kotak Institutional Equities

INDIA DAILY

April 03, 2007

EQUITY MARKETS

India	2-Apr	1-day	1-mo	3-mo
		Change, %		
Sensex	12,455	(4.7)	(3.3)	(11.1)
Nifty	3,634	(4.9)	(2.5)	(9.7)
Global/Regional indices				
Dow Jones	12,382	0.2	2.2	(0.7)
Nasdaq Composite	2,422	0.0	2.3	(0.0)
FTSE	6,316	0.1	3.3	(0.1)
Nikkie	17,165	0.8	(0.3)	(0.4)
Hang Seng	19,810	0.0	1.9	(3.0)
KOSPI	1,455	(0.3)	2.9	3.2

Value traded - India

	2-Apr		1-mo	3-mo
			Moving avg, Rs bn	
Cash (NSE+BSE)	97.0		113.6	126.6
Derivatives (NSE)	288.8		325.3	199.6
Deri. open interest	399.3		530.1	443.7

Forex/money market

	2-Apr	1-day	1-mo	3-mo
		Change, basis points		
Rs/US$	43.3	-	(139)	(109)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	-	1	44

Net investment (US$mn)

	30-Mar		MTD	CYTD
FIIs	190		#N/A	40
MFs	(19)		#N/A	(303)

Top movers -3mo basis

Best performers	2-Apr	1-day	1-mo	3-mo
		Change, %		
Punjab Tractors	304	(0.5)	(5.7)	22.0
SAIL	108	(5.8)	1.7	16.5
Bharti Tele	731	(4.3)	3.3	14.1
Britannia	1,215	(2.9)	(5.9)	10.9
BEL	1,456	(3.0)	(2.1)	9.3
Worst performers				
Acc	705	(4.1)	(17.6)	(34.5)
Century Tex	504	(7.7)	(5.3)	(32.4)
Tvs Motor	57	(4.4)	(6.0)	(32.2)
Hindalco	128	(2.1)	(7.4)	(29.0)
Tata Motors	669	(8.0)	(13.6)	(28.7)

Contents

News Roundup

Corporate

- Fiat Auto India, the 50:50 joint venture between Fiat and Tata Motors, announced on Monday that the company will invest US$900mn in Ranjangaon over five years. The first stage investments would be around US$540mn, of which US$320mn would be for the car plant. (BS)
- Bharat Earth Movers Ltd has slated its public issue - to raise US$100mn by offloading 4.9mn shares - for the first half of June this year. The follow-on issue will mainly finance the modernisation and expansion plans of its metro coach production infrastructure at Bangalore. (BL)
- The Reliance Anil Dhirubhai Ambani Group (ADAG) is now eyeing Miditech, the production house synonymous with reality programming in India, for a 51% buy-out. The company's interest in Miditech stems from its plan to foray into the broadcasting space with a reality and lifestyle channel. (ET)

Economic and political

- India's merchandise exports in February 2007 increased by 7.87 per cent to US$9.7bn (provisional) as against a revised figure of US$9bn in the same month last year. (BS)

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

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Technology

Sector coverage view	Attractive

		Price, Rs	
Company	Rating	2-Apr	Target
TCS	IL	1,189	1,275
Wipro	OP	518	660
Infosys	OP	1,921	2,200
Satyam Comp	IL	446	475
HCL Tech	IL	272	338
i-flex solutions	U	2,057	1,675
Patni	OP	375	510
Hexaware	IL	168	185
Polaris Softwa	U	171	150
Tech Mahindra	IL	1,342	1,900
Mphasis BFL	IL	275	280
iGate Global	U	383	325

Weighed down by the rupee

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- **Rupee likely to impact FY2008 guidance**
- **Strong revenue growth, stable margins likely for Mar '07 quarter**
- **Increase in tax rates will likely have an impact on valuations**
- **Stock prices factor in muted guidance; upside exists on FY2008 numbers**

The rupee appreciation, potential US slowdown and equity dilution will likely lead to modest EPS growth guidance for Infosys and, consequently, to muted stock performance in the near term. We also discuss the impact of the likely increase in tax rates in FY2010 on valuations. Wipro is our top pick in the sector.

Rupee likely to impact FY2008 guidance

As always, Infosys guidance will set the tone for industry growth expectations and stock price performance. The strong demand environment leads us to expect good revenue guidance for FY2008; however, growth in banking and finance (31% of revenues and 50%+ growth in the last two years) is critical. We expect revenue growth guidance to be 28-30% in USD and 24-26% in Rupee terms (FY2007 average Re/USD rate likely to be 45, FY2008 guidance likely to be based on 43.5). We expect EPS growth guidance to be in the 20-22% range (in Rupee terms).

