kotak® Institutional Equities

INDIA DAILY

June 17, 2008

EQUITY MARKETS

India	16-Jun	1-day	1-mo	3-mo
		Change, %		
Sensex	15,396	1.4	(11.7)	4.0
Nifty	4,573	1.2	(11.3)	1.5
Global/Regional indices				
Dow Jones	12,269	(0.3)	(5.5)	2.5
Nasdaq Composite	2,475	0.8	(2.1)	13.7
FTSE	5,795	(0.1)	(8.1)	7.0
Nikkie	14,374	0.1	1.1	21.9
Hang Seng	23,008	(0.1)	(10.2)	9.1
KOSPI	1,748	(0.7)	(7.4)	11.0

Value traded - India

	16-Jun		1-mo	3-mo
			Moving avg, Rs bn	
Cash (NSE+BSE)	151.7		192.2	195.3
Derivatives (NSE)	410.0		381.1	449
Deri. open interest	837.2		742	667

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News Roundup

Corporate

- Anil Ambani-led Reliance Communications said it was continuing its exclusive talks with South African telecom major MTN, unperturbed by what it described as efforts of the estranged brother Mukesh Ambani's Reliance Industries to block the deal. *(BL)*
- Mukesh Ambani-controlled Reliance Industries Ltd, India's largest private company by revenue, is in talks with the country's largest private carrier, Jet Airways (India) Ltd, for picking up a small stake in the airline, according to a person familiar with the development. This person, who did not want to be identified, said Reliance is looking at 6-7% stake in Jet Airways, which is expected to post a loss in the last fiscal year owing to high jet fuel cost and intense competition. *(Mint)*
- JSW Steel Ltd has announced its plan to set up a steel plant in Georgia for which it has entered into a joint venture with a UK-based trader for setting up a steel plant with an initial capacity of 175,000 ton per annum of TMT bars. *(FE)*

Economic and political

- State governments asked the Centre to share at least half of the Rs80 bn revenue loss they would incur on account of reducing duty on petrol, diesel and cooking gas this fiscal. *(ET)*

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

Forex/money market

	16-Jun	1-day	1-mo	3-mo
		Change, basis points		
Rs/US$	43.0	0	48	229
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.4	(1)	35	73

Net investment (US$mn)

	13-Jun		MTD	CYTD
FIIs	(13)		(1,382)	(5,255)
MFs	53		134	1,660

Top movers -3mo basis

Best performers	16-Jun	1-day	1-mo	3-mo
		Change, %		
Chambal Fert	91	(0.5)	14.6	85.9
Infosys	1,908	2.2	1.9	42.6
i-Flex	1,310	(0.8)	(6.6)	38.9
Wipro	488	2.0	(3.6)	37.7
Shipping Corp	251	2.7	(11.2)	35.8
Worst performers				
BPCL	277	3.8	(22.8)	(29.1)
HPCL	190	1.8	(23.3)	(24.8)
Thermax	426	2.8	(6.9)	(24.2)
Siemens India	487	3.4	(16.4)	(22.1)
SBI	1,327	(0.6)	(22.3)	(18.9)

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Technology

WIPR.BO, Rs488	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	560
52W High -Low (Rs)	552 - 324
Market Cap (Rs bn)	706.9

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	197.4	257.1	310.7
Net Profit (Rs bn)	32.2	40.7	50.0
EPS (Rs)	22.2	28.1	34.5
EPS gth	*12.6*	*26.3*	*22.7*
P/E (x)	22	17.4	14.1
EV/EBITDA (x)	17.6	12.6	9.9
Div yield (%)	1.3	1.7	2.2

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	79.4	-	-
FIIs	6.8	0.6	(1.1)
MFs	0.4	0.2	(1.5)
UTI	-	-	(1.7)
LIC	1.1	0.4	(1.2)

Wipro : From 'reactive' to 'proactive'—getting the critical pieces right remains a work in progress

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- **June quarter—relative performance will be impacted by forex losses**
- **Improvement in account management remains the key focus area**
- **Modest revival in telecom OEM vertical likely in FY2009E**
- **Continues to make up lost ground in BFSI/TSP verticals**

Key takeaways from our meetings with the Wipro management: (1) focus on revamping 'account management' model continues; Wipro management alluded to 'fragmented' relationships (multiple points of contact at Wipro and decentralized sales) as its weakest link vis-à-vis other tier-I peers, (2) banking on the recent initiatives (formation of global programs group, integration of consulting organization, mega/ gama account structures, harnessing R&D capabilities outside the telecom/hi-tech verticals, and realignment in top management roles) to drive large account strategy, (3) modest revival in telecom OEM vertical likely in FY2009E—the management expects the growth rate to double to 16-18% from the 8.5% seen in FY2008; however, telecom OEM vertical will continue to remain a drag on overall company growth rate in FY2009E and (4) company continues to remain focused on closing in on its tier-I peers within the BFSI and TSP verticals; we note that Wipro has been making up some of the lost ground in these two verticals over the past two years—we expect Wipro to outperform the industry on growth rates in these two verticals in FY2009E. We like the proactive measures undertaken by Wipro to address historic gaps on the client engagement model, though some still remain work in progress. We would wait for acceleration in revenue growth trajectory and improvement in client metrics before revisiting our view on the company (relative to our top picks Infosys and Satyam). Maintain ADD.

June quarter—relative performance will be impacted by forex losses. Wipro management indicated no change in the cautionary stance on near-term revenue growth. The company reiterated its belief of revenue growth recovery in the 2HFY09. We anticipate substantial forex losses for Wipro in the June 2008 quarter, given its high outstanding hedges (US$3 bn as at end-March 2008). More importantly, Wipro's cash-flow hedge accounting could also negate some of the benefits from Re depreciation (average realized rate would be driven more by the locked-in rate on the derivative contracts than by the spot rate; Re/US$ rate locked in by the derivative contracts entered into over the past two quarters could be lower than the spot rates this quarter). We model EBIT margin of 16.7% for Wipro in the June 2008 quarter, a qoq decline of 80 bps as against the management guidance of stable margin. We model average Re/US$ realization of 41 assuming that rupee remains at the current levels. We consequently model net income of Rs9.1 bn, a yoy growth of 28%. Note that Wipro had a significant forex loss of Rs852 mn in June 2007 quarter.

From 'reactive' to 'proactive'. A reactive, rather than proactive, approach to market trends has been the key reason for Wipro trailing its tier-I peers on revenue growth rates over the past few years, in our view. The reactive approach has showed in being (1) late in identifying and capturing the IT offshoring spend surge in the BFSI and TSP verticals, (2) slower than peers on formalizing a large deal strategy and driving large accounts, (3) slow in BPO transformation, thus allowing peers to close in the gap in BPO revenues, (4) sub-optimal weightage to different businesses in IT services portfolio and (5) late in asking for pricing increases from clients. We believe the company has chalked out various initiatives over the past few quarters to drive improvements on some of these fronts, with improvement in account management the key focus area. We discuss some of the initiatives on account management in detail below.

