overweight**	
Maruti Udyog	0.9	4.0	3.1	Buy	
Mahindra & Mahindra	1.4	4.0	2.6	Buy	
Tata Motors	1.6	4.0	2.4	Buy	
Telecom	**7.3**	**10.0**	**2.7**	**Overweight**	
Bharti Airtel	4.2	5.0	0.8	Buy	
Reliance Comm	2.6	5.0	2.4	Buy	
Engineering/Infrastrcuture	**8.8**	**10.0**	**1.2**	**Overweight**	
L&T	3.3	5.0	1.7	Neutral	
IVRCL Infrastructures	0.0	3.0	3.0	Buy	
HCC	0.0	2.0	2.0	Buy	
Pharmaceuticals	**3.9**	**6.0**	**2.1**	**Overweight**	
Dr Reddy's Lab	0.7	3.0	2.3	Buy	
Ranbaxy Labs	0.8	3.0	2.2	Buy	
Cement	**4.0**	**6.0**	**2.0**	**Overweight**	
Gujarat Ambuja	1.1	2.0	0.9	Buy	
Grasim Industries	1.3	2.0	0.7	Buy	
Shree Cement	0.0	2.0	2.0	Buy	
Petrochemicals	**9.4**	**6.0**	**-3.4**	**Underweight**	
Reliance Inds.	8.3	6.0	-2.3	Neutral	
Metals	**4.4**	**5.0**	**0.6**	**Neutral**	
SAIL	0.6	5.0	4.4	Buy	
FMCG	**7.0**	**5.0**	**-2.0**	**Underweight**	**#**
ITC	4.0	5.0	1.0	Buy	
Oil & Gas	**5.0**	**4.0**	**-1.0**	**Neutral**	
ONGC	3.0	4.0	1.0	Buy	
Utilities	**4.1**	**0.0**	**-4.1**	**Underweight**	
Others	**5.2**	**0.0**	**-5.2**	**Underweight**	
Cash	**0.0**	**0.0**			
Total	**100.00**	**100.0**			

 # Refers to Sectors where the Analyst stance is different from the Effective Stance.

Top picks

Sectoral impact

SECTOR	BUDGET IMPACT	SECTOR STANCE	PAGE
Automobiles	Neutral	Overweight	11
Banking & Finance	Neutral-Banking, Negative-Finance	Overweight	13
Cement	Negative	Overweight	15
Engineering & Power	Positive	Overweight	17
FMCG	Positive	Overweight	19
Infrastructure	Negative	Overweight	22
Information Technology	Negative	Overweight	25
Media	Neutral	Neutral	27
Metals	Neutral	Neutral	28
Pharmaceuticals	Neutral	Overweight	29
Retail	Negative	Neutral	31
Telecom	Positive	Overweight	32
Textiles	Neutral	Neutral	33

Automobiles

Budget Impact: Neutral Sector Stance: Overweight

The Budget was neutral for the automobile industry. The expected excise duty reduction for cars was not declared. However, the reduction in peak customs duty, continued focus on roads and highways and increase in rural credit are positives for the sector.

Excise duty rates maintained

It was expected that this budget would end the disparity between the excise duty rate applicable to cars lesser than 4,000mm in length and having an engine size of less than 1,200cc (petrol) / 1,500cc (diesel) and the excise duty rate applicable to other passenger vehicles. This would have entailed reducing excise levy on other passenger vehicles (PVs) by 8%-16%, which would have resulted in reduction of car prices for buyers.

Our comment: While this will result in a marginally negative sentiment for the sector, we do not foresee this hampering long-term growth for PVs. We expect companies such as Maruti to continue registering strong growth.

Focus on roads / highways

The government's focus on road transport has continued, with the budgetary support for NHDP being enhanced from Rs99.5b in FY07 to Rs106.7b in FY08.

Work on the Golden Quadrilateral is nearly complete and the North-South, East-West corridor project is expected to be completed by 2009. NHDP-III, NHDP-V and NHDP-VI are in advanced stages of planning or implementation.

To quicken project preparation in the public private partnership (PPP) route, a revolving fund with a corpus of Rs1b will be set up, to contribute up to 75% of preparatory expenditure in the form of interest-free loans, which will be recovered from the successful bidder. This will help speed up the implementation of projects under PPP.

Bharat Nirman and other flagship programs will witness creation of 2.4m hectares of additional irrigation potential, and will also result in improving the rural road network.

Our comment: The government's focus on highway development continues, along with emphasis on public-private partnership. Improved rural network and continued progress on the highway projects are positives for CV players such as Tata Motors and Ashok Leyland.

Increase in rural credit

The budget is targeting farm credit of Rs2,250b for FY08, with addition of 5m farmers to the banking system. The government has also provided Rs16.8b towards 2% interest subvention for short-term crop loans.

Our comment: The continuing focus of the government on the rural economy is positive for Mahindra & Mahindra and other tractor manufacturers, as well as to the 2-wheeler sector, as nearly 40%-45% of their sales are to the rural sector.

Automobiles (Contd.)

Taxation is a mixed bag

An additional levy of 1% on all taxes has been imposed to fund secondary and higher education. This is a marginal negative as it will increase the effective tax rate for auto companies by ~0.3%. On the other hand, the 150% weighted tax deduction for R&D expenditure has been extended for five more years until 2012.

Increase in defense allocation

Defense allocation has been increased to Rs960b; this is a positive for Ashok Leyland as it supplies heavy commercial vehicles (HCVs) and water bowsers to the defense sector.

Reduction in peak customs duty to 10%

Peak customs duty is reduced from 12.5% to 10% (it was reduced from 15% to 12.5% in the previous budget).

Our comment: This will be beneficial to the auto component companies Mico, Sona Koyo etc. that import components for their final products. However, it will also make the scenario competitive for the ancillary sector, as auto companies can import components at lower costs. For example, Maruti, which imports 19% of its raw material and 35% machinery spares may increase its import content to some extent to take advantage of the lower duties.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Automobiles													
Ashok Leyland	Buy	12.4	10.3	9.1	6.7	5.3	4.5	0.7	0.6	0.5	3.2	2.8	2.6
Bajaj Auto	Neutral	20.1	16.9	14.6	14.3	11.1	8.9	2.2	1.7	1.3	4.7	4.0	3.3
Bharat Forge	Buy	25.6	19.4	16.1	15.0	11.4	9.0	3.9	3.0	2.3	5.7	4.7	3.7
Eicher Motors	Neutral	15.1	12.4	10.9	5.3	3.8	2.7	0.3	0.3	0.2	1.9	1.7	1.5
Hero Honda	Neutral	14.9	12.5	10.8	9.3	7.6	6.3	1.2	1.0	0.8	5.5	4.6	3.9
Mahindra & Mahindra	Buy	14.6	12.4	10.6	14.6	13.3	11.9	1.8	1.6	1.4	5.7	4.8	3.8
Maruti Udyog	Buy	15.8	13.5	11.3	8.9	7.2	5.6	1.4	1.1	0.9	3.5	2.9	2.4
Punjab Tractors	Neutral	25.4	22.8	21.1	14.9	13.3	12.0	1.9	1.7	1.5	3.2	2.9	2.7
Swaraj Mazda	Neutral	22.2	18.2	15.4	12.0	10.6	9.3	0.7	0.7	0.6	4.7	4.2	3.6
Tata Motors	Buy	13.4	11.8	10.4	8.3	7.2	6.3	1.0	0.9	0.8	4.6	3.8	3.1
TVS Motor	Neutral	18.3	15.1	12.7	8.1	6.7	5.4	0.4	0.3	0.3	1.8	1.6	1.5
Sector Aggregate		**17.6**	**15.2**	**13.3**	**10.3**	**8.5**	**7.1**	**1.3**	**1.1**	**0.9**	**4.4**	**3.7**	**3.1**

Banking & Finance Budget Impact: Neutral-Banks, Negative-Finance Sector Stance: Overweight

Strong macro growth and lower fiscal deficit is a positive for the banking sector. However, with the reduction of benefits on 36 (i) (viii) and hike in dividend distribution tax, overall tax outgo is likely to increase, particularly for companies such as HDFC and IDFC.

Reduction in benefits under section 36(i) (viii)

The Finance Minister has reduced the benefits under section 36 (i) (viii) to 20% of the profits, as against 40% earlier. This provision is related to any financial entity providing long-term finance for specified purposes. On account of this, tax rates for HDFC and IDFC would increase by 3-4% (both these entities have tax rates at 20%-21%). This would reduce the earnings for HDFC by about 6% for FY08. Other major players providing housing finance and infrastructure lending – ICICI Bank and SBI – would also see 1-2% higher tax rates.

Hike in dividend distribution tax

While the dividend distribution tax has been raised from 12.5% to 15%, including the surcharge and cess of 3%, the effective rate is about 17%. While this would impact all the financial sector entities, the high payout companies would be affected more. HDFC (payout of 40%) and Andhra Bank (payout of 25-30%) are likely to be the worst affected.

Distribution tax on dividends by money market funds and liquid funds has been raised to 25%. This augurs well for the banking sector funds, which used to flow through to short-term liquid funds, due to lower tax impact. These funds could now come back to the banking system.

FBT on ESOPs likely to have marginal impact on profits of private banks

While we still await feedback from the bank management, we believe that the impact is likely to be marginal for banks like ICICI Bank and HDFC Bank, as the outstanding ESOPs are not very significant as compared to the current equity.

Lower fiscal deficit; lower net borrowings – positive for yields…

For FY08, the government has budgeted net market borrowings of Rs1,096b – a marginal jump of 2% YoY. This shows the comfortable deficit management by the government without resorting to borrowings. Thus, the overall supply of G-Secs during the next year could be contained. However, with banks also turning net buyers of G-Secs (SLR/NDTL ratio is 27-28%, currently) during FY08, coupled with the growth in demand from other segments such as insurance, pension funds, PFs, etc, there is likely to be excessive liquidity for G-Secs. This should result in higher G-Sec prices and softer yields, going forward.

…SLR cut could happen sooner than expected

This demand-supply mismatch may result in a SLR cut from the RBI sooner than expected. We believe that the SLR cut would happen as soon as the current concerns on inflations subside. We believe that SLR cut would be positive for banks, as it would help improve margins (1% cut can lead to a 3-4bp improvement in margins).

Banking & Finance (Contd.)

Focus on rural development / agriculture continues

The government's thrust on agricultural lending continues and the banking industry has done well by achieving the goal of doubling farm credit in three years, ahead of time by a year. Agriculture credit target of 1,750b for FY07 is likely to be surpassed to reach Rs1,900b. For FY08, the finance minister has fixed a target of Rs2,250b (18% jump YoY) for agricultural credit and an addition of 5m new farmers to the banking system. The 2% subvention for agriculture credit of less than Rs0.3m continues.