Strong revenue growth, stable margins likely for Mar '07 quarter

We expect volume growth of 6-8% for companies under our coverage. We forecast margin improvement for most companies under our coverage, led by pricing improvements and operational efficiencies. Note that that the average Re/USD rate of 44.1 for the Mar'07 quarter is consistent with the Re/USD rate assumed in the guidance of companies.

Increase in tax rates will likely have an impact on valuations

We believe that tax rates for Indian IT services companies may go up to 22-27% in FY2010E, from the present 10-14%. We present various scenarios on the potential tax rates and valuation impact for IT services stocks. Tax rates in FY2010 will hinge on the extent of expansion through SEZs over the next three years-Wipro and Infosys are the best placed.

Stock prices factor in muted guidance; upside exists on FY2008 numbers

IT services stocks have declined by 15-20% over the past month on the back of changes in tax laws, the rupee appreciation and fears of muted Infosys guidance. We believe many of these concerns are factored into the stock prices. Frontline IT names may deliver 20%+ return over the next 12-months from here. Wipro and Infosys are our best picks.

Automobiles

Sector coverage view	Attractive

Company	Rating	Price, Rs 2-Apr	Target
Hero Honda	U	639	625
Bajaj Auto	OP	2,301	2,860
Tata Motors	OP	669	1,055
Maruti	OP	753	950
Mah & Mah	OP	715	1,000
Ashok Leyland	IL	36	47
Punjab Tractor	IL	304	215
TVS Motor	U	57	55
Bharat Forge	OP	303	390

Mar 07 sales

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- **Bajaj Auto: Impending price cut on 'Platina' hits March sales**
- **Hero Honda: March growth likely to add to inventory woes**
- **TVS Motor: Volume growth remains lacklustre**
- **Maruti: Decent mom domestic sales growth in March**
- **M&M: UV growth surprises positively but tractors weaken**

Combined motorcycle sales of the top three players declined 4% yoy in March continuing the weak trend of recent months. A combination of an acute tightening by finance companies, existing high levels of inventories in the system and postponement of demand due to impending price cuts likely led to the weak numbers in March. The four-wheeler companies reported better performance in Mar. Maruti's domestic car sales grew 6% yoy despite strong base effect. Tata Motors, too, saw strong domestic CV growth. M&M reported better-than-expected UV numbers but continued to see tractor demand soften.

Bajaj Auto: Impending price cut on 'Platina' hits March sales

Bajaj Auto reported a disappointing 10% yoy decline in motorcycles in March. The company is planning to cut the price of its entry segment bike 'Platina' by Rs2,000 – Rs3,000 in April when its plant in Uttaranchal commences production. In our view, there would have been a lot of postponement of 'Platina' demand from March to April in anticipation of this price cut likely explaining the drop in March sales. Three-wheeler sales for Bajaj too weakened in March declining 1% yoy. We note that the goods 3W domestic market has weakened substantially in the last few months. 3W exports are the only segment holding up 3W sales for Bajaj right now. Bajaj Auto has ended FY07 with a motorcycle growth of 24% and 3W growth of 28%. Our estimates factor in 15% and 9% growth for motorcycles and 3Ws in FY08 respectively. In its press release, Bajaj Auto has announced that its FY08 total sales growth target is 10%. There now exists downside risk to our EPS estimates for Bajaj Auto.

Hero Honda: March growth likely to add to inventory woes

Hero Honda's March sales grew 2% yoy. Our talks with dealers indicate that dealer inventory has gone up to 30-35 days in the case of Hero Honda. In our opinion, the March dispatches will further add to existing high level of dealer inventories. We also note that Hero Honda was offering a discount of Rs1000 on every bike throughout March implying further margin pressure for the company in 4Q. Hero Honda has ended FY07 with a total volume growth of 11%. Our estimates factor in 8% growth for the company in FY08.

TVS Motor: Volume growth remains lacklustre

Motorcycle sales for TVS Motor declined 13% yoy in March. Scooters and mopeds did better growing 17% and 26% yoy respectively. TVS Motor has now ended FY07 with a volume growth of 15%, 6% and 19% for motorcycles, scooters and mopeds respectively. Our estimates for the company factor in 8% volume growth across the three segments in FY08.

Maruti: Decent mom domestic sales growth in March

Domestic car sales for Maruti grew 6% yoy and 9% mom in March. The lower yoy growth was largely due to the high base of March 2006. Last year Feb sales were very low due to expectation of excise cut in the budget and March sales shot up post the excise cut. However, the decent mom growth of 9% was the positive in the numbers, in our view. Export volumes grew 251% yoy resulting in a total sales growth of 14% for the month. Compact cars outperformed once again growing 26% yoy while both the M-800 and mid-size car segments underperformed reporting yoy declines. Compact car sales were likely boosted by incremental volumes of the new ‘Zen Estilo’ and the recently launched diesel Swift. Maruti has ended FY07 with a domestic growth of 21%, an exports growth of 13% and a total volume growth of 20%. Our estimates for Maruti factor in volume growth of 11% for FY08.