Several initiatives geared towards improving account management albeit with mixed success. Better account management remains the central focal point of Wipro's management; the company emphasized on 'fragmented' relationships with key accounts as its weakest link. We highlight that this has reflected in weak client metrics; the company has only one US$100mn+ account (TCS has 7, and Infosys 6). It also lags peers on US$50 mn+ accounts (Wipro has 14 compared to TCS' 19, and Infosys' 18). Wipro management highlighted some of the key initiatives it has taken over the past 12 to 18 months to iron out the inefficiencies in its account management model

1. **Global Programs group**. Wipro has formed a new 'Global Programs' group to focus on large deals in the market. The company defines a large deal as a deal with a potential of generating US$100 mn+ revenues over five to seven years. Ex-head of BPO operations, T. K. Kurien will head this group. The company has also hired experts (including investment bankers) on large deal structuring and pricing for the group. Management indicated that the Global Program group is currently chasing six large deals.
2. **Mega/Gama account structures**. Wipro adopted a 'stratified' sales approach to large accounts around 18 months back. The company identified a few Mega (potential of US100 mn+ revenues per annum) and a few Gama (potential of US$50 mn+ revenues per annum) accounts and has employed dedicated engagement managers (a single point of contact for the client, responsible for sales as well as delivery) for each of these accounts. In addition, each of the Mega accounts has an executive sponsor within Wipro (the Chairman or one of the two joint CEOs) and each account goes through a periodic senior management review. The company had set itself a target of taking these accounts to their revenue potential within three years and expects to see some positive results over the next six to eight quarters
3. **Integrated Consulting group**. Wipro has pulled all its domain consultants from different verticals and put them in an integrated consulting group. The company indicates that the focus of this group would be to develop industry solutions and expects the group to drive CXO level relationships, critical for success large deals.
4. **Mega partnerships**. Wipro continues to remain focused on strengthening its partnerships with top software/hardware providers of the world like Microsoft, Oracle, SAP, EMC, Cisco etc (it shares a sell-to as well as sell-with, i.e. a client as well as a partner relationship with most of these). The company indicated that these partnerships have played a major role in increasing Wipro's market share, especially in the emerging markets.
5. **Leveraging R&D/Product Engineering strength**. Wipro has realigned Product Engineering from a vertical to a horizontal service line to better leverage its capabilities in newer verticals like automotives, aerospace, energy and utilities, retail, healthcare etc. We note that Wipro's R&D services business has been focused primarily on telecom and hi-tech verticals thus far.

Modest revival in telecom OEM vertical likely in FY2009E. Wipro management expects revenue growth rate in the telecom OEM vertical to double to 16-18% in FY2009E from 8.5% in FY2008. We note that Wipro had been impacted by the spate of M&A activities and post-merger consolidation in some of its top OEM clients. The company indicated it has seen an increase in the number of RFPs and an uptick in R&D spending at some of these clients in the recent months. The management also appeared confident of increased spending from the Telecom OEMs on new product development in areas like 3G, LTE, femtocells, etc.

Continues to make up lost ground in BFSI/TSP verticals: Increasing the company's market share in BFSI and Telecom Service Provider verticals (the two largest offshoring verticals) remains a high focus area of Wipro management. We note that Wipro was a late entrant in both these verticals but has done a good job at growing them over the past two years. Management expects continued revenue outperformance in these verticals vis-à-vis other tier-I companies in FY2009E.

Variable compensation structure stabilizing; better aligned to corporate objectives. Wipro indicated it has made small changes to its variable compensation structure after overhauling it around two years back. The company has linked the variable compensation of the senior management (above the President level) to a single factor—Wipro's overall company performance (plus a relative growth multiplier for relative outperformance/underperformance of the business unit versus competition). At the VP level, the variable comp (which is 25-40% of overall comp) depends equally on overall business as well as individual BU performance. We see the alignment in senior management variable comp as a key step towards moving from a siloed structure to an integrated 'one-company' structure.

Wipro has done a commendable job on growing its BFSI revenues over the past two to three years

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
BFSI revenues (US$ mn)												
TCS	233	251	277	304	327	371	424	430	493	547	588	599
Infosys	173	187	201	214	240	279	317	319	335	373	399	387
Wipro	78	89	98	111	121	133	145	158	173	193	225	242
Satyam	64	73	75	82	90	95	92	96	102	115	120	127
% of revenues												
TCS	40.8	41.3	41.8	41.8	41.2	42.7	43.5	41.3	43.1	43.3	44.0	43.8
Infosys	36.3	35.7	36.0	36.0	36.4	37.4	38.6	37.0	36.1	36.5	36.8	33.9
Wipro	19.5	20.6	20.7	21.6	22.4	22.6	22.7	22.9	23.8	24.2	24.7	25.2
Satyam	27.0	28.7	28.0	28.8	29.7	28.6	25.6	24.7	23.8	23.8	22.4	21.8

Source: Companies, Kotak Institutional Equities.

Wipro: Profit & Loss Statement Statement (Consolidated US GAAP Statements)—March fiscal year-ends

Rs mn	2007	2008	2009E	2010E
Revenues	**149,431**	**197,428**	**257,148**	**310,662**
Cost of revenues	(102,576)	(138,872)	(180,218)	(217,335)
Gross profit	**46,855**	**58,556**	**76,930**	**93,326**
Selling and marketing exp	(16,719)	(24,229)	(31,837)	(38,003)
EBIT (before amortization)	**30,136**	**34,327**	**45,093**	**55,323**
Amortization of Goodwill & Intangible Assets	(269)	(617)	(768)	(768)
EBIT (after amortization)	**29,867**	**33,710**	**43,725**	**54,555**
Other Income, net	2,667	2,167	2,397	2,768
PBT- before extraordinary items	**32,534**	**35,877**	**46,122**	**57,323**
Gain/(loss) on sale of stock of affiliate	-	-	-	-
PBT	**32,534**	**35,877**	**46,122**	**57,323**
Income Taxes	(4,423)	(3,873)	(5,683)	(7,661)
Income before share of equity in affiliates	**28,111**	**32,004**	**40,439**	**49,662**
Equity in earnings of affiliate	318	257	283	305
Minority Interest	-	(24)	-	-
Income from continuing operations	**28,429**	**32,237**	**40,722**	**49,968**
Income Tax Benefit	700	-	-	-
Adjustments	39	-	-	-
Net Profit- Reported	**29,168**	**32,237**	**40,722**	**49,968**
EPS (Rs/ share)	**19.7**	**22.2**	**28.1**	**34.5**
EPS (before amortization of intangibles)	**19.9**	**22.7**	**28.6**	**35.0**
Margins (%)				
Gross Profit margin	31.4	29.7	29.9	30.0
EBITDA Margin	22.8	20.1	20.1	20.3
EBIT Margin	20.0	17.1	17.0	17.6
NPM	19.0	16.3	15.8	16.1
Growth Rates (%)				
Revenues	40.8	32.1	30.2	20.8
Gross Profit	36.5	25.0	31.4	21.3
EBIT (before amortization & exchange gains)	34.9	13.9	31.4	22.7
EBIT (after amortization & exchange gains)	35.9	12.9	29.7	24.8
Income before affiliates earnings	40.6	13.8	26.4	22.8
Income from continuing operations	40.2	13.4	26.3	22.7

Source: Kotak Institutional Equities estimates.