Certain enabling provisions for growth of regional rural banks (RRBs), like recapitalizing the weak RRBs, extending the SARFAESI Act to loans given by RRBs and permitting RRBs to accept NRE/FCNR deposits reiterate the government's thrust on rural and inclusive banking.

Maintain positive stance on banking

With overall positive outlook for the economy, we continue to be bullish on the prospects of the Indian banking industry. While we rate the budget as neutral for the sector, we believe that the markets are exaggerating concerns on margins and NPAs and valuations at current levels are extremely attractive. In fact, our discussions with several bankers over the last week reveal that core earnings are likely to remain strong and could surprise positively.

We prefer banks with high CASA ratio and that have high visibility on margins and NII growth. Our top picks in the sector are PNB, Bank of Baroda, ICICI Bank and Andhra Bank. We also believe that post underperformance, valuations have turned attractive – even for HDFC Bank and SBI.

VALUATION MATRIX

	RECO	P/E (X)			P/BV (X)			P/ABV (X)			ROE (%)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Banking													
Andhra Bank	Buy	6.7	5.5	4.5	1.2	1.0	0.9	1.2	1.0	0.9	18.2	19.7	21.0
Bank of Baroda	Buy	7.5	6.3	5.2	1.0	0.9	0.8	1.0	0.9	0.8	13.0	14.0	15.0
Bank of India	Buy	8.6	7.0	5.5	1.4	1.2	1.1	1.5	1.3	1.1	17.4	18.7	20.4
Canara Bank	Buy	6.2	5.5	4.4	1.1	0.9	0.8	1.1	1.0	0.8	18.2	17.7	19.4
Corporation Bank	Sell	7.2	6.2	5.3	1.0	0.9	0.8	1.0	0.9	0.8	14.5	14.9	15.5
HDFC Bank	Buy	25.6	19.6	15.0	4.7	3.9	3.2	4.8	4.0	3.3	19.8	21.9	23.6
HDFC	Neutral	24.5	20.9	17.4	7.0	5.9	4.9	7.1	5.9	5.0	31.1	30.5	30.7
ICICI Bank	Buy	22.6	18.6	15.2	3.0	2.7	2.4	3.2	2.9	2.4	14.0	15.3	16.6
Indian Overseas Bank	Buy	5.8	5.0	4.2	1.5	1.2	1.0	1.5	1.2	1.0	27.0	25.6	24.7
J&K Bank	Buy	10.0	8.5	7.0	1.5	1.3	1.1	1.5	1.3	1.2	15.8	16.4	17.5
Karnataka Bank	Buy	10.4	8.9	7.7	1.7	1.5	1.3	1.7	1.5	1.3	17.1	17.5	17.4
Oriental Bank	Neutral	4.8	4.7	4.3	0.9	0.7	0.7	0.9	0.8	0.7	16.8	15.7	16.0
Punjab National Bank	Buy	7.8	6.1	5.0	1.3	1.1	0.9	1.3	1.1	0.9	17.0	18.9	19.9
State Bank	Buy	13.2	11.1	9.4	1.8	1.6	1.4	2.0	1.7	1.4	14.2	15.1	15.7
Syndicate Bank	Buy	4.9	4.3	3.8	1.1	0.9	0.8	1.2	0.9	0.8	23.1	22.3	21.1
Union Bank	Buy	5.9	4.9	4.1	1.1	0.9	0.8	1.2	1.0	0.8	17.4	18.3	19.4
UTI Bank	Buy	19.8	15.1	11.7	3.8	3.1	2.5	4.0	3.3	2.6	20.7	22.7	24.0
Vijaya Bank	Neutral	5.8	4.9	4.1	1.0	0.9	0.8	1.0	0.9	0.8	18.0	18.6	19.6
Sector Aggregate		**13.2**	**11.0**	**9.1**	**2.2**	**1.9**	**1.7**	**2.1**	**1.8**	**1.5**	**16.8**	**17.7**	**18.7**

Cement

Budget Impact: Negative | Sector Stance: Overweight

The Union Budget 2007-08 is negative for the cement industry, as the government introduced differential excise duty structure. Also, there would be minor increase in tax outgo due to increase in education cess by 1% and dividend distribution tax to 15% (from 12.5%). However, the government continues to focus on infrastructure, which should result in higher cement demand.

Differential excise duty structure to increase tax burden

The finance minister has introduced a differential excise duty structure on cement. For cement sold at or below a retail price of Rs190/bag, an excise duty of Rs408/ton would apply. For cement sold at a retail price of over Rs190/bag, an excise duty of Rs618/ton would apply. Since the current cement prices across markets are higher than Rs190/bag, there would be an added burden of Rs210/ton (~51.5% increase in excise). This move reduces scope for increase in cement prices, as it would narrow the differential between domestic and import parity prices (Rs237-242/bag). Any further cement price increase would first compensate for higher excise burden (~Rs12/bag). However, our interactions with the industry participants suggest that this incremental burden of excise duty would be passed on to the consumers.

Continued focus on infrastructure to boost cement demand

Overall, there has been continued focus on infrastructure creation, which should result in higher cement demand. The following measures, which would boost cement demand:

- Higher outlay for Bharat Nirman program at Rs246b in FY08 (~up 32%). This program focuses on irrigation, rural roads and rural housing.
- Incremental outlay of Rs60b to Rs160b under the Rural Infrastructure Development Fund, for creation of rural infrastructure.
- Creation of two wholly-owned subsidiaries of IIFCL with the objective of easing finance for infrastructure projects.

Impact

Post-budget, we have moderated our pricing assumptions for 4QFY07 to Rs2/bag hike (v/s Rs5/bag earlier), to factor in the reduced scope for increase in cement prices immediately (post price hikes to factor in higher excise). However, we are maintaining our FY08 price increase assumption at Rs5/bag (which is marginally lower than 4QFY07E prices), and a Rs5/bag decline in FY09. As a result, our earnings estimates are impacted by 2-8% each for FY08 and FY09.

Sector outlook

While inflation is a concern in the short-term, the industry still has strong cycle fundamentals ahead (implying price increases once inflation is under control). The outlook for the Indian cement sector remains positive based on strong fundamentals (~10% CAGR in demand over FY06-09E and delay in new capacity additions), leading to prolonged upturn in cement cycle. The cement stocks are already 25-30% off from their peaks, on fears of various inflation containment measures. We maintain our positive stance on the sector with Buy ratings on Gujarat Ambuja and Grasim. Among mid-caps, we like Birla Corp, Kesoram and Shree Cement.

Cement (Contd.)

VALUATION MATRIX

NAME	RECO	P/E (X) FY07E	P/E (X) FY08E	P/E (X) FY09E	EV/EBITDA (X) FY07E	EV/EBITDA (X) FY08E	EV/EBITDA (X) FY09E	EV/SALES (X) FY07E	EV/SALES (X) FY08E	EV/SALES (X) FY09E	P/BV (X) FY07E	P/BV (X) FY08E	P/BV (X) FY09E
Cement													
ACC	Neutral	15.3	12.0	13.0	10.6	7.8	7.9	3.0	2.4	2.1	5.5	4.1	3.3
Birla Corporation	Buy	5.9	5.5	5.7	3.4	2.6	2.3	1.1	0.9	0.7	3.0	2.1	1.6
Grasim Industries	Buy	10.8	9.6	9.8	7.7	6.9	6.6	2.2	2.1	1.8	3.1	2.4	2.0
Gujarat Ambuja	Buy	12.2	10.7	11.3	8.9	6.8	6.6	3.2	2.7	2.5	5.4	4.2	3.5
Shree Cement	Buy	11.3	8.1	6.9	7.3	4.9	3.7	3.3	2.2	1.6	6.6	3.8	2.5
UltraTech Cement	Buy	14.6	11.9	10.9	8.4	7.0	6.2	2.5	2.2	2.0	6.4	4.3	3.2
Sector Aggregate		**13.0**	**11.0**	**11.3**	**8.3**	**6.7**	**6.2**	**2.6**	**2.2**	**2.0**	**4.9**	**3.7**	**2.9**

Engineering & Power

Budget Impact: Positive

Sector Stance: Overweight

The Union Budget 2007-08 provides significant impetus to the pace of capacity addition in power sector through accelerated reforms and new initiatives like award of coal blocks, merchant power capacity, etc. Acceleration in the pace of investments is **positive for engineering companies**.

Key budget initiatives

(1) **Fuel availability:** Imported coal is exempted from 5% customs duty, which would lower cost of power generation. The government has also allotted 26 coal blocks with reserves of 8,581m ton and four lignite blocks with reserves of 755m ton till December 2006 for various industries including Power Sector. The definition of end-user for coal blocks has been enlarged to include underground coal-gasification and coal-liquefaction to encourage investments in such technologies in the future.
(Key beneficiaries: NTPC, Tata Power, Reliance Energy and CESC)

(2) **Focus on ultra mega power projects:** As expected, the Finance Minister reiterated that of the seven ongoing ultra mega power projects, two projects would be awarded by July 2007.
Key beneficiaries: NTPC, Tata Power, Reliance Energy, CESC, Lanco, GMR (power projects); BHEL, Siemens, ABB, Crompton Greaves etc (equipment suppliers)

(3) The government has extended the **APDRP scheme** beyond FY07. Budgetary allocation towards APDRP was raised from Rs6.5b in FY07 to Rs8b for FY08. Further, the APDRP scheme has been extended to district headquarters and towns with a population of more than 50,000.
Key beneficiaries: Siemens, ABB, Crompton Greaves etc (equipment suppliers)

(4) The budget allocation under **Rajiv Gandhi Gram Vidyutikaran Yojana** has been extended to Rs4b during FY08 from Rs3b during FY07.

(5) Wind Energy

- Accelerated depreciation benefits of 80% under the Income Tax Act retained
- Budget provides grant of Rs6b for non-conventional sources of energy, which will trigger greater effort on the part of the government to identify new wind sites, conduct wind flow studies, R&D, etc.
  (Key beneficiary: Suzlon)

(6) The government has increased budgetary allocation for **defense sector** in FY08 to Rs960b, which includes Rs420b for capital expenditure. This compares with Rs890b (including Rs375b for capital expenditure) during FY07.
(Key beneficiary: Bharat Electronics)

Direct tax measures

- Increased corporate tax, due to 100bp increase in education cess
- Increased dividend distribution tax from 12.5% to 15.0%
  (**Impact:** Neutral for NTPC, Tata Power, and Reliance Energy etc as under Minimum Alternate Tax Regime; Negative for equipment suppliers as most of companies are in the full corporate tax bracket)

Engineering & Power (Contd.)