Tata Motors: Strong domestic CV growth

Tata Motors’ domestic CV sales grew a strong 13% in March despite ‘base effect’ driven by a 8% growth in M&HCVs and a 18% growth in LCVs. The mom growth, too, was strong at 8% for M&HCVs and 13% for LCVs. Car sales in the domestic market grew 11% yoy. Domestic ‘Indigo’ sales improved 27% mom driven by volumes of the recently launched ‘Indigo XL’. Domestic UV sales, too, were strong growing 23% yoy. Total exports declined 3% yoy. We are awaiting break-up of exports between various segments. Tata Motors has ended FY07 with a domestic CV growth of 39% (M&HCVs: 34% and LCVs: 46%).

M&M: UV growth surprises positively but tractors weaken

M&M’s UV sales grew a better-than-expected 24% yoy in March. Scorpio sales at 4,769 units rose a strong 62% yoy in March. Non-Scorpio UVs, too, grew a decent 12% boosted by strong demand for the new Maxx pick-up truck and the recently re-launched ‘Bolero’. Tractor sales, however, came in weak growing just 7% yoy. We note that this is the second month of single-digit growth for M&M’s tractors in a row pointing towards far softer growth in FY08 versus FY07. M&M has ended FY07 with a UV growth of 12%, tractor growth of 21% and 3W growth of 50%. Our estimates for M&M factor in UV growth of 13%, tractor growth of 10% and 3W growth of 15% in FY08.

Reported monthly sales of top two-wheeler companies - March 2007

	Mar-07	Mar-06	yoy %	Feb-07	mom %	YTD, FY07	YTD, FY06	yoy %
Bajaj Auto								
Geared Scooters	-	744	-100.0%	-		5,254	63,384	-91.7%
Ungeared Scooters	3,462	1,668	107.6%	2,440	41.9%	15,226	52,612	-71.1%
Step thrus	-	-		-	0.0%	-	870	-100.0%
Motorcycles	165,524	183,927	-10.0%	171,780	-3.6%	2,376,519	1,912,577	24.3%
Total 2-Wheelers	**168,986**	**186,339**	**-9.3%**	**174,220**	**-3.0%**	**2,396,999**	**2,029,443**	**18.1%**
3 Wheelers	24,576	24,723	-0.6%	27,992	-12.2%	321,796	252,006	27.7%
TVS Motor								
Motorcycles	73,239	83,896	-12.7%	70,155	4.4%	925,123	806,654	14.7%
Scooty	20,297	17,410	16.6%	19,937	1.8%	258,967	245,276	5.6%
Moped	34,671	27,551	25.8%	30,018	15.5%	344,013	290,273	18.5%
Total 2-Wheelers	**128,207**	**128,857**	**-0.5%**	**120,110**	**6.7%**	**1,528,103**	**1,342,203**	**13.9%**
Hero Honda								
Total 2-Wheelers	277,915	272,312	2.1%	280,515	-0.9%	3,336,756	3,000,739	11.2%

Source: Company.

4-wheelers March 2007 sales performance

	Mar-07	Mar-06	yoy %	Feb-07	mom %	YTD, FY07	YTD, FY06	yoy %
Tata Motors								
M&HCV	17,673	16,312	8.3%	16,306	8.4%	172,849	128,714	34.3%
LCV	13,047	10,977	18.9%	11,553	12.9%	125,792	86,236	45.9%
Domestic CV sales	30,720	27,289	12.6%	27,859	10.3%	298,641	214,950	38.9%
Mahindra & Mahindra								
UVs	15,210	12,299	23.7%	9,486	60.3%	127,913	114,688	11.5%
LCVs	1,011	593	70.5%	739	36.8%	8,694	6,735	29.1%
Tractors	7,805	7,326	6.5%	7,003	11.5%	102,536	85,029	20.6%
3 Wheelers	3,648	2,686	35.8%	3,041	20.0%	33,700	22,419	50.3%
Total	**27,674**	**22,904**	**20.8%**	**20,269**	**36.5%**	**272,843**	**228,871**	**19.2%**
Maruti Udyog						-	-	
Entry (A) segment	6,141	10,937	-43.9%	5,955	3.1%	79,245	89,223	-11.2%
Van-segment	8,661	8,390	3.2%	8,069	7.3%	83,091	66,366	25.2%
Compact (B) segment	47,068	37,279	26.3%	42,913	9.7%	440,375	335,136	31.4%
Mid-size (C) segment	2,414	3,735	-35.4%	1,798	34.3%	29,697	31,939	-7.0%
MUV	272	800	-66.0%	360	-24.4%	3,221	4,374	-26.4%
Domestic	**64,556**	**61,141**	**5.6%**	**59,095**	**9.2%**	**635,629**	**527,038**	**20.6%**
Exports	7,216	2,055	251.1%	3,904	84.8%	39,295	34,784	13.0%
Total	**71,772**	**63,196**	**13.6%**	**62,999**	**13.9%**	**674,924**	**561,822**	**20.1%**

Source: Company, Kotak Institutional Equities.