Property

UNTE.BO, Rs199	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	250
52W High -Low (Rs)	547 - 172
Market Cap (Rs bn)	322.4

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	48.0	61.7	82.6
Net Profit (Rs bn)	18.6	24.0	30.3
EPS (Rs)	11.5	14.8	18.6
EPS gth	*42.7*	*28.7*	*26.2*
P/E (x)	17.3	13.5	10.7
EV/EBITDA (x)	13.2	10.1	8.3
Div yield (%)	0.5	1.0	2.0

Shareholding, March 2008

	Pattern	% of Portfolio	Over/(under) weight
Promoters	74.6	-	-
FIIs	6.6	0.4	(0.8)
MFs	0.5	0.2	(1.0)
UTI	-	-	(1.2)
LIC	1.3	0.4	(0.8)

Unitech : JV attracts private equity of US$175 mn

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- **Lehman invests US$175 mn in Mumbai slum rehabilitation projects**
- **Breakeven price for Lehman will be at Rs230/sq. ft**
- **Mumbai to see large commercial space in next 18 months**

Lehman Brothers Real Estate Partners (Lehman) has agreed to invest US$175 mn to acquire a 50% stake in the initial phase of a project on the Western Expressway of Mumbai. The project is being jointly developed by Unitech and their local Mumbai partners (Western Expressway JV). The initial phase entails development of 1mn sq. ft of commercial estate. This deal implies a leasing rate of Rs230/sq. ft at WACC of 13% and leasing rate of Rs260/sq. ft at a WACC of 20%. Lehman and the Western Expressway JV will each contribute 50% of the construction costs. Currently, we retain our REDUCE rating and target price. Our target price of Rs250 is based on March 2009 NAV of Rs224 along with a terminal value based on 0.5X FY2011 P/B. We will revisit our rating and target post declaration of FY2008 results next week.

Breakeven price for Lehman will be at Rs230/sq. ft

In late 2007, Unitech gained entry into Mumbai through slum rehabilitation (SRA) project. Unitech has tied up with Rohan Developers to undertake a 127-acre SRA project near Bandra Karla Complex (BKC) under Western Expressway JV (WEJ). We have currently assumed saleable area of 8 mn sq. ft for the project with 4 mn sq. ft attributable to Unitech. However, management has indicated that WEJ will have a saleable area of 18 mn sq. ft. We will await more details about number of tenants and permissible FSI for the lands before building in higher saleable area. We highlight that the management has indicated that of the part the 127-acre project, Letter of Intent has been received for 19 acres with 12 acres due shortly. We summarize below the key project details.

Project size. 1 mn sq. ft of commercial area.

Investment size. Lehman will invest US$175 mn to purchase a 50% stake. This amount will go WEJ in lieu of 50% stake sale

Construction cost. Lehman and Western Expressway JV will each contribute 50% of the construction costs.

Start of construction. January 2009

Construction period. 18-24 months

Post-tax capitalization rate. 9%

Exhibit 1 shows that Lehman's investment implies a commercial rental of Rs230/sq. ft at a WACC of 13%. In order for Lehman to earn IRRs of 20%, the commercial building will have to earn rentals of Rs260+. Eventhough currently, rentals for Grade A properties in the area will be Rs300+, we don't expect these rentals to sustain given lot of supply is coming in competing areas (Exhibit 2).

WEJ intends to use US$175 mn raised from stake in development of other projects as well as to expedite getting approvals in Western Expressway.

Commercial real estate in Mumbai will see a large supply over the next 30 months; commercial space could become 3X

We expect commercial supply of over 18 mn sq. ft in Mumbai in CBD and SBD areas of Mumbai. Most of the supply is coming from mill redevelopment and slum rehabilitation projects. We have compiled this information from plans indicated by various companies and most of this supply is already under construction (see Exhibit 2). Actual supply could be higher on account of 1) airport slum rehabilitation carried out by HDIL, 2) Dharavi redevelopment, 3) Unitech slum rehabilitation project and 4) other redevelopment of mill land.

Currently Grade A supply in Mumbai will be of the order of 7-8 mn sq. ft with very few additions over the past three years. Currently, under construction projects have the potential to increase the commercial stock to 3X and this will likely put downward pressure on commercial prices. We also highlight growing importance of Lower Parel as a commercial destination with several projects coming in this region—DLF, Indiabulls, Bombay Dyeing, Peninsula Land. However, we highlight that there has been delay in construction of few commercial projects (Indiabulls Real estate, Ruby Mills, Peninsula Land) and hence commercial projects getting completed in the near term will command a premium.

Breakeven for the transaction will happen at a rental of Rs230/sq. ft

Key details of area (mn sq. ft) and NAV (Rs bn), March fiscal year-ends, 2007-2012E

Land cost (Rs mn)	0
Leasing volumes (mn sq. ft)	1
Residential volumes (mn sq. ft)	0

	2008	2009	2010	2011
Leasing space				
Operational space (mn sq. ft)				1
Leasing rate (Rs/sq. ft)				230
Income (Rs mn)				2,760
Operating costs (Rs mn)				276
EBIDTA (Rs mn)				2,484
EBIDTA margin (%)				90%
PBT				2,484
PAT				1,987
Cash accrual				1,987
% complete		5	40	55
Construction cost		**(150)**	**(1,200)**	**(1,650)**
Residential				
Total cost		**(150)**	**(1,200)**	**(1,650)**
Capitalized leases		0	0	22,080
WACC (%)		**13**		
		1.0	1.1	1.3
PV		**(150)**	**(1,062)**	**16,000**
NAV		**14,788**		

		WACC (%)				
	14,788	**13**	**16**	**20**	**22**	**25**
Leasing rate (Rs/sq. ft)	**180**	11,029	10,431	9,704	9,368	8,893
	200	12,532	11,858	11,038	10,658	10,122
	220	14,036	13,285	12,371	11,948	11,351
	240	15,540	14,712	13,704	13,238	12,580
	260	17,043	16,139	15,038	14,528	13,808
	280	18,547	17,566	16,371	15,817	15,037

Source: Kotak Institutional Equities estimates.

More than 18 mn sq. ft of commercial space under development in island Mumbai

List of commerical properties being developed in South Mumbai

Office Name	Location	Expected Supply (mn sq. ft)	Time
Marathon Innova	Lower Parel	0.2	Ready
Windsor	BKC	0.4	Ready
Indiabulls Jupiter	Lower Parel	1.5	Jun-07
Naman Chambers	BKC	0.2	Jun-07
TCG	BKC	0.1	Jun-07
Enam	BKC	0.3	Jun-07
Greenbird	BKC	0.1	Jun-07
Gardenia	BKC	0.1	Jun-07
Reliance	BKC	1.0	Jun-07
Akruti	BKC	0.1	mid 2008
Indiabulls Elphinstone	Lower Parel	1.4	Mar-09
Orbit - Hafeez Contractor House	Lower Parel	0.3	Jun-09
Marathon Future X	Lower Parel	0.3	Jun-09
Peninsula Land (Dawn Mills)	Lower Parel	1.1	Jun-09
Ruby Mills	Dadar	0.8	end 2009
Market City, Kurla - Phoenix Mills	Kurla	0.8	end 2009
Adani	BKC	1.8	end 2009
Neptune Evolution	Kurla	0.7	end 2009
Adani Group	Byculla	0.8	end 2009
Bombay Dyeing	Worli	1.3	mid 2010
Bombay Dyeing	Wadala	2.0	end 2010
DLF	Lower Parel	1.8	mid 2010
Wadhawa Group	BKC	0.1	end 2009
Reliance Industries	BKC	0.1	end 2009
TCG and Hiranandani	BKC	0.1	end 2009
Jet Airways	BKC	0.3	end 2009
Starlight	BKC	0.1	end 2009
Century	Plans not yet finalized		
Total		**17.7**	

Source: Property 2007, Property 2008, Internet, Company websites, Kotak Institutional Equities.