Positive for Engineering and Power sectors

We believe the Union Budget FY08 is positive for power and engineering sectors, as it aims to accelerate the pace of capacity addition and push through reforms.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Engineering													
ABB	Neutral	45.9	33.5	26.4	30.7	21.4	16.1	3.4	2.4	1.9	13.0	9.8	7.4
Alstom Projects	Neutral	33.6	27.4	23.7	31.6	24.1	20.1	2.4	2.1	1.7	9.0	7.7	6.5
Bharat Electronics	Buy	18.1	14.8	12.4	9.1	7.1	5.6	2.3	1.9	1.4	4.8	3.8	3.0
BHEL	Buy	22.5	18.4	15.4	13.4	10.7	8.7	2.7	2.2	1.9	5.8	4.6	3.7
Crompton Greaves	Buy	25.1	20.4	16.7	21.3	16.4	13.4	2.2	1.7	1.4	11.1	8.7	6.8
Cummins India	Neutral	22.3	18.5	11.8	14.4	11.5	6.8	2.0	1.6	1.2	5.2	4.5	3.4
Larsen & Toubro	Buy	25.8	20.9	16.9	24.5	19.8	16.5	2.4	2.0	1.7	7.4	6.5	5.8
Siemens	Neutral	32.5	23.0	18.2	20.8	15.5	13.4	2.2	1.6	1.3	13.3	10.2	7.6
Thermax	Buy	23.5	17.8	12.5	14.6	10.8	7.7	2.2	1.6	1.1	7.8	6.3	4.6
Sector Aggregate		**25.2**	**20.0**	**16.3**	**17.3**	**13.7**	**11.1**	**2.5**	**2.0**	**1.6**	**7.8**	**6.3**	**5.1**
Utilities													
CESC	Buy	12.1	11.7	11.0	7.9	7.8	7.6	1.7	1.6	1.6	1.6	1.4	1.3
Neyveli Lignite Corporation	Buy	8.8	8.7	8.4	3.3	3.6	4.1	2.2	2.4	2.7	1.0	1.0	0.9
NTPC	Neutral	17.3	15.7	14.6	10.9	9.5	9.4	3.6	3.2	3.1	2.3	2.2	2.0
PTC India	Buy	22.7	15.1	11.6	22.6	13.9	11.5	0.2	0.1	0.1	3.3	2.9	2.5
Reliance Energy	Buy	13.7	11.7	10.8	6.8	3.9	2.6	0.8	0.6	0.4	1.3	1.2	1.1
Tata Power	Buy	18.6	17.0	16.8	11.3	10.5	9.6	2.2	2.2	2.1	1.8	1.7	1.6
Sector Aggregate		**15.9**	**14.4**	**13.5**	**9.8**	**8.6**	**8.5**	**2.6**	**2.3**	**2.2**	**2.1**	**1.9**	**1.7**

FMCG

Budget Impact: Positive — Sector Stance: Overweight

Macro level: The budget is positive for the FMCG sector due to increased thrust on agriculture and infrastructure development, which will boost employment generation and hence the disposable income. The macro initiatives for the sector have been along the previous year's lines but with focus on improving credit flow to rural areas and productivity increase. The following macro initiatives are expected to boost long term demand potential in the economy:

- Expansion of integrated Oil Seeds, Pulses and Maize development program.
- Special purpose fund for Coffee, Rubber, Species, Cashew and Coconut as was done for tea
- Outlay on irrigation will be increased from Rs71.1b in 2006-07 to RS110b with targeted addition to irrigation potential at 0.9m hectares
- Continuation of policies in key sectors such as IT/ITES, Retail, Construction etc. which have been tipped as major employment generators in the coming years.

Food Processing: No specific announcements as against high expectations due to agricultural linkages

- Excise duty exempted on all kinds of food mixes including instant food mixes like Gulab Jamun, Sâmbhar, Soups, Cakes etc.
- Import duty on machinery imported for food processing, reduced from 10% to 7.5%
- Biscuits whose retail sale price is below Rs50 per kg will be fully tax exempt.
- Import duty on packaging machines for food processing reduced from 15% to 5%

Cigarettes: Increase in excise duty to the extent of 5% will require 2.3% average price increase on the portfolio. We believe cigarette companies will pass on this cost to the consumer. Our estimates already factor in 7% volume growth for FY08 v/s 8% volume growth during 9mFY07. Increase in excise of branded *bidis* from Rs7 to Rs11 per thousand for non-machine made *bidis* and Rs17 to Rs24 for machine made *bidis* – would make *bidis* expensive, although the huge price differential between cigarettes and *bidis* will not result in any shift in demand in favor of cigarettes.

PRODUCTS

	CUSTOMS DUTY (%)		EXCISE DUTY (RS)	
	2006-07	2007-08	2006-07	2007-08
Filter				
>85mm	30.6	30.6	2,100	2205
75-85mm	30.6	30.6	1,708	1793
70-75mm	30.6	30.6	1,285	1349
<70mm	30.6	30.6	792	832
Non Filter				
60-70mm	30.6	30.6	530	557
<60mm	30.6	30.6	161	169

Personal Care & Detergents: Reduction in peak rate of customs duty will lower the price of key raw materials for detergents; this is positive but the materials are also subject to 4% countervailing duty, which can be adjusted against excise duty. Thus companies having units in backward areas with zero excise benefits will not get any benefits.

FMCG (Contd.)

Products

	CUSTOMS DUTY (%)		EXCISE DUTY (%)		ABATEMENT (%)	
	2006-07	2007-08	2006-07	2007-08	2006-07	2007-08
Personal Care and Household Products						
Hair Oils	12.5	10	16.3	16.3	40.0	40.0
Beauty, Make up or Skin Care preparations	12.5	10	16.3	16.3	40.0	40.0
Pre Shave, Shaving or after shave	12.5	10	16.3	16.3	40.0	40.0
Preparations	12.5	10	16.3	16.3	40.0	40.0
Personal Deodorants and anti perspirants	12.5	10	16.3	16.3	40.0	40.0
Shampoos	12.5	10	16.3	16.3	40.0	40.0
Toothpaste	12.5	10	16.3	16.3	40.0	40.0
Toilet Soaps	12.5	10	16.3	16.3	40.0	40.0
Detergents	12.5	10	16.3	16.3	40.0	40.0
Laundry Soaps	12.5	10	16.3	16.3	40.0	40.0
Raw Materials						
Caustic Soda	12.5	10	16.3	16.3	-	-
Soda Ash	12.5	10	16.3	16.3	-	-
LAB	12.5	10	16.3	16.3	-	-

Packaging materials: Reduction in import duty on major materials used in making plastics such as PTA, MEG, and DMT from 10% to 7.5% provide some respite to FMCG companies from rising costs of packing materials.

Fringe Benefit Tax: ESOPS brought under the purview of FBT.

Corporate Tax: Effective tax rate to go up by 0.3%. Dividend distribution tax increased from 14% to 17%, to be a big negative, given that FMCG companies are high dividend paying companies.

ITC — Positive

Specific excise duties on cigarettes have been increased by 5% although there were expectations of imposition of VAT on cigarettes. We expect the industry to pass on the excise increase to the consumer which should come to be 2.3% of average selling price. Budget has put at rest speculation regarding the imposition of VAT, at least for the time being. ITC will also benefit from the removal of excise on biscuits below Rs50 per kg. Sunfeast glucose biscuits account for around 45% volume of ITC biscuit portfolio. Lower excise duty will result in faster breakeven of the biscuit business. Removal of excise duty on food processing items like instant mixes will benefit the company. Thrust on rural credit and employment generation will increase demand.

HLL — Positive

Increased thrust on employment generation and rural credit is a big positive as the company drives 50% sales from rural areas. Customs duty decline on key detergent inputs is a positive to the extent they are not manufactured in backward areas. Packaging costs will decline due to cut in duty on raw materials. Exemption of excise duty on instant mixes will include HLL's *Knorr* range of soups. Exemption of excise duty on water filters not using electricity is a big positive for HLL's budding water business under the brand "Pure It", as the company has plans for national rollout during CY07.

FMCG (Contd.)

Nestle — Positive

Reduction in duty on packing materials, a big positive for Nestle. Exemption of excise duty on instant mixes will be beneficial for the company. Lower import duty on machinery imported for food processing will also benefit the company.

Dabur India — Neutral

Reduction in duty on packaging material will be beneficial. Rural thrust will be big positive as the company derives more than 35% of sales from rural areas.

Tata Tea — Positive

Issue of bonds to raise money against cross holdings in companies will benefit Tata Tea, especially when it is looking to raise money to fund its various acquisitions. Thrust on rural development and increased credit will benefit the company. Similar fund will be set up for coffee and spices plantation. Implementation of VAT in remaining states will benefit demand growth for organized sector.

Asian Paints — Neutral

Titanium Dioxide has been excluded from the list of customs duty reduction. Thrust on infrastructure development will boost the demand in the economy.

Britannia — Positive

A big positive for Britannia's Tiger bran, since biscuits whose retail price does not exceed Rs50 per kg have been exempted from excise duty. Tiger contributes around 33% of Britannia's biscuit volumes. The company has been reeling under the pressure of high input costs for quite sometime. We estimate the excise duty impact to be Rs0.19 per 100 gm, which will boost our estimated PAT by 10%.

Marico — Negative

Marico's edible oil business will be negatively impacted since crude as well as refined edible oil have been exempted from the additional CV duty of 4%. Import duty on crude as well as sunflower oil has been reduced by 15 percentage points.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
FMCG													
Asian Paints	Buy	26.6	22.1	18.1	16.0	13.1	10.8	2.4	2.0	1.7	9.4	7.8	6.2
Britannia	Buy	32.1	19.6	14.3	19.3	11.5	8.0	1.1	0.9	0.7	4.8	4.1	3.4
Colgate	Neutral	22.7	19.8	16.7	19.6	16.4	13.6	3.2	2.7	2.3	14.5	12.8	11.3
Dabur	Neutral	30.2	24.5	19.9	23.4	19.2	15.8	3.8	3.3	2.8	13.9	11.0	8.7
GSK Consumer	Buy	18.8	16.4	14.5	12.5	10.4	8.9	2.1	1.7	1.5	4.3	3.7	3.2
Godrej Consumer	Neutral	24.6	19.1	15.6	19.4	15.1	12.6	3.6	3.0	2.6	33.3	28.0	22.1
HLL	Buy	25.2	21.6	18.7	21.9	18.3	15.7	3.0	2.7	2.4	14.8	14.2	12.9
ITC	Buy	23.3	19.7	16.6	14.9	12.4	10.2	4.8	4.0	3.2	6.2	5.4	4.7
Marico	Buy	28.5	20.0	16.4	16.9	12.9	10.7	2.5	2.1	1.7	24.1	14.1	9.4
Nestle	Neutral	26.9	21.8	18.1	16.4	13.9	11.5	3.3	2.9	2.6	14.6	13.0	11.5
Tata Tea	Neutral	10.6	9.6	8.6	7.2	6.6	5.6	1.3	1.2	1.0	1.7	1.5	1.3
Sector Aggregate		**23.9**	**20.1**	**17.0**	**16.5**	**13.7**	**11.4**	**3.3**	**2.8**	**2.4**	**8.0**	**6.9**	**6.0**

Infrastructure

Budget Impact: Negative

Sector Stance: Overweight

Withdrawal of Section 80(IA) benefits for construction profits, with a retrospective effect from FY00 has resulted in increased tax rates for the sector, and led to earnings downgrades. This is **negative for infrastructure companies.** The Union Budget 2007-2008 had laid significant thrust on infrastructure development and has increased budgetary allocation for most of the segments.