Strategy

Sector coverage view	N/A

India equity strategy: A storm that will pass

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- **Market view: Near-term volatility, consolidation in 2HFY08E**
- **April risks: monsoon forecast, earnings, inflation peak-off, RBI, UP polls**
- **Real lending rates to climb to 7.8% potential growth; further RBI adventurism to hurt**
- **Lead indicators: Valuations fair but not compelling enough to brave risks**
- **Strategy: Buy on dips, large-caps, avoid rate sensitives, bottomfish banks**
- **Overweight: Construction, Industrials, IT, Oil & Gas, Utilities**
- **Neutral: Autos, Banks, Cement, Consumers, Media**
- **Underweight: Chemicals, Metals, Pharmaceuticals, Telecom**
- **Top Ten: In- BHEL, Tata Power; Out- Bajaj Auto, Tata Motors**

We expect volatility to persist through 1HFY08, as markets contend with deepening uncertainties ' US slowdown, domestic inflation and government/RBI policy reactions ' without the support of favorable valuations. Of particular concern is a higher interest rate regime with a likely 100bp ' 50bp earlier ' PLR hike closing the gap between real lending rates (7%) and the 7.8% potential real GDP growth rate that has powered the India story so long. Matters will likely improve in the latter half of the year if domestic monetary policy is able to top off ' as we still expect - at a neutral interest rate regime by 2HFY08 with an inflation peak off and more definitive prospects of US monetary easing. Although risk repricing in the face of an impending US slowdown will likely tar all emerging market equities with the same brush, we continue to expect eventual differentiation to support the India story. Our expectation of near-term volatility is supported by the fact that our lead indicators are just about in fair range. We therefore advice investors to ride out the volatility by (1) rebalancing portfolios in favor of large caps, (2) avoiding interest rate sensitives, such as autos and real estate, and (3) bottom fishing PSU banks.

Market volatility ahead. Markets will likely have to face a rather formidable build-up of uncertainties in 1HFY08 without the support of valuations.

- Global risks, for example, will likely deepen as markets focus on a likely US slowdown and perceived domino effects, such as an unwinding of the yen carry trade, and impact of reduction in US export demand on the Far-East and on IT.
- Domestic macro concerns about inflation – even overheating (which we do not believe) – interest rates and political risks will get sharper as markets contend with the series of politically-driven anti-inflationary measures: CRR hikes, cement price control, etc.
- The full contours – impact on autos, consumers, real estate - of the jump in interest rates engineered by the RBI will become clearer in the months ahead.

Ides of April: a month of five event risks. The government's India Meterological Department will publish its south-west monsoon 2007 forecast – although scarcely infallible - in the latter half of April 2007 at a time of agro shocks.

- Earnings results – and guidance from IT companies – will set the market mood.
- Inflation data will test our hypothesis of a peak off from mid-April 2007 onwards.
- The RBI's April 24 FY2008 monetary policy will provide direction – we expect a top off by 1HFY08 – about the rising concerns about excessive monetary tightening destroying the India story.
- The critical UP polls commence in early April.

Excessive monetary tightening an emerging risk. We grow increasingly concerned about excessive monetary tightening that could put the India story at risk.

- The good news: a rational monetary policy top off could well put the India story on a powerful steady-state trajectory of about 8% real GDP (8.3% FY08E) and 5% WPI inflation (5% FY08E).
- Monetary conditions are, after all, now approaching neutral: the gap between real lending rates (7% currently) and potential real GDP growth rate (7.8%) will likely close in FY2008E with a 100 bp increase in lending rates (assuming 21% credit offtake) (Exhibit 1).
- This happy scenario still has a lot going for it: no sign of overheating even after 4 years of above-trend growth; FY08E liquidity in the bag with the recent US$20 bn forex intervention; and the RBI's new found authority to cut the statutory liquidity ratio (1% FY08E/ 3% FY09E) to calibrate credit offtake to growth while containing M3 growth (16.4% FY08E) to 5% inflation.
- The bad news: growing imprudence – the RBI has actually hiked CRR (and lending rates) by 150 bps for the second time in 20 years in a futile battle against agro shock driven inflation – raises the spectre of monetary policy – however inadvertently – squandering a historic national opportunity.
- It is true that we are still way off the FY1998-99 blowout - real lending rates (8.8%) had then crossed the 6% potential real GDP growth rate by 280 bps.
- Although the RBI now says that it will not sacrifice growth, the cost of its occasional flipflops will be much higher than before. We recall that Governor Rangarajan could not undo his 100bp FY1995 CRR hike even with a desperate 550bp CRR cut in the next two years.