Our target price of Rs250 is based on March 2009 based NAV of Rs224/share

	March '09 based NAV — Growth rate in selling prices per annum			
	0%	**3%**	**5%**	**10%**
Valuation of land reserves	**284.2**	**338.2**	**377.8**	**492.1**
Residential projects	152	188	215	295
Commercial projects	66	73	78	91
Retail projects	67	77	85	106
Add: Hotel business	15	15	15	15
Add: Construction business	10	10	10	10
Add: Investments as on March 31, 2008	15	15	15	15
Add: Consultancy fees received from Unitech Corporate Parks, JVs	10	10	10	10
Less: Net debt as on March 31, 2008	(34)	(34)	(34)	(34)
Less: Land cost to be paid as on March 31, 2008	(30)	(30)	(30)	(30)
NAV (Rs bn)	**270**	**324**	**364**	**478**
NAV/share (Rs)	**166**	**200**	**224**	**294**
Terminal value based on 0.5X FY2011E P/B discounted back to FY2009	**44**	**44**	**44**	**44**
Total no. of shares (mn)				1,624
Valuation/share (Rs)				**251**

Source: Kotak Institutional Equities estimates.

Banking

Sector coverage view			Neutral
		Price, Rs	
Company	Rating	16-Jun	Target
SBI	ADD	1,327	1,800
HDFC	ADD	2,161	2,700
HDFC Bank	BUY	1,149	1,500
ICICI Bank	ADD	797	933
Corp Bk	ADD	321	375
BoB	ADD	241	335
PNB	BUY	455	650
OBC	ADD	157	210
Canara Bk	SELL	197	200
LIC Housing	REDUCE	298	330
Axis Bank	REDUCE	736	850
IOB	REDUCE	105	145
Shriram Transp	REDUCE	304	330
SREI	BUY	121	200
MMFSL	REDUCE	270	230
Andhra	REDUCE	68	81
IDFC	ADD	132	170
PFC	REDUCE	122	150
Federal Bank	BUY	200	310
J&K Bank	ADD	607	750
India Infoline	ADD	637	1,225
Indian Bank	ADD	115	150
Union Bank	BUY	130	210
Central Bank o	SELL	75	85

India comfortable on liquidity if oil remains stable, will also likely lead to significant reversal in stock performance

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- **Rise in crude oil prices could impact BoP position and overall liquidity conditions**
- **RBI could use the policy option of running down MSS securities to maintain liquidity**
- **RBI would need to reduce SLR by 1-2% in FY2009 to prevent significant spike in interest rates in the credit market**
- **HDFC Bank and ICICI Bank are our top picks amongst private banks. PNB, Union Bank and BoB are preferred picks amongst public banks**

Rising oil prices can have a significant impact on the market liquidity, interest rates and therefore the banking sector's stock performance. In this note, we assess the impact and risk of higher oil prices on the market liquidity situation. In our estimate, the gap between the supply of SLR and non-SLR securities will likely be met comfortably by reduction in MSS and cut in SLR, if Brent crude oil remains are around US$120 per barrel. Beyond this, there could be pressure on liquidity and interest rates. The banking sector has underperformed the Sensex by close to 40% YTD, and does provide significant value. However, we would expect volatility in prices and sustainable reversal in prices will come only once concerns on oil prices recede. In this challenging environment, banks with strong liability profile and/or banks with significant freedom to price their credit products will likely fare better and are therefore our preferred picks i.e. private banks HDFC Bank and ICICI Bank. Within public banks we prefer PNB, Union Bank and BoB.

Rising oil prices could lead to significant increase in government liabilities

- The sharp increase in dated Brent crude oil prices by 36% since March 2008 and the incomplete pass-through of these price increases to the consumer level will likely lead to a sharp increase in government liabilities (Exhibit 1).
- This strain on government finances is likely to be accentuated by the (1) proposed wage hikes to government employees as per the Sixth Pay Commission award, (2) debt waiver scheme announced for distressed farmers, (3) heightened government procurement of food grains given the sharp increase in agricultural price inflation, (4) higher subsidy to fertilizer companies to insulate the farmers and (5) reduction in excise and custom duty on oil.
- We estimate that these developments will likely result in the government budgeted borrowing program for FY2009 to increase to Rs1.7 tn from Rs1 tn earlier (as per budget estimates) and Rs1.1 tn last year. In addition to this, the government will need to issue oil and fertilizer bonds (currently not considered in the fiscal deficit) in excess of Rs1.7 tn v/s Rs550 bn last year assuming Brent crude oil at US$120/barrel. Note that this number increases significantly with the increase in oil prices and Exhibit 1 elaborates the impact on borrowing program due to higher oil prices.

Technically, RBI has enough leeway/instruments to increase liquidity

- RBI could mitigate this pressure on domestic liquidity by (1) unwinding the outstanding MSS bonds (Rs1.7 tn outstanding, sufficient to support 18.2 % of M3 as of May 23, 2008), (2) repo operations against the bonds issued to the oil companies and (3) reducing CRR for banks (currently at 8.25%).

- Our calculations suggest that at an average Brent crude price of US$140 per barrel, RBI will likely have to run down Rs844 bn of MSS bonds to achieve its stated M3 growth objective of 17%, while maintaining the CRR at the current level of 8.25%. Note, however, that M3 growth continues to remain high at 22.5% yoy as of May 23, 2008 well ahead of RBI's targeted money supply growth. In the immediate future, therefore, our economist Dr Mridul Saggar expects RBI to hike CRR by 50 bps.
- RBI could also use the option of repo operations against the bonds issued to oil companies to manage the liquidity situation. Dr Saggar believes the RBI will buy an estimated Rs500 bn of oil bonds in FY2009. However, this amount could be increased if the oil prices continue to rise.
- The reduction in the outstanding MSS bonds by RBI would reduce the supply of SLR securities in the market and exert a downward pressure on Gsec yields. However, the gap in the credit market could widen and create an upward pressure on interest rates.
- Our analysis shows that the gap in funding will be large for non-SLR securities v/s SLR securities and the RBI might thus have to consider reduction in SLR by 2% in the current fiscal. This will provide liquidity in the non-SLR market for meeting the 20% credit growth and increased non-SLR liabilities of the government, while maintaining M3 growth at 17% and without creating undue stress on interest rates.
- Our sensitivity analysis of gap in credit and Gsec markets at a M3 growth of 17% is presented in Exhibit 2. A similar exercise with a 2% reduction in SLR is presented in Exhibit 3.
- We believe the reduction in the SLR ratio by RBI could be a long-term positive for the sector and allow banks greater discretion in allocating their resources.
- The government and RBI may mitigate stress on BoP by liberalizing capital flows like FII, FDI, ECB etc.