Withdrawal of income tax benefits (Sec 80IA) for construction profits

The Union budget 2007-2008 has clarified that the purpose of tax benefit under Sec 80-IA has been to encourage private sector participation by way of investments in development of infrastructure sector and not for the persons who merely execute the civil construction work or any other works contract. The amendment is from retrospective effect from 1 April 2000. The clarification states that in case where the person makes the investment and himself executes the civil construction work, he will be eligible for tax benefits under section 80 (IA).

COMPARATIVE TAX RATES (RS M)

	FY01	FY02	FY03	FY04	FY05	FY06
Gammon						
Profit Before Tax	202	316	250	438	516	1,112
Tax	53	119	165	252	134	69
Tax rate (%)	26	38	66	58	26	6
Profit After Tax	149	197	85	186	381	1,043
Hindustan Construction						
Profit Before Tax	429	580	452	605	750	1,383
Tax	83	154	166	248	10	135
Tax rate (%)	19	27	37	41	1	10
Profit After Tax	346	426	286	357	740	1,248
IVRCL						
Profit Before Tax	154	199	240	339	595	1,037
Tax	26	68	85	-53	28	108
Tax rate (%)	17	34	35	10	5	10
Profit After Tax	128	131	155	392	567	930
Nagarjuna Construction						
Profit Before Tax	55	156	233	404	700	1,262
Tax	4	24	49	88	127	223
Tax rate (%)	8	15	21	22	18	18
Profit After Tax	50	132	184	316	573	1,039
Patel Engineering						
Profit Before Tax	211	253	236	284	438	770
Tax	18	96	56	54	48	46
Tax rate (%)	9	38	24	19	11	6
Profit After Tax	193	157	180	230	390	724

Shading area indicates the year from which Sec 80 (IA) benefits have been considered

Infrastructure (Contd.)

IMPACT ANALYSIS: TAX ARREARS FOR FY01-FY06 (RS M)

Gammon	350
Hindustan Construction	450
IVRCL	579
Jaiprakash	-
L&T	-
Nagarjuna Construction	158
Patel Engineering	376

As companies had already paid taxes (under protest) based on the corporate tax rates, we believe that impact on funds flow towards arrears would be marginal. We downgrade our earnings estimates to factor in 1) withdrawal of tax benefits under Sec 80 (IA) 2) increased corporate tax, due to 100bp increase in education cess and 3) increased dividend distribution tax from 12.5% to 15.0%.

IMPACT ANALYSIS: EARNINGS DOWNGRADES (RS M)

	REVISED NET PROFIT			EARNINGS DOWNGRADE (%)		
	FY07	FY08	FY09	FY07	FY08	FY09
Gammon	913.9	1,366.7	1,836.9	-22.5	-23.6	-21.3
Hindustan Construction	770.6	1,409.4	1,955.8	-21.5	-20.3	-19.6
IVRCL	1,110.3	1,880.1	2,323.2	-20.8	-19.3	-16.5
Jaiprakash	4,354.4	5,420.3	7,960.2	-0.6	-0.7	-0.9
L&T	16,552.4	20,434.3	25,290.8	-1.0	-1.0	-1.0
Nagarjuna Construction	1,418.4	2,211.4	2,741.9	-21.4	-19.3	-14.2
Patel Engineering	779.2	1,123.9	1,387.9	-26.0	-23.3	-24.0

Key Budget Incentives that will drive demand: The Budget has increased allocations towards various ongoing schemes. However, no significant policies or new programmes have been announced.

- **Bharat Nirman:** Increased allocation from Rs18b during FY07 to Rs24.6b during FY08, up 31.6% YoY.
- **Jawaharlal Nehru Urban Renewal Mission:** Allocation for FY08 increased to Rs5.0b during FY08, from Rs4.6b during FY07. Till date, 538 projects with total investment of Rs24b in segments like Water supply, Sanitation, Transportation, Roads and Housing have been sanctioned.
- **Accelerated Irrigation Benefit Programme:** Budget allocation for FY08 increased to Rs11b from Rs7.1b during FY07.
- **Rural Infrastructure Development Fund:** Allocation increased to Rs120b in FY08, from Rs100b in FY07. Besides this, a window under the scheme for developing rural roads with capital outlay of Rs40b in FY07 is continued in FY08 with similar allocation.
- **Revamp of Water bodies in various states, with World Bank:** Tamil Nadu was the first beneficiary under the arrangement, and would receive Rs21.8b interest free loan from World Bank. Work scope covers around 5763 water bodies having a command area of 400,000 hectares. Similar agreement is likely to concluded for Andhra Pradesh by March 2007. Other states like Karnataka and West Bengal too are working on similar proposals. It is expected that by June 2007, two more states would avail the similar loans for revamp of local water bodies.
- **National Highway Development Programme:** Budgetary allocation has increased from Rs10b in FY07 to Rs10.7b for FY08.

Infrastructure (Contd.)

Ease of Project Funding: The government has outlined initiatives towards improving project financing for mega projects being setup on Public Private Partnership basis. Mutual funds have been permitted to set up dedicated schemes towards Infrastructure projects. Besides this, the committee headed by Mr Deepak Parekh to suggest measure to improve financing of infrastructure projects has made certain recommendations including utilization of Foreign exchange reserves. The Committee also suggested formation of two subsidiaries of India Infrastructure Finance Company Limited (IIFCL):

- To borrow funds from RBI and lend to Indian companies implementing infrastructure projects in India, or to co-finance their ECBs for such projects, solely for capital expenditure outside India
- To borrow funds from RBI, invest such funds in highly rated collateral securities, and provide 'credit wrap' insurance to infrastructure projects in India for raising resources in international markets.

VALUATION MATRIX

	RECO	P/E (X)			ADJ. P/E (X)			EV/EBITDA (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Infrastructure													
Gammon India	Buy	30.2	20.2	15.0	12.7	8.5	6.3	14.3	10.1	7.6	2.8	2.6	2.3
Hindustan Construction	Buy	34.1	19.9	14.4	15.8	9.2	6.6	14.7	9.7	7.7	2.9	1.9	1.8
IVRCL Infra.	Buy	35.3	20.8	16.9	17.1	10.1	8.1	16.9	11.5	9.5	2.9	2.6	2.3
Jaiprakash Associates	Buy	29.6	23.8	16.2	22.4	18.0	12.3	16.4	13.7	10.1	3.2	2.9	2.5
Nagarjuna Construction	Buy	22.7	14.6	11.7	16.3	10.4	8.4	14.1	10.0	8.4	1.6	1.3	1.1
Patel Engg.	Buy	26.6	18.4	14.9	14.1	9.8	7.9	14.4	10.4	8.8	3.2	2.8	2.4
Sector Aggregate		**29.5**	**20.6**	**15.2**				**15.6**	**11.7**	**9.1**	**3.5**	**2.8**	**2.4**

Information Technology Budget Impact: Negative Sector Stance: Overweight

The provisions of Union Budget 2007-08 would be Negative for the IT services sector.

Key budget provisions:

- **Extension of Minimum Alternate Tax (MAT) to income in respect of which earlier deduction was allowed u/s 10A/10B**

  Impact: MAT imposition will increase the current tax rate (payable to the government) by 3-7% across industry. This increase in the tax rate through MAT can be carried forward for the next five years. From FY10 tax exemption u/s 10A and 10B will be withdrawn and all companies under section 10A/10B will be required to pay full tax rate from FY10. However, additional MAT carry forward in FY08 and FY09 will be set off against tax required to be paid from FY10 onwards, for which the companies will create a deferred asset provision in income statement in FY08 and FY09 (risk here could be extension of 10A/10B benefit beyond FY09). Therefore, the overall tax rate (current tax rate plus deferred tax rate) will not change significantly and will not impact the EPS materially. However, additional MAT will impact the cash flow in FY08 and FY09 adversely.

- **Extension of Fringe Benefit Tax (FBT) to include ESOPs**

  Impact: ESOPs will be fully taxed to the extent of differential between the fair market value and the exercise price on the date of exercise of the option. This could be significantly negative for Tech Mahindra, considering that around 14% of its current equity is outstanding currently as ESOP. However, based on our interactions with various companies, more clarity is required in terms taxable component of ESOP benefit. Therefore, we have not changed our EPS estimates currently on account of this FBT.

- **Service tax extended to include rentals of immovable property for commercial purposes, to be taxed at 12.5%**

  Impact: We do not expect any significant impact as most of the companies operate from owned facilities. Among the large caps, the impact could be the highest for TCS and the least for Infosys. The impact will be relatively higher for midcap companies.

Overall the budget proposals are negative for IT companies. Barring clarity on FBT on ESOP, we do not expect any significant downgrades in the EPS estimates. Therefore, we continue to remain overweight on the sector considering the robust demand outlook. Our top picks are Infosys, TCS and Wipro. We are also upgrading HCL Tech and Satyam to Buy, as valuations have become attractive after the sharp correction in the recent past, and given the strong growth ahead.

Information Technology (Contd.)