Selective entry: Valuations fair, but not compelling enough. The BSE Sensex still persists at the upper half of our fair band of 11,400-13,600 based on FY2008E earnings (and 12,600-15,100 based on FY2009E earnings).

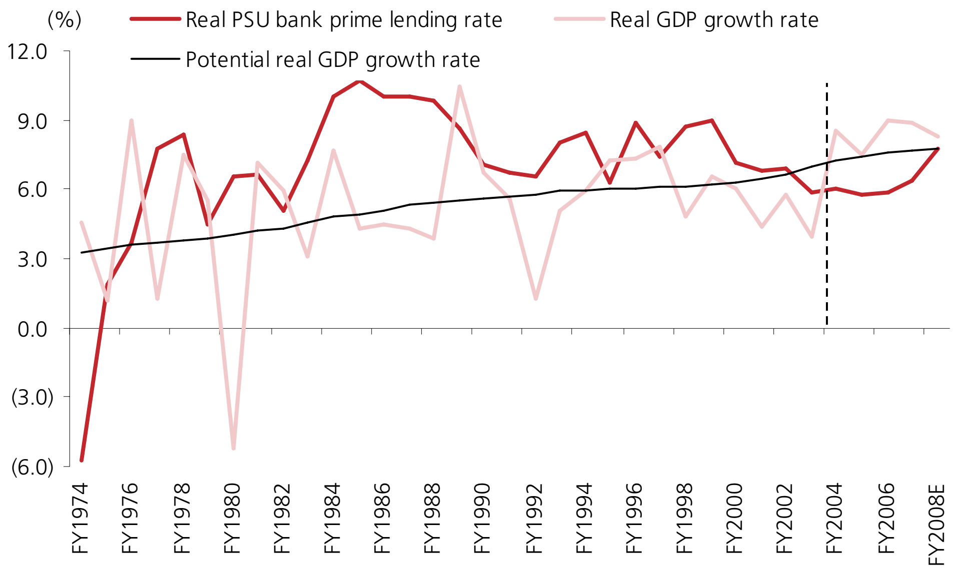
- Our lead indicators - 1-year forward valuations, liquidity-adjusted valuations and implied equity risk premium – have retreated from the overbought position of November 2006 but do not still support market revival (Exhibit 2).
- The 1-year rolling forward P/E is still above our comfort zone of 12-15X.
- Our liquidity (M3 growth rate) adjusted valuations have now come down below our benchmark trend. This partly reflects the fact that monetary growth – at 22% - has run up far above the 17.5% optimal rate consistent with 5% inflation. We expect the 150bp CRR hike to bring M3 growth rate to 16.4% in FY2008E.
- The implied equity risk premium – computed at a 7.5% risk-free rate – has risen above our 400bp safeguard (Exhibit 3).

Strategy: Stick to large caps, avoid interest rate sensitives, bottom fish banks. We continue to advice investors to stick to large caps, now available again at reasonable valuations, to ride out market volatility. Mid-caps will likely take some time to recover.

- We advice investors to avoid interest rate sensitives – autos, for example – given our expectation of a 100 bp hike in lending rates in FY2008E on the back of a persistent credit gap.
- We advice investors to be neutral in the near term as far as bank stocks are concerned given the present uncertainties about monetary policy. At the same time, PSU bank stocks will likely see multiple triggers ahead: (1) cheap valuations; (2) a sustained regime switch to stable yields and rising lending rates from rising yields and cheap lending rates and (3) higher CASA to protect NIMS from deposit rate hikes.
- Exhibits 4 and 5 present our Top-10 and Model portfolio.