Recent developments in credit market point to a hardening of rates. We highlight three developments that indicate likely hardening of rates in the credit market: (1) some public banks have increased their deposit rates across maturities by up to 50-75 bps, (2) credit growth as of May 23, 2008 was 26% yoy and (3) recent increase in repo rate by RBI likely signaling rising rate environment. While banks have yet to hike their PLR, we are of the view that most banks want to increase their rate and are likely waiting for the green signal from the finance ministry. We believe the strong credit growth in the recent month reflects higher borrowing by oil companies, demand from the infrastructure sector and a possible shift in demand for credit from international to domestic market given higher credit spreads overseas.

Caveat on analysis—indicative not accurate: Macro parameters have several linkages, whereas our analysis assumes a simple one-on-one relation between higher oil prices and BoP, assuming no implication on other parameters like capital flows, remittances, etc. However, there will be a risk to liquidity which we find difficult to factor in our analysis in case of significant currency depreciation. Our analysis of the liquidity situation therefore is only indicative and should be read as such.

Exhibit 1: Estimated demand for funds could rise as oil prices increase, though liquidity issues could be reduced by unwinding MSS and reducing CRR

Supply of SLR, non-SLR securities and credit under different scenarios of oil prices (Rs bn)

			2008	2009E				
	Dated Brent crude oil price (US$/bbl)		79	120	140	150	160	
I	**Supply of SLR securities**							
1	Government borrowing programme based on fiscal deficit		1,107	1,200	1,200	1,200	1,200	Has been increased recently post the duty cuts
	Fertilizer subsidy		220	310	310	310	310	
	Food subsidty		315	327	327	327	327	
2	Additional market borrowing not budgeted							
	Pay commission		—	290	290	290	290	
	Agriculture debt waiver		—	250	250	250	250	As announced
3	State government securities		562	545	545	545	545	
4	**Total supply of SLR securities**	**= (1) + (2) + (3)**	**1,669**	**2,285**	**2,285**	**2,285**	**2,285**	The RBI is sitting on close to Rs1.7 tn of MSS paper, this can be run down, in case liquidity tightens. In our estimate the full amount can be reduced to zero without impacting RBI's target of 17% M3 growth.
5	Change in MSS o/s		1,057	(77)	(844)	(1,286)	(1,741)	
6	**Overall supply of SLR securities (considering change in MSS)**	**= (4) + (5)**	**2,726**	**2,208**	**1,441**	**999**	**544**	
II	**Supply of Non-SLR securities**							
7	Oil bonds		353	900	1,130	1,245	1,360	
8	Excess fertilizers		150	600	600	600	600	Excess fertilizer subsidty burden on the government is based on estimates provided by Union Minister of Fertilizer and Chemicals. This number will likely get worse as both oil and commodity prices rise.
9	Excess food		47	170	170	170	170	Our estimate - factors in 15 mn tonnes of wheat procurement at a MSP price of Rs1,000; 28 mn tonnes of rice procurement at Rs865 per tonne
10	**Total supply of Non-SLR bonds**	**= (7) + (8) + (9)**	**550**	**1,670**	**1,900**	**2,015**	**2,130**	
11	**Total supply of securities (without considering change in MSS)**	**= (4) + (10)**	**2,219**	**3,955**	**4,185**	**4,300**	**4,415**	If RBI runs down MSS, the supply of paper can reduce significantly
12	**Total supply of securities (considering change in MSS)**	**= (6) + (10)**	**4,945**	**3,878**	**3,341**	**3,014**	**2,674**	Interestingly, the total supply of paper in FY2008 was higher than is likely to be issued in FY2009—including the paper issued under MSS. In FY2009, with Brent crude oil at US$140/barrel, the total amount of borrowing will be Rs4.2 trillion assuming no MSS issuance, against Rs4.9 trillion issued in FY2008 including MSS issuance.
III	**Incremental credit demand**		**4,173**	**4,608**	**4,608**	**4,608**	**4,608**	
14	**Overall demand for funds from credit, SLR and non-SLR securities**							
	Without considering any change in MSS	= (4) + (10) + (III)	**6,392**	**8,563**	**8,793**	**8,908**	**9,023**	
	Considering change in MSS	= (6) + (10) + (III)	**7,449**	**8,486**	**7,949**	**7,622**	**7,282**	
	Net borrowings of central, state governments and supply of non-SLR securities as % of GDP (considering change in MSS)		**4.7**	**7.5**	**7.9**	**8.1**	**8.3**	
	Net borrowings of central, state governments and supply of non-SLR securities as % of GDP (without considering change in MSS)		**7.0**	**7.3**	**6.3**	**5.7**	**5.0**	

Note:

(1) Analysis assumes CRR remains unchanged at 8.25%.

Source: Kotak Institutional Equities estimates.

Exhibit 2: There could be stress on interest rates if RBI maintains M3 target of 17% and off-balance sheet items continue to increase

Estimated sources of funds assuming M3 growth of 17%, credit growth of 20% and SLR of 25% for banks (Rs bn)

			2008	2009E				
	Dated Brent crude oil price (US$/bbl)		79	120	140	150	160	
I	**Sources of funds from banking sector**							
1	Deposits		5,802	5,500	5,500	5,500	5,500	
2	Call/term funding		200	223	223	223	223	
3	Overseas currency borrowing		136	152	152	152	152	
4	Equity (incl. reserves)		668	535	535	535	535	
5	Bank reserves with RBI		769	742	742	742	742	
6	Foreign assets of banks		(186)	(110)	(110)	(110)	(110)	
7	**Total supply of banking sector funds**	**= (1) + (2) + (3) + (4) - (5) - (6)**	**6,223**	**5,778**	**5,778**	**5,778**	**5,778**	
8	Bank investments in SLR securities		1,812	1,498	1,498	1,498	1,498	Bank investments assumed at 25% of NDTL
II	**Sources of funds from non-banking sector**							
9	RBI - repo against oil		—	500	500	500	500	
10	Insurance		534	670	670	670	670	
11	Other sources (includes pension funds)		159	203	203	203	203	
12	**Total supply of non-banking sector funds**	**= (9) + (10) + (11)**	**693**	**1,373**	**1,373**	**1,373**	**1,373**	
III	**Supply of SLR securities**							
13	Supply of SLR securities (without considering change in MSS)		1,669	2,285	2,285	2,285	2,285	Refer Exhibit 1 for details
14	Supply of SLR securities (considering change in MSS)		2,726	2,208	1,441	999	544	Refer Exhibit 1 for details
IV	**Credit demand and supply of non-SLR securities**							
15	Credit demand and supply of non-SLR securities		4,723	6,278	6,508	6,623	6,738	Refer Exhibit 1 for details
16	**Gap in meeting demand from SLR securities (without considering any change in MSS)**	**= (8) + (10) + (11) - (13)**	**836**	**86**	**86**	**86**	**86**	There will be no gap in meeting the demand for SLR securities if we assumed no paper is issued under the MSS program.
17	**Gap in meeting demand from SLR securities (considering change in MSS)**	**= (8) + (10) + (11) - (14)**	**(221)**	**163**	**930**	**1,372**	**1,827**	In the event Brent crude oil prices remain high at or above US$140/ barrel, and leads to worsening balance of payment and liquidity conditions, the RBI may have to consider running down MSS. This will reduce the supply of SLR v/s demand and reduce pressure on Gsec yields.
	As % of overall supply for SLR securities		**(8)**	**7**	**65**	**137**	**336**	
18	**Gap in meeting demand from non-SLR securities and credit demand**	**= (7) + (9) - (8) - (15)**	**(312)**	**(1,498)**	**(1,728)**	**(1,843)**	**(1,958)**	Concomitantly, the credit market will likely suffer from lower liquidity and lead to a hardening of interest rates. In this event, the RBI will likely need to cut SLR to around 23% to meet credit demand and avoid excessive hardening of rates in the credit market. This policy action could be achieved at a M3 growth of 17%.
	As % of credit demand and supply of non-SLR securities		**(7)**	**(24)**	**(27)**	**(28)**	**(29)**	