VALUATION MATRIX

NAME	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Information Technology													
Geometric Software	Buy	17.7	10.7	6.9	10.6	6.1	4.1	1.9	1.0	0.7	3.1	2.5	1.9
Hexaware	Buy	16.0	11.7	9.6	12.6	9.3	7.0	2.0	1.4	1.0	2.7	2.3	1.9
HCL Technologies	Buy	19.7	16.1	13.3	12.8	9.7	7.6	2.9	2.1	1.6	4.3	3.8	3.6
i-flex solutions	Neutral	49.6	33.8	26.4	36.8	23.5	18.7	7.0	5.0	4.0	7.0	6.0	5.1
Infosys	Buy	30.9	23.8	20.1	24.9	18.5	14.8	7.9	5.8	4.5	11.2	8.1	6.1
Infotech Enterpr	Buy	20.7	14.9	11.7	13.7	9.7	7.4	2.9	2.0	1.4	5.6	4.2	3.1
KPIT Cummins Inf	Buy	20.6	15.4	11.5	15.1	10.6	7.8	2.4	1.7	1.3	5.2	4.0	3.0
MphasiS	Buy	35.8	22.3	19.1	20.1	13.8	11.3	3.5	2.7	2.1	8.7	6.8	5.4
Patni Computer	Neutral	16.3	13.6	11.4	9.2	7.1	5.4	1.7	1.4	1.0	2.6	2.2	1.9
Sasken Comm	Buy	28.4	16.3	12.6	17.6	10.2	7.4	2.9	2.0	1.5	3.2	2.7	2.3
Satyam Computer	Buy	19.7	16.1	13.7	15.1	11.6	9.2	3.6	2.6	2.0	4.9	3.9	3.2
TCS	Buy	28.0	21.6	17.8	22.6	17.1	13.8	6.2	4.6	3.6	12.9	8.8	6.4
Tech Mahindra	Buy	31.9	23.8	16.9	23.1	16.8	11.8	5.9	3.7	2.7	13.0	8.6	5.8
Wipro	Buy	28.6	21.8	18.4	22.4	16.3	12.8	5.1	3.7	2.9	7.8	6.0	4.7
Sector Aggregate		**27.6**	**21.2**	**17.4**	**21.5**	**16.0**	**12.6**	**5.5**	**4.0**	**3.1**	**8.5**	**6.5**	**5.0**

Media

Budget Impact: Neutral

Sector Stance: Neutral

The provisions announced by the Union Budget 2007-08 are **Neutral** for the media sector.

Key highlights:

- The exemption on countervailing duty (CVD) for specified components of set top boxes is withdrawn.
  Impact: Considering the limited scope to increase prices, we expect subsidies for the DTH and digital cable players to increase.

- Customs duty exemption on recorded magnetic tapes for producing TV serials and specified goods like TV cameras, audio recording equipment, tabletop desk production video machine, 8 channel video mixer/switches, has been withdrawn.
  Impact: This is likely marginally negative for content producers, the cost of which will be partly borne by broadcasters.

- Excise duty exemption on recorded videocassettes intended for television broadcasting is withdrawn and excise duty @ 8% is imposed.
  Impact: This is likely to be marginally negative.

- Increase in dividend distribution tax from 12.5% to15% and additional levy of 1% for secondary education.
  Impact: This is marginally negative for Zee Telefilms

Overall, impact of the withdrawal of exemption on excise and customs duties will be marginal for broadcasters. Though higher subsidies for set top boxes will negatively impact DTH players, we do not expect any material impact on Zee's earnings. We maintain **Neutral** on Zee.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Media													
Zee Entertainment	Neutral	49.4	28.1	34.1	29.2	17.0	12.7	7.1	5.1	4.0	3.7	3.3	2.9
Sector Aggregate		**49.4**	**28.1**	**34.1**	**29.2**	**17.0**	**12.7**	**7.1**	**5.1**	**4.0**	**3.7**	**3.3**	**2.9**

Metals

Budget Impact: Neutral

Sector Stance: Neutral

Duty structure

- Customs duty on import of steel and base metal remains unchanged at 5%. However, duty on import of seconds and defective steel is reduced from 20% to 10%. Excise levy too remains unchanged.
- Customs duty exemption on import of low ash (below 14% ash content) coking coal has been extended (by removing the 5% duty) to all categories of coking coal.
- Rs300 per ton export tax has been imposed on export of iron ore and concentrates. Rs2,000 per ton export tax has been imposed on chrome ore and concentrate exports.

Implications

- The Union Budget is neutral on the metal sector as duties remain unchanged. In January 2007, import duty on base metals was brought down by 7.5% to 5%, in line with the duty on steel. Exemption of duty on import of low ash coking coal has been extended to all categories of coking coal. Large steel producers in India import only low ash coking coal and hence remain unaffected. Bringing down of duty from 20% to 10% on import of seconds and defective steel too would have no implication on the industry. This would perhaps be beneficial to the unorganized sector.
- Export tax on iron ore will adversely affect the earnings of miners like Sesa (FY08 EPS would be lower by Rs32 to Rs170) who sell a majority of iron ore on a long term contract basis. Long term contracts have been recently negotiated for 9.5% for supplies in 2007-2008. However, Indian miners would try to pass on the additional burden by raising spot prices depending on pricing power from time to time. Also, the iron ore (pure) traders who buy ex-mines and export on a spot basis will have no room to play and their business would be wiped out. This would reduce overall availability of iron ore in spot sales and perhaps cap total export volumes. India is the third largest exporter of iron ore in world with 12% market share and absolute volumes of 90mt.
- Export tax on chrome ore will discourage exports and benefit stand-alone ferro-chrome smelters. Tata Steel sells 150,000 tons of ferro-chrome produced from its own mined ore.

Outlook

We believe that discouraging export of iron ore would introduce further tightness in global iron ore supply and widen the competitive advantage for India steel producers (Tata Steel, SAIL, JSW Steel and Jindal Steel & Power) versus international steel producers. Firm pricing of steel in the global market due to strong demand, supply side discipline due to rising global consolidation in industry and rising iron ore costs for international steel producers, continue to tilt the fundamentals in favor of domestic steel producers. We prefer integrated players SAIL and Jindal steel & Power. Nalco and Hindustan Zinc would benefit from strong aluminium and zinc prices at LME respectively. Sterlite too will benefit due to its holdings in Balco (aluminium producer) and Hindustan Zinc.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Metals													
Hindalco	Buy	6.1	6.0	5.3	4.4	4.1	3.5	1.0	0.9	0.8	1.3	1.0	0.9
Jindal Steel & Power	Buy	10.1	7.6	6.8	7.6	5.5	4.1	3.0	2.0	1.6	2.9	2.1	1.8
JSW Steel	Buy	6.7	5.2	4.5	4.2	3.3	3.4	1.4	1.1	1.1	1.5	1.2	1.0
Nalco	Buy	5.8	7.5	7.4	2.9	3.8	3.5	1.7	2.0	1.8	1.7	1.5	1.3
SAIL	Buy	7.5	6.7	5.2	9.3	8.9	7.4	2.7	2.6	2.4	2.5	1.9	1.4
Tata Steel	Buy	6.0	5.6	3.8	3.5	2.9	2.0	1.1	0.9	0.7	1.8	1.4	1.0
Sector Aggregate		**6.7**	**6.3**	**4.9**	**5.8**	**5.4**	**4.4**	**1.8**	**1.6**	**1.4**	**1.9**	**1.5**	**1.2**

Pharmaceuticals

Budget Impact: Neutral

Sector Stance: Overweight

Budget 2007-08 is neutral for the pharmaceutical sector. There were very few major sector specific measures that could have a material bearing on the immediate prospects of Pharma companies. However, the budget left excise duty untouched for the pharmaceutical products, as against expectation of reduction to 8% from 16%. The reduction in custom duty is unlikely to result in any significant benefits as a major portion of imports are duty free, particularly for Indian companies.

Some of the key sector specific measures in the budget include:

1) Applicability of Minimum Alternate Tax (MAT) for EoUs
Impact: This will be applicable to only those companies, which are currently under MAT, but which get exemption on profits from Export Oriented Units (EoU). Applicability of MAT on EoU profits is likely to increase the tax outgo for these companies. However, since the EoU benefits are expiring in 2009, the deferred tax component is likely to reduce resulting in no change in the effective tax rate for companies. Since this will involve an additional tax outgo till 2009, we have modeled higher tax rate for these companies assuming that the EoU benefits will be extended beyond 2009. Companies likely to be impacted by this are Biocon, Cadila Healthcare (Altana JV is an EoU) and Aurobindo Pharma.

2) Reduction in peak custom duty for non-agricultural products from 12.5% to 10%
Impact: Marginally positive, as majority of imports of the pharmaceutical industry are duty-free against export commitments, particularly for Indian companies. Also, in the past, customs duty cuts have been passed on to consumers and retailers due to the intensely competitive market. Hence, we do not expect any major impact of the customs duty cut.

3) Extension of 150% weighted deduction on R&D till 2012
Impact: This benefit was expiring on 31st Mar-07 and hence its extension by another 5 years implies that pharmaceutical companies will continue to get this benefit. We do not expect any change in our estimates due to this as we had already factored in the extension of this benefit.

4) Fringe Benefit Tax (FBT) to exclude expenses on free samples of medicines and of medical equipment distributed to doctors
Impact: Marginally positive, as all the companies were paying FBT at marginal rate of tax on 20% of value of free samples of medicines distributed to doctors. However, the amount of saving due to exclusion of free samples from FBT would be negligible.

Besides, there are certain general measures that would impact pharma companies:

Additional 1% “Secondary Education Cess”
Impact: We expect a very marginal increase in tax liability due to this.

Earnings Outlook: Earnings estimates for our pharmaceutical coverage remain largely unchanged (except for Biocon, Cadila and Aurobindo), since the budget had no major proposal specific to the pharma sector that would lead to a near term impact on growth or profitability. However, zero reduction in excise duty would compel some of the players who do not have access to excise-exempt zones, to re-look at options of either setting-up a facility at such locations or outsource from existing units at these locations.

Pharmaceuticals (Contd.)

PHARMA – EARNINGS IMPACT DUE TO MAT ON EOU (RS M)

COMPANY	FY08E - CURRENT					FY08E - REVISED					EPS
	PBT	TAX RATE (%)	TAX	PAT	EPS	PBT	TAX RATE (%)	TAX	PAT	EPS (RS)	CHG. (%)
Aurobindo Pharma	3,431	18.0	618	2,729	39.9	3,431	20.0	686	2,661	38.9	-2.4
Biocon	2,884	10.0	288	2,616	26.2	2,884	15.0	433	2,472	24.7	-5.5
Cadila Healthcare	3,194	13.0	415	2,779	22.1	3,194	14.7	469	2,724	21.7	-1.9

Note:Although, the overall tax rate for these companies may not change due to reduction in deferred tax, since it will involve an actual cash outflow for the companies, we have modeled higher tax rate assuming that the EoU benefits will be extended beyond 2009.

Sector strategy and recommendation

Overall, we remain favorably inclined towards Large Generic Companies and MNC Pharma stocks in the long-term. We also believe that the Indian contract manufacturing segment will witness secular growth (given India's advantages) with the financial impact visible from FY08/09 onwards.

In the generics segment, we prefer to bet on larger companies with strong product baskets, diversified geographical presence and vertically integrated manufacturing. Leading Pharma MNCs are also geared to gain from the opportunities arising in the stronger patent regime post 2005. The potential upside from product patents would create 'option value' in these stocks over the longer term. Ranbaxy Labs, GSK Pharma and Nicholas Piramal remain our top picks.