Exhibit 1: Interest rates in neutral zone

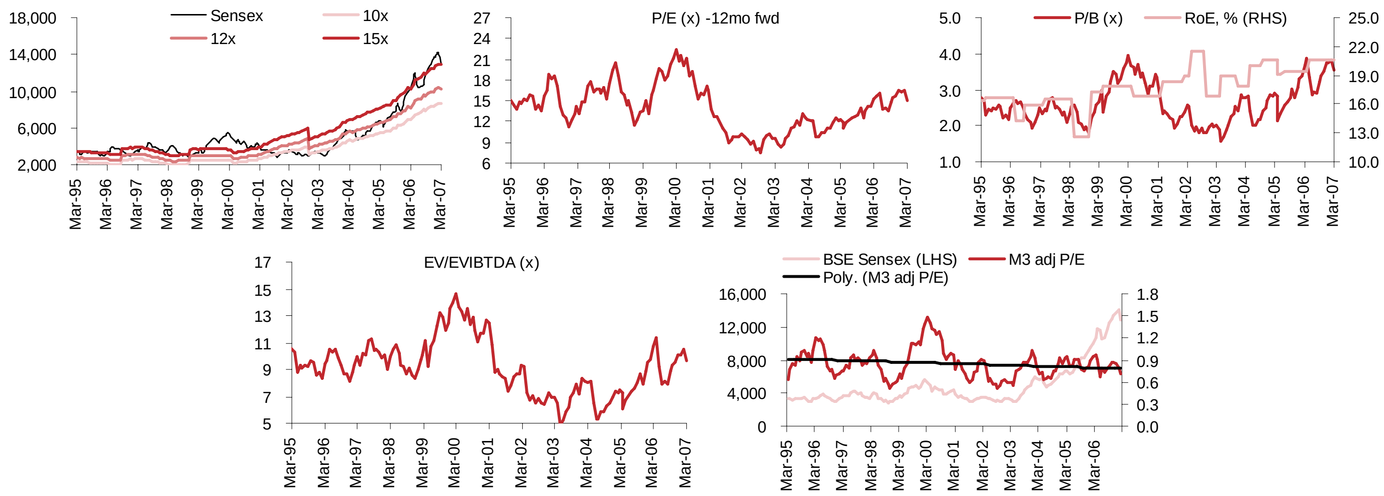
Real PSU bank prime lending rate, real GDP growth rate (%)



Source: CSO, RBI, Kotak Institutional Equities.

Exhibit 2: Lead indicators just about reasonable

1-year rolling forward P/E, P/B, RoE, EV/EBIBTDA, M3 growth rate adjusted valuations



Source: Bloomberg, Kotak Institutional Equities.

Exhibit 3: Equity risk premium has begun to sober up

Equity risk premium (%) for BSE Universe, using our proprietary tool, Whizdom

Equity risk premium		Implied BSE Sensex	
	Rf = 8%	Rf = 7.5%	Rf = 7%
5.5	10,580	11,407	12,369
5.0	11,220	12,147	13,234
4.5	11,941	12,987	14,227
4.0	12,757	13,948	15,378
3.5	13,691	15,061	16,731

Source: Kotak Institutional Equities estimates.

Exhibit 4: Kotak Institutional Equities Top 10 List

30-Mar-07			CMP	Mkt Cap	Target	EPS (Rs)			P/E (X)			EV/EBDITA (X)			Liquidity: 3mo
Companies	Sector	Rating	(Rs)	(mn USD)	(Rs)	2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E	(Rs mn)
Larsen & Toubro	Industrials	OP	1,619	10,479	1,750	37.9	58.9	71.5	42.8	27.5	22.6	25.3	17.1	13.8	180
Wipro	Technology	OP	558	18,405	660	14.2	19.8	26.1	39.2	28.3	21.4	29.9	21.9	15.8	715
State Bank of India	Banking	OP	993	12,021	1,200	83.7	75.5	98.5	11.9	13.1	10.1	0.0	0.0	0.0	1,896
Tata Power	Utilities	IL	509	2,493	670	26.3	20.2	33.4	19.3	25.3	15.3	12.6	12.6	9.0	178
Maruti Udyog	Automobiles	OP	820	5,449	950	41.1	52.7	60.2	19.9	15.6	13.6	9.9	8.0	6.5	940
Satyam Computer Services	Technology	IL	470	7,106	475	15.1	21.1	26.1	31.1	22.3	18.0	23.9	17.7	13.3	1,997
Bharat Heavy Electricals	Industrials	IL	2,261	12,729	2,450	68.5	100.0	126.6	33.0	22.6	17.9	18.1	12.5	10.1	1,650
ICICI Bank	Banking	OP	853	17,462	950	32.8	34.3	41.7	26.0	24.9	20.4	0.0	0.0	0.0	1,650
Oil & Natural Gas Corporation	Energy	OP	878	43,206	1,100	73.4	94.1	105.6	12.0	9.3	8.3	5.4	4.4	4.3	1,303
Mid Cap Basket															
Indian Overseas Bank	Banking	OP	103	1,291	130	14.4	17.5	17.9	7.2	5.9	5.7	0.0	0.0	0.0	33
Kalpataru	Transmission	OP	1,088	663	1,150	35.9	52.5	63.1	30.3	20.7	17.2	22.0	12.6	10.4	48
Mahindra Gesco	Property	OP	568	465	1,100	5.3	10.1	16.3	107.0	56.3	34.9	59.1	26.6	19.0	440
NCCL	Construction	OP	161	767	198	6.1	7.0	10.0	26.4	22.9	16.0	21.4	13.4	9.8	300
Maharashtra Seamless	Industrials	OP	510	831	550	24.2	32.7	42.6	21.0	15.6	12.0	18.2	9.5	6.9	93
BSE-30			**13,072**												

Source: Company, Bloomberg, Kotak Institutional Equities.