Source: Kotak Institutional Equities estimates.

Exhibit 3: Stress on interest rates in the credit market could be reduced if SLR is reduced by 2% and Brent crude oil price rise upto US$140/barrel
Estimated sources of funds assuming M3 growth of 17%, credit growth of 20% and SLR of 23% for banks (Rs bn)

			2008	2009E				
	Dated Brent crude oil price (US$/bbl)		79	120	140	150	160	
I	**Sources of funds from banking sector**							
1	Deposits		5,802	5,500	5,500	5,500	5,500	
2	Call/term funding		200	223	223	223	223	
3	Overseas currency borrowing		136	152	152	152	152	
4	Equity (incl. reserves)		668	535	535	535	535	
5	Bank reserves with RBI		769	742	742	742	742	
6	Foreign assets of banks		(186)	(110)	(110)	(110)	(110)	
7	**Total supply of banking sector funds**	**= (1) + (2) + (3) + (4) - (5) - (6)**	**6,223**	**5,778**	**5,778**	**5,778**	**5,778**	
8	Bank investments in SLR securities		1,812	632	632	632	632	Bank investments assumed at 23% of NDTL
II	**Sources of funds from non-banking sector**							
9	RBI - repo against oil		—	500	500	500	500	
10	Insurance		534	670	670	670	670	
11	Other sources (includes pension funds)		159	203	203	203	203	
12	**Total supply of non-banking sector funds**	**= (9) + (10) + (11)**	**693**	**1,373**	**1,373**	**1,373**	**1,373**	
III	**Supply of SLR securities**							
13	Supply of SLR securities (excl. MSS)		1,669	2,285	2,285	2,285	2,285	Refer Exhibit 1 for details
14	Supply of SLR securities (incl. MSS)		2,726	2,208	1,441	999	544	Refer Exhibit 1 for details
IV	**Credit demand and supply of non-SLR securities**							
15	Credit demand and supply of non-SLR securities		4,723	6,278	6,508	6,623	6,738	Refer Exhibit 1 for details
16	**Gap in meeting demand from SLR securities (excl. MSS)**	**= (8) + (10) + (11) - (13)**	**836**	**(780)**	**(780)**	**(780)**	**(780)**	
17	**Gap in meeting demand from SLR securities (incl. MSS)**	**= (8) + (10) + (11) - (14)**	**(221)**	**(703)**	**65**	**506**	**962**	Reduction in SLR to 23% would reduce the gap in meeting credit demand to Rs1.1 trillion from Rs2 trillion when Brent crude oil averages US$160/barrel and SLR remains unchanged at 25%.
	As % of overall supply for SLR securities		**(8)**	**(32)**	**4**	**51**	**177**	
18	**Gap in meeting demand from non-SLR securities and credit demand**	**= (7) + (9) - (8) - (15)**	**(312)**	**(632)**	**(862)**	**(977)**	**(1,092)**	If the average Brent crude oil crosses US$140/barrel, RBI may need to cut SLR further.
	As % of credit demand and supply of non-SLR securities		**(7)**	**(10)**	**(13)**	**(15)**	**(16)**	

Source: Kotak Institutional Equities estimates.

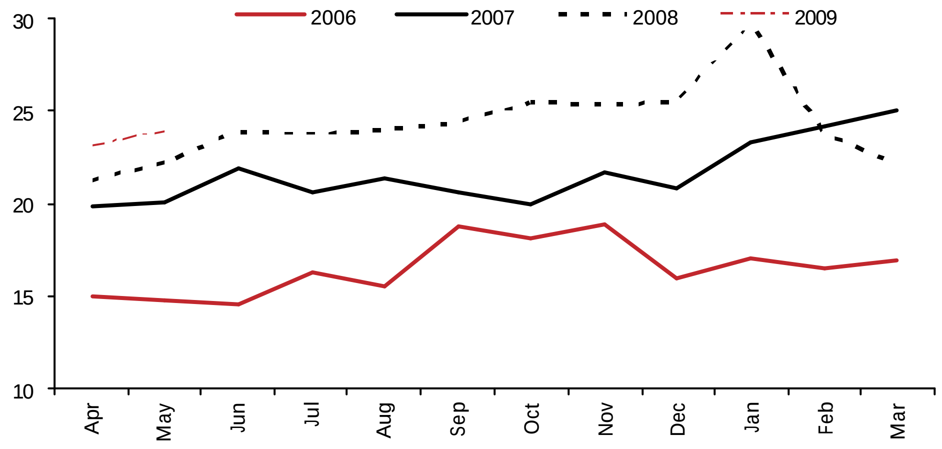
Exhibit 4: Some public banks have increased their rates on deposit rates in the recent past
Current and prior interest rates (%)

	SBI		BOB		Union Bank of India		IOB		Andhra Bank	
	Previous rates	Current rates	Previous rates	Current rates	Previous rates	Current rates	Previous rates	Current rates	Previous rates	Current rates
<6 months	3.75-7.00	3.75-7.00	3.50-6.25	3.50-6.25	3.75-5.50	3.75-5.50	3.50-6.00	3.50-6.00	2.75-6.25	2.75-6.25
6 months- 1 year	7.50	7.50	7.25-8.50	7.25-8.50	6.50-8.25	6.50-8.25	6.50-7.25	6.50-7.25	7.00	7.00
400 days						9.00				
1year - 2 years	8.75	8.75	8.50	8.50	8.25	8.25	8.50	8.50	8.75	8.75
2- 3 years	8.50	8.75	8.25	8.50	8.50	8.50	8.50	8.50	8.50	8.50
3-5 years	8.50	8.85	8.25	8.60	8.75	8.25	8.75	8.50	8.75	9.00
> 5 years	8.50	9.00	7.50-8.00	8.00	8.75	8.25	8.50	8.75	8.75	8.75

Source: Companies.