VALUATION MATRIX

NAME	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Pharmaceuticals													
Aurobindo Pharma	Sell	20.0	16.3	12.6	12.5	10.3	8.4	2.1	1.8	1.7	3.3	2.6	2.1
Aventis Pharma	Buy	16.2	14.8	13.0	10.0	8.1	6.8	2.7	2.3	2.1	4.6	3.8	3.2
Biocon	Buy	22.3	18.5	16.2	15.7	11.8	10.0	4.5	3.7	3.6	4.4	3.7	3.1
Cadila Health	Buy	17.4	14.8	12.2	10.7	8.9	7.4	2.3	1.9	1.5	4.4	3.6	2.9
Cipla	Buy	25.1	21.1	17.4	18.9	15.4	12.4	4.7	3.9	3.8	5.4	4.5	3.7
Divis Labs	Neutral	30.2	23.3	18.9	20.6	16.2	13.5	5.9	4.9	4.9	8.5	6.6	5.1
Dr Reddy' s Labs	Buy	27.3	18.9	16.4	16.7	13.7	12.2	2.9	2.5	2.4	3.2	2.8	2.5
GSK Pharma	Buy	27.1	24.1	20.7	18.4	15.7	13.1	5.7	5.0	4.8	8.2	6.8	5.6
Jubiliant Organosys	Buy	20.3	15.3	13.1	11.6	9.2	7.2	2.1	1.8	1.6	3.0	2.5	2.0
Lupin	Buy	24.4	16.9	14.6	16.8	12.4	10.4	2.6	2.1	2.1	6.1	4.7	3.7
Matrix	Neutral	27.0	14.2	12.9	21.3	14.4	11.1	2.4	2.0	1.9	2.6	2.2	1.9
Nicholas Piramal	Buy	20.9	15.1	12.0	13.3	10.9	8.8	2.2	1.9	1.8	4.4	3.8	3.2
Pfizer	Neutral	18.7	21.9	19.0	12.2	13.0	10.8	2.9	3.0	2.9	5.0	4.6	4.1
Ranbaxy Labs	Buy	24.9	19.6	15.1	14.7	12.1	9.8	2.3	2.0	1.6	4.7	4.1	3.6
Shasun Chemicals	Buy	-53.4	9.0	6.3	8.6	6.0	4.6	0.8	0.6	0.6	2.6	2.2	1.8
Sun Pharma	Buy	26.4	22.1	18.0	23.9	19.3	15.5	8.0	6.5	6.2	7.9	6.5	4.9
Wockhardt	UR	14.5	11.7	10.5	10.0	7.1	6.3	2.3	1.7	1.7	11.8	9.3	8.4
Sector Aggregate		**23.9**	**18.8**	**15.6**	**15.9**	**12.8**	**10.6**	**3.2**	**2.7**	**2.5**	**5.3**	**4.4**	**3.7**

Retail

Budget Impact: Negative | Sector Stance: Neutral

Retail sector has not received any specific incentives to propel growth. Lease rentals paid by retail companies have been brought under 12% service tax net, which is expected to increase the lease rentals by 9-10%. This will either get reflected in lower margins or lower discounts by the retailers to the consumers. The companies like Reliance Retail will be big beneficiaries as they plan to own a big chunk of real estate. Most of the existing retailers in India have either leased space or have a franchisee model. We expect the impact to decline for the properties which are yet to be signed but the impact for the existing properties will be full.

Pantaloon Retail — Negative

Pantaloon Retail will report sharp increase in lease rentals due to service tax. As the company has already tied up for over 23m square ft of space, the hit could be felt even on the properties which are likely to be commissioned in next 2-3 years. We expect the estimated EPS to take a hit of 9% (current estimates of Rs14.2 and Rs21.4 for FY08 and FY09) if the company absorbs full impact of service tax.

Shoppers Stop — Negative

Shopper's Stop has been slower than Pantaloon on the property acquisition front. We expect estimated profits to be lower by 11% for Shopper's Stop (current estimates of Rs12.6 and 19.0 for FY08 and FY09) if the company absorbs full service tax impact.

Titan Industries — Neutral

Titan Industries will benefit from reduction in import duty on polished diamonds, gemstones etc. in its jewellery division. In addition the company will also gain from reduction in import duty on watch components as it imports watch moments for Sonata as well as high-end watches like Xylus. Titan has limited owned stores and operates through a franchisee model. But the company has plans to open 85 owned watch stores in the coming 15 months. Service tax can have impact on stores which have already been tied up. We do not rule out a change in strategy of the company to expand owned retail stores, in the event of service tax.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Retail													
Pantaloon Retail	Buy	49.4	29.5	19.6	25.2	15.0	11.1	1.9	1.2	0.8	8.7	5.7	4.4
Shopper's Stop	Neutral	61.3	49.7	35.4	29.7	23.5	17.3	2.6	1.9	1.4	7.8	7.1	6.4
Titan Industries	Neutral	38.4	24.3	16.7	20.0	14.0	10.5	1.8	1.5	1.2	12.8	7.4	5.4
Sector Aggregate		**46.1**	**28.7**	**19.5**	**24.0**	**15.7**	**11.6**	**2.0**	**1.3**	**1.0**	**9.4**	**6.2**	**4.9**

Telecom

Budget Impact: Positive

Sector Stance: Overweight

The provisions announced by the Union Budget 2007-08 are **positive** for the sector.

Key highlights:

- The Government of India has asked DOT to constitute a committee to study the multifarious structure of levies and make suitable recommendations for a unified and single levy on revenue.
  Impact: This will likely be a step in the direction of reducing license fee, as Indian telecom operators pay up to 28%-30% of revenues to the government whereas China pays merely 3%-5%. Though the reduction in levies will be passed on, it will be positive for both Bharti and RCom, as the addressable market for these companies would expand.

- Contrary to street expectation, service tax is not increased, however service tax has been extended to the development and supply of content for use in telecom.
  Impact: Negative for telecom content providers. But we do not expect any impact on service providers, considering the strong bargaining power of operators.

- Allocation to Universal Service Obligation (USO) funds has increased from Rs150b to Rs180b
  Impact: Positive on wireless operators, as more subsidies are allocated for rural expansion

- Peak customs levy reduced to 10% from 12.5%.
  Impact: Reduction in peak customs duties would be marginally positive for the telecom operators, as they import materials for their expansion activities.

- Increase in dividend distribution tax from 12.5% to15% and additional levy of 1% for secondary education
  Impact: This is marginally negative for all telecom companies

Though there are no material changes to our earnings estimates, we think the Finance Minister has recognized the need to rationalize levies paid by telecom operators.

We remain positive on the sector and maintain Buy on Bharti Airtel and RCom.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Telecommunication													
Bharti Airtel	Buy	32.7	22.5	18.2	19.0	12.7	9.6	7.6	5.2	4.0	10.2	7.0	5.1
Reliance Comm	Buy	27.6	18.1	14.1	14.9	9.8	7.5	5.9	4.0	3.1	5.6	4.3	3.4
VSNL	Neutral	28.5	26.8	22.1	11.4	9.3	7.7	2.5	2.2	2.0	1.7	1.6	1.5
Sector Aggregate		**30.4**	**20.9**	**16.6**	**16.9**	**11.4**	**8.7**	**6.4**	**4.5**	**3.5**	**6.7**	**5.1**	**4.0**

Textiles

Budget Impact: Neutral

Sector Stance: Neutral

We view the Union Budget 2007-08 as Neutral for the textile industry. A prominent measure relating to this industry is extension of the Textile Upgradation Fund (TUF) scheme to the Eleventh Plan (2008-2012).

Other key announcements:

- Increase in outlay for scheme for integrated textile parks (SITP) from Rs1.9b to Rs4.3b
- Increase in outlay for TUF scheme from Rs5.4b in FY07 to Rs9.1b for FY08
- Import duties for polyester fibers and yarns reduced from 10% to 7.5%.

The budget however failed to address labor reforms, which was the key demand of the textile industry.

Key highlights:

Extension of TUF scheme by 5 years: The Union Budget 2007-08 has extended the Textile Upgradation Fund (TUF) scheme to the Eleventh Plan (2008-2012). Though extension of the TUF scheme by five years is a long term positive for textiles, in the medium-to-short term, it is likely to compound the prevailing problem of overcapacity due to the continued availability of subsidized funds. Further, attractiveness of the TUF scheme has also reduced considerably due to the increased interest rate scenario. Earlier, the effective interest cost for textile companies after TUF subsidy was 3%-4%, going forward it would increase to 7%-8% due to the prevailing high interest rates.

Outlay for Scheme for Integrated Textile Parks (SITP) increased from Rs1.9b to Rs4.3b: Will benefit this industry, in particular, the small and medium scale companies.

Outlay for TUF scheme increased: The Budget increased the outlay for Textile Up-gradation Fund (TUF) scheme from Rs5.4b in FY07 to Rs9.1b for FY08. This should be positive for the industry.

Cut in customs duty on man-made textiles: Import duties for polyester fibers and yarns from 10% to 7.5%. Reduction in import duty of polyester chips and raw materials (PTA, MEG) would marginally benefit Alok, Indo Rama Synthetics and Spentex.

We continue to maintain **Neutral** rating on Arvind, Alok, Welspun, Raymond and Himatsingka Seide. We remain bullish on Vardhman Textiles and Gokaldas and rate them as our top picks in the textile industry.