Exhibit 5: KS Model Portfolio

	30-Mar		Weightage, %		Diff
Company	Price (Rs)	Rating	BSE-30	KS Reco	(bps)
State Bank of India	993	OP	2.9	4.9	200
Indian Overseas Bank	103	OP	-	0.8	80
Banking			**2.9**	**5.7**	**280**
HDFC Bank	949	IL	3.0	2.5	(50)
ICICI Bank	853	OP	8.2	10.2	200
HDFC	1,520	IL	4.3	-	(427)
Pvt Banking/ Financing			**15.5**	**12.7**	**(277)**
Infosys Technologies	2,013	OP	11.0	11.5	50
Satyam Computer Services	470	IL	3.6	5.6	200
Wipro	558	OP	2.0	4.0	200
Technology			**19.6**	**21.1**	**150**
Reliance Industries	1,368	U	13.1	9.3	(379)
Chemicals			**13.1**	**9.3**	**(379)**
Hindustan Lever	205	IL	2.8	0.8	(200)
ITC	150	OP	4.9	4.9	-
Consumers			**7.7**	**5.7**	**(200)**
Ranbaxy Laboratories	353	OP	1.1	1.1	-
Sun Pharmaceuticals	1,054	OP	-	1.0	100
Pharmaceuticals			**3.6**	**2.1**	**(147)**
Tata Motors	728	OP	2.1	2.1	-
Maruti Udyog	820	OP	1.2	3.2	200
Bajaj Auto	2,425	OP	2.1	2.1	-
Automobiles			**6.3**	**7.4**	**115**

	30-Mar		Weightage, %		Diff
Company	Price (Rs)	Rating	BSE-30	KS Reco	(bps)
Bharat Heavy Electricals	2,261	IL	2.4	4.4	200
Larsen & Toubro	1,619	OP	5.0	7.0	200
Industrials			**7.4**	**11.4**	**400**
NTPC	150	IL	2.3	2.3	-
Tata Power	509	IL	-	2.0	200
Utilities			**3.3**	**4.3**	**102**
Grasim Industries	2,091	OP	1.9	1.9	-
ACC	735	IL	1.1	1.1	-
Cement			**4.5**	**3.0**	**(144)**
Bharti Airtel Limited	763	U	6.3	3.9	(239)
Reliance Communication	420	IL	1.6	-	(160)
Telecom	**-**	**0**	**7.9**	**3.9**	**(399)**
Maharashtra Seamless	510	OP	-	0.8	80
NCCL	161	OP	-	0.8	80
Mahindra Gesco	568	OP	-	0.8	80
Kalpataru	1,088	OP	-	0.8	80
Infrastructure basket			**-**	**3.2**	**320**
Oil & Natural Gas Corporation	878	OP	4.7	6.7	200
Bharat Petroleum	302	OP	-	0.5	50
Energy			**4.7**	**7.2**	**250**
Tata Iron & Steel Co	450	U	2.3	2.3	-
Sterlite Industries	468	OP	-	0.5	50
Metals			**3.5**	**2.8**	**(70)**
BSE-30			**100.0**	**100.0**	

Source: Kotak Institutional Equities.

Economy

Sector coverage view N/A

India's widening US$55.9 bn Apr 06—Feb 07 trade deficit: Exports expectedly revive, but import demand stronger

Indranil Sen Gupta : indranil.sengupta@kotak.com, +91-22-6634-1216

- **US$55.9 bn Apr 06—Feb 2007 trade deficit; FY2007E US$58bn**
- **Exports revive: FY08 likely to decelerate to 15.2% on base effects**
- **Non-oil imports drive up trade deficit: slower growth to pull imports down**
- **Apr-Oct 2006: exports led by engineering, oil; vibrant 36.8% capex imports**

We have upped our FY2007 merchandise trade deficit forecast to US$58 bn from US$54 bn. The current account deficit is correspondingly projected at 1.8% of GDP in FY2007E and 1.1% of GDP in FY2008E. Non-oil import demand remains very strong recording 39.8% y-o-y growth. Oil imports stagnated at February 2006 levels on the back of lower prices. 11MFY07 exports, at US$109 bn, remain on track to our projections: y-o-y export growth expectedly jumped back to 23.8% after last month's 14.1% dip. Assuming February 2007 oil exports at February 2006 levels, non-oil exports were even more robust at 28.8%. We do however expect exports to normalize (US$144 bn/ 15.2%) in FY2008E with somewhat slower world GDP growth (Exhibits 1-2). Non-oil imports are expected to similarly slow down (US$148 bn/ 16.5%) with slower real GDP growth (8.3%) and stable oil prices (US$60/bbl). Every US dollar increase in the barrel price of the India basket hits the balance of payments by about US$ 500-600 mn.