Exhibit 5: Deposit growth continues to remain high in 2009

yoy growth in deposits (%)



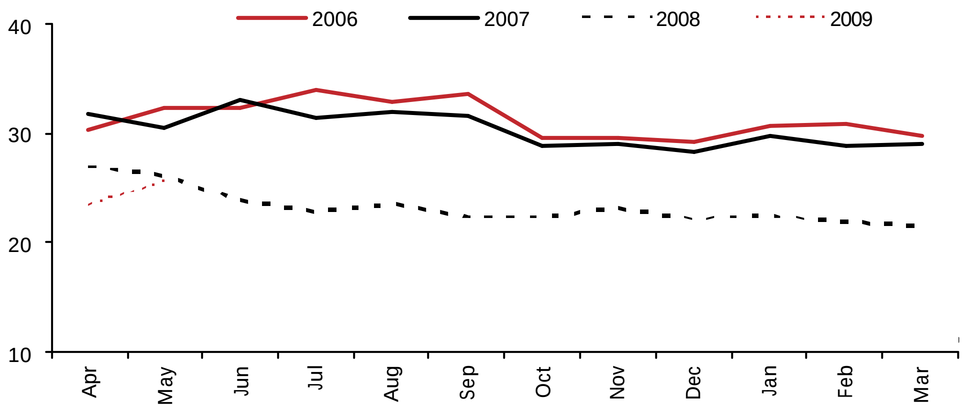
Note:

Deposit growth in January 2008 impact by IPO flows.

Source: RBI.

Exhibit 6: Loan growth remains high

yoy growth in advances, March fiscal year-ends (%)



Source: RBI.

Metals

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**16-Jun**	**Target**
Hindalco	ADD	171	215
NALCO	REDUCE	486	400
Tata Steel	ADD	849	800
Hindustan Zinc	ADD	589	850
JSPL	ADD	2,113	2,900
Sterlite	ADD	797	1,000
Sesa	ADD	3,676	3,900
JSW	ADD	994	1,040

Govt imposes 15% ad-valorem duty on iron ore exports; removes export duty on flat steel

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- **The govt finally imposed a 15% ad-valorem duty on all iron ore exports versus Rs300/ton specific duty earlier**
- **Export tax on flat steel products removed but export duty on long products increased to 15% from 10% earlier**
- **We believe this will negatively impact Sesa Goa's earnings—we cut our earnings estimates for Sesa Goa by 12% and 17.5% for FY2009E and FY2010E, respectively, to factor in the impact of higher export duty**
- **Lower our target price on the stock to Rs3,900/share (Rs4,400/share previously), retain ADD rating on the stock**
- **JSW Steel not to be impacted too much as it will still have to pay export tax on slabs that it will export to its plant in the US—we retain our earnings estimates and our target price of Rs1,040/share with an ADD rating**

The Government of India imposed a 15% ad-valorem duty on exports of all grades of iron ore versus Rs300/ton of export duty on iron ore with Fe content less than 62% earlier. Besides, it removed export tax on flat steel products; however, increasing the export duty on long products to 15% from 10% earlier. We believe the imposition of duty on iron ore will not have too much of an impact on the quantity of iron ore exports as the demand for ore continues to be strong. However, this will negatively impact the profits of the mining companies. We cut our earnings estimates for Sesa Goa by 12% and 17.5% for FY2009E and FY2010E, respectively, to factor in the impact of higher export duty. We have lowered our target price for Sesa Goa to Rs3900/share (Rs4,400 previously) to factor in the earnings decline. On the other hand, the abolition of export duty on flat products and the increase in duty on long products to 15% from 10% will not have too much of an impact on steel manufacturers as not much of long products were being exported earlier. We believe JSW Steel not to be impacted too much as it will still have to pay export tax on slabs that it will export to its plant in US—we retain our earnings estimates and our target price of Rs1,040/share with a ADD rating on JSW Steel.

Imposition of 15% ad-valorem duty on exports of iron ore to impact Sesa Goa's earnings

The govt imposed a 15% ad-valorem duty on exports of all grades of iron ore versus Rs300/ton of export duty on iron ore with Fe content less than 62% earlier. We believe the imposition of duty on iron ore will not have too much of an impact on the quantity of iron ore exports as the demand for ore continues to be strong. However, this will negatively impact the profits of the mining companies as they would have to pay higher export tax of US$12.5/ton versus just about US$7.5/ton earlier—an increase of US$5/ton of iron ore exported.

Hike in export duty to hurt Sesa Goa's profits—lower target price to Rs3,900/share; retain ADD rating

We believe the hike in export duty will negatively impact Sesa Goa's profits as the company will now have to pay additional duty of US$5/ton. We believe given the current market situation for iron ore, it would not be able to pass on this increase in duty. We cut we cut our earnings estimates for Sesa Goa by 12% and 17.5% for FY2009E and FY2010E, respectively, to factor in the impact of higher export duty. We estimate FY2009E and FY2010E EPS for Sesa Goa at Rs451.1 and Rs463.2, respectively, (Rs512.4 and Rs561.2 previously). We lower our target price on the stock to Rs3,900/share (Rs4,400/share previously)—retain ADD rating on the stock.

Govt abolishes export duty on flat products; increases duty on long products by 500 bps

The govt has abolished export duty on flat products (15% earlier) while it has increased export duty on long products by 500 bps to 15% from 10% earlier. We believe the imposition of duty on long products would not have too much of an impact on the steel companies as not much quantity of long steel is exported. Meanwhile, the abolition of duty on flat products was in line with our expectations and will not have any major impact on steel companies such as Tata Steel and SAIL.

JSW Steel not to be impacted too much—retain earnings estimates, maintain target price of Rs1,040/share with ADD rating on the stock

We believe JSW Steel will not be impacted too much as it will still have to pay export tax on slabs that it will export to its plant in US. We retain our earnings estimates for JSW Steel—we estimate JSW Steel's standalone EPS at Rs109.6 and Rs156.7, respectively, for FY2009E and FY2010E. We maintain our target price of Rs1,040/share with a ADD rating on JSW Steel.

Sesa Goa, Sum-of-the-parts valuation, March fiscal year-ends, 2009E basis (Rs mn)

	EBITDA (Rs mn)	Multiple (X)	Valuation (Rs mn)	Value (Rs/share)	Basis
Sesa Goa - standalone	26,770	5.0	133,849	3,400	Based on discount to global average of CY2008E EV/EBITDA
Sesa Industries	391	5.0	1,955	50	Based on 20% discount to Sesa Goa - standalone
Enterprise value			**135,804**	**3,450**	
Less: Net debt of Sesa Goa			17,947	456	FY2009E basis, adjusted for cash and liquid securities
Less: Net debt of Sesa Industries			472	12	FY2009E basis, adjusted for cash and liquid securities
Target market capitalization			**117,385**	**3,918**	
Target price				**3,900**	

Source: Company, Kotak Institutional Equities estimates.

Sesa Goa, change in estimates, March fiscal year-ends (Rs mn)

	Revised estimates		Old estimates		% Change	
	2009E	2010E	2009E	2010E	2009E	2010E
Iron ore sales ('000 tons)	14,250	16,387	14,250	16,387	-	-
Average iron ore realisation (Rs/ton)	3,421	3,244	3,421	3,244	-	-
Net revenues	54,550	58,792	54,550	58,792	-	-
EBITDA	26,770	27,777	30,387	33,561	(11.9)	(17.2)
Net profit	17,756	18,233	20,168	22,091	(12.0)	(17.5)
EPS (Rs)	451.1	463.2	512.4	561.2	(12.0)	(17.5)

Source: Kotak Institutional Equities estimates.