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Textiles													
Alok Ind	Neutral	8.4	5.9	4.7	8.6	6.6	5.5	1.9	1.5	1.3	1.1	1.0	0.8
Arvind Mills	Neutral	35.2	12.9	10.4	9.5	8.1	7.4	1.9	1.6	1.4	0.7	0.7	0.6
Gokaldas Exports	Buy	12.1	9.7	8.2	7.8	6.5	5.3	0.9	0.7	0.6	0.9	0.7	0.8
Himatsingka Seide	Neutral	20.6	13.3	10.7	18.6	9.4	7.6	5.3	2.3	1.9	2.0	1.8	1.6
Raymond	Neutral	11.9	9.9	7.9	7.4	6.1	4.9	1.1	1.0	0.8	1.5	1.4	1.2
Vardhman Textiles	Buy	7.8	6.6	5.5	7.0	7.3	6.2	1.2	1.4	1.2	1.1	1.0	0.9
Welspun Ind	Neutral	10.1	7.7	6.1	9.2	8.1	6.9	1.7	1.6	1.5	1.0	0.9	0.8
Sector Aggregate		**11.5**	**8.6**	**7.0**	**8.6**	**7.2**	**6.1**	**1.5**	**1.4**	**1.2**	**1.2**	**1.1**	**1.0**

Valuation Matrix

VALUATION MATRIX

NAME	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Automobiles													
Ashok Leyland	Buy	12.4	10.3	9.1	6.7	5.3	4.5	0.7	0.6	0.5	3.2	2.8	2.6
Bajaj Auto	Neutral	20.1	16.9	14.6	14.3	11.1	8.9	2.2	1.7	1.3	4.7	4.0	3.3
Bharat Forge	Buy	25.6	19.4	16.1	15.0	11.4	9.0	3.9	3.0	2.3	5.7	4.7	3.7
Eicher Motors	Neutral	15.1	12.4	10.9	5.3	3.8	2.7	0.3	0.3	0.2	1.9	1.7	1.5
Hero Honda	Neutral	14.9	12.5	10.8	9.3	7.6	6.3	1.2	1.0	0.8	5.5	4.6	3.9
Mahindra & Mahindra	Buy	14.6	12.4	10.6	14.6	13.3	11.9	1.8	1.6	1.4	5.7	4.8	3.8
Maruti Udyog	Buy	15.8	13.5	11.3	8.9	7.2	5.6	1.4	1.1	0.9	3.5	2.9	2.4
Punjab Tractors	Neutral	25.4	22.8	21.1	14.9	13.3	12.0	1.9	1.7	1.5	3.2	2.9	2.7
Swaraj Mazda	Neutral	22.2	18.2	15.4	12.0	10.6	9.3	0.7	0.7	0.6	4.7	4.2	3.6
Tata Motors	Buy	13.4	11.8	10.4	8.3	7.2	6.3	1.0	0.9	0.8	4.6	3.8	3.1
TVS Motor	Neutral	18.3	15.1	12.7	8.1	6.7	5.4	0.4	0.3	0.3	1.8	1.6	1.5
Sector Aggregate		**17.6**	**15.2**	**13.3**	**10.3**	**8.5**	**7.1**	**1.3**	**1.1**	**0.9**	**4.4**	**3.7**	**3.1**
Cement													
ACC	Neutral	15.3	12.0	13.0	10.6	7.8	7.9	3.0	2.4	2.1	5.5	4.1	3.3
Birla Corporation	Buy	5.9	5.5	5.7	3.4	2.6	2.3	1.1	0.9	0.7	3.0	2.1	1.6
Grasim Industries	Buy	10.8	9.6	9.8	7.7	6.9	6.6	2.2	2.1	1.8	3.1	2.4	2.0
Gujarat Ambuja	Buy	12.2	10.7	11.3	8.9	6.8	6.6	3.2	2.7	2.5	5.4	4.2	3.5
Shree Cement	Buy	11.3	8.1	6.9	7.3	4.9	3.7	3.3	2.2	1.6	6.6	3.8	2.5
UltraTech Cement	Buy	14.6	11.9	10.9	8.4	7.0	6.2	2.5	2.2	2.0	6.4	4.3	3.2
Sector Aggregate		**13.0**	**11.0**	**11.3**	**8.3**	**6.7**	**6.2**	**2.6**	**2.2**	**2.0**	**4.9**	**3.7**	**2.9**
Engineering													
ABB	Neutral	45.9	33.5	26.4	30.7	21.4	16.1	3.4	2.4	1.9	13.0	9.8	7.4
Alstom Projects	Neutral	33.6	27.4	23.7	31.6	24.1	20.1	2.4	2.1	1.7	9.0	7.7	6.5
Bharat Electronics	Buy	18.1	14.8	12.4	9.1	7.1	5.6	2.3	1.9	1.4	4.8	3.8	3.0
BHEL	Buy	22.5	18.4	15.4	13.4	10.7	8.7	2.7	2.2	1.9	5.8	4.6	3.7
Crompton Greaves	Buy	25.1	20.4	16.7	21.3	16.4	13.4	2.2	1.7	1.4	11.1	8.7	6.8
Cummins India	Neutral	22.3	18.5	11.8	14.4	11.5	6.8	2.0	1.6	1.2	5.2	4.5	3.4
Larsen & Toubro	Buy	25.8	20.9	16.9	24.5	19.8	16.5	2.4	2.0	1.7	7.4	6.5	5.8
Siemens	Neutral	32.5	23.0	18.2	20.8	15.5	13.4	2.2	1.6	1.3	13.3	10.2	7.6
Thermax	Buy	23.5	17.8	12.5	14.6	10.8	7.7	2.2	1.6	1.1	7.8	6.3	4.6
Sector Aggregate		**25.2**	**20.0**	**16.3**	**17.3**	**13.7**	**11.1**	**2.5**	**2.0**	**1.6**	**7.8**	**6.3**	**5.1**
FMCG													
Asian Paints	Buy	26.6	22.1	18.1	16.0	13.1	10.8	2.4	2.0	1.7	9.4	7.8	6.2
Britannia	Buy	32.1	19.6	14.3	19.3	11.5	8.0	1.1	0.9	0.7	4.8	4.1	3.4
Colgate	Neutral	22.7	19.8	16.7	19.6	16.4	13.6	3.2	2.7	2.3	14.5	12.8	11.3
Dabur	Neutral	30.2	24.5	19.9	23.4	19.2	15.8	3.8	3.3	2.8	13.9	11.0	8.7
GSK Consumer	Buy	18.8	16.4	14.5	12.5	10.4	8.9	2.1	1.7	1.5	4.3	3.7	3.2
Godrej Consumer	Neutral	24.6	19.1	15.6	19.4	15.1	12.6	3.6	3.0	2.6	33.3	28.0	22.1
HLL	Buy	25.2	21.6	18.7	21.9	18.3	15.7	3.0	2.7	2.4	14.8	14.2	12.9
ITC	Buy	23.3	19.7	16.6	14.9	12.4	10.2	4.8	4.0	3.2	6.2	5.4	4.7
Marico	Buy	28.5	20.0	16.4	16.9	12.9	10.7	2.5	2.1	1.7	24.1	14.1	9.4
Nestle	Neutral	26.9	21.8	18.1	16.4	13.9	11.5	3.3	2.9	2.6	14.6	13.0	11.5
Tata Tea	Neutral	10.6	9.6	8.6	7.2	6.6	5.6	1.3	1.2	1.0	1.7	1.5	1.3
Sector Aggregate		**23.9**	**20.1**	**17.0**	**16.5**	**13.7**	**11.4**	**3.3**	**2.8**	**2.4**	**8.0**	**6.9**	**6.0**

Valuation Matrix (Contd.)

VALUATION MATRIX

NAME	RECO	P/E (X) FY07E	P/E (X) FY08E	P/E (X) FY09E	EV/EBITDA (X) FY07E	EV/EBITDA (X) FY08E	EV/EBITDA (X) FY09E	EV/SALES (X) FY07E	EV/SALES (X) FY08E	EV/SALES (X) FY09E	P/BV (X) FY07E	P/BV (X) FY08E	P/BV (X) FY09E
Information Technology													
Geometric Software	Buy	17.7	10.7	6.9	10.6	6.1	4.1	1.9	1.0	0.7	3.1	2.5	1.9
Hexaware	Buy	16.0	11.7	9.6	12.6	9.3	7.0	2.0	1.4	1.0	2.7	2.3	1.9
HCL Technologies	Buy	19.7	16.1	13.3	12.8	9.7	7.6	2.9	2.1	1.6	4.3	3.8	3.6
i-flex solutions	Neutral	49.6	33.8	26.4	36.8	23.5	18.7	7.0	5.0	4.0	7.0	6.0	5.1
Infosys	Buy	30.9	23.8	20.1	24.9	18.5	14.8	7.9	5.8	4.5	11.2	8.1	6.1
Infotech Enterpr	Buy	20.7	14.9	11.7	13.7	9.7	7.4	2.9	2.0	1.4	5.6	4.2	3.1
KPIT Cummins Inf	Buy	20.6	15.4	11.5	15.1	10.6	7.8	2.4	1.7	1.3	5.2	4.0	3.0
MphasiS	Buy	35.8	22.3	19.1	20.1	13.8	11.3	3.5	2.7	2.1	8.7	6.8	5.4
Patni Computer	Neutral	16.3	13.6	11.4	9.2	7.1	5.4	1.7	1.4	1.0	2.6	2.2	1.9
Sasken Comm	Buy	28.4	16.3	12.6	17.6	10.2	7.4	2.9	2.0	1.5	3.2	2.7	2.3
Satyam Computer	Buy	19.7	16.1	13.7	15.1	11.6	9.2	3.6	2.6	2.0	4.9	3.9	3.2
TCS	Buy	28.0	21.6	17.8	22.6	17.1	13.8	6.2	4.6	3.6	12.9	8.8	6.4
Tech Mahindra	Buy	31.9	23.8	16.9	23.1	16.8	11.8	5.9	3.7	2.7	13.0	8.6	5.8
Wipro	Buy	28.6	21.8	18.4	22.4	16.3	12.8	5.1	3.7	2.9	7.8	6.0	4.7
Sector Aggregate		**27.6**	**21.2**	**17.4**	**21.5**	**16.0**	**12.6**	**5.5**	**4.0**	**3.1**	**8.5**	**6.5**	**5.0**
Media													
Zee Entertainment	Neutral	49.4	28.1	34.1	29.2	17.0	12.7	7.1	5.1	4.0	3.7	3.3	2.9
Sector Aggregate		**49.4**	**28.1**	**34.1**	**29.2**	**17.0**	**12.7**	**7.1**	**5.1**	**4.0**	**3.7**	**3.3**	**2.9**
Metals													
Hindalco	Buy	6.1	6.0	5.3	4.4	4.1	3.5	1.0	0.9	0.8	1.3	1.0	0.9
Jindal Steel & Power	Buy	10.1	7.6	6.8	7.6	5.5	4.1	3.0	2.0	1.6	2.9	2.1	1.8
JSW Steel	Buy	6.7	5.2	4.5	4.2	3.3	3.4	1.4	1.1	1.1	1.5	1.2	1.0
Nalco	Buy	5.8	7.5	7.4	2.9	3.8	3.5	1.7	2.0	1.8	1.7	1.5	1.3
SAIL	Buy	7.5	6.7	5.2	9.3	8.9	7.4	2.7	2.6	2.4	2.5	1.9	1.4
Tata Steel	Buy	6.0	5.6	3.8	3.5	2.9	2.0	1.1	0.9	0.7	1.8	1.4	1.0
Sector Aggregate		**6.7**	**6.3**	**4.9**	**5.8**	**5.4**	**4.4**	**1.8**	**1.6**	**1.4**	**1.9**	**1.5**	**1.2**
Pharmaceuticals													
Aurobindo Pharma	Sell	20.0	16.3	12.6	12.5	10.3	8.4	2.1	1.8	1.7	3.3	2.6	2.1
Aventis Pharma	Buy	16.2	14.8	13.0	10.0	8.1	6.8	2.7	2.3	2.1	4.6	3.8	3.2
Biocon	Buy	22.3	18.5	16.2	15.7	11.8	10.0	4.5	3.7	3.6	4.4	3.7	3.1
Cadila Health	Buy	17.4	14.8	12.2	10.7	8.9	7.4	2.3	1.9	1.5	4.4	3.6	2.9
Cipla	Buy	25.1	21.1	17.4	18.9	15.4	12.4	4.7	3.9	3.8	5.4	4.5	3.7
Divis Labs	Neutral	30.2	23.3	18.9	20.6	16.2	13.5	5.9	4.9	4.9	8.5	6.6	5.1
Dr Reddy' s Labs	Buy	27.3	18.9	16.4	16.7	13.7	12.2	2.9	2.5	2.4	3.2	2.8	2.5
GSK Pharma	Buy	27.1	24.1	20.7	18.4	15.7	13.1	5.7	5.0	4.8	8.2	6.8	5.6
Jubiliant Organosys	Buy	20.3	15.3	13.1	11.6	9.2	7.2	2.1	1.8	1.6	3.0	2.5	2.0
Lupin	Buy	24.4	16.9	14.6	16.8	12.4	10.4	2.6	2.1	2.1	6.1	4.7	3.7
Matrix	Neutral	27.0	14.2	12.9	21.3	14.4	11.1	2.4	2.0	1.9	2.6	2.2	1.9
Nicholas Piramal	Buy	20.9	15.1	12.0	13.3	10.9	8.8	2.2	1.9	1.8	4.4	3.8	3.2
Pfizer	Neutral	18.7	21.9	19.0	12.2	13.0	10.8	2.9	3.0	2.9	5.0	4.6	4.1
Ranbaxy Labs	Buy	24.9	19.6	15.1	14.7	12.1	9.8	2.3	2.0	1.6	4.7	4.1	3.6
Shasun Chemicals	Buy	-53.4	9.0	6.3	8.6	6.0	4.6	0.8	0.6	0.6	2.6	2.2	1.8
Sun Pharma	Buy	26.4	22.1	18.0	23.9	19.3	15.5	8.0	6.5	6.2	7.9	6.5	4.9
Wockhardt	UR	14.5	11.7	10.5	10.0	7.1	6.3	2.3	1.7	1.7	11.8	9.3	8.4
Sector Aggregate		**23.9**	**18.8**	**15.6**	**15.9**	**12.8**	**10.6**	**3.2**	**2.7**	**2.5**	**5.3**	**4.4**	**3.7**