Rumours of export slowdown greatly exaggerated. Some media reports have erroneously suggested a slowdown in export growth to 8%. The government publishes trade data for the current month (February 2007) on provisional basis and the corresponding month of the previous year (February 2006) on provisional as well as provisionally revised (bureaucracy!) basis. On like-to-like, ie, provisional to provisional, export growth works out to 23.8%. Export growth slows down to 8% (5.5% last month) if we compare the 2007 provisional to the 2006 provisionally revised ' which the media has focused on.

Exhibit 1:Trade deficit still within bounds

India's merchandise trade (US$bn)

			April-February			
Item	**FY 2005**	**FY2006**	**FY 2006**	**FY 2007**	**FY 2007E**	**FY 2008E**
Exports	80.5	100.6	88.7	109.0	125.0	144.0
% growth				22.9		
Imports	109.2	140.2	126.3	165.0	183.0	204.0
% growth				30.6		
Oil	29.8	43.8	39.7	52.6	56.0	56.0
% growth				32.5		
Non-Oil	79.4	96.4	89.4	112.4	127.0	148.0
% growth				25.7		
Trade Balance	-28.7	-39.6	-37.6	-55.9	-58.0	-60.0

Note: April-February 2006 data include discrepancies in calculation by the Ministry of Commerce.

Source : DGCI&S. Excludes non-DGCI&S - essentially defence - imports.

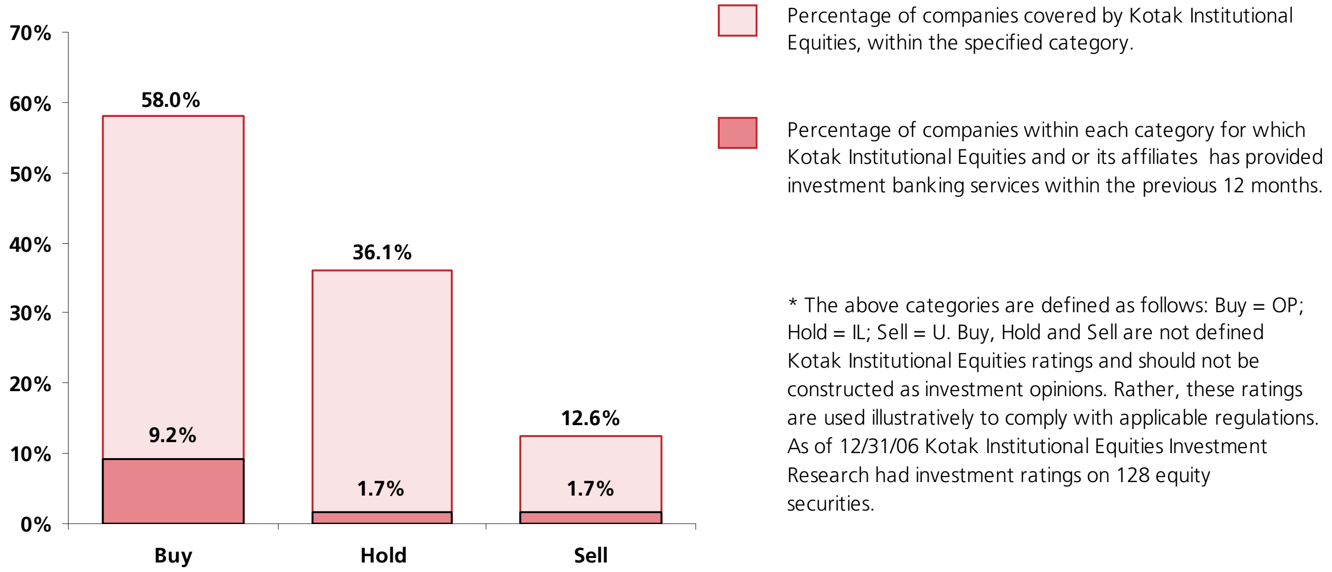
Exhibit 2: Seasonality now favors exports

Source: RBI.

"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: Abhijeet Naik, Alroy Lobo, Indranil Sen Gupta, Kawaljeet Saluja."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 12/31/06 Kotak Institutional Equities Investment Research had investment ratings on 128 equity securities.

Source: Kotak Institutional Equities. *As of December 31, 2006*

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

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

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

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

Other ratings/identifiers

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