Sesa Goa, summary financials, March fiscal year-ends, 2007-10E (Rs mn)

Income statement	2007	2008E	2009E	2010E
Net revenues	**20,051**	**36,022**	**54,550**	**58,792**
Expenditure	**(11,161)**	**(13,930)**	**(27,780)**	**(31,015)**
Raw materials	(5,105)	(6,905)	(19,908)	(22,749)
Employee expenses	(525)	(560)	(616)	(647)
Other expenditure	(5,531)	(6,465)	(7,256)	(7,619)
EBITDA	**8,890**	**22,092**	**26,770**	**27,777**
Non-operating income	443	703	738	775
Depreciation	(313)	(558)	(888)	(1,217)
EBIT	9,020	22,237	26,620	27,335
Interest expenses	(22)	-	-	-
Adjusted pre-tax profits	8,998	22,237	26,620	27,335
Unusual or infrequent items	-	-	-	-
Reported pre-tax profits	**8,998**	**22,237**	**26,620**	**27,335**
Taxes	(2,934)	(7,405)	(8,865)	(9,103)
Reported net income	**6,064**	**14,832**	**17,756**	**18,233**
Adjusted net income	**6,064**	**14,832**	**17,756**	**18,233**
EPS (Rs), based on wtd avg shares	**154.1**	**376.8**	**451.1**	**463.2**
EPS (Rs), based on fully diluted shares	**154.1**	**376.8**	**451.1**	**463.2**
Year-end shares outstanding (mn)	39.4	39.4	39.4	39.4
Weighted average shares outstanding (mn)	39.4	39.4	39.4	39.4
Fully diluted shares outstanding (mn)	39.4	39.4	39.4	39.4

Cash flow statement	2007	2008E	2009E	2010E
Cash flow from operating activities				
PBT	8,998	22,237	26,620	27,335
Add: Depreciation	313	558	888	1,217
Less: Taxes paid	(3,022)	(7,405)	(8,865)	(9,103)
Add: Working capital changes	(25)	(4,346)	(4,239)	(971)
Total operating cash flow	**5,842**	**11,044**	**14,404**	**18,479**
Operating Cash flow w/o working capital	5,867	15,390	18,643	19,450
Cash flow from investing activities				
Capital expenditure	(1,008)	(5,000)	(5,000)	(5,000)
Investments	(3,517)	-	-	-
Interest and dividend received	412	-	-	-
Total investing cash flow	**(4,113)**	**(5,000)**	**(5,000)**	**(5,000)**
Cash flow from financing activities				
Share issuances	-	-	-	-
Loans	(96)	-	-	-
Less: Dividends paid (including dividend tax)	(1,800)	(2,755)	(3,149)	(3,936)
Total financing cash flow	**(1,896)**	**(2,755)**	**(3,149)**	**(3,936)**
Net change in cash	**(167)**	**3,289**	**6,255**	**9,543**
Opening cash	311	144	3,433	9,688
Closing cash	**144**	**3,433**	**9,688**	**19,231**

Balance sheet	2007	2008E	2009E	2010E
Equity capital	394	394	394	394
Reserves and surplus	14,670	26,747	41,354	55,650
Deferred tax liability	521	521	521	521
Total Equity	**15,585**	**27,661**	**42,268**	**56,565**
Secured loans	-	-	-	-
Unsecured loans	-	-	-	-
Total borrowings	**-**	**-**	**-**	**-**
Current liabilities	2,373	3,686	4,837	5,101
Total capital	**17,957**	**31,347**	**47,105**	**61,665**
	-	-	-	-
Cash	144	3,433	9,688	19,231
Inventory	2,550	5,897	8,931	9,625
Debtors	2,271	4,583	6,941	7,480
Other current assets	325	325	325	325
Total current assets	**5,291**	**14,239**	**25,884**	**36,661**
Gross block	5,968	10,968	15,968	20,968
Less: Depreciation	(2,139)	(2,697)	(3,584)	(4,801)
Net block	3,829	8,271	12,384	16,167
Add: Capital work-in-process	159	159	159	159
Total fixed assets	**3,988**	**8,430**	**12,543**	**16,326**
Investments	8,678	8,678	8,678	8,678
Miscellaneous expenditure	-	-	-	-
Total assets	**17,957**	**31,347**	**47,105**	**61,665**

Ratios (%)	2007	2008E	2009E	2010E
Effective tax rate	32.6	33.3	33.3	33.3
EBITDA margins	44.3	61.3	49.1	47.2
EBIT margins	45.0	61.7	48.8	46.5
Net debt/equity	(1.7)	(9.5)	(18.9)	(31.0)
Net debt/capitalization	(1.7)	(10.6)	(23.4)	(45.0)
ROACE	45.0	68.6	50.8	36.9
ROAE	45.1	68.6	50.8	36.9

Valuations (X)	2007	2008E	2009E	2010E
Price to Diluted earnings	27.3	11.1	9.3	9.1
EV/EBITDA	17.7	7.0	5.5	5.0
EV/Sales	7.8	4.3	2.7	2.3
M.cap/Sales	8.2	4.6	3.0	2.8
Price to book	10.6	6.0	3.9	2.9

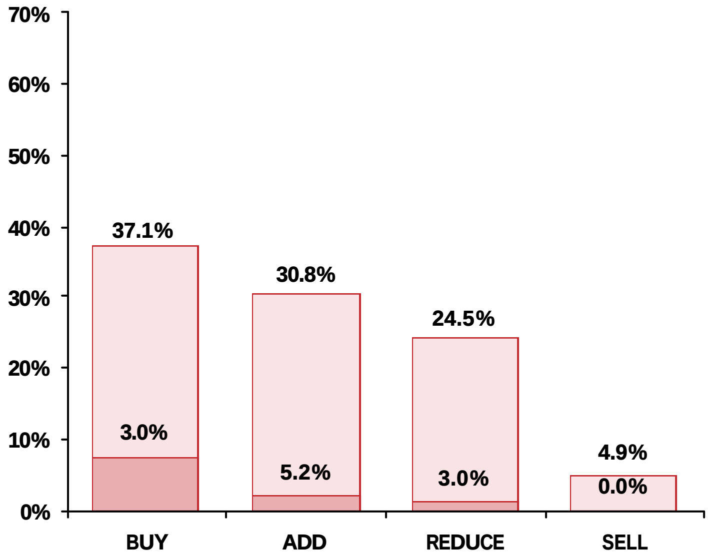
Per share numbers (Rs)	2007	2008E	2009E	2010E
Reported Earnings	154.1	376.8	451.1	463.2
Diluted Earnings	154.1	376.8	451.1	463.2
Cash earnings	162.0	391.0	473.6	494.1
Free cash	122.8	153.6	238.9	342.4
Book	395.9	702.7	1,073.8	1,437.0

Source: Company data, Kotak Institutional Equities estimates

"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: Kawaljeet Saluja, Puneet Jain, Tabassum Inamdar, Jigar Mistry."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



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Source: Kotak Institutional Equities. As of March 31, 2008

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
SELL: We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

Old 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.

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