Valuation Matrix (Contd.)

VALUATION MATRIX

	RECO	P/E (X)			EV/EBITDA (X)			EV/SALES (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Retail													
Pantaloon Retail	Buy	49.4	29.5	19.6	25.2	15.0	11.1	1.9	1.2	0.8	8.7	5.7	4.4
Shopper's Stop	Neutral	61.3	49.7	35.4	29.7	23.5	17.3	2.6	1.9	1.4	7.8	7.1	6.4
Titan Industries	Neutral	38.4	24.3	16.7	20.0	14.0	10.5	1.8	1.5	1.2	12.8	7.4	5.4
Sector Aggregate		**46.1**	**28.7**	**19.5**	**24.0**	**15.7**	**11.6**	**2.0**	**1.3**	**1.0**	**9.4**	**6.2**	**4.9**
Telecommunication													
Bharti Airtel	Buy	32.7	22.5	18.2	19.0	12.7	9.6	7.6	5.2	4.0	10.2	7.0	5.1
Reliance Comm	Buy	27.6	18.1	14.1	14.9	9.8	7.5	5.9	4.0	3.1	5.6	4.3	3.4
VSNL	Neutral	28.5	26.8	22.1	11.4	9.3	7.7	2.5	2.2	2.0	1.7	1.6	1.5
Sector Aggregate		**30.4**	**20.9**	**16.6**	**16.9**	**11.4**	**8.7**	**6.4**	**4.5**	**3.5**	**6.7**	**5.1**	**4.0**
Textiles													
Alok Ind	Neutral	8.4	5.9	4.7	8.6	6.6	5.5	1.9	1.5	1.3	1.1	1.0	0.8
Arvind Mills	Neutral	35.2	12.9	10.4	9.5	8.1	7.4	1.9	1.6	1.4	0.7	0.7	0.6
Gokaldas Exports	Buy	12.1	9.7	8.2	7.8	6.5	5.3	0.9	0.7	0.6	0.9	0.7	0.8
Himatsingka Seide	Neutral	20.6	13.3	10.7	18.6	9.4	7.6	5.3	2.3	1.9	2.0	1.8	1.6
Raymond	Neutral	11.9	9.9	7.9	7.4	6.1	4.9	1.1	1.0	0.8	1.5	1.4	1.2
Vardhman Textiles	Buy	7.8	6.6	5.5	7.0	7.3	6.2	1.2	1.4	1.2	1.1	1.0	0.9
Welspun Ind	Neutral	10.1	7.7	6.1	9.2	8.1	6.9	1.7	1.6	1.5	1.0	0.9	0.8
Sector Aggregate		**11.5**	**8.6**	**7.0**	**8.6**	**7.2**	**6.1**	**1.5**	**1.4**	**1.2**	**1.2**	**1.1**	**1.0**
Utilities													
CESC	Buy	12.1	11.7	11.0	7.9	7.8	7.6	1.7	1.6	1.6	1.6	1.4	1.3
Neyveli Lignite Corporation	Buy	8.8	8.7	8.4	3.3	3.6	4.1	2.2	2.4	2.7	1.0	1.0	0.9
NTPC	Neutral	17.3	15.7	14.6	10.9	9.5	9.4	3.6	3.2	3.1	2.3	2.2	2.0
PTC India	Buy	22.7	15.1	11.6	22.6	13.9	11.5	0.2	0.1	0.1	3.3	2.9	2.5
Reliance Energy	Buy	13.7	11.7	10.8	6.8	3.9	2.6	0.8	0.6	0.4	1.3	1.2	1.1
Tata Power	Buy	18.6	17.0	16.8	11.3	10.5	9.6	2.2	2.2	2.1	1.8	1.7	1.6
Sector Aggregate		**15.9**	**14.4**	**13.5**	**9.8**	**8.6**	**8.5**	**2.6**	**2.3**	**2.2**	**2.1**	**1.9**	**1.7**

VALUATION MATRIX

	RECO	P/E (X)			ADJ. P/E (X)			EV/EBITDA (X)			P/BV (X)		
NAME		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Infrastructure													
Gammon India	Buy	30.2	20.2	15.0	12.7	8.5	6.3	14.3	10.1	7.6	2.8	2.6	2.3
Hindustan Construction	Buy	34.1	19.9	14.4	15.8	9.2	6.6	14.7	9.7	7.7	2.9	1.9	1.8
IVRCL Infra.	Buy	35.3	20.8	16.9	17.1	10.1	8.1	16.9	11.5	9.5	2.9	2.6	2.3
Jaiprakash Associates	Buy	29.6	23.8	16.2	22.4	18.0	12.3	16.4	13.7	10.1	3.2	2.9	2.5
Nagarjuna Construction	Buy	22.7	14.6	11.7	16.3	10.4	8.4	14.1	10.0	8.4	1.6	1.3	1.1
Patel Engg.	Buy	26.6	18.4	14.9	14.1	9.8	7.9	14.4	10.4	8.8	3.2	2.8	2.4
Sector Aggregate		**29.5**	**20.6**	**15.2**				**15.6**	**11.7**	**9.1**	**3.5**	**2.8**	**2.4**

Valuation Matrix (Contd.)

VALUATION MATRIX

NAME	RECO	P/E (X)			P/BV (X)			P/ABV (X)			ROE (%)		
		FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Banking													
Andhra Bank	Buy	6.7	5.5	4.5	1.2	1.0	0.9	1.2	1.0	0.9	18.2	19.7	21.0
Bank of Baroda	Buy	7.5	6.3	5.2	1.0	0.9	0.8	1.0	0.9	0.8	13.0	14.0	15.0
Bank of India	Buy	8.6	7.0	5.5	1.4	1.2	1.1	1.5	1.3	1.1	17.4	18.7	20.4
Canara Bank	Buy	6.2	5.5	4.4	1.1	0.9	0.8	1.1	1.0	0.8	18.2	17.7	19.4
Corporation Bank	Sell	7.2	6.2	5.3	1.0	0.9	0.8	1.0	0.9	0.8	14.5	14.9	15.5
HDFC Bank	Buy	25.6	19.6	15.0	4.7	3.9	3.2	4.8	4.0	3.3	19.8	21.9	23.6
HDFC	Neutral	24.5	20.9	17.4	7.0	5.9	4.9	7.1	5.9	5.0	31.1	30.5	30.7
ICICI Bank	Buy	22.6	18.6	15.2	3.0	2.7	2.4	3.2	2.9	2.4	14.0	15.3	16.6
Indian Overseas Bank	Buy	5.8	5.0	4.2	1.5	1.2	1.0	1.5	1.2	1.0	27.0	25.6	24.7
J&K Bank	Buy	10.0	8.5	7.0	1.5	1.3	1.1	1.5	1.3	1.2	15.8	16.4	17.5
Karnataka Bank	Buy	10.4	8.9	7.7	1.7	1.5	1.3	1.7	1.5	1.3	17.1	17.5	17.4
Oriental Bank	Neutral	4.8	4.7	4.3	0.9	0.7	0.7	0.9	0.8	0.7	16.8	15.7	16.0
Punjab National Bank	Buy	7.8	6.1	5.0	1.3	1.1	0.9	1.3	1.1	0.9	17.0	18.9	19.9
State Bank	Buy	13.2	11.1	9.4	1.8	1.6	1.4	2.0	1.7	1.4	14.2	15.1	15.7
Syndicate Bank	Buy	4.9	4.3	3.8	1.1	0.9	0.8	1.2	0.9	0.8	23.1	22.3	21.1
Union Bank	Buy	5.9	4.9	4.1	1.1	0.9	0.8	1.2	1.0	0.8	17.4	18.3	19.4
UTI Bank	Buy	19.8	15.1	11.7	3.8	3.1	2.5	4.0	3.3	2.6	20.7	22.7	24.0
Vijaya Bank	Neutral	5.8	4.9	4.1	1.0	0.9	0.8	1.0	0.9	0.8	18.0	18.6	19.6
Sector Aggregate		**13.2**	**11.0**	**9.1**	**2.2**	**1.9**	**1.7**	**2.1**	**1.8**	**1.5**	**16.8**	**17.7**	**18.7**

NOTES

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